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INTERNATIONAL MARKETING

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SYLLABI-BOOK MAPPING TABLE

International Marketing

Syllabi	Mapping in Book
BLOCK I: INTERNATIONAL MARKETING AND STRATEGIES **UNIT 1:** International Marketing - Scope of International Marketing - International Marketing vs. Domestic Marketing - Principles of International Marketing - Customer Value and the Value Equation - Competitive or Differential Advantage - Management Orientations - MNCs and TNCs, Benefits of International Marketing. **UNIT 2:** International Marketing Environment - Political Environment - Political Systems - Legal and Regulatory Environment - Socio - Cultural Environment - Economic Environment - Technological Environment - Challenges in Global Marketing. **UNIT 3:** International Trade Environment - Classical Trade Theories - Modern Trade Theories - Trade Barriers - Quotas - Implications of Tariffs - Types of Agreements - General Agreement on Tariffs and Trade (GATT) - Functions and Objectives of WTO - Implication of WTO on International Marketing - India's Role in International Trade Theories. **UNIT 4:** International Market Entry Strategies - Different Entry Modes and Market Entry Strategies - Joint Ventures - Strategic Alliances - Direct Investment - Manufacturing and Franchising.	**Unit 1:** International Marketing **(Pages 1-20);** **Unit 2:** International Marketing Environment and Challenges **(Pages 21-52);** **Unit 3:** International Trade Environment **(Pages 53-87);** **Unit 4:** International Market Entry Strategies **(Pages 88-104)**
BLOCK II: INTERNATIONAL MARKETING RESEARCH, PRODUCT, PRICING POLICIES **UNIT 5:** International Marketing Research - Concept of Marketing Research - Need for Marketing Research - Approach to Marketing Research - Scope of International Marketing Research - International Marketing Research Process - Market Surveys - Marketing Information System. **UNIT 6:** International Product Policy and Planning - Products - National and International - the New Product Development - International Product Planning - Product Adoption and Standardization - International Market Segmentation - Influences on Marketing Plan and Budget - International Product Marketing - Marketing of Services. **UNIT 7:** International Pricing Policy - Price and Non-Price Factors - Methods of Pricing - International Pricing Strategies - Dumping and Price Distortion - Counter Trade. **UNIT 8:** International Distribution and Logistics Planning - International Logistics Planning - Distribution - Definition and Importance - Direct and Indirect Channels - Factors Involved in Distribution Systems - Modes of Transportation - International Packaging.	**Unit 5:** International Marketing Research **(Pages 105-121);** **Unit 6:** International Product Policy and Planning **(Pages 122-152);** **Unit 7:** International Price Policy **(Pages 153-168);** **Unit 8:** International Distribution and Logistics Planning **(Pages 169-181)**

BLOCK III: INTERNATIONAL PROMOTIONAL STRATEGIES, FOREIGN MARKET

UNIT 9: International Promotional Strategies - Communications Process - Principles of Communication - Status of Promotion - Promotion Appeals - Media Selection - Personal Selling - Public Relations and Publicity - Sales Promotion - Advertising - E-Marketing.

UNIT 10: Foreign Markets and Export Marketing Process - Choosing Appropriate Mode of Operations - Issues Related to Exports - Processing an Export Order - Entering into Export Contract - Export Pricing and Costing - Export-Import (EXIM) Policy - 2002-2007.

UNIT 11: Export Marketing Documentation - Significance of Export Documentation - the Statutory Control - Declaration Forms - Disposal of Export Documentation Form - Major Documents.

Unit 9: International Promotional Strategies **(Pages 182-207);**
Unit 10: Foreign Markets and Export Marketing Process **(Pages 208-239);**
Unit 11: Export Marketing Documentation **(Pages 240-254)**

BLOCK IV: FOREIGN TRADE POLICY, INTERNATIONAL FINANCIAL INSTITUTIONS

UNIT 12: Foreign Trade Policy - Export Promotion Capital Goods Scheme - Duty Exemption/Remission Schemes - Gem and Jewellery Promotion Scheme - Diamond Import License - Special Economic Zones (SEZS) - Free Trade Warehousing Zones (FTWZ) - Star Export Houses - Deemed Exports - Agri Export Zones - Target Plus Scheme.

UNIT 13: Foreign Exchange and Foreign Currency - Organization of the Foreign Exchange Market - Exchange Rate Policy and Management - Triangular Arbitrage - Future and Forward Market - Foreign Currency Options - Forecasting Foreign Exchange Rates.

UNIT 14: International Financial Institutions - IMF - World Bank - IBRD - International Finance Corporation - Organization for Economic Cooperation and Development (OECD) - Legal and Ethical Issues in International Marketing - Nature of International Business Disputes and Proposed Action - Legal Concepts Relating to International Business - International Dispute Settlement Machinery - Ethical Consideration in International Marketing and Marketing Communications.

Unit 12: Foreign Trade Policies **(Pages 255-268);**
Unit 13: Foreign Exchange and Foreign Currency **(Pages 269-284);**
Unit 14: International Financial Institutions and Legal and Ethical Issues in International Marketing **(Pages 285-298)**

CONTENTS

BLOCK I: INTERNATIONAL MARKETING AND STRATEGIES

UNIT 1 INTERNATIONAL MARKETING 1-20

1.0 Introduction
1.1 Objectives
1.2 Meaning and Nature of International Marketing
1.2.1 Scope of International Marketing
1.2.2 International Marketing vs. Domestic Marketing
1.3 Principles of International Marketing
1.4 Customer Value and the Value Equation
1.5 Competitive or Differential Advantage
1.6 Management Orientations: MNCs and TNCs
1.7 Benefits of International Marketing
1.8 Answers to Check Your Progress Questions
1.9 Summary
1.10 Key Words
1.11 Self Assessment Questions and Exercises
1.12 Further Readings

UNIT 2 INTERNATIONAL MARKETING ENVIRONMENT AND CHALLENGES 21-52

2.0 Introduction
2.1 Objectives
2.2 Political Environment and Political Systems and Challenges
2.2.1 Political Interventions; 2.2.2 Political Systems
2.3 Legal and Regulatory Environment and Challenges
2.4 Socio-Cultural Environment and Related Challenges
2.4.1 Cultural Variables and International Business Environment
2.4.2 Impact of Social and Cultural Environment on Marketing Industrial and Consumer Products
2.5 Economic Environment and its Challenges
2.5.1 Macroeconomic Environment; 2.5.2 Microeconomic Environment
2.6 Technological Environment and its Challenges
2.7 Answers To Check Your Progress Questions
2.8 Summary
2.9 Key Words
2.10 Self Assessment Questions And Exercises
2.11 Further Readings

UNIT 3 INTERNATIONAL TRADE ENVIRONMENT 53-87

3.0 Introduction
3.1 Objectives
3.2 Classical Trade Theories
3.2.1 Mercantilism; 3.2.2 Absolute Advantage; 3.2.3 Comparative Advantage
3.3 Modern and Neo-Classical Trade Theories
3.3.1 Factor Proportions Theory
3.3.2 New Trade Theory and Country Similarity Theory; 3.3.3 The Product-Life Cycle

3.4 Trade Barriers or Trade Protection
3.4.1 Types of Tariff and Non-Tariff Barriers Like Quotas; 3.4.2 Implication of Tariffs
3.5 Types of Agreements
3.5.1 General Agreement on Tariffs and Trade (GATT); 3.5.2 Functions and Objectives of WTO
3.5.3 Implication of WTO on International Marketing; 3.5.4 India's Role in International Trade Theories
3.6 Answers To Check Your Progress Questions
3.7 Summary
3.8 Key Words
3.9 Self Assessment Questions And Exercises
3.10 Further Readings

UNIT 4 INTERNATIONAL MARKET ENTRY STRATEGIES 88-104

4.0 Introduction
4.1 Objectives
4.2 Basics of Different Entry Modes and Market Entry Strategies
4.3 Exporting
4.4 Contractual Agreements including Licensing
4.5 Franchising
4.6 Joint Ventures
4.7 Strategic Alliances
4.8 Wholly-owned Subsidiaries
4.9 Direct Investment and Manufacturing
4.10 Answers to Check Your Progress Questions
4.11 Summary
4.12 Key Words
4.13 Self Assessment Questions and Exercises
4.14 Further Readings

BLOCK II: INTERNATIONAL MARKETING RESEARCH, PRODUCT, PRICING POLICIES

UNIT 5 INTERNATIONAL MARKETING RESEARCH 105-121

5.0 Introduction
5.1 Objectives
5.2 Concept of Marketing Research
5.2.1 International Marketing Research; 5.2.2 Need for Marketing Research
5.2.3 Approach to Marketing Research; 5.2.4 Scope of International Marketing Research
5.3 International Marketing Research Process
5.4 Market Surveys
5.5 Marketing Information System
5.6 Answers to Check Your Progress Questions
5.7 Summary
5.8 Key Words
5.9 Self Assessment Questions and Exercises
5.10 Further Readings

UNIT 6 INTERNATIONAL PRODUCT POLICY AND PLANNING 122-152

6.0 Introduction
6.1 Objectives

6.2 Products: National and International
6.2.1 The New Product Development
6.3 International Product Planning
6.3.1 Customization and Product Adoption and Standardization; 6.3.2 Product Planning
6.4 International Market Segmentation
6.5 Influences on Marketing Plan and Budget
6.6 International Product Marketing and Marketing of Services
6.7 Answers to Check Your Progress Questions
6.8 Summary
6.9 Key Words
6.10 Self Assessment Questions and Exercises
6.11 Further Readings

UNIT 7 INTERNATIONAL PRICE POLICY 153-168

7.0 Introduction
7.1 Objectives
7.2 International Price Policy: Overview
7.2.1 Parameters for Pricing of Products in International Marketing
7.2.2 Price and Non-Price Factors
7.3 Methods of Pricing
7.4 International Pricing Strategies Including Dumping
7.4.1 Price Distortion; 7.4.2 Counter Trade
7.5 Answers to Check Your Progress Questions
7.6 Summary
7.7 Key Words
7.8 Self Assessment Questions and Exercises
7.9 Further Readings

UNIT 8 INTERNATIONAL DISTRIBUTION AND LOGISTICS PLANNING 169-181

8.0 Introduction
8.1 Objectives
8.2 Distribution: Definition and Importance
8.2.1 Channel Marketing: Direct and Indirect Channels
8.2.2 Factors Involved in Distribution Systems
8.3 International Logistics Management and Modes of Transportation
8.4 International Packaging
8.5 Answers To Check Your Progress Questions
8.6 Summary
8.7 Key Words
8.8 Self Assessment Questions And Exercises
8.9 Further Readings

BLOCK III: INTERNATIONAL PROMOTIONAL STRATEGIES, FOREIGN MARKET

UNIT 9 INTERNATIONAL PROMOTIONAL STRATEGIES 182-207

9.0 Introduction
9.1 Objectives
9.2 Communications Process
9.2.1 Principles of Communication

9.3 Promotional Strategy: Planning Process
9.4 Status of Promotion and Promotion Appeals
9.4.1 Media Selection
9.5 Public Relations and Publicity, Personal Selling, Sales Promotion and Direct Marketing
9.6 Advertising
9.6.1 Standardization vs Adaptation in International Advertising; 9.6.2 Media Decisions
9.7 E-Marketing
9.8 Answers to Check Your Progress Questions
9.9 Summary
9.10 Key Words
9.11 Self Assessment Questions and Exercises
9.12 Further Readings

UNIT 10 FOREIGN MARKETS AND EXPORT MARKETING PROCESS 208-239

10.0 Introduction
10.1 Objectives
10.2 Choosing Appropriate Mode of Operations
10.3 Issues Related to Exports
10.4 Processing an Export Order
10.5 Export Contract
10.6 Export Pricing and Costing
10.7 EXIM Policies
10.7.1 Export-Import (EXIM) Policy – 2002-2007
10.7.2 Export-Import (EXIM) Policy – 2009-2014
10.7.3 Foreign Trade Policy 2015-20
10.8 Answers to Check Your Progress Questions
10.9 Summary
10.10 Key Words
10.11 Self Assessment Questions and Exercises
10.12 Further Readings

UNIT 11 EXPORT MARKETING DOCUMENTATION 240-254

11.0 Introduction
11.1 Objectives
11.2 Significance of Export Documentation
11.2.1 The Statutory Control; 11.2.2 Declaration Forms
11.3 Major Documents
11.4 Answers To Check Your Progress Questions
11.5 Summary
11.6 Key Words
11.7 Self Assessment Questions And Exercises
11.8 Further Readings

BLOCK IV: FOREIGN TRADE POLICY, INTERNATIONAL FINANCIAL INSTITUTIONS

UNIT 12 FOREIGN TRADE POLICIES 255-268

12.0 Introduction
12.1 Objectives

12.2 Major Foreign Trade Policy Schemes
12.2.1 Export Promotion Capital Goods Scheme
12.2.2 Duty Exemption/Remission Schemes
12.2.3 Gem and Jewellery Promotion Scheme and Diamond Import License
12.2.4 Special Economic Zones (SEZs)
12.2.5 Free Trade Warehousing Zones (FTWZ)
12.2.6 Star Export Houses; 12.2.7 Deemed exports
12.2.8 Agri Export Zones; 12.2.9 Target Plus Scheme
12.3 Answers to Check Your Progress Questions
12.4 Summary
12.5 Key Words
12.6 Self Assessment Questions and Exercises
12.7 Further Readings

UNIT 13 FOREIGN EXCHANGE AND FOREIGN CURRENCY 269-284

13.0 Introduction
13.1 Objectives
13.2 Introduction and Organization of Foreign Exchange Market
13.3 Exchange Rate Policy and Management
13.3.1 Determining and Forecasting Foreign Exchange Rates
13.4 Currency Arbitrage and Triangular Arbitrage
13.5 Forward Market
13.6 Futures Market
13.7 Foreign Currency Options
13.8 Answers to Check Your Progress Questions
13.9 Summary
13.10 Key Words
13.11 Self Assessment Questions and Exercises
13.12 Further Readings

UNIT 14 INTERNATIONAL FINANCIAL INSTITUTIONS AND LEGAL AND ETHICAL ISSUES IN INTERNATIONAL MARKETING 285-298

14.0 Introduction
14.1 Objectives
14.2 International Financial Institutions
14.2.1 IMF; 14.2.2 IBRD-World Bank
14.2.3 International Finance Corporation
14.2.4 Organization for Economic Cooperation and Development (OECD)
14.3 Legal and Ethical Issues in International Marketing
14.3.1 Nature of International Business Disputes and Proposed Action
14.3.2 Legal Concepts and International Dispute Settlement Machinery
14.3.3 Ethical Consideration in International Marketing and Marketing Communications
14.4 Answers to Check Your Progress Questions
14.5 Summary
14.6 Key Words
14.7 Self Assessment Questions and Exercises
14.8 Further Readings

INTRODUCTION

NOTES

According to the American Marketing Association (AMA), 'international marketing is the multinational process of planning and executing the conception, pricing, promotion and distribution of ideas, goods, and services to create exchanges that satisfy individual and organizational objectives.' International marketing or global marketing refers to marketing carried out by companies overseas or across national borderlines. In other words, international marketing is the application of marketing principles to expand trade across national boundaries. This implies an extension of the techniques used in the home country of a firm.

Globalization is here to stay. Advances in technology and communication have made the world a smaller place, facilitating cross-border trade and business. For companies seeking to go global, however, there are a number of issues at stake. Doing business in a foreign location is not the same as doing business in one's home country. International trade is a tempting option when gains are taken into account. Although conducting business is a creative enterprise but doing so beyond national borders is a challenging task indeed. There could be significant legal, cultural and political barriers. The same mix of products, marketing strategies and pricing that works so well in the home country may be a complete failure in a foreign market. Therefore, it is important that the potential market is studied and analysed carefully. Product and market segmentation is an essential step in that direction. It is also important to know the standards and product rules and regulations followed in the country and the cultural habits prevailing in the target market.

This book, *International Marketing*, has been designed keeping in mind the self-instruction mode (SIM) format and follows a simple pattern, wherein each unit of the book begins with the Introduction followed by the Objectives for the topic. The content is then presented in a simple and easy-to-understand manner and is interspersed with Check Your Progress questions to reinforce the student's understanding of the topic. A list of Self-Assessment Questions and Exercises is also provided at the end of each unit. The Summary and Key Words further act as useful tools for students and are meant for effective recapitulation of the text.

BLOCK - I
INTERNATIONAL MARKETING AND STRATEGIES

NOTES

UNIT 1 INTERNATIONAL MARKETING

Structure

1.0 Introduction
1.1 Objectives
1.2 Meaning and Nature of International Marketing
  1.2.1 Scope of International Marketing
  1.2.2 International Marketing vs. Domestic Marketing
1.3 Principles of International Marketing
1.4 Customer Value and the Value Equation
1.5 Competitive or Differential Advantage
1.6 Management Orientations: MNCs and TNCs
1.7 Benefits of International Marketing
1.8 Answers to Check Your Progress Questions
1.9 Summary
1.10 Key Words
1.11 Self Assessment Questions and Exercises
1.12 Further Readings

1.0 INTRODUCTION

The process of penetrating an international market is a difficult task for most companies in the current international business environment. Most companies, even multinationals, still identify this task as an Achilles' heel in their global capabilities. Generally, in the start-up phase most firms lack experience in sales, marketing infrastructure and knowledge of the market. Despite this, companies usually treat this situation as if it were an extension of their business, a source of incremental revenues for existing products and services.

There are two issues which are important in the context of international marketing.

- Companies often pursue international marketing as a new business opportunity. They are aware that with a focus on this approach they can minimize their risk and investment.
- Most firms are also aware that from the marketing perspective it would be good to start by analysing the market, and then, and only then, decide on its offer in terms of products, services, and marketing programmes.

In this unit, you will learn about the meaning and nature of international marketing, along with

NOTES

1.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the meaning and nature of international marketing
- Discuss the basis of international trade
- Describe the scope of international marketing
- Examine the principles of international marketing
- Discuss the concept of customer value and value equation
- Explain the management orientations of MNCs and TNCs
- Describe the benefits of international marketing

1.2 MEANING AND NATURE OF INTERNATIONAL MARKETING

The difference between the selling and marketing approach has been well highlighted by Theodore Levitt (1960) in his classic article 'Marketing Myopia' in the *Harvard Business Review*:

> 'Selling focuses on the needs of the seller; marketing on the needs of the buyer. Selling is pre-occupied with the seller's need to convert his product into cash, marketing with the idea of satisfying the needs of the customer by means of the product and whole cluster of things associated with creating, delivering and finally consuming it.'

Definition of Marketing

Till date, no universally accepted definition of marketing has been formulated. The reason, to a large extent, is that since companies have to operate in dynamic exogenous conditions, they adapt their business philosophies to what seems to be appropriate at the time.

The definitions of marketing have altered accordingly. Let us go with the following definition by Philip Kotlar (1988):

> 'Marketing is a social and managerial process by which individuals and groups obtain what they need and want through creating and exchanging products and value with others.'

Note that instead of being 'company centered', the above definition focuses on 'exchange' by individuals and groups. By implication, the company and customers have been considered as equally important parties in the exchange process. For marketing to take place, both the parties should be able to obtain

NOTES

what they need and want, i.e., there should be beneficial exchanges rather than one-sided rip offs.

Companies want to earn profit and consumers want value for their money. In simple terms, consumers want that the product should be able to satisfy their specific needs and wants. Profit for the company comes through creating consumer satisfaction.

Our definition of marketing suggests that the needs and wants of the customers should be the deciding factors in all our marketing efforts. However, the markets for any product consist of a large number of customers having different characteristics.

Another term which is now being widely used is 'global marketing'. Some authors distinguish between this and international marketing.

'An organization that engages in global marketing focuses its resources on global market opportunities and threats. A company that engages in global marketing conducts important business activities outside the home country market.'

This definition shows that the decision of countries to enter the global market is made on an assessment of their potential. Companies do not enter the most convenient market, but the one which offers the best 'returns'. The customers and their needs and the business environment may differ between countries. Accordingly, different countries will offer different levels of potential or profit. International marketing involves evaluating and selecting the best of these. It does not mean entering every market throughout the world.

Difference in customers or practices often means that aspects of products, their promotion, distribution and pricing may have to change if a company is to be successful. Very few products (indeed, some people say that there are no products) can be sold in an entirely standardized way throughout the world.

A leading marketing author, Theodore Levitt, encouraged marketing managers to standardize their international marketing plans and activities. A key factor here was that globalization could reduce costs, and that lower prices would stimulate demand. The view of standardization is often closely associated, incorrectly, with global marketing. Standardization of marketing activities has not proven to be the key to success for modern global business. Indeed, global marketing is now coming to mean that the company should have a global view, but it should interpret and implement activities locally. These decisions are amongst the 'important business activities' mentioned in Keegan's definition.

International Marketing Definitions

The above discussion has focused on aspects of international business, and not exclusively on international marketing. What is the difference?

First, international business concerns the full range of activities involved in bringing about inter-firm trade in international markets. This includes human

resources, production, sourcing, distribution, advertising and finance. International marketing is concerned with the organization's marketing decisions in other countries.

NOTES

An examination of definitions shows what this involves. From your previous studies, you will be aware that:

Marketing is the management process responsible for anticipating, identifying and satisfying customer's requirement profitably.

So, effective marketing relies on a company being able to meet customer requirements better than competitors in a changing business environment. This will involve getting all aspects of marketing—including the management of the marketing mix of product, price, place and promotion—designed around customer requirements. It is about creating a competitive advantage through the management of these areas.

> Historically, most companies start by meeting the needs of customers in their home country. After a time, they get involved in selling to customers in other countries. So marketing activities are extended to cover: '…that segment of business concerned with the planning, promoting, distributing, pricing and servicing of the goods and services desired by intermediate and ultimate consumers…….. marketed across political boundaries.'

This takes our definition of marketing to an international context, that is across political borders. It also defines some significant tasks—those which detail the key areas of marketing mix management.

Traditionally, companies chose to enter new countries gradually. Often they would select one market, and opt to export there. Over time, they started extending their activities to other markets, often one after another. Management decisions moved from being made in the home market, to being made on a market basis to meet the needs of each market. Thus, in this way they moved over time from domestic marketing to marketing internationally.

People differ in their preferences, buying habits and geographical locations besides many other things. Their needs and wants, therefore, are different. Take, for example, any consumer product like shoes or detergent.

'Marketing consists of the strategies and tactics used to identify, create and maintain satisfying relationships with customers that result in value for both the customer and the marketer.'

Global Marketing

Companies go for global marketing assuming that what works in their home country will work in another country. Initially, they introduce the same product, same advertising campaign, same brand names and packaging. In some cases, they are successful and in some cases they are not. This is because of the differences that exist between countries and cultures. Some companies successfully follow a

NOTES

standardized marketing strategy in the international market. But the same approach cannot work in all markets. Therefore, different markets especially at the international level require sufficient research that addresses this question.

Possibly, the most challenging concept in marketing deals with understanding why buyers do what they do (or do not do). Such knowledge is critical for marketers since having a strong understanding of buyer behaviour will shed light on what is important to the customer and also suggest the important influences on customer decision-making. Using this information, marketers can create marketing programmes that they believe will be of interest to customers.

In fact, it is essential to understand that international markets only provide opportunities to increase the sales of existing products. Therefore, there is a need to adopt a 'sales push' rather than a market-driven approach. Due to this confusion between sales push and market-driven approach, the performance of many companies has been disappointing.

The link between this perspective and a view of international sales as incremental business is self-evident. Many firms enter new country-markets through the indirect channel of a local independent distributor or agent, in which case the multinationals will not know their costs and, therefore, their operating profitability in the markets.

Although, the more mature firms are altering the way in which they enter and penetrate new international markets, the mixed results in the post-2001 recession demonstrate that this remains a challenging phase of internationalization.

- This common mismatch between expectations and situational requirements stems from a failure to follow domestic marketing strategies in international operations. This may be because participation in the market is indirect (i.e., via an independent local distributor or agent, rather than through a directly controlled marketing subsidiary).
- It also often reflects a lack of control over strategic marketing and a failure to think rigorously about how the business will develop over the course of several years. While it is true that certain distinctive characteristics of an international marketing situation demand a different approach to marketing, this is not a reason for the standards of strategic marketing management to be relaxed.

1.2.1 Scope of International Marketing

Scope of international marketing can be understood by the definition of international marketing. American marketing association defines international marketing as the process of planning and executing the conception pricing promotion and distribution of goods service and ideas to create exchanges that satisfy individual and organisational objectives in more than one nation it means in international marketing the activities are undertaken in several countries and such activities are to be coordinated across Nations. Thus international marketing can be considered as a

NOTES

coordinated marketing process which is undertaken in several countries through one or more of the following functions:

- Export: it is a function of international marketing where by goods produced in one country are sent to another country for the sales or trade.
- Import: It is a function of international marketing whereby goods produced in one country are brought into another country for use or sale.
- Re export: It is a function of international marketing whereby semi finished goods are imported from one country for the further processing and the finished goods are exported back.
- Management of international operations: the management of international operations such as operating marketing and sales facilities abroad establishment production or assembly facilities in foreign countries and monitoring the operations and practices of other MNCs and agencies.

To undertake these operations the exporter performs various activities, other than just exporting and importing goods the goods and services these activities are summed up as under:

- **Setting up a branch:**

  Setting up a branch in the foreign markets for processing, packaging or assembling the goods according to the needs and requirements of the markets. Sometimes complete manufacturing is carried out by the branch through direct investments.

- **Entering into Joint Ventures and Collaborations:**

  Under these arrangements, the company works in collaboration and coordination with the foreign firm in order to exploit the foreign markets.

- **Establishing Licensing Arrangements:**

  The company, under the system, establishes licensing arrangements with the foreign firm whereby foreign enterprises are granted the right to use the exporting company's know- how, patents, processes or trademarks according to the terms of agreement with or without financial investment.

- **Offering Consultancy Services:**

  The scope of international marketing also includes the offering of consultancy services. The exporting company offers consultancy services by undertaking turnkey projects in foreign countries. For this purpose, the exporting company sends its consultants and experts in foreign countries who guide and direct the manufacturing activities on the site of operations.

- **Sharing of Technical and Managerial Know-How:**

  International marketing also includes the technical and managerial know-how provided by the exporting company to the importing company.

The technicians and managerial personnel of the exporting company guide and train the technicians and managers of the importing company.

Thus, scope of international marketing is not just restricted to export or import of goods but also to broader area of coordinated management of the whole international operations.

1.2.2 International Marketing vs. Domestic Marketing

International and domestic marketing are two different concepts. However, there are some points of similarity between them. These are:

- Both aim at satisfying the needs of their customers. Both try to find out the needs and requirements of their customers and plan a strategy to fulfil their needs.
- Both aim at building friendly relationships with their customers. A friendly environment makes it easy to implement the organizational strategies in domestic and international marketing. In order to increase sales, it is necessary to provide guarantees and after-sales services for products to customers.
- Both should have their own research and development centres for the continuous improvement of their products.

The differences between international and domestic marketing are:

- **Independent political entities:** Every country in the world is an independent political entity and the organizations in these countries carry out their international business activities. Such organizations have to face a number of problems. Some of them are:
  - ***Customs duties:*** Customs duty is applied on imported goods from a foreign country. The custom duty makes the product very expensive. Organizations with weak economic systems sometimes find it difficult to import expensive goods.
  - ***Quantitative restrictions:*** These restrictions are applied on the goods to protect domestic industries.
  - ***Exchange controls:*** Exchange controls are the various controls that are applied by the government on the import/export business. Some of these controls can be the use of foreign currency in the country, amount of money that can be imported or exported and the fixed exchange rates.
  - ***Local taxes:*** Local taxes applied on foreign goods are used to make them costlier than domestic goods in order to promote the domestic goods.
- **Different legal systems:** The legal systems of countries differ from each other in many respects. Some countries follow the English Common Law, while some other follow the civil law. Some European countries have

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developed their own legal systems to make the life of businessmen comfortable. Incoterms and Uniform Customs and Practices on Documentary Credits developed by the International Chamber of Commerce tries to bring about a consistency between the different legal systems of different countries.

- **Different financial systems:** The financial system and exchange values of countries differ from each other. Some countries also use different exchange rates for different business transactions. However, the International Monetary Fund tries to build some rules to bring about a consistency between the different financial systems of different countries.
- **Different market characteristics:** The market characteristics of countries also differ from each other. Market characteristics can contain the demand pattern, distribution modes and promotion methods. However, market characteristics can also differ within the country. Countries like India and USA have different characteristics in their different states.
- **Different procedures and documentations:** Procedures and documentations are the rules and regulations to carry out the business activities. Each country has its own rules regarding the import or export of products from foreign countries by their organizations.
- **Cultural differences:** Organizations have to carry out international business in a cross-cultural environment. The marketer of a different country has to adjust himself to the foreign environment to promote his products. Culture can also be divided into two categories—low-context culture and high-context culture. Low-context culture prefers written communication rather than interpersonal and business relationships. However, high-context culture gives importance to interpersonal and business relationships. Therefore, even the oral word is enough to show commitment in a high-context culture. Countries like India have high-context culture because most of the business transactions in India are carried out verbally. The different characteristics of culture can be:
  - Culture can be instinctive.
  - Culture is persistent and interrelated.
  - Culture is shared by all the members of the group.

Check Your Progress

1. What does effective marketing relies on?
2. What is the re-export function of international marketing?

1.3 PRINCIPLES OF INTERNATIONAL MARKETING

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Three principles of international marketing can be summed up as follows

i. The principle of customer value
ii. The principle of competitive advantage
iii. The principle of concentration of customer need.

Let's discuss these principles in detail here.

i. The principle of customer value

One of the main principles of international marketing is in creating customer value, this value needs to be greater than the value which is created by the competitors. The company can work towards enhancing the value for the customer by an effort directed towards value increase by expanding or improving product and service benefits or by reducing the price or by a combination of all these elements. Companies that use price as a competitive advantage or competitive strategy must have a strategic cost advantage in order to create a suitable and sustainable competitive advantage in terms of price. The inputs might come for this strategy in the form of the availability of cheap labour or access to cheap raw material or it might be in form of economies of scale in production or in the form of effective or efficient management.

Knowledge of the customer value in combination with creativity and innovation can help a company make improvements in the products and services which actually matter to the customer. If these benefits are strong enough and valued enough by the customer a company does not need to be the low-price competitor in order to win the customers.

ii. The principle of competitive advantage

The second principle is that of competitive advantage. A competitive advantage is a total offer of a company that is in comparison to the relevant competition. This offer of the company has to be more attractive than the competitor's offer to the customers. The advantage could exist in any element of the companies offer for example it may be in the product or the price or advertising or the point of sale promotion or the distribution of products to name a few. In any case the total offer must be more attractive than that of the competition in order to create a competitive advantage.

A company might have a product that is equivalent in quality to that of the competition if not better but if it offers this product at a significantly lower price and if it can get customers to believe that the quality of the company's product is equal to that of the competition the price advantage will give the company a competitive advantage.

The competitive advantage must exist relative to relevant competitors. Thus, if the company is in a local industry these competitors will be local and if it is a national industry, it will have national competitors and if it is a global company it will have global competitors.

iii. The principle of concentration of customer need.

The third principle is the focus on the concentration of customer need. The focus is required to succeed in the task of creating customer value at a competitive advantage. All the successful organisations are successful because they understand and apply this principle. The focus on customer needs and wants and on the competitive offer is needed to mobilise the efforts required to maintain a differential advantage this can be accomplished only by focusing on the resources and efforts on customer needs and wants and how to deliver a product that will meet these needs and wants.

1.4 CUSTOMER VALUE AND THE VALUE EQUATION

The term Value has several meanings. For some value may mean price and for others it may mean benefit.

The term Customer value can be defined as the perception of what a product or service is worth to a customer as compared to the available alternatives. Worth here means whether the customer feels that they have received appropriately what they had paid for.

It is simply a ratio of what he pays and what he gets, to express it as an equation:

Customer value = Benefits – cost.

Benefits are both functional as well as emotional benefits such as the benefits may include the advantage of quality of the product service image and the brand of the company or brand of the product brand values experience and success one gets in using the product while cost paid is not just in terms of money but also in terms of several non-price or non-monetary terms such as time, effort, energy and inconvenience.

Thus, customer value= total benefits – total cost or

customer value = benefits / cost

Value increases with increase of benefits or decrease of costs.

An increased customer value means increased customer satisfaction and customer experience.

Good customer experience create value for the customer. Creating customer value increases loyalty in turn it increases market share increases efficiency and higher market share and better efficiency lead to higher profits.

1.5 COMPETITIVE OR DIFFERENTIAL ADVANTAGE

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The globalization effort of most companies comprises extending their business models geographically with necessary modifications to maximize the company's economies of scale. The key strategic challenge becomes to determine how much to adapt the business model – how much to standardize from country to country versus how much to localize to respond to local differences. Companies focus on similarities across countries and balance localization and standardization. The primary focus is on similarities so that greater scale economies are achieved. Differences from country to country are viewed as obstacles to be overcomed.

But in their rush to exploit similarities across borders, multinational companies have ignored the original global strategy – arbitrage, the strategy of difference. Though still important, arbitrage is much more than cheap capital or labour. The scope of arbitrage is as wide as the differences among countries, which continues to be broad and deep. Following are the types of arbitrages:

- **Cultural arbitrage:** It exploits differences in culture. The international success of French haute couture, cuisine, wines and perfumes is due to cultural arbitrage. U.S. based fast-food chains exploit the general global surge of American popular culture. Less developing countries and regions also have strong cultures with which outsiders are fascinated. The persistent association of Brazil with football, carnival, beaches and sex helps in the marketing of youth-oriented products and services when such products are believed to be coming from these markets. Super premium beers imported from Brazil are very popular. The reductions in tariffs and transport costs will increase the viability of cultural arbitrage.
- **Administrative arbitrage:** Legal, institutional and political differences from country to country enable administrative arbitrage. Tax differentials are common examples.
- **Geographic arbitrage:** Because of decrease in transportation costs, new opportunities for geographic arbitrage have been created. Millions of flowers and plants are auctioned off every day in Netherlands's Aalsmeer international flower market. Blooms flown from India are sold to customers in the United States and Europe on the day they arrive. Hong Kong based Li & Fung earns its revenues from a sophisticated kind of geographic arbitrage. It sets up and manages multinational supply channels for clients through its offices in more than 30 countries.
- **Economic arbitrage:** Economic arbitrage comes from differences in the costs of labour and capital, as well as variations in more industry-specific inputs such as knowledge or the availability of complementary products, technologies, or infrastructures. The best type of economic

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arbitrage is the exploitation of cheap labour, which is common in labour-intensive industries like clothing. Capital cost differentials are slimmer but considering that most companies earn returns within two to three percentage points of their cost of capital, even such small differences are consequential. The subtlest form of arbitrage is exploitation of knowledge differential. The rush to establish R&D and software development centers in India is due to availability of relevant talent.

A global company must leverage its competencies from all the locations where it has operations.

Most industries are global. In the global market, cost and quality will be important drivers of success and low margins will be the norm. Global competitive advantage will mean having the best technologies and processes for designing, manufacturing, selling and servicing products at the lowest possible cost.

To gain lasting global competitive advantage a company has to leverage its capabilities around the world so that the company as a whole is greater than sum of its parts. Selling globally, having global brands or having operations in different countries will not be enough. Most so-called global companies have acquired or established businesses all over the world, but each regional or national division still operates as autonomous business with its own unique constraints, its own finite opportunities and its own strategies. Such companies will not have global competitive advantage. A global company's geographical businesses will have to be integrated so that the most advanced expertise in any given area, be it technology, or marketing, or accounting, is not confined to one location or division. The company will have to leverage its expertise, wherever available, in all its operations worldwide.

Varying consumer preferences may require a company to have regional manufacturing centers. Even though features, dimensions and configurations of the products may vary from market to market, much of the technologies and manufacturing processes employed in regional manufacturing centers should be the best that the company has. Different products can be built on the same basic platform, so while each market gets the product according to its requirements, the company gains benefits of economies of design. A large proportion of common components can also be used in the products meant for different markets which will reduce the cost of design and manufacturing and will also improve quality. A global company which will design and make entirely new products for each of its markets will incur extra costs in designing and will not get the economies of scale of manufacturing of common components.

Employees of a global company should be comfortable exchanging ideas, processes and systems across borders. They should work together to identify the best global opportunities and the worst global problems facing the company. The unifying value of such a global company is focus on the customer and an intensive and stretched effort to understand and respond to genuine customer needs. Such

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an effort leads to breakthrough products and services that earn customer loyalty.

A company cannot become a global company overnight just because its CEO is mandating it to become one. Employees have to find the idea attractive and beneficial to them and this is essentially a slow and educative process. Senior managers have to relentlessly communicate the company's vision and its long term goals. Every employee must believe that there is great value in managing the company in an integrated manner. People from various regions and countries have to be brought together on real projects that tackle real problems. When these forced interactions among employees of different divisions, regions and countries start showing results in the projects that they have been assigned to work on, they start believing in the usefulness of accessing talents and technologies from wherever it is available in the company. And if the company does not have to go back to its erstwhile regions, it has to periodically assign people from various divisions, regions and countries on common projects. Ultimately, a global company will have cross-border business teams that will run all their operations throughout the world. These teams will have functional and brand objectives and will identify and serve the best global opportunities.

Check Your Progress

3. Why is the focus on customer needs and wants and competitive offer needed?
4. State customer value as an equation.
5. What must companies do to gain a lasting competitive advantage?

1.6 MANAGEMENT ORIENTATIONS: MNCs AND TNCs

Almost over 90 per cent of international business is done by MNCs. Also all the best known companies in the world are MNCs. Exports by medium and small enterprises (SMEs) are the only exceptions. In other words, non-MNCs perform the pivotal roles in terms of international business policies, strategies and outcomes. All multinational enterprises (MNCs) operate in a complex international business environment which is quite different from national business environment. Diversity of political situations, economic systems, social and cultural patterns make the environment so different. These diversities lead to or explain differences in consumer tastes and preferences, product/market adaptations, host country controls and regulations, etc. An understanding of the international business environment is essential for MNCs to operate effectively or successfully. Therefore, an analysis of the international business environment is also undertaken here along with MNEs in two separate parts.

A. Multinational Enterprise (MNE)

What Is An MNC?

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MNC is a very commonly used and standard term for a multinational company or corporation; this is also referred by many as a multinational enterprise (MNE). MNE sounds more appropriate or strategic considering the entrepreneurial, enterprising and innovative methods adopted by these companies or corporations. However, MNC and MNE can be used interchangeably.

Different attempts have been made to define an MNC or MNE. Three definitions are given below including the one by ILO which is more detailed or comprehensive:

- 'A multinational enterprise (MNE) is a company that is headquartered in one country but has operations in one or more other countries.'
- 'A multinational corporation/company is an organization doing business in more than one country.'
- 'The essential nature of the multinational enterprise lies in the fact that its managerial headquarters are located in one country (referred for convenience as the "home country") while the enterprise carries out operations in a number of other countries as well ("host countries"). Obviously, what is meant is a corporation that controls production facilities in more than one country, such facilities having been acquired through the process of foreign direct investment. Firms that participate in international business, however large they may be, solely by exporting or by hunting technology, are not multinational enterprises.

As the ILO definition clearly indicates, just by exporting or trading, a company does not become an MNC or MNE. To be a multinational corporation or enterprise, it has to have presence in at least one host country in terms or operations—manufacturing, marketing, distribution, etc. All multinationals like GE, Ford, Unilever, McDonald's, Sony, Honda, Nestlé, LG satisfy this definition.

Adhikari (2004) has given definitions of MNCs from different perspectives: structure, operations, functions and culture or behaviour. Four different definitions based on these perspectives are given below:

a. An MNC may be identified in terms of its organizational structure, i.e., whether it has a foreign subsidiary or branch or an international division to oversee foreign operations. This is a *structural* definition.
b. An MNC refers to a corporate organization which owns and/or controls income generating assets in more than one country. This is an operational definition adopted by UNCTC (United Nations Centre for TNCs).

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c. An MNC may be identified in terms of performance or positioning criteria such as Market Value Added (MVA) or Economic Value Added (EVA), the range or products, ratio of foreign sales to total sales, etc. This can be termed as functional definition.

d. An MNC may be described in terms of organizational culture and managerial behaviour\ rather than performance. For example, Western MNCs and Eastern MNCs have certain distinct cultural differences. This may be called cultural definition or behavioural definition.

International Corporation, Multinational Corporation, Transnational Corporation and Global Corporation

Definitions and descriptions of MNCs/MNEs go further. Bartlett and Ghoshal (1998), among other, have made a distinction between and International Corporation, Multinational Corporation, Transnational Corporation and Global Corporation. These are explained below.

- *International Corporation (INC):* An international company conducts operations in one or more foreign countries, but with domestic orientation. Such companies believe that business practices adopted in the domestic market—products, promotion an marketing strategies—are superior to those of other countries.
- *Multinational Corporation (MNC)*: Multinational corporations recognize differentiated needs of different foreign markets regarding product, promotion and price. MNCs operate in more than one country, but function almost like a domestic company of the country or market concerned.
- *Transnational Corporation (TNC):* Transnational corporations recognize differentiated needs of different countries/markets and, at the same time, are also integrated worldwide. A transnational corporation, to some extent, combines the business features of an international corporation and a multinational corporation. The UN prefers this term and has created a Research Centre for TNCs.
- *Global Corporation (GC):* A global corporation is similar to an international corporation, but is more worldwide or global in terms of impact or operations. Technology and products of global corporations have more universal applications (like Intel chips).

Table 1.1 summarizes major characteristics of IC, MNC, TNC and GC in terms of assets and capabilities, overseas operations and knowledge development and diffusion (technology, product design/development, etc.)

Table 1.1 *Characteristics of INC, MNC, TNC and GC*

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Organizational characteristics	*Multinational*	*Global*	*International*	*Transnational*
Configuration of assets and capabilities	Decentralized and nationally self-sufficient	Centralized and globally scaled	Sources of core competencies centralized, others decentralises	Dispersed, interdependent and specialized
Role of overseas operations	Sensing and exploiting local opportunities	Implementing parent company strategies	Adapting and leveraging parent company competencies	Differentiated contributions by national units to integrated worldwide operations
Development and diffusion of knowledge	Knowledge developed and retained within each unit	Knowledge developed and retained at the centre	Knowledge developed at the centre and transferred overseas units	Knowledge developed jointly and shared worldwide

Source: Bartlett, C.A., and Ghoshal, S., Managing Across Borders, Harvard Business School Press, 1998.

1.7 BENEFITS OF INTERNATIONAL MARKETING

International business consists of the private or governmental business activities involving two or more countries. The role of international business has become significant at the macroeconomic and microeconomic levels. All the countries in the world depend on other countries to import or export something. No country in the world is able to produce all goods or products by itself. These countries need to import items that cannot be produced domestically. These countries also try to export their items to foreign countries to make a balance of payments in the import and export goods.

Many companies all over the world performing international business activities are involved in the export and import of products. Export involves the logical process to understand the environment and structure of the target country, developing a plan based on the country's structure, implementing the plan using the formulated strategy and using a control method to ensure that the plan is consistent with the strategy.

International business allows companies from various countries to interact and form an international network to get business-related advantages in the global market. Foreign Direct Investment (FDI) plays an important role in building an international business network. FDI organizations assist economically weaker partners financially. The FDI has certain aims that include acquiring natural resources, research and development expenditures recovery and earning large profits. International business also helps countries fulfil their needs. The organizations in a particular country can import the products from other countries that they cannot produce domestically. International business also helps in building good relationships

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between countries. The organizations performing international business activities are also able to improve their competitiveness. Therefore, the organizations have to be global in the areas of production and marketing to be a successful participant in the globally competitive environment. The organizations have to pass through different stages before becoming successful in the international business area.

Check Your Progress

6. Define transnational corporation.
7. What plays an important role in building an international business network?

1.8 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Effective marketing relies on a company being able to meet customer requirements better than competitors in a changing business environment.
2. Re export: It is a function of international marketing whereby semi finished goods are imported from one country for the further processing and the finished goods are exported back.
3. The focus on customer needs and wants and on the competitive offer is needed to mobilise the efforts required to maintain a differential advantage this can be accomplished only by focusing on the resources and efforts on customer needs and wants and how to deliver a product that will meet these needs and wants.
4. Customer value is simply a ratio of what he pays and what he gets, to express it as an equation:

   Customer value = Benefits – cost.
5. To gain lasting global competitive advantage a company has to leverage its capabilities around the world so that the company as a whole is greater than sum of its parts.
6. *Transnational Corporation (TNC):* Transnational corporations recognize differentiated needs of different countries/markets and, at the same time, are also integrated worldwide. A transnational corporation, to some extent, combines the business features of an international corporation and a multinational corporation.
7. Foreign Direct Investment (FDI) plays an important role in building an international business network.

1.9 SUMMARY

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- Till date, no universally accepted definition of marketing has been formulated. The reason, to a large extent, is that since companies have to operate in dynamic exogenous conditions, they adapt their business philosophies to what seems to be appropriate at the time.
- For marketing to take place, both the parties should be able to obtain what they need and want, i.e., there should be beneficial exchanges rather than one-sided rip offs.
- 'An organization that engages in global marketing focuses its resources on global market opportunities and threats. A company that engages in global marketing conducts important business activities outside the home country market.'
- International business concerns the full range of activities involved in bringing about inter-firm trade in international markets. This includes human resources, production, sourcing, distribution, advertising and finance. International marketing is concerned with the organization's marketing decisions in other countries.
- In international marketing, it is imperative to create a relationship that holds value for customers and for the organization.
- Companies go for global marketing assuming that what works in their home country will work in another country. Initially, they introduce the same product, same advertising campaign, same brand names and packaging. In some cases, they are successful and in some cases they are not.
- A country specializes in a specific commodity due to mobility, productivity and other endowments of economic resources. This stimulates a country to go for international trade. The basis of international trade lies in the diversity of economic resources in different countries. All countries are endowed by nature with the same productive facilities.
- International marketing can be considered as a coordinated marketing process which is undertaken in several countries through one or more of the following functions: export, import, re export and management of international operations.
- Three principles of international marketing can be summed up as follows
    iv. The principle of customer value
    v. The principle of competitive advantage
    vi. The principle of concentration of customer need.
- The term Customer value can be defined as the perception of what a product or service is worth to a customer as compared to the available alternatives.

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Worth here means whether the customer feels that they have received appropriately what they had paid for.

- The globalization effort of most companies comprises extending their business models geographically with necessary modifications to maximize the company's economies of scale. The key strategic challenge becomes to determine how much to adapt the business model – how much to standardize from country to country versus how much to localize to respond to local differences.
- All multinational enterprises (MNCs) operate in a complex international business environment which is quite different from national business environment. Diversity of political situations, economic systems, social and cultural patterns make the environment so different. These diversities lead to or explain differences in consumer tastes and preferences, product/market adaptations, host country controls and regulations, etc.
- MNC is a very commonly used and standard term for a multinational company or corporation; this is also referred by many as a multinational enterprise (MNE).
- International business consists of the private or governmental business activities involving two or more countries. The role of international business has become significant at the macroeconomic and microeconomic levels.

1.10 KEY WORDS

- **Marketing**: It is a social and managerial process by which individuals and groups obtain what they need and want through creating and exchanging products and value with others.
- **Customer value:** It can be defined as the perception of what a product or service is worth to a customer as compared to the available alternatives.

1.11 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Mention the two issues which are important in the context of international marketing.
2. How do some authors distinguish between 'global marketing' and international marketing?
3. Briefly discuss the approach marketers use in decision making to achieve the desired goals for creating a valuable relationship between customers and organization.

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4. Write a short note on customer value and value equation.
5. List the types of arbitrages.
6. Define the terms international corporations, multinational corporations, transnational corporations and global corporations.
7. Briefly explain the benefits of international marketing/business.

Long-Answer Questions

1. Examine the basis of international trade.
2. Explain the scope of international marketing.
3. Discuss the points of similarity and differences between international and domestic marketing.
4. Describe the principles of international marketing.

1.12 FURTHER READINGS

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UNIT 2 INTERNATIONAL MARKETING ENVIRONMENT AND CHALLENGES

Structure

2.0 Introduction
2.1 Objectives
2.2 Political Environment and Political Systems and Challenges
  2.2.1 Political Interventions
  2.2.2 Political Systems
2.3 Legal and Regulatory Environment and Challenges
2.4 Socio-Cultural Environment and Related Challenges
  2.4.1 Cultural Variables and International Business Environment
  2.4.2 Impact of Social and Cultural Environment on Marketing Industrial and Consumer Products
2.5 Economic Environment and its Challenges
  2.5.1 Macroeconomic Environment
  2.5.2 Microeconomic Environment
2.6 Technological Environment and its Challenges
2.7 Answers To Check Your Progress Questions
2.8 Summary
2.9 Key Words
2.10 Self Assessment Questions And Exercises
2.11 Further Readings

2.0 INTRODUCTION

Marketing environment has a very significant impact on the functioning of any business. When businesses scale up to conduct their operations across national borders, the environmental factors become more complex. For a business to successfully conduct its activities in international markets, it must have a great understanding of the type of market it is functioning in. The market environment for international marketing includes different aspects like political, legal, economic, socio-cultural and technological environment. In this unit, you will learn about the concept of all these environmental factors along with challenges of each of them in global setting.

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2.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the international political environment and political systems
- Discuss the legal and regulatory environment
- Examine the economic environment for international marketing
- Describe the socio-cultural environment
- Explain the technological environment
- Discuss the challenges of global marketing

2.2 POLITICAL ENVIRONMENT AND POLITICAL SYSTEMS AND CHALLENGES

It is important to understand that the global political environment has a great role to play in all business and economic matters. Today, however, it remains in constant flux. The political system of a country is shaped after passing through major processes of growth, decay, breakdown and a ceaseless ferment of adaptation and adjustment. The magnitude and variety of the changes that occurred in the world's political systems between the 1920s and 1980s describe the complex dimensions of the problem. It may be observed that during the last century great empires disintegrated, while nation-states emerged, flourished briefly, and then vanished. Two consecutive world wars transformed the international system and created new ideologies that swept the world and shook established groups from power-grid nations. However, many developing countries experienced civil wars and political revolutions during the post-world-war period in order to determine the most effective governing system. Domestic politics in every system were contorted by social strife and economic crisis. In the middle of the twentieth century, the nature of political life was changed everywhere by novel forms of political activity as the new means of mass communication, increase of popular participation in politics and the rise of new political issues offered better understanding towards international politics and popular governance in reference to global integration. Besides, the extension of the scope of governmental activity and other innumerable social, economic, and technical developments in the developing countries needed stability in the government for effective implementation of the international development programmes, and trade policies have been one among the international priorities.

There are many factors that influence the ideological transition, development and change in the world's political systems. In the recent past, industrialization, population growth, the 'revolution of rising expectations' in the less developed countries, and international tensions have affected political thinking to a large extent.

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However, political instability generally occurs when the distribution of wealth fails to correspond with the distribution of political power. This situation may be described in reference to the classical school of political thought, as political stability in a country is largely based on a large middle class in a country. On the contrary, Marxist theories of economic determinism view all political changes as the result of changes in the mode of production. According to the neo-classical political thinkers the prime cause of revolutions and other forms of violent political changes is due to power polarization and alienation with the capitalistic economic countries. The majority of the world's political systems have experienced one form or another of internal warfare leading to violent collapse of the governments in power and certain crisis situations seem to increase the likelihood of breakdown in the governing politics of a region or a country. In the politico-economic scenario, economic crises are another common stimulus to political setbacks, as may be witnessed in the recent Argentinean crisis. The Brazilian economy was also at the edge of the cliff in the late 90s due to internal economic instability. The political situation of a country may be explained in terms of economic growth as reflected in gross domestic product and also the prevailing social scarcity. However, the political environment of a country also contributes in building the social position of individuals. A sense of insecurity and uncertainty for the future, and eroding relationships among social classes also results in politico-economic conflicts in a country. A severe national economic crisis develops distrust in the political system of the country and triggers outbreak of revolutions that either overhand on totally transform the existing political systems. The political unrest in a country triggers the test conditions for the stability of political systems in extremely revealing ways, which often demand either for a change in the political leadership or—at a more fundamental level—the very structure and process of governance in the system. Since the quality of the political leadership is often decisive, those systems that provide methods of selecting able leaders and replacing them possess important advantages towards internal and global political concerns. Unstable political systems are those that prove vulnerable to crisis pressures and break downs into various forms of internal warfare. The fundamental causes of such failures appear to be the lack of a widespread sense of legitimacy of state authority and the absence of general agreement on appropriate forms of political action.

One aspect of political sovereignty may be expressed as a country's desire to assert its authority over foreign business through various sanctions. Political sovereignty is the assertion of self determination of its citizens, and the manifestation of their freedom. It is in and through the determination of its sovereignty that the order of the nation is constituted and maintained. Such sanctions are regular and evolutionary, and therefore predictable. An example is increase in taxes over foreign operations. Many of the developing countries impose restrictions on foreign business to protect their independence. These countries want to safeguard their political freedom at all costs, even if it means a slow economic growth without the help of MNCs. Thus, the issue of political sovereignty exists mainly in developing countries.

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Determining Political Environment

The political philosophy and the legal environment of a nation largely influence the practice of international marketing. The political environment of a country comprises the international environment, host-country environment and the home-country environment. Many studies have shown that dealing with problems in the political arena is the principal challenge facing international managers in developing pro political strategies to run the business successfully in the host country. It is observed that each country has its own set of national goals; most countries also share many common objectives. Nationalism and patriotism refer to citizens' feelings about their country and its interests. Such feelings exist in every country and the multinational firms, individually or collectively, may be perceived as a threat to that sovereignty. Foreign firms perceive greater threats if they are larger in size and more in number in a country. At the time of any political turmoil, the foreign firms may be targets for attack. Many countries seek 'national solutions' to help troubled companies to retain what are perceived to be national champions. International firms need to be sensitive to these issues and to be careful not to be too 'foreign.' This has to be seen in all areas including advertising and branding policies as well as ownership and staffing. Establishing local R&D would be perceived favourably in this context.

The international political environment involves political relations among the countries of common ideologies. The foreign firm has to make all adjustments with the host country's international relations, no matter how non-aligned it may try to be. Such strategic adjustments in tune to the international environment of the host country are required as its operations are frequently related also to the neighbouring countries, either on the supply or demand side or both. Another critical factor affecting the political environment is the diplomatic relations of the host countries with others in the region or beyond. If a country is a member of a regional group, such as the EU, NAFTA, ASEAN, etc., its political identity influences the firm's operational and expansion opportunities.

If a nation has particular friends or enemies among other nations, the firm must modify its international logistics to comply with how that market is supplied and to whom it can sell. For example, the United States limits trade with various countries, and Arabian countries do not entertain any business activities with Israel. The participation of the host country in the regional trade agreements or with the international trade organizations may affect patents, communication, transportation, and other items of interest to the international marketer. As a rule, the more international organizations a country belongs to, the more regulations it accepts, and the more dependable is its economic, political and legal environment.

The political environment at home is also an important indicator for a firm to decide its entry into the host country. However, an adverse environment therein may constrain its international operations as well as its domestic operations. The best-known example of the home-country political environment affecting international operations used to be South Africa. Home-country political pressures induced more than 200 American firms to leave that country altogether. In the

private sector, the bottom line is shareholder value. In government, the objectives can be harder to pinpoint as they may be clouded by political agendas, turf battles, special interests and economics. Some of the key issues in reference to measuring the performance of the government in the given political environment of the home country may be considered by the firm as:

- **Measuring performance**: The government has to gauge performance by what has been achieved. Leaders should understand the real results that are being delivered, and how much real progress is being made.
- **Improving through competition**: The government's position is often perceived to be precarious vis-à-vis social pressures. The issues of trade protection, allowing foreign companies to participate in the host country, repatriation of profits and other economic issues are subject to the prevailing political ideology in the host country.
- **Streamlining operations**: It is necessary for a foreign firm to examine the conduct of government activities in the home country. Many government operations can be performed by third parties often at lower cost and with equal or higher quality.
- **Promoting efficiency**: Most government employees are smart, industrious people. But like any workforce, their behaviour is largely driven by the organization's rewards and incentives.

Many multinational companies face uncertainty in political environment due to instability of political leadership, coalitions and external pressures. Even if the home country and the host country give them no problems, they can face threats in the neighbouring markets. Firms that do not have problems with their home government or the host government may be bothered or boycotted in neighbouring countries. Escalation of political conflict in many developing countries and their impact on economic development has been a topical issue in recent development literature. The overwhelming emphasis on 'ethnic conflicts' in this literature has, however, precluded looking at political conflict in the wider context of the development process, going beyond the ethnic dimension. In particular, because of the preoccupation with the ethnic roots as the prime source of these conflicts, reverse causation running from economic policy to political conflict has been virtually ignored in the debate.

Political conflict in general could be defined as dynamic and manifest conflict processes consisting of certain phases. In this case the term 'conflict' is used in a more specific way: a political process (dynamic situation) in which engaged political parties have incompatible attitudes and behaviours. Internal as well as international conflicts have three interrelated components:

- Conflict situation, manifested in expressing various political aims or conflict of interest that cannot be simultaneously resolved, and for that reason can be qualified as mutually exclusive;

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- Conflict behaviour (in the first place aimed at achieving the aforementioned political aims); and
- Conflicting attitudes and perceptions having an emotional dimension (feeling of anger, mistrust, fear, scorn, hatred, etc.) as well as a cognitive dimension.

Many countries in different parts of the world undergo political conflict such as turmoil, internal war, and conspiracy that can be irregular, revolutionary, and/or sporadic. Turmoil refers to instant upheaval on a massive scale against an established political regime. The internal unrest in a country refers to large-scale, organized violence against a government, such as guerrilla warfare. Some examples are Vietnam's actions in Cambodia, and internal violence by the self proclaimed people's groups like in the north-eastern states of India.

Political change in a country sometimes leads to a more favourable economic and business climate. The factors associated with political conflicts and their impact on trade is exhibited in Figure 2.1. The political conflict in a country may lead to unstable conditions, but those conditions may or may not affect business. Therefore, political risk may or may not result from political unrest. International business houses must analyze chronologically the occurrence of political conflicts and assess the likelihood of its impact on the business environment.

Often political unrest is temporarily focused on the international policies of the government. There have been anti-globalization protests in many countries during the international political movements on persuading the developing countries to join the World Trade Organization. It is important to understand the nature of political conflict in foreign countries and the motivation behind government actions. If a change in government policy is only symbolic without any indications of the change in implementation process, it represents less risk to foreign firms.

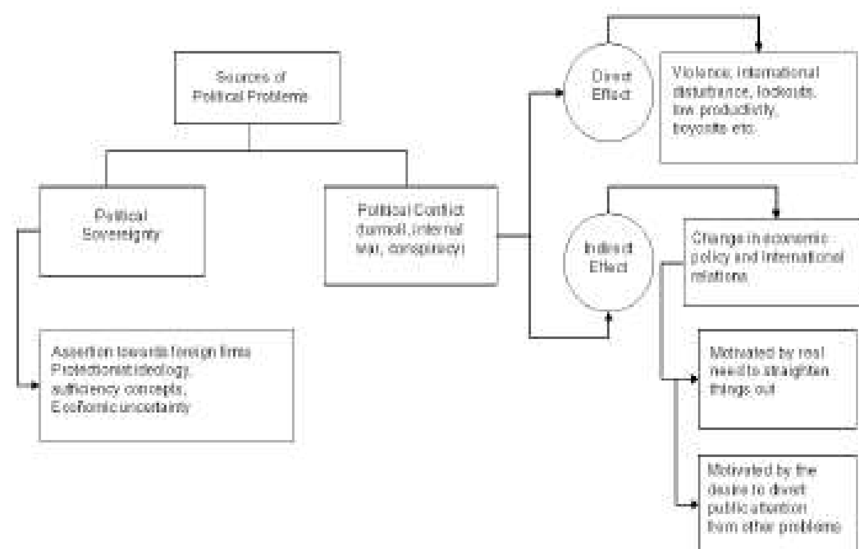


Fig. 2.1 Political Conflicts and their Consequences

2.2.1 Political Interventions

Political intervention may be described as a decision taken by the government of the host country intended to force a change in the operations, policies, and strategies of a foreign firm in the interest of the country. Such interventions may range from enforcing control to complete takeover, or annexation of the foreign enterprise. The magnitude of intervention varies according to the company's business existing in the host country and the nature of political decisions taken thereof. In countries where foreign investment plays a significant role in the economy, the possibilities of political interference in the operations of foreign firms would be higher and more stringent. Besides, the political system of a country be it democracy, communism or mixed economies, also indicates the nature of intervention. If a foreign company is prominent in the economy of a developing country such as Zambia, Guinea, Iran, and Tanzania, the possibilities of government intervention are relatively greater in reference to the public policies of the country.

Political intervention may affect the marketing-mix functions of a firm in the host country in several ways. The intervention may be observed in a host country to the extent of local content law, technology content, restrictions on the sale of some products, products' functional range, design of products, useful life, and adaptability to local conditions, patent life, local manufacturing and assembling leading to amendment of product strategies of a foreign firm. The political directions may also govern the functions related to transfer pricing, price ceiling and price floor, price contracts, price paid for local raw materials and price paid for imported raw materials to be used in production in the host country. Besides, the activities of distribution and product retailing may also be subject to political interventions in many developing countries. Advertising and communication is another important area for a foreign firm that is affected by political interference in a country. Of these, local production of commercials, local artists, type of message, type of copy, availability of media and time restrictions on the use of certain media are significant political interventions faced by a foreign firm.

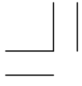
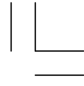
Expropriation, Domestication and Nationalization

Developing countries generally intervene directly in the operations of foreign firms engaged in business, in order to pursue the special interests of their country. Of the many different forms of political intervention, expropriation, domestication, exchange control, import restrictions, market control, tax control, price control, and labour restrictions are the most common ones. *Expropriation* is one of the most stringent and pervasive political interventions that a foreign firm may face in a host country. It may be described as official seizure of foreign property by a host country whose intention is to use the seized property in the public interest. Such intervention is recognized by international law as the right of sovereign states, provided the expropriated firms are given prompt compensation, at fair market value, in convertible currencies. The act of expropriation without offering any compensation to the foreign or local firms may be described as *confiscation*. In

legal terms, it may be explained that expropriation occurs when a government takes over property for a purpose deemed to be in the public interest, even though the owner of the property may not be willing to sell it. Any interest in land, plant and machinery and/or value additions thereof, such as permanent constructions, may be expropriated. The business capital may also be subject to expropriation in many countries. However, technology can serve as the defence against expropriation, if the technology of the enterprise cannot be transferred to or duplicated by the host country or despite transfer of technology it cannot be made operational by the expropriators. Further, if a firm is not holding an independent status in the host country and is vertically integrated with the parent firm wherein the supplies for production or the market for the product is controlled by the parent firm located elsewhere, such firms are unlikely to be targeted for expropriation. *Domestication* is another form of expropriation, which may also be conceived as creeping expropriation. In this process of political intervention, the controls and restrictions placed by the host country authorities on the foreign firm, gradually reduce the control of owners. Domestication is thus a slow process of expropriation and a foreign firm may lose its control in all financial, operational and management areas over a period of time. Domestication involves several measures, including gradual transfer of ownership to nationals, promotion of a large number of nationals to higher levels of management, greater decision-making powers accorded to nationals, more products produced locally rather than imported for assembly and specific export regulations designed to dictate participation in world markets.

Traditionally expropriation (in the foreign investment sense) referred to the seizure of property by the host government, e.g., forced *nationalization* of assets. In recent years, more expansive definitions of expropriation have appeared, such as ‘creeping expropriation’, ‘regulatory taking over’ and ‘measures tantamount to expropriation’, which can sometimes be used as a strategy against government measures that might simply dent a foreign investor’s profitability. The clause on ‘measures tantamount to expropriation’ has been particularly controversial in the investment-related details of NAFTA. The clause argues that expropriation may not necessarily be a taking over of the companies in public interest as it may be unreasonable and does not justify political interference. However, the regional trade agreements stress on the investor rights to protect the undue losses to the investing companies in the host country. The governments of countries (Canada, USA and Mexico) under NAFTA are required to compensate the investor for the full market value of the property.

On the contrary, *nationalization* may be described as the taking over of assets into state ownership. The process of nationalization refers to the transfer of an entire industry within the country from private to public ownership with no discrimination to the foreign or local ownership of firms. This may be explained as a policy of bringing a country’s essential services and industries under public ownership.

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Exchange Control

In addition to expropriation and domestication, there are other means of government intervention in foreign enterprise, usually in the form of legislative action or a decree enacted in the best national interest. It has been observed that many countries exercise restrictions on foreign exchange in order to discourage the free and flexible operations of foreign firms. Such strategy may be described as a government policy designed to restrict the outflow of domestic currency and prevent a worsened balance of payments position by controlling the amount of foreign exchange that can be obtained or held by domestic citizens. Often resulting from overvalued exchange rates, the process of exchange control emerges as a system of controlling inflows and outflows of foreign exchange; devices include licensing multiple currencies, quotas, auctions, limits, levies and surcharges. Many countries face serious deficits in their balance of payments and are short of foreign exchange. Hence, they restrict the use of foreign convertible currency according to their priorities. Foreign firms may be low on that priority list and have difficulty getting foreign exchange for necessary imports or profit repatriation.

Import Restrictions

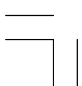
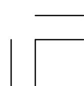
Import restriction is a type of political intervention that is primarily intended to support the native industries. Consider a foreign apparel manufacturing company traditionally importing certain synthetic yarn and dyes from the parent company. If the host country places restrictions on imports, the company may be forced to depend on local sources of supply for these new materials. The import restrictions would help the country to encourage domestic industry as a matter of industrial policy; however, such measures tend to jeopardize the functions of foreign business. Globalization, and the birth of a new international trade order with the emergence of World Trade Organization has reduced the occurrence of import restrictions in many countries.

Market Control

The government of a country sometimes imposes market control to prevent foreign companies from competing in certain markets. Market control may be imposed by a country at various phases of the business operations of a foreign form. If allowed to enter the country, the firm may be restricted to the types of industries it may enter. It may be prohibited from acquiring a national firm. It may not be allowed to have total ownership but may be required to enter into a joint venture with a national firm. The firm may also be restricted by the government to choose its areas of operation and sell its products.

Tax and Human Resources Controls

Some countries may also impose tax control by means of excessive and non-traditional taxes on foreign firms. For example, a new tax imposed on foreign firm would be that of an excessive levy on volume of production, for which there is no

precedent. Imposing such taxes on the foreign business houses may be backed by reasons like an out-of-the-way monetary burden on foreign companies, to explore additional sources of revenue to meet the fiscal deficit of the country without putting pressure on the citizens of the country and to construct a tax barrier as a retaliatory measure against the international policies or general dissatisfaction in diplomatic relations with other countries. In many countries like China, labour unions play a significant role in political decisions and have great political clout. In such countries labour restrictions are an effective form of government intervention. Traditionally, labour unions in America have been able to prevent layoffs, plant shutdowns, and the like, even when business could not afford to meet their demands.

2.2.2 Political Systems

There are three major ideologies that are embedded in the political systems of the world—democracy, communism and capitalism. All political systems are oriented towards the power of ruling with the conventional and modern philosophies in reference to their respective schools of thought.

The System of Democracy

Democracy is a political system composed of people, institutions and their relations in regard to the governance of a state under which the ultimate political power ostensibly lies with the people of the country. Under such a system, executive and legislative decisions are made by the people's representatives who act through the consent of the people, as enforced by elections and the rule of law. Thus, direct democracy may be described as any form of government based on a theory of civics in which all citizens can directly participate in the decision-making process. Some adherents want both legislative and executive powers to be handled by the people, but most existing systems only allow legislative decisions. Modern direct democracy comprises three main constituents—initiative, referendum and recall. 'Initiative' provides a means by which an appeal signed by a certain minimum number of registered voters can force a public vote on a proposed statute, constitutional amendment, charter amendment, or an ordinance. The political system of Switzerland may be described as the strongest example of a modern direct democracy, as it exhibits the first two pillars at both the local and federal levels. In the past 120 years more than 240 initiatives have been put to referendum. The populace has been conservative, granting about 10 per cent of the initiatives put up; in addition, they have often opted for a version of the initiative rewritten by the government. The democratic political system is largely based on the philosophy that describes governance as belonging to the people—*'of the people, by the people and for the people',* as Abraham Lincoln said in his immortal Gettysberg Address.

The *open-closed* characteristic is used broadly to distinguish political systems, as between liberal democracies or polyarchies on the one hand, and

dictatorships, autocracies, or totalitarian systems on the other. But this is a characteristic and not a dichotomy. The right of involvement of the people in changing the system is a spectrum. For some states, this right may involve full representation through the power to initiate or directly approve laws, as in Switzerland. However, in the United States, the masses may have the power to control the class through the right to elect or reject their incumbency and by opposition to 'elitist' policies, as through interest groups. In some states, such as Spain, people can only produce change or opposition through communal groups like the church, which are participants in the political system.

Authoritarianism

Another type of political system is *authoritarianism*. It is closed, with authoritative political positions open to only a few by virtue of birth or other ascribed status, and based on customary law. Groups are autonomous so long as they do not try to alter the traditional status quo, and the elite's goals are concerned with conserving traditions.

The Philosophy of communism

As a social system, *communism* would be a type of egalitarian society with no state, no private property and no social classes. In communism, all property is owned by the community as a whole, and all people enjoy equal social and economic status. Perhaps the best known principle of a communist society is *from each according to his ability, to each according to his need*. As an ideology, the word 'communism' is a synonym for Marxism and its various derivatives. In terms of ideology and politics, communism is a sub- category of socialism. Communist ideology is a specific branch of socialist ideology and the communist movement is a specific branch of the larger socialist movement. A person who calls himself or herself a "communist" is a certain kind of socialist; in other words, all communists are socialists but not all socialists are communists. In terms of socio-economic systems, however, communism and socialism are two vastly different things.

Hence, political risk assessment (PRA) is necessary for foreign firms in order to identify countries that may turn out to be unsafe tomorrow and to identify the actual situation in various countries, avoiding any bias.

Check Your Progress

1. How is the political system of a country shaped?
2. Mention some of the ways in which political interventions affect the marketing mix functions of a firm in the host country.
3. What are the measures used in domestication in international marketing?

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2.3 LEGAL AND REGULATORY ENVIRONMENT AND CHALLENGES

In addition to the political environment in a country, the legal environment comprising local laws, civil and criminal laws and trade regulations also influences the operations of a foreign firm. It is important for a foreign firm to know the regulatory provisions in each market, as such legal environment constitutes the 'rules of the game.' At the same time, the firm must know the political environment because it determines how the laws are enforced and indicates the direction of new legislation. Thus the legal environment of international marketing has a dyadic relationship with political and regulatory systems in a country. Accordingly, it is necessary for an international firm to acquaint itself with host country laws, international law, and domestic laws in each of the firm's foreign markets. Multinational enterprise in its global exercise must cope with widely differing laws. The legal barriers in most of the countries include antidumping laws, tariff structures, horizontal price fixing among competitors, market division by agreement among competitors, and price discrimination. Hence, international firms should also understand the arbitration procedures as an alternative to legal recourse.

Traditionally, two types of legal systems may be distinguished: common law and code law. *Common law* is based on precedents and practices established in the past and interpreted over time. Common law was first developed in England, and most of the commonwealth countries follow this system. *Code law* is based on detailed rules for all eventualities. Code law was developed by the Roman empires and is popularly practiced by a number of free world countries such as Italy, France, Germany, Mexico and Switzerland. The distinction between common law and code law may be best illustrated with an example in context to the right to proprietary issues such as trademarks. A country exercising common law would largely depend on the chronological use of the property. Under common law, the judicial decision would go in favour of the party actually using the trademark on its package and in its advertising campaign, despite not having formally registered the trademark. On the contrary, according to code law, the right of property would rest with the party which has actually registered the trademark.

Business firms may encounter major problems when a country respects more than one legal system and generates conflicting values. If a business contract contains a clause specifying the jurisdiction, stipulating which country's legal system should be used to settle disputes, the matter can be settled accordingly. However, in absence of any such a provision, disputes cannot be settled choosing a legal system of any country in particular. An example could be that of an accidental leak of the poisonous gas methyl isocyanate that occurred in a chemical plant at Bhopal (India) belonging to Union Carbide, a company of United States of America, causing over 2,000 casualties in 1984. In this situation, the Indian government would have preferred to settle the issue of compensation to the survivors in the

US court of law than in Indian courts as the decision in Indian courts would consume more time. On the other hand, the American judiciary is considered to be liberal in awarding such strictures on humanitarian grounds. Simultaneously, the Union Carbide management might have preferred to get the issue settled in the Indian courts in its own economic interest. However, it took over a decade to settle the compensation issues to the survivors of the Bhopal tragedy. An out-of-court compromise was worked out between the Government of India and the company.

Tariff Barriers

Host country laws affect the business operations of a foreign firm. Such regulations may adversely affect the entry of a firm into the host country and may appear in many forms, including tariff, anti-dumping laws, export/import licensing, investment regulations, legal incentives and restrictive trading laws. A tariff may be defined as government levies on exports and imports. The tax on exports may be determined as export duty while the tax on imports is known as import duty or customs duty. The objective for a country of imposing an export duty is to discourage selling overseas so as to maintain adequate supply at home. Heavy import duty is levied in order to protect home industry from penetration by cheap imports, to gain a source of revenue for the government, and to prevent the dilution of foreign exchange balances.

Besides the above *non-tariff barriers*, a country may directly intervene in trade activities with the objective of comprehensively discouraging imports as well as participation of foreign firms in the home country, in any manner. Under such measures, the government involves itself indirectly in trade activities through procurement policies favouring the products of the home country over the products of other countries. The government may also impose export subsidies in terms of tax incentives to the domestic firms and lavying *countervailing duties* that may be described as taxes designed to protect domestic products from low-priced imported products that had been given export subsidy by the exporting country's government. A country may also proceed to levy various types of other charges on imports to make them less competitive against domestic goods. Such non-tariff measures include prior import deposit requirement, administrative fee, supplementary duties and other variable levies.

Anti-Dumping Laws

The act of exporting a product by an international firm at a price lower than the price it normally charges in its own home market is defined as 'dumping' the product. Dumping is a type of pricing strategy for selling products in foreign markets below cost, or below the price charged to domestic customers. Such strategy is adopted to capture a foreign market and to damage rival foreign national enterprises.

Though dumping is not commonly regarded as a healthy business strategy for foreign firms, there are sometimes good management reasons for doing so. A typical case describing the positive side of this strategy may be occasioned by the

need to survive in a large competitive market by selling at very low prices. Another case is when a company has overproduced and wants to sell the product in a market where it has no brand franchise to protect. However, if firms have indulged in dumping, they can well reverse it. The 'reverse dumping' refers to the less-common practice of selling products at home at prices below cost. This would be done in extreme cases where the share at home needs to be protected while monopolistic market positions abroad can be used to generate surplus funds. Nonetheless, dumping is considered to be illegal since it is destructive of trade, and competitors can take an offender to court to settle a dumping case. The usual penalty for manufacturers whose products are found to violate the anti-dumping laws is a countervailing duty, an assessment levied on the foreign producer that brings the prices back up over production costs and also imposes a fine.

Import Licensing

Many countries have laws on their books that require exporters and importers to obtain licenses before getting into international deals. Import licensing is imposed by nations to control the unnecessary purchase of goods from other countries. Such restrictions help governments to conserve foreign exchange balances for other important purposes, like the import of pharmaceuticals, chemicals, and machinery.

Check Your Progress

4. What does the legal barriers in most countries include?
5. What is re-dumping?

2.4 SOCIO-CULTURAL ENVIRONMENT AND RELATED CHALLENGES

The socio-cultural values concerned with different societies should be taken care in international marketing research process. The attitudes and values are a society's cornerstone; they often drive demographic, economic, political/legal, and technological changes. Firms should be aware of attitudinal and cultural changes across global societies. Some of the factors which are diverse and have considerable impact on international marketing, therefore these should be identified, scanned, observed and forecasted.

Approaches to Cultural Factors

'Culture' refers to the distinctive way of life of a group of people—their complete 'design for living'. Culture seems to be the master concept of American anthropologists. For ethnologists, folklorists, anthropological linguists, archaeologists

and social anthropologists, culture is always a point of departure or a point of reference if not invariably the point of emphasis.

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Facets of Culture vis-à-vis International Business

- Technology and material culture
- Language
- Aesthetics
- Education
- Religion
- Perceptions and Attitudes
- Social Values and Life Style (VALS)
- Social organization
- Political life

2.4.1 Cultural Variables and International Business Environment

Culture may be understood as the underlying value framework that governs individual and group behaviour. It is reflected in the perceptions of individuals in observed events, personal interactions, and in the selection of appropriate responses in social situations. Culture often manifests itself in learned behaviour, as individuals grow up and gradually come to understand what their culture demands of them.

Material Culture

Material culture includes the tools and artifacts – the material or physical objects – in a society, excluding the physical objects found in nature unless they undergo some technological procedure. For example, a tree *per se* is not part of a culture, but the Christmas tree is, and so is an orchid. Technology refers to the techniques or methods of making and using those things. Technology and material culture are related to the way a society organizes its economic activities. The term 'technology gap' refers to differences in two societies' ability to create, design, and use things. The level of technology in a cultural environment manifests in many ways including the societal response to technology diffusion, perceived use value of the technological appliances and rate of adaptation. This may be explained in terms of sophisticated electric kitchen appliances, cutters, can openers and fry pans are acceptable largely in the developed countries unlike India where they are less attainable and probably unwanted as disposable income is spent more meaningfully on better houses, clothing, or food. Such concepts as preventive maintenance are foreign in many low-technology cultures. In the United States, Japan, Germany and other developed countries with high levels of technology, the general population has a broad level of technical understanding that allows them to adapt and learn new technology more easily than populations with lower levels of technology. Material culture affects the level of demand, the quality and types of products

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demanded, and their functional features, as well as the means of production of these goods and their distribution. Culture directly influences consumers with reference to what they understand, analyze and adapt. This interpretation of culture is useful for global marketing managers. It suggests that culture is more important for *how* managers should decide, and less to do with *what* the decision should be. Culture affects implementation and execution of strategies more than their formulation. Countries with large populations such as India, China, Russia, and the United States are really multicultural, meaning that they contain a wide variety of cultures within their borders. The same goes for some smaller nations, such as Belgium, Canada, South Africa. In other cases, several countries can be seen as one cultural grouping such as the Scandinavian countries (Denmark, Norway, Finland and Sweden) and Latin American countries (Mexico, Venezuela, Colombia, Ecuador, but not necessarily Brazil).

Language

Language is an important cultural tool for effectively conducting international business in the host countries. Language has a deep-rooted sentiment in people. It is just not a spoken word, but also symbolic communication of time, space, things, friendship, and agreements. The language people speak is part of the culture in which they are raised. Therefore, the language used in all marketing communications, including advertising, public relations, and general communications, should reflect the unique cultural expressions and values of the target locale. Non-verbal communication occurs through gestures, expressions, and other body movements. The language in business should be regarded to offer the most appropriate sense of communication and should not be literally translated into the other language. Some examples may be illustrated such as the phrase, *body by Fisher.* If translated literally into Flemish language spoken widely in Belgium, the Netherlands and Luxemburg (Benelux) countries, it conveys the meaning *corpse by Fisher*. Similarly, the *Nova* model of the car of General Motors means *it does not go* in Spanish and it has been difficult for the company to position this brand in the Latin American market. The English language differs so much from one English-speaking country to another that sometimes the same word means something entirely opposite in a different culture. *Table the report* in the US means postponement; in England and India it means *bring the matter for discussion*.

Marketing activities are highly dependent on communication particularly in developing localized advertising, branding, packaging, personal selling, and conducting marketing research. The management of the company should speak the same language as its various consumers if they are to reach the market extensively and penetrate the segments intensively. In each of its foreign markets, the company must communicate with several audiences including its workers, managers, customers, suppliers, and the government. Each of these audiences may have a distinctive communication style within the language common to all. The number of language areas the firm operates is approximates the number of

countries it is selling in. Any advantage gained by the fact that one language may be used in more than one country is partly offset by the fact that in many countries, more than one language is necessary.

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Language differences can affect all sorts of business dealings, contracts, negotiations, advertising, and labelling. International marketing communication managers must constantly struggle with the difficulties of localizing their messages for multiple audiences that speak and understand different languages and have diverse cultures. In an age of growing globalization, international companies cannot afford to ignore the importance of localizing their messages effectively and to ensure consistency, companies need not depend solely on the traditional word-for-word approaches to translation. Multinational companies should operate through the various links available in the markets as cultural bridges in many countries. For example, in countries where the firm is operating through a distributor, the distributor may act as the bridge between the firm and its local market. In advertising, the firm can rely on a local advertising agency. Agency personnel, like the distributor, probably speak the advertising manager's language—especially if the firm communicates principally in English. The Netherlands firm Philips uses English as the official company language; even though its native language is Dutch in view of its global operations. However, language is one of the most difficult cultural elements to master unless a strong social and cultural empathy is developed towards the activities of the company, and towards business and corporate social responsibility.

Understanding the conventions of culture as well as the individual cultural differences and similarities of target locales empowers marketing professionals to realize that one universal message whether verbal or visual, can never reach a global audience. One global culture comprising people with identical values does not exist, even within a country. Differences in learning and thinking patterns influence the way people process information, as demonstrated in their innate responses to marketing communications. Audiences differ in the way they perceive and value concepts of time, space, money, relationships, power, risk, and even the protocols of gender roles. It is important to note that when attempting to customize communications with cultural differences in mind, it is just as important to recognize the cultural similarities. As much as localization vendors like to overemphasize 'extreme customization', cultural similarities do exist, and are deeply embedded in the core values of product and service offerings. Culture is an omnipresent evolution of social behaviours that continually transforms over the spatial, temporal and demographic sub-groups. This is a different concept than tradition, which does not change but may have an influence on societal behaviours. Often, false assumptions are created because too much emphasis is placed on tradition rather than on culture, which results in a negative connotation for the marketing attempt.

Aesthetics

Aesthetics may be described as a set of creative ideas embedded in culture concerning the sensory appeals of the people towards beauty, arts and taste. Since,

NOTES

actions or behaviour can be said to have beauty beyond sensory appeal, aesthetics and ethics often overlap to the degree that this impression is embodied in a moral or ethical code. A value system, which is the prioritization of the values held by an individual or group in a society, forms the basis of moral code. Such dimensions are reflected in consumer behaviour. In conservative societies in Asia, such as Japan and India, any communication or art that exposes women is not socially accepted, despite the aesthetic standpoint of the critics. In some cultures, the relationship between moral and legal codes is often one and the same. Moral codes drive personal conduct. Aesthetics include the arts, drama, music, folk culture, and architecture prevalent in a society and these convey its concept of beauty and modes of expression. In different societies colours have different meanings across countries. In western societies, wedding gowns are usually white, but in Asia, white symbolizes peace or sorrow. The aesthetic values of a society show in the design, styles, colours, expressions, symbols, movements, emotions, and postures valued and preferred in a particular culture. These attributes have an impact on the design and promotion of different products. In many situations the symbolic expressions of communication have greater appeal than the actual words, and people respond accordingly. Therefore, an international businessperson must understand nonverbal cultural differences to avoid communicating the wrong message.

2.4.2 Impact of Social and Cultural Environment on Marketing Industrial and Consumer Products

The issue of 'culture and international marketing' has now acquired strategic significance. There is intrinsic relationship between cultural goods and cultural value. Cultural goods facilitate cultural identity and contribute to social cohesion; at the same time, they constitute a key free factor of production in the new knowledge economy. Culture is an essential dimension of business development. Business solutions should be designed for local traditions and institutions and should employ local expertise and knowledge. The international company entering the host country should ensure that people, their cultures and society, and their organizations and institutions are taken into account in formulating business goals and operational strategies. Such development coordination with local culture improves the lives of people, especially the poor, and builds the social capital for a company to sustain long in the host country. There is need to study diversity in international markets through conducting marketing research of diverse markets in the international business.

The integration of global markets has provided opportunities to consumers to purchase goods from all over the world in their local shops and supermarkets. Not only do local businesses have to compete with these foreign goods on home ground, they also have new opportunities to develop their export markets by selling in a multitude of other countries. These cultural goods and services are also affected by these new patterns of production, consumption and trade. There is

need to observe, scan, identify and forecast these emerging cultural trends by conducting market research.

There is also classification of cultural industries as 'creative industries, 'sunrise' or 'future-oriented industries' in the jargon of economics, or content industries in technological jargon. These cultural industries generally include printing, publishing and multimedia, audio-visual, phonographic and cinematographic production, as well as crafts and design. For some countries, this concept also includes architecture, visual and performing arts, sports, manufacturing of musical instruments, advertising and cultural tourism. Currently in the process of globalization these cultural industries add value to content and generate values for individuals and societies. They are knowledge and labour-intensive, create employment and wealth, nurture creativity – the 'raw material' they are made from – and foster innovation in production and commercialization processes. At the same time, cultural industries are central in promoting and maintaining cultural diversity and in ensuring democratic access to culture. This two-fold nature – both cultural and economic – builds up a distinctive profile for cultural industries.

Check Your Progress

6. What does culture consist of?
7. What does aesthetics include?

2.5 ECONOMIC ENVIRONMENT AND ITS CHALLENGES

The global economic environment is changing rapidly. Globalization has led to surprising increases in global trade. Greater participation in international trade is a prerequisite for economic growth and sustainable development in today's competitive world economy.

2.5.1 Macroeconomic Environment

Macroeconomics is the study of the entire economy in terms of the total amount of goods and services produced, total income earned, the level of employment of productive resources, and the general behaviour of prices. Macroeconomics can be used to analyse how best to influence policy goals such as economic growth, price stability, full employment and the attainment of a sustainable balance of payments. It considers the performance of the economy of a country as a whole. The principal macroeconomic topics of a country may include economic growth, inflation, changes in employment and unemployment, trade performance with other countries as reflected in the balance of payments and the relative success or failure of fiscal and monetary policies. The economy of a country is based on allocation and management resources of its livelihood system. As all economies operate at

NOTES

different levels, it is necessary to have a clear idea of the economic situation of a particular host country in order to make appropriate decisions in international marketing.

Demography and Income Distribution

There are over 7 billion inhabitants in the world today. More than 3 billion will potentially be added to our human family over the next 50 years. For decades, environmentalists have warned that ever-rising number of people and their impact on the earth's finite resources could lead to disaster, not only for wildlife and ecosystems but also for human populations. Besides, the demographic explosion in some countries has led to serious concerns on resources management, consumption levels, income distribution, employment and other macroeconomic factors. These factors, in turn affect the market in so far as people constitute the market. The world today produces and consumes more than ever before.

Rapid population growth continues to undermine efforts to reduce poverty in Africa and Asia. A poor economic performance, limited natural resources and high rates of population increase have led to declines in per capita incomes in some countries. Because of continued increases in numbers, many countries will find themselves 'running faster in order to stand still' in their efforts to improve access and quality in health services and education until well into the next century. The pace of population growth inexorably affects markets, capital accumulation, labour availability, employment generation, immigration, migration, health care, retirement benefits, education, and a host of other national considerations. The population of western Asia is projected to more than double by 2050, going from 204 million to 418 million. Though the economic growth and prices are the key drivers of food demand, demographic changes such as urbanization, growth in populations, and changes in the age structure of populations, are likely to have more profound long-term implications for the food system of the country.

Population growth also affects the pattern of income distribution in a country. The aggregate consuming capacity depends on the total population as well as per capita income. Thus, the advanced countries where growth of population is low, exhibit high propensity to consume goods and services. It may be observed that multinational companies from the United States of America are actively performing business in the advanced countries of Western Europe, Japan and Canada where per capita income and propensity of consumption are higher. In contrast, Bangladesh and Bhutan as well as other developing countries do not offer a sizeable market potential for multinational companies.

Economic Indicators

Economic indicators are variables that are used to measure the soundness of a country's economy, such as GDP per head, the rate of unemployment or the rate of inflation. Such statistics are often subject to huge revisions in the months and years after they are first published, thus causing difficulties and embarrassment for

the economic policymakers who rely on them. The analysis of factors of production is an important consideration in international marketing to optimize the comparative advantages over natural resources, labour, capital and entrepreneurship. Entrepreneurs thus play an important role in enabling the economy to adapt to changing conditions and to new possibilities for material improvements by creating new production organizations, and even to whole new industries. Because of its essential role in initiating the process of production, entrepreneurship is identified by some economists as a 'fourth factor of production,' alongside land, labour and capital. It may thus be explained that higher the productivity of a factor of production, higher may be the income that accrues to its providers. On the other hand, anything that rises above the expected levels of productivity within a society is responsible for increase in the overall prosperity of the society.

The price indicators in the international markets broadly include export and import price indices, consumer prices, wholesale prices and industrial producer prices. The export and import price indices can be used to determine the impact of exchange rate movements on the prices of exports and imports. International price data have been useful for both multilateral and bilateral trade agreements as countries often utilize these statistics to negotiate trade agreements for some important industrial and consumer products such as construction material, plantation crop products like tea and coffee, cotton textiles, oil, air freight services, etc. A primary reason for measuring import prices is to track the impact they have on domestic inflation. Movement in import prices can often be an indicator of future inflation since some inputs to domestic production, as well as consumption, are imported. Export and import price indices are essential for assessing the impact of international trade on the domestic economy. Among their most important uses are analyzing developments in the trade balance, measuring foreign prices' contribution to domestic inflation, and deflating nominal values of exports and imports for estimating the volume of gross domestic product. The Producer Price Index (PPI) is a family of indices that measures the average change over time in selling prices received by domestic producers of goods and services. PPIs measure price change from the perspective of the seller. This contrasts with other measures, such as the Consumer Price Index (CPI), that measures price change from the purchaser's perspective. Sellers' and purchasers' prices may differ due to government subsidies, sales and excise taxes, and distribution costs. It is difficult for a marketer to access information about and review all these indicators from each country. However, at any given time, economic indicators may be identified to determine the entry strategies of a firm. These indicators may reflect on the marketer's domestic operations and the potential business in the host country.

Financial Indicators

Financial indicators related to international marketing consist of corporate bond yield, factor income, value of local currency with reference to US dollars and money supply. Besides, the extent of foreign direct investment in a country also

reveals its financial strength. A foreign investment is classified as a direct investment if the foreign investor holds atleast 10 per cent of the ordinary shares or voting rights in an enterprise and exerts some influence over its management. The higher yields of the corporate bonds indicate the soundness of the financial conditions in a country. Corporate bond interest rates and associated yield spreads are core topics in financial economics. The factors that affect the level of changes in these variables are important to many financial analysts. An examination of these variables and the relationships between them, as well as possible linkages between yield spreads and stock market behaviour, is the focus of major financial analysis. In particular, changes in yield spreads between high and medium quality corporate bonds and treasury bonds are examined, as are changes in the spread between the differing quality corporate bonds. Variations in the interest rates are given in financial market history, and are important guide posts for financial analysis. Changes in macro-economic factors such as inflation and the business cycle cause these fluctuations. Investor perception of risk, affects both interest rates and stock market valuations. Interest rates tend to move together due to common influences, such as inflation. Although this is true, the difference between corporate and government bond interest rates, and between corporate bonds rates on different quality bonds is not constant. Other vital financial indicators include exchange rate, stock trends and long term interest rates. The sensitivity of longer-term interest rates to growth. Also, the interdependencies among financial markets have certainly increased with globalization. Consequently, the foreign exchange markets and bond markets abroad collectively have become much more sensitive to changes in financial conditions in partner countries. However, long-term interest rates are not fully protected from the influence of external factors, even in the developing countries.

Economic System

The economic system of a country is another important factor that a marketer must understand. Traditionally, there are two types of economic systems — state-owned and capitalist. The state-owned, or Marxist system is pursued in communist countries, where all activities related to production and distribution are controlled by the state. The roots of capitalism in the economy and society are deep. The patterns of economic activity that characterized the period of state capitalism began to change during the boom of the 1950s and the 1960s. State capitals increasingly traded with each other – and as they did so, the basis was laid for a new internationalization of production. World trade grew, on average, at about twice the rate of world output, and until the 1970s, trade in manufacturing sector was about the same proportion of world output as it had been in 1900 and 1930. Trade did not contract with the recessions of the mid-1970s and early 1980s as it had in the inter-war years. Despite a contraction of world output and world trade in 1982, trade grew faster than output throughout the rest of the 1980s. The concentration of industry through takeovers and mergers, often under the tutelage of the state, had led to the emergence in particular countries of huge firms that

were able to channel resources into innovation and productive investment on a scale undreamt of before. The Japanese car firms established production facilities in the US, turning out more vehicles than the third biggest American firm, Chrysler; the nationalized French firm Renault began a series of acquisitions in the US, beginning with the small fourth US car firm American Motors; Volvo took over General Motors' heavy truck production in the US; Ford and Volkswagen merged their car production in Brazil; Nissan built an assembly plant in north-east England to produce hundreds of thousands of cars a year, while Honda bought a 20 per cent stake in Rover.

The living standards of rich and poor countries do not converge at welfare economics standards and most of the gains go to multinationals functioning in the developing countries. Such socio-economic conditions lead towards continuously growing polarization between the rich and the poor countries. The multinational companies are moving to the lowest-cost location implementing their production sharing strategies and emphasize the concept of 'knowledge economy' that advocates operations with lesser manpower in order to gain competitive advantage and streamline their operations. Thus, capitalism in the new global economic order has been characterized largely by private ownership of the means of production and the freedom of transactions in the international market governed by regional trade agreements among the countries with less political interventions. The globalization policies with focus on privatization attempt to overrule the political-economic doctrines that advocate governments to impose political barriers to international trade, usually in the form of taxes on imports or quantitative restrictions limiting the volume of legally allowable imports of each particular good in order to 'protect' domestic firms manufacturing these same goods from foreign competition and thereby make them more profitable than would otherwise be the case under free competition.

2.5.2 Microeconomic Environment

An environment surrounding a specific product or market concerning the competition rather than a country's overall economic environment refers to the microeconomic environment. A careful analysis of a microenvironment indicates whether a company can successfully enter a specific market. It may be hypothesized that rising prosperity of a nation depends on the productivity with which it uses its human, capital and natural resources. This is manifested in the way in which a nation's firms compete. Productivity, in turn, is a function of the interplay of three factors: the political, legal and macroeconomic context; the quality of the microeconomic business environment; and the sophistication of company operations and strategy. Together, they determine the capacity of a nation to produce internationally competitive firms and support rising prosperity: a context that continuously creates pressure for firms to upgrade the source and sophistication of their advantage and at the same time supports the upgrading process is a favourable microeconomic context. Pressure for upgrading is supplied by *demand*

conditions featuring sophisticated and demanding customers, whose demands spur the local firms to innovate in order to upgrade their product/service offerings. Particularly valuable is pressure from local customers that anticipates the nature of demand elsewhere in the world. Different competitors, however, might aim to satisfy different types of demand: existing, latent, or incipient. *Existing demand* refers to a product bought to satisfy a recognized need. *Latent demand* is applied in a situation where a particular need has been recognized, but no products have been offered. *Incipient demand* describes a projected need that will emerge when customers become aware of it sometime in the future.

Competition may be analyzed in reference to the characteristics of products as breakthrough, competitive, and improved. A *breakthrough product* is a unique innovation that is mainly technical in nature, such as the digital watch, and personal computer in the past and smartphones and artificial intelligence. A *competitive product* is one of many brands currently available in the market and has no special advantage over the competing products. An *improved product* is not unique but is generally superior to many existing brands. The companies need to analyze some important issues as below while examining the micro-economic environment:

- Who is the competition now, and who will it be in the future?
- What are the key competitors' strategies, objectives and goals?
- How important is a specific market to the competitors?
- What unique strengths do the competitors have?
- Do they have any weaknesses that make them vulnerable?
- What changes are likely in the competitors' future strategies?
- What are the implications of competitors' strategies on the market, and those of one's own company?

One of the ways to examine competition is to draw up a demographic profile of the industry. Markets dominated by small, single-industry businesses or small regional competitors differ significantly from those dominated by national or multi-industry companies. The competitor strengths may be measured by analyzing various functional indicators in marketing as described below:

- Market share
- Differential advantages
- Cost advantages
- Reputation
- Distribution capabilities
- Core competencies
- Perceptions of target buyers

- Competitors' financial strength, which determines their ability to spend money on advertising and promotions, among other things
- Competitor's ability and speed of innovation for new products and services

It is necessary to list the strengths and weaknesses of the competitors from the customer's viewpoint and analyze how a company can capitalize on their weaknesses and meet the challenges represented by their strengths. Financial information on competitors might be easily obtained by getting a copy of their annual report. However, many information sources will have to be tapped and analyzed to understand competitors' strategies and objectives. In an international market, business takes place in a highly competitive, volatile environment, so it is important to understand the competition.

The soundness of the economy of a country largely governs consumer confidence, which further determines the buying plans of the consumers. A favourable economic environment helps consumers to optimize their buying decisions and augment spending. The reverse occurs when economic conditions are unfavourable.

The microeconomic environment of a product or market also plays a significant role in its market performance in overseas markets.

Screening the Microeconomic Environment

A foreign firm intending to operate marketing activities in the host country, may perform an opportunity analysis to determine the suitability to seek entry into a foreign country's market in terms of economic cost-benefit ratio. A conceptual scheme for analyzing economic environment may be drafted and implemented by the firm in order to evaluate existing and potential marketing opportunities in the host country. The conceptual scheme requires consideration of some of the following variables:

Financial Variables

- Capital acquisition
- Interest rates for commercial borrowings
- Payback tenure
- Cash inflow by period
- Cash outflow by period
- Returns on capital employed
- Exchange rate fluctuations
- Repatriation of funds status
- Projected investments linked to productivity
- Functional cost indicators in the business

Marketing Variables

- Market size and potential
- Distribution and logistics
- Competition mapping
- Promotional costs
- Socio-cultural and community factors

NOTES

Product-market Engineering Variables

- Availability of raw material for building infrastructure
- Raw material for manufacturing
- Accessibility factors
- Availability of labour (skilled/unskilled)
- Regional economic infrastructure
- Physical and environmental factors
- Local management factors
- Quality control and standardization
- Services management indicators

Economic and Political Variables

- Foreign investment policy of the host government
- Capital flow controls
- Tax regulations
- International relations of host country
- Civil/Labour unrest in the host country
- Inflation status
- Internal political stability
- Political ideology

Social and Legal Variables

- Education, religion and social behaviour of the people
- Demography and household status
- Ownership restrictions
- Acquisition of immobile assets
- Community and culture
- Import/Export regulations

There are many other microeconomic variables that may be selected for industry or market analysis in the host country depending upon the specific requirements of the firm. The microeconomic foundations of productivity rest on two interrelated areas, the sophistication with which companies compete, and the quality of the microeconomic business environment. The analysis of the above listed variables would help in determining the scarcity dimensions of the product or services in the selected market in the host country, production possibilities, and opportunity costs that may favour the firm's decision towards entry into the host country market. A careful examination of these variables would also help the firm to know the supply and demand situation, free markets, the price system, and government policy. Microeconomic analysis of business decisions in competitive and non-competitive markets, labour markets, capital and natural resource markets, and externalities can also be determined by the international firms through the analysis of the spatial and temporal microeconomic variables in the host country. In addition, the analysis of most relevant microeconomic variables can help in assessing the strategic decision-making issues like market breakdown, income redistribution, and role of government, trade and tariff regimes and anticipated gains from international trade over short and long run. The major microeconomic factors can substantially influence trade forecasts. This can include shortages, strikes, supply problems, defects, capital problems, mergers, consolidations and a variety of other factors.

Criteria for Analyzing Market Opportunity

With the use of these variables, analysis of marketing opportunity centres on two sets of criteria: cost/benefit criteria and risk/reward criteria. The cost-benefit criteria should respond to a series of questions towards the efficiencies of markets,

competition, and the financial implications of doing business in a foreign country. In view of the micro-economic environment, the firm may determine the consumer preferences on products by available segments. More significantly, the firm may determine the consumer price sensitivity, propensity of consumption and whether the consumers have enough to pay a price that will yield a profit to the firm. The size of the market may also be known by analyzing the microeconomic variables in the host country.

2.6 TECHNOLOGICAL ENVIRONMENT AND ITS CHALLENGES

Technological environment, i.e., technology level or technological change can, and often have major impact on international business strategies. Technology or technological innovation can spread quickly across countries because of radical improvement in communication/transmission system.

An innovation can lead to creation of new products or even industries; and innovation can also make a company's technology or product obsolete. Two important factors should be highlighted in international technological environment, namely technology clusters and spread of the Internet.

Technology Cluster

Technological innovation can occur anywhere in the world, but such innovations or advances often take place in a 'technology cluster', that is, a location where progressive companies from the same sector are linked to high-quality university or a research centre. The best known cluster in information technology is Silicon valley in California. The smaller clusters include India's Silicon Valley near Bangalore, the Multimedia Super Corridor in Malaysia and Silicon Fen near Cambridge in the UK. One strategy for a multinational company may be to locate inside a cluster to benefit from its advanced knowledge networks. For example, companies like Olivetti and Oracle (whose research centre was later taken over by AT&T) located some of their research activities in Silicon Fen. Many companies in Silicon Fen benefited from proximity to the University of Cambridge, and from advanced research in information technology by other companies located in the region.

Spread of the Internet

Spread of the Internet has almost revolutionized the way international business is done. This has led to three kinds of distinct developments. Creation of new types of product/service, (e.g., communications, tools and online auctions) and better customer service and relationships, (e.g., 24-hour service and personalized marketing and customer service).

Some feel that wealth will be largely created through partnerships in future and the internet will play the role of a catalyst in this. Global partnership among different companies will spread because the Internet can connect people working

NOTES

on the same product or project in different countries at a low cost. In future, managers may simply start with a new idea for a product/service and a blank sheet of the production and delivery system, and then create a network of companies to carry out all necessary activities including research, production and marketing. A leading company in the network will identify activities which create value and communicate them out to appropriate business Web partners. A key ingredient of successful strategy will be Web partnerships; ownership of distinct activities and rivalry may be less important.

Check Your Progress

8. List the price indicators in the international markets.
9. Mention the two types of economic systems.
10. What are the major microeconomic factors can substantially influence trade forecasts?
11. Define technology clusters.

2.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The political system of a country is shaped after passing through major processes of growth, decay, breakdown and a ceaseless ferment of adaptation and adjustment.
2. Political intervention may affect the marketing-mix functions of a firm in the host country in several ways. The intervention may be observed in a host country to the extent of local content law, technology content, restrictions on the sale of some products, products' functional range, design of products, useful life, and adaptability to local conditions, patent life, local manufacturing and assembling leading to amendment of product strategies of a foreign firm.
3. Domestication involves several measures, including gradual transfer of ownership to nationals, promotion of a large number of nationals to higher levels of management, greater decision-making powers accorded to nationals, more products produced locally rather than imported for assembly and specific export regulations designed to dictate participation in world markets.
4. The legal barriers in most of the countries include antidumping laws, tariff structures, horizontal price fixing among competitors, market division by agreement among competitors, and price discrimination.

5. 'Reverse dumping' refers to the less-common practice of selling products at home at prices below cost. This would be done in extreme cases where the share at home needs to be protected while monopolistic market positions abroad can be used to generate surplus funds.
6. Culture consists of patterns, explicit and implicit of and for behaviour acquired and transmitted by symbols, constituting the distinctive achievement of human groups, including their embodiment in artifacts.
7. Aesthetics include the arts, drama, music, folk culture, and architecture prevalent in a society and these convey its concept of beauty and modes of expression.
8. The price indicators in the international markets broadly include export and import price indices, consumer prices, wholesale prices and industrial producer prices.
9. The economic system of a country is another important factor that a marketer must understand. Traditionally, there are two types of economic systems — state-owned and capitalist.
10. The major microeconomic factors can substantially influence trade forecasts. This can include shortages, strikes, supply problems, defects, capital problems, mergers, consolidations and a variety of other factors.
11. 'Technology cluster' refers to a location where progressive companies from the same sector are linked to high-quality university or a research centre.

2.8 SUMMARY

- It is important to understand that the global political environment has a great role to play in all business and economic matters. Today, however, it remains in constant flux. The political system of a country is shaped after passing through major processes of growth, decay, breakdown and a ceaseless ferment of adaptation and adjustment.
- There are many factors that influence the ideological transition, development and change in the world's political systems.
- The political environment of a country comprises the international environment, host-country environment and the home-country environment. Many studies have shown that dealing with problems in the political arena is the principal challenge facing international managers in developing pro political strategies to run the business successfully in the host country.
- Many multinational companies face uncertainty in political environment due to instability of political leadership, coalitions and external pressures. Even if the home country and the host country give them no problems, they can face threats in the neighbouring markets.

NOTES

- Political intervention may be described as a decision taken by the government of the host country intended to force a change in the operations, policies, and strategies of a foreign firm in the interest of the country. Such interventions may range from enforcing control to complete takeover, or annexation of the foreign enterprise.
- There are three major ideologies that are embedded in the political systems of the world—democracy, communism and capitalism. All political systems are oriented towards the power of ruling with the conventional and modern philosophies in reference to their respective schools of thought.
- Political, economic, religious and other tensions can shift at a moment's notice and disrupt business operations for exporters, traders, investors, banks and other organizations involved in international commerce.
- In addition to the political environment in a country, the legal environment comprising local laws, civil and criminal laws and trade regulations also influences the operations of a foreign firm. It is important for a foreign firm to know the regulatory provisions in each market, as such legal environment constitutes the 'rules of the game.'
- The socio-cultural values concerned with different societies should be taken care in international marketing research process. The attitudes and values are a society's cornerstone; they often drive demographic, economic, political/ legal, and technological changes. Firms should be aware of attitudinal and cultural changes across global societies.
- The international company entering the host country should ensure that people, their cultures and society, and their organizations and institutions are taken into account in formulating business goals and operational strategies.
- Macroeconomics can be used to analyse how best to influence policy goals such as economic growth, price stability, full employment and the attainment of a sustainable balance of payments.
- An environment surrounding a specific product or market concerning the competition rather than a country's overall economic environment refers to the microeconomic environment. A careful analysis of a microenvironment indicates whether a company can successfully enter a specific market.
- A foreign firm intending to operate marketing activities in the host country, may perform an opportunity analysis to determine the suitability to seek entry into a foreign country's market in terms of economic cost-benefit ratio.
- Technological environment, i.e., technology level or technological change can, and often have major impact on international business strategies. Technology or technological innovation can spread quickly across countries because of radical improvement in communication/transmission system.

- An innovation can lead to creation of new products or even industries; and innovation can also make a company's technology or product obsolete.

2.9 KEY WORDS

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- **Political environment:** It comprises the international environment, host-country environment and the home-country environment.
- **Political intervention:** It may be described as a decision taken by the government of the host country intended to force a change in the operations, policies, and strategies of a foreign firm in the interest of the country.
- **Tariff:** It may be defined as government levies on exports and imports. The tax on exports may be determined as export duty while the tax on imports is known as import duty or customs duty.
- **Technological environment:** It refers to technology level or technological change.

2.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. List the factors determining the effectiveness of a political system.
2. Briefly explain the three major ideologies that are embedded in the political systems of the world.
3. What are the two types of legal systems which can be distinguished?
4. List the three basic concepts in reference to culture.
5. Write a short note on technological environment of business.

Long-Answer Questions

1. Examine the determination of political environment in international marketing.
2. Assess the political interventions in international marketing.
3. Analyse the constituents of the legal environment of international business.
4. Describe the cultural variables in the international business environment.
5. Explain the criteria for analysing competition and market opportunities in the international business environment.

2.11 FURTHER READINGS

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UNIT 3 INTERNATIONAL TRADE ENVIRONMENT

Structure

3.0 Introduction
3.1 Objectives
3.2 Classical Trade Theories
  3.2.1 Mercantilism
  3.2.2 Absolute Advantage
  3.2.3 Comparative Advantage
3.3 Modern and Neo-Classical Trade Theories
  3.3.1 Factor Proportions Theory
  3.3.2 New Trade Theory and Country Similarity Theory
  3.3.3 The Product-Life Cycle
3.4 Trade Barriers or Trade Protection
  3.4.1 Types of Tariff and Non-Tariff Barriers Like Quotas
  3.4.2 Implication of Tariffs
3.5 Types of Agreements
  3.5.1 General Agreement on Tariffs and Trade (GATT)
  3.5.2 Functions and Objectives of WTO
  3.5.3 Implication of WTO on International Marketing
  3.5.4 India's Role in International Trade Theories
3.6 Answers To Check Your Progress Questions
3.7 Summary
3.8 Key Words
3.9 Self Assessment Questions And Exercises
3.10 Further Readings

3.0 INTRODUCTION

International trade is not a new phenomenon and it has been working in different forms since ages. International trade theories help explain the characteristics of trade pattern of a trading country, and from those characteristics it can be deduced what, why, where and how countries actually trade. Trade theories also help explain the effects of trade on the domestic economy and help diagnose the cause and effect relationship between trade and the domestic economy which in turn helps policy makers evaluate different kinds of policy. As a result, governments can plan for policy interventions to boost up trade and international commerce, bringing prosperity to a country.

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International trade theories are broadly classified into three categories. They can be seen in Figure 3.1 below.

CLASSICAL THEORIES	NEO-CLASSICAL THEORIES	MODERN FIRM BASED THEORIES
• Mercantilist Theory • Adam Smith Absolute Cost Advantage Theory • Ricardo's Comparative Cost Advantage Theory	• Hecksher Ohlin Factor Endowment Theory • Opportunity Cost Theory	• Product Life Cycle Theory • Global Strategic Rivalry • Country Similarity • Port National Competitive Theory

Fig. 3.1 *International Trade Theories*

In this unit, you will learn about the different international trade theories, the concept of trade barriers and protection measures and the concept of GATT and WTO in international trade.

3.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the classical trade theories
- Discuss the modern and neo-classical trade theories
- Describe the trade barriers and trade protection measures
- Explain the concept of GATT and WTO and India's role in international trade theories

3.2 CLASSICAL TRADE THEORIES

In this section, you will learn about the classical trade theories.

3.2.1 Mercantilism

The mercantilist theory of international trade originated in England in the middle of the 16th century. The mercantilist theory of international trade is based on the principal assertion that government control of foreign trade is of paramount importance for ensuring the prosperity and military security of the state. The main tenet of this theory was that gold and silver were the mainstays of national wealth and government should endeavours their best so as to increase the inflow of gold and silver. This was to be achieved by exporting more and importing less and thus having a surplus balance of trade. The theory argued that national wealth and prosperity would increase with more and more inflow of gold and silver which were the main currency of international trade at that point of time. An English

mercantilist writer Thomas Mun in 1630 stated, 'States should focus on increasing export and controlling imports; thus, to increase our wealth and treasure; by accumulation of gold and silver. We must ever observe the selling of more to strangers yearly than what we consume of theirs in value yearly'.

Mercantilism was one of the first efforts by economists to understand the gamut of international trade and the benefits that came along with it. Mercantilist theory was based on the idea that a '*country's wealth was determined by the amount of its gold and silver holdings'*. By increasing its holdings of gold and silver by promoting exports and discouraging imports, a country would have more money flowing into the system than was going out. Mercantilists always emphasized upon having a trade surplus and avoiding a trade deficit. In the period between the mid-16th century to the 18th century, governments around the world, being influenced by mercantilism, advocated and executed policy interventions to achieve a surplus in the balance of trade. Mercantilist theory believes that it is not important to increase the volume of foreign trade but to solely focus on maximizing exports and minimizing imports. This could be done through tariffs and quotas on imports and subsidies for exports.

Mercantilism theory suffered from many flaws and inconsistencies which were rightly pointed out by the classical economist David Hume in 1752. Hume propounded that if England had a favourable balance of trade with France, the resultant inflow of gold and silver would enhance the flow of money in the domestic system which would result in inflation as the people of England would have more purchasing power. Alternatively, people in France would buy less as their purchasing power would become less with the outflow of gold and silver to England. As a result, the prices of commodities in England would go up and in France they would go down due to a lack in demand and monetary contraction. Thus, the people of France would be able to buy less English goods as they would have less purchasing power and because English goods would become expensive. Hence, English trade would be affected until there would be equilibrium in the balance of trade. Hume's criticisms of the mercantilist theory of international trade were sound. Noted classical economists like Adam Smith and David Ricardo also argued that trade is a 'positive sum game' and not a 'zero sum game' as the mercantilists argued. Trade benefited all due to a variety of reasons such as cost competitiveness, comparative advantages, absolute advantages, PLC cycle, factor endowments, etc.

The mercantilist trade theory was relevant in the era of colonization and imperialism when many nations from Europe expanded their wealth by using their colonies in Asia, Africa and Latin America to not only control trade but to amass more riches and wealth. The British Empire is one such example. France, Portugal, Spain, Italy, Netherland, Belgium and even Germany amassed a lot of wealth by exploiting their colonies and bringing back home the wealth from such country by

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all possible means. The Indian economist and thinker Dadabhai Naoroji rightly point out the harmful effects of these policies for the colonies in his drain of wealth theory. He asserted that British colonists would sell to Indians finished goods at higher prices and brought our raw material at far lower prices. As a result, British traders made great fortunes and there was a drain of wealth from India to Britain. Although, mercantilism is the oldest theory of trade, its principles are relevant even today as there are countries that follow mercantilist trade policies in some way. You studied about China's neo-mercantilist policies. Along with China, Japan, South Korea, Singapore, and even Germany favour exports and discourage imports. These countries adopt a number of measures to make their export competitive in the international market; at the same time back home they promote protectionist policies, putting restrictions on imports and giving subsidies to the domestic-industry to make it competitive vis a vis imported goods.

3.2.2 Absolute Advantage

Adam Smith in his magnus opus *The Wealth of Nations* (1776) attacked the theory of mercantilism and argued that countries differ in their ability to produce goods and services efficiently due to a variety of reasons. At that time England, by virtue of their superior manufacturing processes, was the world's most efficient textile manufacturer. This was due to a combination of factors such as favorable climate, good soil, a skilled work force and accumulated experience and expertise in textile production. On the other hand, the French had one of the most efficient wine industries in the world. Thus, England had an absolute advantage in the manufacture of textiles and France had an absolute advantage in the production of wine. Adam Smith argued that a country has an absolute advantage if it has the most efficient and cost-effective product in comparison to any other country producing the same product.

The crux of Smith's absolute advantage theory is that a country should not produce goods at home in which it does not have cost advantage and should import it from others. Absolute advantage theory was based on a 'positive sum game' where countries benefit from trade unlike mercantilism theory that was based on a zero-sum game. The following table illustrates the benefits of absolute advantage theory.

Table 3.1 *Benefits of Absolute Advantage Theory*

India South Korea Comprehensive Economic Partnership Agreement: Practical case of Absolute Cost Advantage

If the cost of producing a barrel of oil in South Korea and India is 20 labour hours and 24 labour hours respectively and the cost of producing a metre of textile in the South Korea and India is 24 labour hours and 26 labour hours respectively, South Korea has an 'absolute advantage' over India in the production of oil and textiles, as labour cost is cheaper in South Korea vis a vis India.

If India and South Korea opened their markets for each other in oil and textiles, the relative price for oil would be:

	Relative price for Oil	Relative Price for Textiles
South Korea	20/ 24 = 1 / x x = 1.2 yards of cloth per barrel of oil	24 / 20 = 1/x x = .83 barrels of oil per yard of cloth
India	Oil: 24 / 26 = 1/x x = 1.083 yards of cloth per barrel of oil	Cloth: 26 / 24 = 1/x x = .923 barrels of oil per yard of cloth

India has a comparative advantage in the production of oil because its relative cost per barrel of oil is cheaper than that of South Korea and South Korea has comparative advantage in textiles. Hence, India should specialize in the production of oil and South Korea in textiles.

Key Assumptions of Absolute Cost Advantage Theory

Adam Smith's trade theory of absolute cost advantage was based on certain assumptions like there are 'two Countries and two Commodities' for trade. Such an assumption is completely unrealistic when there are around 200 countries in the world today. Additionally, there are around 11,500 tariff lines of goods classified under the ITC (HS Code) and around 161 services open for international trade commerce. The second assumption of absolute cost advantage theory is that it considers labour as an input from factors of production. It is grossly unrealistic to accept that factors of production like land/capital/information/entrepreneurship, etc., do not have any bearing on the cost of goods and services manufactured/ rendered. The third unrealistic assumption of the theory of absolute cost advantage is that it assumes that there is a single currency for international trade among countries, thereby eliminating the effects of exchange rate changes and trade benefits/losses arising from these changes. Another assumption of absolute cost theory is that since there is a single currency for trade, there are no losses or gains due to exchange rate differentiation, thus there exists homogenous labour units which can be moved from one production function to another resulting in no requirement of specialized labour. These units of production can be further divided into compact units. Other assumptions include no government restrictions on the movements of goods and services across borders and that all factors of production are fully employed. The assumptions of the theory of absolute cost advantage can be seen in Figure 3.2.

Criticism of Absolute Cost Theory

Adam Smith's absolute cost advantage theory was criticized for the unrealistic assumptions stated before. Most of economists called it an 'incomplete' theory as it was addressed to an unrealistic situation where one country enjoyed an absolute advantage in production of a commodity/services over another country. The theory did not address the totality of trade function, how it took place among countries,

factors affecting it, government intervention and policy reactions. Economists also criticized the theory for considering labour as the only factor of production.

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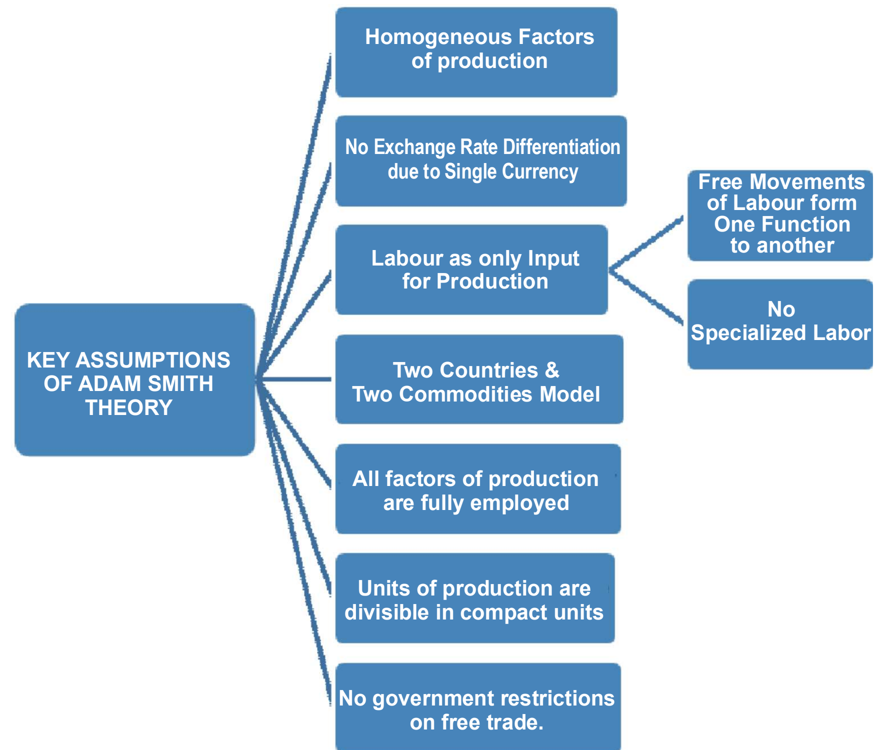

Fig. 3.2 *Assumptions of the Theory of Absolute Cost Advantage*

3.2.3 Comparative Advantage

The theory of comparative cost advantage was developed by the British economist David Ricardo in the 19th century. In 1817, Ricardo published an essay on *Political Economy and Taxation* in which he described the law of comparative cost advantage. In some aspects, his theory was similar to the theory of absolute cost advantage as it stated that international trade between two countries was solely due to the differences in the productivity of labour. However, Ricardo's theory was an improvement on the absolute cost advantage theory as it stated that trade occurs because of comparative cost advantage not absolute cost advantage.

According to David Ricardo, international trade occurs among countries as one country may enjoy a comparative cost advantage vis a vis another because countries differ in their stage of development and the resources that they endow. The very basis of international trade between countries is that they exchange goods and services in which they have comparative cost advantage with another country. This way, both countries gain from trade.

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Key Assumptions of Ricardian Comparative Cost Advantage Theory

Comparative cost theory is based on certain key assumptions. These assumptions include each country has a fixed endowment of resources, the factors of production are immobile, all units of each particular resource is identical, there exists a full employment at macro level in an economy and the economy is characterized by perfect competition. Another key assumption of the theory is that just like Adam Smith's absolutely cost advantage theory, the comparative cost theory is a 'two countries and two-commodity' model. There is zero transport cost if the goods are traded and there are no governmental restrictions or interventions in the free movement of goods and services across borders for international trade.

The key assumptions of the theory of comparative cost advantage are listed in Figure 3.3 below.

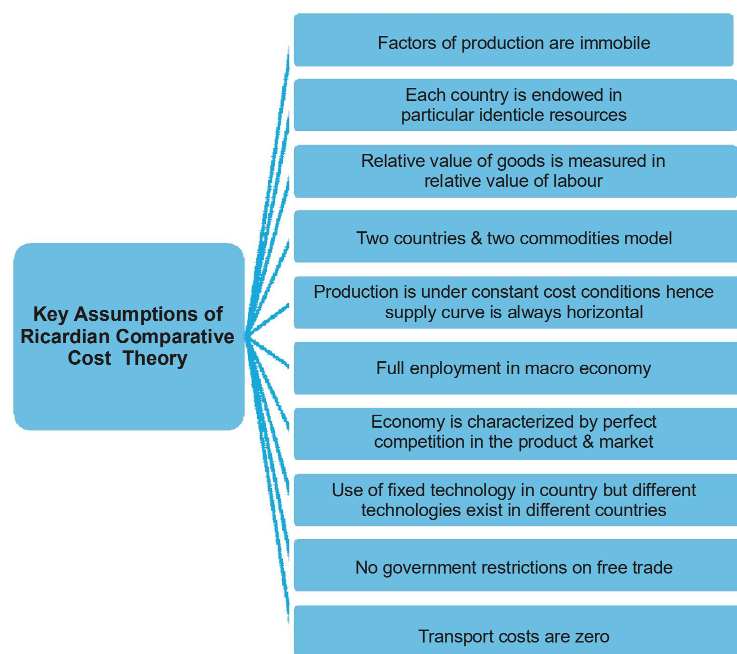

Fig. 3.3 *Assumptions of the Theory of Comparative Cost Advantage*

Comparative cost advantage theory can be elaborated by using the following example. Let us suppose that there are two countries, namely the United Kingdom that produce cloth and France that produces wine. Table 3.2 below illustrates the comparative cost advantage as it gives labour hours required for the production of one unit of two commodities in the United Kingdom and France.

Table 3.2 *Illustration of Comparative Cost Advantage*

Country	Cloth	Wine	Price Ratio between UK and France
United Kingdom	1 Hour Per Unit	3 Hour Per Unit	1 Unit of Wine: 3 Unit of Cloth
France	2 Hour Per Unit	4 Hour Per Unit	1 Unit of Wine: 2 Units of Cloth

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Table 3.2 indicates that the United Kingdom has an absolute cost advantage in the production of both the commodities. The UK has a lower labour cost in production of both cloth and wine in comparison to France that is just half in case of cloth and ¾ in case of wine. Thus, the United Kingdom will benefit from the trade of both cloth and wine as it enjoys absolute cost advantage in the case of the production of both the items.

The Ricardian comparative cost theory is based on the principle that countries benefit from the international trade of goods in which they specialize. Thus, like Adam Smith's absolute cost theory, the Ricardian comparative cost theory is not based on a 'zero sum game'. The comparative cost theory argues that international trade is mutually profitable even when one country can produce every commodity more cheaply than other nations. Ricardo advocated that each country should specialize in the production of those goods and services in which it has a comparative cost advantage and that is of greatest relative value and efficiency. For example; in the above case, the UK should specialize in the production of cloth where it enjoy a far higher relative efficiency than France. In the production of wine, although the UK has greater efficiency, it should forego the production of wine and import it from France. This is because the UK will have better terms of trade while trading cloth than wine as the terms of trade are the limits set by the internal price ratio of goods produced before trade.

Criticisms of the Comparative Cost Theory

Ricardo's Comparative Cost Advantage Theory is criticized on the following grounds:

- **Two Countries and Two Commodity Model:** The Ricardian theory of comparative advantage is based on the assumption of two countries and two commodities. This makes the analysis and assessment of comparative cost advantage between group of countries (there exist 200 countries in world trade) a cumbersome and lengthy process. However, Ricardo's observation that countries trade due to comparative cost advantage seems sound as countries do exchange the goods and services in which they have lower cost of production.
- **Zero Transport Costs:** The Ricardian theory's assumption that there are no transport cost seems illogical and unrealistic as the comparative cost enjoyed by the country may get traded off if it is too far from key markets. For example, India enjoys a comparative cost advantage in the manufacturing of textiles but it goods get priced out in many Latin American markets as the cost of transportation is a significant factor while doing trade with Latin American countries.

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- **No Government Restrictions / Interventions for Free Trade:** The Ricardian theory of comparative cost advantage is based on the assumption that there are no government restrictions for free trade. This is unrealistic as there exists a plethora of tariff and non-tariff barriers when goods are traded internationally. The comparative cost enjoyed by a country may be well set off by the existence of tariff and non tariff barriers. For example, India enjoys a natural comparative cost advantage in the production of agri commodities but Indian goods do not enjoy market access in Pakistan as it has not granted India a 'Most Favored Nation' status.
- **Different Tastes and Preferences:** Ricardo's comparative cost advantage theory does not explain that there can be trade between two countries due to differences in tastes and preferences of a country. For example, Japan is undoubtedly a major producer of fishery products but it imports huge quantities of fish as Japanese love eating fish of different varieties.
- **Labour as only Factor of Production:** Similar to Adam Smith's absolute cost advantage theory, Ricardo's theory also considers only labour as a differentiation input for assessing the comparative cost advantage. Subsequent theories, particularly the opportunity cost theory rectified this problem and enunciated that countries trade due to differences in their opportunity costs.

Check Your Progress

1. State the main tenet of mercantilism theory.
2. On what argument did Adam Smith attacked the theory of mercantilism?
3. Why is Ricardo's theory better than absolute cost advantage?

3.3 MODERN AND NEO-CLASSICAL TRADE THEORIES

Let us study the various modern and neo-classical trade theories.

3.3.1 Factor Proportions Theory

The factor endowment theory was developed in the beginning of 20th century by two Swedish economists named Eli Heckscher and Bertil Ohlin. This theory was also known as the 'Factor Proportions Theory' but a majority of contemporary authors calls the theory either the 'Factor Endowment Theory' or the 'Heckscher-Ohlin Theory'. The Heckscher-Ohlin theory stresses that countries should produce and export those goods and services in which a country has abundant factor resources, i.e., land, labour and capital and should import those goods and services

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in which factor resources are scarce. The theory is similar to Ricardo's comparative cost advantage theory but differs slightly as it stresses that trade takes place due to different factor endowment rather than efficiency of the country in a particular goods and service. In the other words, the comparative cost advantage and absolute cost advantage theories focus on the 'productivity of the production process' for a particular goods and services of a country while the factor endowment theory stresses that a country should specialize in production and export of those goods and services which are cheaply available in abundance.

Heckscher and Ohlin criticized the classical theories of international trade and referred to them as incomplete as they failed to explain the reasons why a particular country had a comparative cost advantage in certain kinds of goods and services. They principally accepted that trade occurred due to comparative cost advantage of one country in certain kinds of goods and services and its subsequent ability to supply these goods at lower cost vis a vis its competitors. The Heckscher-Ohlin theory went a step beyond and provided an explanation that the comparative cost advantage mainly came because of the differences in factor endowments of a country. For example, a country more endowed with labour would specialize in the production and export of those goods and services which require more labour input. A country that is rich in capital will focus on the production of those goods which require more capital and a country with more land will specialize in industries and services which require more land as an input for the production of those goods and services.

Heckscher-Ohlin argued that the main determinant of the pattern of production and trade among different countries and regions was mainly due to differing factor endowments. A country will always try to specialize in the production of those goods and services where factors of production are abundantly and cheaply available. Factor prices are important for the production and trade of goods and services and that mainly comes due to the abundance or the scarcity of land, labour and capital of a country. For example, Africa is rich in mineral resources which cost lower when compared internationally and thus its export basket mainly consists of raw material. On the other hand, Germany is rich in capital and accordingly, its export basket consists of mainly high technology capital goods and services. India is rich in land and labour and thus the Indian export basket consists of items such as gems, handicrafts, handlooms, textiles, apparel, engineering items, tools, hosiery, leather and agriculture goods, etc. India has also emerged as a global services hub mainly due to the difference in the labour costs of developed countries with that of India. India's IT exports of $75 billion are a testimony to the cheap labour that India employs in its software and IT enabled industry.

Assumptions of Heckscher-Ohlin Theory

The Heckscher-Ohlin theory is based on certain assumptions which are listed in Figure 3.4.

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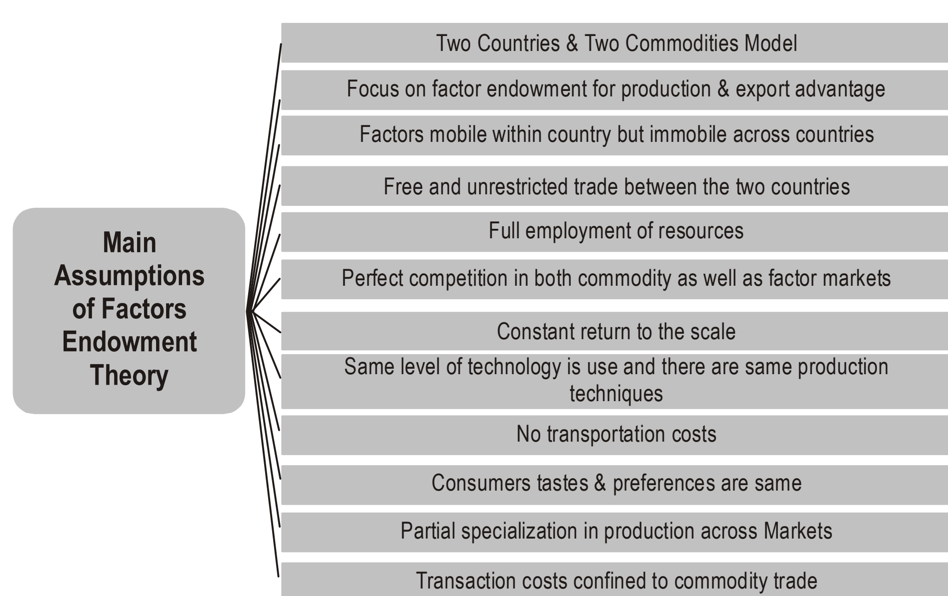

Fig. 3.4 *Assumptions of Heckscher-Ohlin Theory*

Based on these assumptions, Heckscher and Ohlin argued that the reason for international trade among countries is mainly due to the differences in relative prices of commodities from one country to another. Such price differentiation in commodities is mainly caused by differences in the relative demand and supply of factors such a labour or capital which may be endowed differently in two or more countries. If a country has a scarcity of one factor such as labour, the price of labour-intensive products will be higher due to labour shortages in the local markets resulting in disequilibrium in the demand and supply. Such a country has to import labour intensive goods and services from labour abundant countries. Similarly, the country that is abundantly endowed in capital will export those items which require a lot of capital investments in order to produce them. Heckscher and Ohlin contended that a country will specialize in the production and export of those goods and services where the production can be done relatively cheaper in comparison to other countries due to the abundance of a particular factor. For example, the textile industry requires a lot of labour, accordingly textile industries are based in labour rich countries such as China, Bangladesh, India, Vietnam, Thailand etc. The beauty of the H-O model is that it considers the abundance of factor endowments in relative terms and not in absolute terms. The abundance of

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the mobile factors such as capital and labour is considered if one is higher than the other. This can be understood from Table 3.4:

Table 3.4 *Estimation of Relative Abundance of Factor: H-O Model*

Country India	Supply of labor = 500 units Supply of Capital = 250 units **Capital-Labor Ratio = 0.2**
Country USA	Supply of labor = 600 units Supply of capital = 900 units **Capital-Labor Ratio = 1.50**

From the table above, it is clear that India is poorly endowed in capital while the United States is abundantly endowed in capital. Hence, India should specialize in the production and exports of goods that are labour intensive and the U.S. should specialize in the production and export of capital intensive goods and services. Alternatively, India has a scarcity of capital, hence, it will import goods that are capital intensive and the U.S. will import goods which are labour intensive. The H-O model concludes that under such disequilibrium in the demand and supply, participating countries tradeoff with each other to import desired goods and services. The tradeoff between countries is depicted in Figure 3.5.

Fig. 3.5 *Tradeoff between Countries*

One of the notable features of the H-O theory is that it rightly points out that the very basis of international trade among countries is the difference in prices of commodities from one country to another or from one region to another. Countries exchange those goods and services in which they are better endowed with the one in which they are poorly endowed. The ultimate cause of international trade is the difference in the prices of commodities due to different factor endowment of countries. A country exports goods in which it has an abundance of resources and specialization and imports goods in which it does not have factor resources adequately available locally. However, there are exceptions to this theory when we try to test it empirically.

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The H-O model is an improvement on the classical theory particularly that of David Ricardo's comparative cost advantage theory, as it put the context and the rationale of the comparative cost advantage enjoyed by one country. Ricardo contended that comparative cost advantage was mainly due to the labour input difference while the H-O theory provided a wider and acceptable justification for comparative cost advantage which was due to not only labour but also on the account of other factor endowments such as an abundance of capital and land. When countries trade with each other with abundant factor endowed goods with that of scarce factor endowed goods, the result will be that there will be equalization in the commodity prices in participating countries as well as equalization in the factor prices.

Shortcomings of the Heckscher-Ohlin Theory

The H-O model is undoubtedly superior to classical theories of international trade like Ricardo's comparative cost advantage theory. The H-O theory is more precise and scientific and explains in totality the reasons why trade occurs among nations. However, the H-O theory is based on certain over simplified assumptions and thus, many economists refer it as an 'over simplified theory. The theory relies on certain unrealistic assumptions such as perfect competition, identical tastes and preferences, identical demand patterns, homogenous factors of production, homogenous production techniques, full employment of resources and constant returns to scale, no transportation costs, etc. Hence, it is considered an unrealistic model and is criticized by economists on the following grounds discussed below:

(a) **Static Trade Analysis:** The factor endowment theory explains the pattern of international trade in a static setting and neglects trade analysis in a dynamic economic system. In the era of economic globalization, the findings of H-O theory analysed in a static setting may not be relevant as there are developments in the global trade regime on a daily basis, based on negotiations taking place at bilateral, regional and multilateral forums.

(b) **Homogeneous Production Techniques**: The Heckscher-Ohlin model is based on the assumption that there are homogenous production techniques for the production of goods in two different countries. This assumption is also a highly unrealistic assumption as production techniques vary from country to country due to a variety of factors such as different geographical conditions, different climatic conditions, varying stages of development, technological differentiation, etc.

(c) **Homogeneous Factors of Production:** The factor endowment theory of Heckscher-Ohlin is based on the hypotheses that there exist homogeneous factors of production quantitatively and qualitatively in two different countries. This is an unrealistic assumption since firstly this is not possible and secondly the results so arrived by 'calculating factor endowment ratios' can be challenged on qualitative grounds.

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(d) **Neglect Transport Costs**: The factor endowment theory does not take into consideration costs involved in transporting goods from one country to another as the theory is based on the assumption of 'No Transport Cost'. When goods and price differences. Thus, the possibility of foreign trade exists only at customer acceptance of landed cost of products. Thus, the attractiveness of goods and services cannot be judged at production stage. Transport cost is an important and integral part of the trading of goods and services.

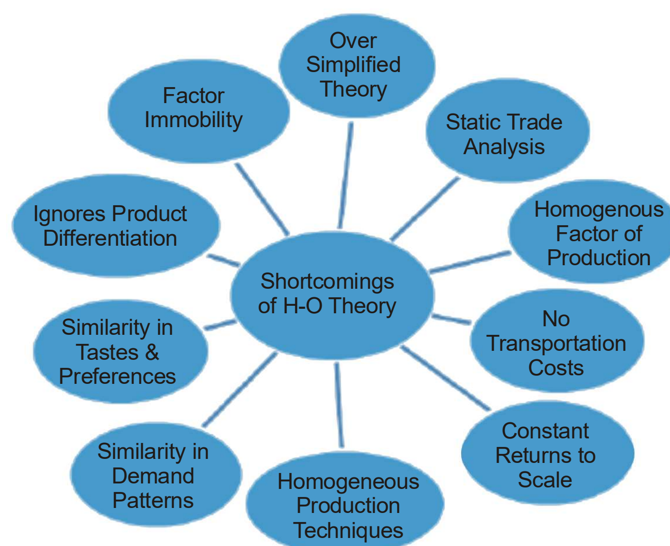

Fig. 3.6 *Shortcomings of the Heckscher-Ohlin Theory*

(e) **Similarity in Tastes and Preferences:** The H-O model is based on the assumption that the tastes and preferences for goods are similar among consumers of different countries and identical goods, if produced at comparative low costs, can be traded to a group of countries. This is an unrealistic assumption as consumer tastes and preferences are not similar across the regions/countries of the world.

(f) **Similarity in Demand Patterns**: The factor endowment theory unrealistically assumes that demand patterns of internationally traded goods are identical and similar. This is not true as demand patterns in international trade varies constantly due to new inventions or technological breakthroughs.

(g) **Constant Returns to Scale:** The Heckscher-Ohlin model is based on the unrealistic assumption that the returns to scale are constant. The H-O model argued that when nations engage in international trade, with increase in production and trade, they can reap the benefits of constant return to scale (economies of scale). However, trade is not only dependent on comparative cost advantage due to greater economies of scale but is also dependent on a variety of other factors.

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(h) **Ignores Product Differentiation:** The Heckscher-Ohlin theory unrealistically believes that there are standard products for the global market. However, this is only true for a few products only. Product differentiation is the key to trade expansion and diversification as consumers from different regions/ countries may have different tastes and preferences and may seek a variety of products.

(i) **Factor Immobility:** One of the most criticized assumptions of the H-O theory is that it assumes that the factors of production are immobile. Land undoubtedly is an immobile factor, but in an era of economic globalization, the other factors of production such as labour and capital are mobile. This is especially true when countries have regional economic groupings such as the Economic Union and Common Markets where there are no restrictions on the free movement of labour and capital from one region to another.

3.3.2 New Trade Theory and Country Similarity Theory

New trade theory (NTT) suggests that a critical factor in determining international patterns of trade are the very substantial economies of scale and network effects that can occur in key industries.

These economies of scale, and network effects, can be so significant that they outweigh the more traditional theory of comparative advantage. In some industries, two countries may have no discernible differences in opportunity cost at a particular point in time. But, if one country specializes in a particular industry then it may gain economies of scale and other network benefits from its specialization.

Another element of new trade theory is that firms who have the advantage of being an early entrant can become a dominant firm in the market. This is because the first firms gain substantial economies of scale meaning that new firms cannot compete against the incumbent firms. This means that in these global industries with very large economies of scale, there is likely to be limited competition, with the market dominated by early firms who entered, leading to a form of monopolistic competition.

Country Similarity Theory

According to the Heckscher-Ohlin theory, a country specializes in production and export of a commodity depending on its factor endowments—it may be a primary product or a manufactured good. S. B. Linder, a Swedish economist, made a distinction between trade in *primary products* and *manufactures*. In regard to primary products, he agrees with Heckscher-Ohlin theory. However, in regard to trade in manufactures, he formulated his own theory. According to his theory, *a country produces and exports a commodity for which it has a large domestic market and production capacity.* It implies that a country exports only that manufactured good, which it can produce in excess of its domestic demand, i.e.,

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export of a country is the overflow of its excess production. That is why his theory is also known as *spillover theory*. His theory may be summarized as follows.

A manufacturer produces a new product first for its domestic market. In case its market size is large, it provides scope for large-scale production. Large-scale production gives economies of scale and, therefore, the cost of production decreases. In the process, it gains production skill and improves production techniques. This results in reduction in the cost of production and makes the product price internationally competitive. The producer then begins to export the product to other countries 'with similar income and taste.' In other words, foreign trade is simply an extension of the domestic trade.

An important conclusion of Linder's theory is that the volume of trade in manufactured goods is high between countries with high and similar per capita income. This conclusion contradicts the Heckscher-Ohlin theory. There is not much empirical support for Linder's theory. Instead, there are many exceptions to his theory. An important exception is the export of Christmas trees, cards and ornaments by non-Christian countries like Japan and Korea to Christian countries. What contradicts strongly Linder's theory is the fact that these countries do not have a domestic market for these goods.

3.3.3 The Product-Life Cycle

The International Product Life Cycle (IPLC) theory is a modern theory of international trade and was propounded by Raymond Vernon in 1966. Vernon wrote a series of essay explaining internationalization patterns of companies and organizations engaged in foreign trade. Through his IPLC model, Vernon explained the phases and reasons why US Multinational National Corporations (MNCs) became global. He argued that the wealth and size of the U.S. market gave American firms a strong incentive to develop new consumer products and in addition, the high cost of labour was an incentive to develop cost-saving innovations. His International Product Life Cycle theory is considered one of the best and most realistic trade theories developed so far as it can be tested empirically with the findings of the theory made in a constantly changing environment.

Vernon's International Product Life Cycle Theory was developed in response to the failures of the Heckscher-Ohlin theory. As you learned, the H-O model failed to explain the 'observed pattern of international trade'. According to the IPLC theory when products enter into the second phase of their life cycle and become adopted in other countries/regions of the world, the production of such goods gradually moves away from the point of origin due to a variety of reasons. There is a possibility that products may be imported by the very country that has invented it as the cost of production of such goods may be a fraction of the costs that will be incurred if manufactured locally. For example, in the earlier stage of the product life cycle, computers were invented and developed in the United states as it was a product which was aimed at fulfilling the needs and demand of a high-income group. In later stages, the production of computers shifted to other

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production centers such as Japan/South Korea/Taiwan and more importantly to China to cater to the growing markets of Asia/Africa and Latin America and to take advantage of lower production costs. Computers are now imported in the United States as it is cheaper to manufacture abroad then to manufacture them locally in the United States. The IPLC theory concludes that the pattern of international trade can be understood through the different phases of a product life cycle. Vernon gives the following stages of a product life cycle:

(a) New Product
(b) Maturing Product
(c) Standard Product

Using the above three stages of the product life cycle, one can say that computers were produced and consumed in the United States in the new product stage of the life cycle and no export trade occurred from the United States during this phase. In the maturing product stage, computer firms in the United States developed mass-production techniques so as to cater to the growing needs of developed countries, thus the computer market expanded in key developed countries. U.S. firms thus started exporting computers to other developed countries. In the standardized product stage, the production of computers moved to developing countries of Asia and Latin America and is now moving to the developing markets of Africa. Mass production along with lower labour costs resulted in greater economies of scale and firms based in developing markets started to cater to the demand in developed countries. The IPLC model demonstrates the dynamic comparative advantage that helps firms to move their production base from one region to another. The production base of computers changed from the innovating country to the developing countries so as to reap the benefits of comparative cost advantage. The beauty of IPLC trade theory is that it explains the rationale and reasons for changes in the observed pattern of trade which the H-O model failed to respond to. In a nutshell, the IPLC theory postulates a '*dynamic comparative advantage*' because the source country of exports shifts throughout the life cycle of the product.

Stages and Limitations of IPLC Theory

As you learned above, the International Product Life Cycle trade theory consists of three stages. The three stages are explained in detail in the section below:

Stages of IPLC Theory

(I) New Product

The life cycle of a product begins when a firm usually from a developed or a technologically advanced country wants to launch a new product in order to cater to newer market segments. This is achieved through a technological breakthrough by the firm. Such a technological breakthrough is more likely to come from a firm of a developed country as there is a lot of funding for research in these nations by

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both private as well as public sector organizations. Moreover, the consumers from such developed countries are affluent and are willing to experiment with new, unique and expensive products. Being the inventor and innovator, the developed country does the production of the product locally to cater to domestic market needs and to minimize risk and uncertainty. The focus at this stage is to cater to the domestic market. The prices of goods are usually high at this stage and products are positioned for the rich, affluent and high-income groups. Consumers from other developed countries may buy or even import such goods but trade at this stage is very small and miniscule. The prices of new products are usually high and the product is advertised as a unique product meant for rich consumers.

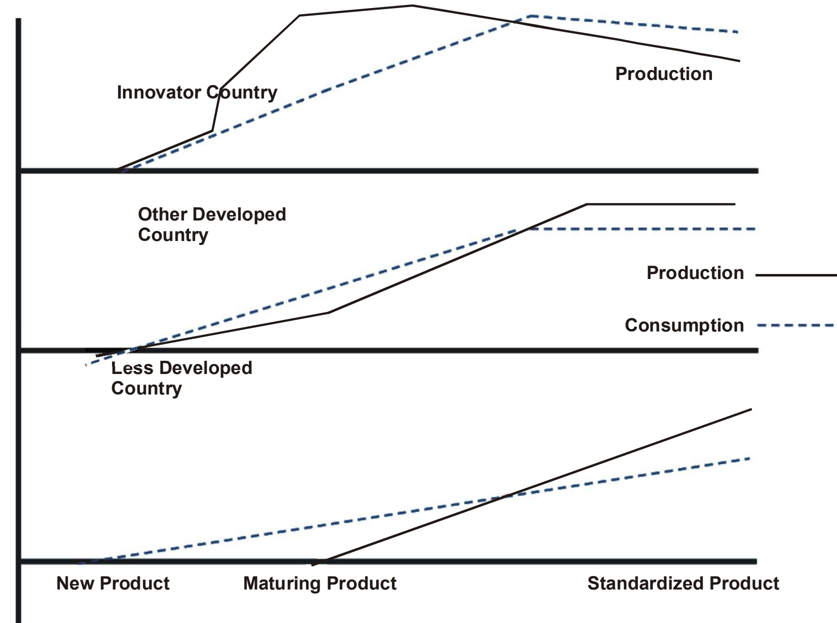

Fig. 3.7 *Understanding International Product Life Cycle Theory*

Source: Adapted from FAO Fisheries Report No. 708

(II) Maturing Product

At the maturing stage of the product life cycle, a firm engages in the export of the product especially to other developed/advanced countries. Ways and means are exploited to make it accessible to a large number of consumers so that firms can exploit economies of scale and scope in key advanced markets. There comes maturity and standardization in the product design and the production process. Firms can invest in key advanced economies through wholly owned subsidiaries, joint ventures, etc., so as to start local production. This helps firms achieve lower unit price as the transportation cost/import duties, etc., become negligible. Goods are still targeted for the high-income group. Decentralized production centers in key markets aim their efforts to serve local market needs. Even at the maturing

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stage, the production of goods requires highly skilled manpower. Firms get orders from lower income countries to which it caters. The genesis of the IPLC theory, thus, is based on the idea that diffusion takes place from economically advanced countries to developing countries.

(III) Standardized Product

As depicted in Figure 3.7, a product becomes saturated from the market in the third stage of the product life cycle. The production process as well as product features become increasingly standardized and firms from innovator countries try to cut down production and delivery cost and shift the production base to countries where the production cost would be the lowest. The focus is to 'do mass production and ensure mass consumption' of the product. The inventor country's comparative cost advantage gets eroded under such a scenario and a firm shifts their production base to countries where they have maximum economies of scale and scope for further expansion and diversification of products. The consumers of lower income countries get access to such standardized products. Counterfeiting takes place as some local firms in developing countries try to come up with cheaper counterfeit products to cater to the lower segments of the markets. Under the standardized phase of the IPLC, the investor country imports the product from developing countries where they are produced to cater to the global demand of the product. China is the best example for many standardized engineering items which were first innovated in developed countries of North America or Europe but are now mass produced in China to cater to the global demand of such product. For example, mobile phones, laptops, computers, toys, etc., were first produced in advanced countries but are now mass produced in China.

Limitations of IPLC Theory

The International Product Life Cycle theory is criticized by many on various grounds. These criticisms are listed below:

(i) Raymond Vernon's IPLC theory proposes that the diffusion process of a new technology occurs slowly. This allows firms the time to sell even older/obsolete products in low-income countries. This assumption may have been true during the 1960s but is unrealistic in today's environment when MNCs/TNCs rule world trade. Communication and the information technology revolution have made the diffusion process much faster.

(ii) Vernon's assumes that after invention, the product is first sold in the domestic market, then exported and then foreign investment takes place from the country of invention to low-cost production center. In the era of economic globalization under the WTO, when major trade and investments barriers have been abolished, such an assumption seems grossly unrealistic as firms may have presence across the globe.

(iii) The IPLC model gives the sequence that a product takes when it is launched. There are cases when a product fails even at the invention stage. Sometimes, a product is reinvented/reengineered at the maturity stage. Thus, the sequencing of various products may differ in different markets.

(iv) The IPLC theory does not make clear when exactly a product enters a different stage in the life cycle. The theory seems simple but the absence of a predictive model to decide the stage of the product in a country makes it difficult. Firms are unable to decide when a product has reached maturity or standardization and thus this hampers their decision matrix for expansion/withdrawal/switch-over, etc.

(v) Some scholars have argued that the IPLC theory is incomplete as it fails to establish the relationship between a firm and the country. The IPLC theory puts emphasis on the supply side of the product by discussing various stages. It does not consider the demand side, i.e., observed pattern of consumption of the product.

(vi) Vernon assumes that diffusion takes place from developed countries to developing countries but there are many empirical cases when it has taken place from developing country to developed countries. Vernon's assumption that firms from developed countries can sell older or obsolete product in developing countries may have been relevant during the 1960s but this is not true today. Consumers from developing countries today are equally informed about newer inventions and innovations of products and their uses. Firms also launch such products simultaneously in developed and developing countries as continuous technological breakthroughs has made the product life cycle much shorter than what it was during the 1960s when Vernon propounded this theory.

(vii) The assumption that a foreign market consists of only lower income consumers is not justified as such markets may have a section of affluent consumers who can afford the expensive newly invented products. India is an example of such a foreign market. Although India's per capita income is just $1500 but there are a lot of customers in India who can afford the most expensive newly invented products. For example, the iPhone was launched in India only a day after it was launched in the United States.

Check Your Progress

4. Who developed the factor proportions theory?
5. Why is the H-O model considered to be an improvement over Ricardo's theory?
6. Mention the stages of a product life cycle as given by Vernon.

3.4 TRADE BARRIERS OR TRADE PROTECTION

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The much-advocated free trade policy did not really exist in its form and content on a universal scale. For some political and economic reasons, most countries had adopted a restrictive or protectionist trade policy at some point in the history of their foreign trade. In fact, world market conditions were hardly ever as perfectly competitive as required by the models of free foreign trade. As economists have pointed out, world economic conditions 'reasonably approximated' to the world of theoretical models between 1860 and 1914, the year of outbreak of the First World War. Even during this period, tariffs existed in many countries (e.g., in France, Holland, Belgium, the United States and Germany), though at relatively lower rates. But free trade did exist for a short period on and off. For instance, there was a good deal of free trade between 1921 and 1928, the period between the First World War and the Great Depression of 1920–1934. It is important to note here that free trade itself created conditions for protective trade policy with the purpose of capturing a larger foreign market share. Capturing a larger market share had become a necessity of the developed countries because of their growing industrial output.

There was another big phase of trade protectionism. The disadvantages of free trade along with the disastrous consequences of World War II revived the economic nationalism on the one hand and protectionism on the other. Consequently, the trend in tariff reduction was reversed, and tariff has stayed as a fact of world economy. For the purpose of regulating foreign trade for protecting the country's interest in the foreign trade, tariff is one of the most important tools. By imposing tariffs, i.e., the levy on imports and exports, a country can influence the pattern, volume and direction of its trade with the rest of the world. The imposition of tariffs changes the relative price structure which, in its turn, changes the structure and pattern of trade between a country and the rest of the world. For example, if India wants to curb her imports of luxury goods that are cheaper even on a comparable quality basis, it will impose tariffs on imported luxury goods at a rate which can more than neutralize the price differences. As a result, Indian consumers would divert their demand from foreign to domestic goods. And, import of foreign luxury goods would decrease. But if even after the imposition of a 100 per cent tariff Japanese goods remain cheaper than domestic goods while other foreign goods become costlier, India's demand for foreign luxury goods will be diverted from other countries to Japanese goods. This is how tariffs change the direction of trade. An antithesis of tariff is subsidy. While tariffs tend to reduce the volume of international trade, subsidies increase the same.

Before we look into the arguments that have been put forward from time to time in favour of protected or controlled trade policy. Let's learn about the types of tariff and non-tariff barriers like Quotas.

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3.4.1 Types of Tariff and Non-Tariff Barriers Like Quotas

Tariff barriers are duties and taxes that are imposed on exportable and imported goods. Tariffs if imposed effectively can create obstacles for trade, although this is not necessarily the purpose of putting tariffs in place. The reasons for the imposition of tariffs are many. They range from revenue generation for the country, the prohibition of harmful products, discouraging imports for macro-economic reasons, providing protection to the domestic industry from foreign cost-effective goods. Various kinds of tariffs are imposed in order to serve different pre-determined purposes. For example, an ad valorem duty is imposed on an importer who has to pay a duty which is calculated as a percentage of the value of the goods being imported. If the price of goods increases, its import is discouraged as the amount of import duty payable also becomes high. Specific tariffs, on the other hand, are levied irrespective of the value of goods. In recent years, countries are imposing environmental tariffs in order to penalize nations which have poor environmental compliance records.

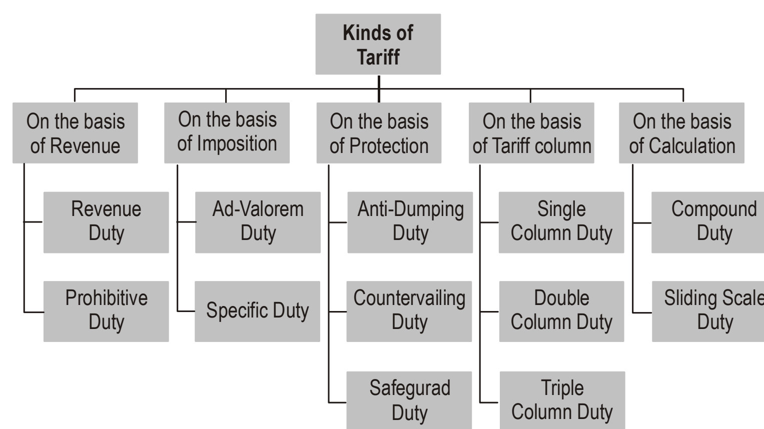

Fig. 3.8 *Kinds of Tariffs*

Non-Tariff Trade Barriers: Investment Barriers and Other Government Support Programmes

Non-tariff barriers are policy instruments aimed at restricting or prohibiting imports into the country. While tariff measures bring revenue to the government and makes imported goods expensive and priced out vis a vis domestic goods, providing protection to the domestic industry, Non-Tariff Barriers, on the other hand, restrict or prohibit imports, i.e., goods are not given import clearance. Tariff measures are transparent while non-tariff measures are sometimes imposed on flimsy grounds. There are various reasons and arguments given for the imposition of non-tariff barriers. These are listed in Figure 3.9.

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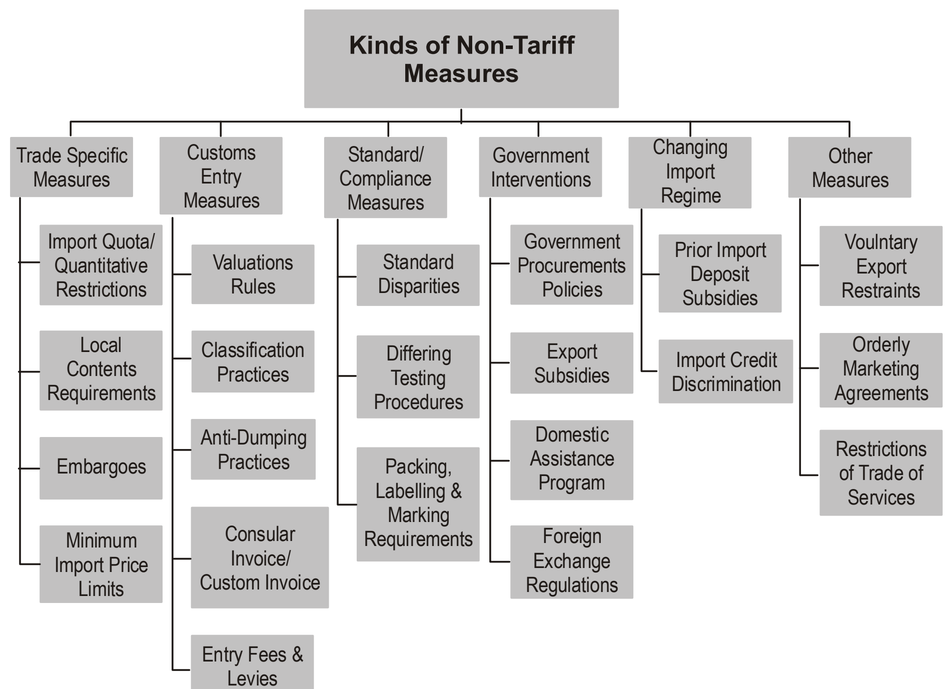

Fig. 3.9 *Kinds of Non-Tariff Measures*

Source: *Adapted from http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm9_e.htm*

We will only discuss quota and its types.

Import Quotas/Quantitative Restrictions: Quantitative restrictions/ import quota refers to restrictions imposed on the quantity or the value of a particular good to be imported. An importer has to take licenses/approvals from the country of import to clear his cargo from customs. A licensing authority issues only fixed quota of licenses beyond which goods cannot be imported at any cost. Under the WTO trade regime, import quota/quantitative restrictions have largely been abolished. The import quota system is further divided into the following sub segments:

a) **Unilateral Quota:** Government fixes the maximum permissible limit of goods to be imported without consulting with exporting countries.

b) **Tariff/Customs Quota:** Under this system, a country allows the importing of a product up to certain limits without duty or at a preferential duty or a normal duty. The country of import charges a higher rate of duty after the permissible limit is reached. This is similar to orderly marketing arrangements agreement.

c) **Bilateral Quota:** Under this system, participating countries fix the permissible limit of imports allowed into their country after consulting or negotiating with each other.

d) **Mixing Quota:** Under this system, manufacturers are obliged to use domestic raw materials up to a certain proportion in the finished product.

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3.4.2 Implication of Tariffs

Economists have put forward several arguments in favour of trade protection on different grounds. However, the important arguments in favour of trade protection are based on the following aspects.

i. Protection of infant industries from foreign competition
ii. Diversification of the industrial base of the country
iii. Promotion of employment
iv. Improving terms of trade or correcting adverse terms of trade
v. Protecting the domestic industry from dumping

These arguments are discussed here briefly.

(1) Infant-industry argument

An argument in favour of controlled trade was put forward to protect the infant industries of the country. This argument was first advanced in 1790 by Alexander Hamilton, the secretary of Treasury to the US President, George Washington. It was developed further by Fredrick List in 1840s as an argument for tariff protection to German industries which were then in their infancy. The argument was later supported by other orthodox economists like Mill, Marshall and Taussig. Incidentally, the economists who put forward the case for tariff protection to the infant industries were called 'free traders.'

The core of the argument is that in the initial stage of industrial growth of an economy, most industries are in their infancy, not mature enough to stand the competition from highly developed and well-established industries of the developed countries. The industries of the developed countries have achieved a high technical efficiency, economies of scale and financial strength. Infant industries exposed to the competition with the industries of highly developed nations would, therefore, run the risk of dying out in their infancy. The infant industries of the developing economies, therefore, need tariff protection until they achieve competitive strength. Tariff imposition on competing imported goods makes their prices comparable with that of products of infant industries in the domestic market, and thus, helps them survive and grow.

However, the tariff protection was recommended only for the period of infancy, to be withdrawn when the industry achieved the competitive strength. In fact, the idea was not to plead the case for controlled trade as a measure of economic development but to develop industries in the less developed countries with a view to widening the scope for international division of labour and promoting

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free trade. Thus, tariff was recommended as a short-run protective measure to help the infant industries grow to the competitive level.

The infant industry argument has a great deal of plausibility in it. History provides the evidence that tariff protection has helped industries in the various countries to grow strong enough to face international competition. But, there are larger evidences to show that industries provided with tariff protection could never come up to expectations and tariff shelter became a permanent feature for them. It is therefore suggested that tariff protection is warranted only, 'if the industry in question is clearly suited to the country's factor endowment, market prospects, and facilities for obtaining raw materials, and has enough potentialities to grow within a reasonably short period.'

(2) Diversification of industries

One of the earlier and famous arguments for tariff protection is based on the need for diversification of industries along with balanced growth of the economy in the long run. The argument for industrial diversification and balanced growth of the country is contrary to the theory of comparative advantages. The trade theory suggests that the countries should specialize in those industries in which they have a comparative advantage. Naturally, most countries would specialize in a narrow range of industries and depend on foreign countries for the rest of their requirements. The specialization theory would possibly work in the best interest of the world economy only under the following conditions.

- Peace prevails in the world and no major wars take place.
- World economy remains stable, i.e., economic upheavals, like the Great Depression of 1930s, do not occur.
- There is no political or economic rivalry between the nations except for fair economic competition.
- There is no economic integration or formation of trade groups.

Two questions arise here: What are the options if these conditions do not exist? And, if a major world war breaks out or the Great Depression of 1930s repeats itself and trade channels and economic relations are disrupted, what would be fate of economically dependent countries? The answer is such economies will be completely shattered.

The world has had such an experience during the period between the two World Wars. Countries like Australia, Argentina, Mexico and Chile, having a high degree of specialization in foodstuffs and raw materials, have suffered a great deal.

It is, therefore, in the best interest of the nations to secure their economy against the world economic disruption by setting out for a fairly balanced growth and for a reasonable degree of self-reliance. This can be achieved by providing

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tariff protection to the sectors that have potentialities to achieve a reasonable level of growth under protection. Latin American economists also suggested the use of tariffs against the growth of the 'mono-culture' of industrial growth. Many Canadians plead for autarky even at the cost of 5–10 per cent reduction in their standard of living.

Although the industrial diversification argument has a strong popular appeal, it does not make a general case of tariff protection. It applies only to the highly specialized economies dependent on developed countries for their imports. Besides, for this argument to be applicable, the cost of protection should not prove to be prohibitive. In certain isolated cases, however the infant-industry argument may be more plausible. But the problem of securing economy against war and depression should then be solved through some other measures.

(3) Promotion of employment

Tariff protection is also suggested as an effective remedy for the serious unemployment problem of the countries with surplus labour and facing the unemployment problem like the one the world had experienced during the 1930s. Imposition of tariff on the imports reduces the quantity of imports and encourages domestic production. Efforts to increase production directly help to expand employment opportunities in the import-competing industries by securing the domestic market for them. The employment effect of tariffs does not remain confined only to the protected industries but also it spreads to their ancillary industries and to other industries through the general growth effect.

Limitations

The tariff as a measure of employment promotion has, however, certain serious limitations.

- Employment creation through tariff protections is based on an implicit assumption that the exports of the country will not be affected, or that other countries will continue to import as much as they used to before the tariff imposition. In general, however, the affected countries do impose retaliatory tariffs on their imports. This neutralizes the employment effect of tariff protection.
- Even if other countries do not take retaliatory steps, the efficacy of tariff protection is even otherwise doubtful because the tariff levied on imports reduces the exports of the tariff-affected countries. A fall in their exports tends to reduce their production and imports. A corresponding fall in production in tariff imposing country negates the employment effect of tariff production. It is in this way that the employment effect of tariff protection may get counterbalanced with unemployment generation in the export sector.
- Employment creation through tariff protection can involve a permanent reallocation of resources which may result in a temporary gain but permanent malallocation of resources affecting employment adversely.

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- If the growth potentials of the protected industries are not fairly large and self sustaining, tariffs may not only become a permanent feature but would also yield only a marginal gain in terms of additional employment.
- Tariff may be an effective measure to promote employment only if the unemployment problem is confined to a few countries only, but not if the unemployment problem is a global phenomenon.

(4) Improving the terms of trade

A case for tariff is also built on the grounds that it improves the terms of trade. Tariff imposition reduces imports of foreign goods, disturbing the demand and supply conditions in the exporting countries. Their overall supply exceeds the overall demand and, therefore, the prices of their exports go down. Price reduction abroad turns the terms of trade in favour of the tariff-imposing country.

But the effectiveness of this measure depends on the elasticity of supply in the exporting country. If the supply is highly elastic, the prices may not be affected at all. Besides, such a measure has always a possibility of being retaliated by the affected countries. In case of retaliation, the terms of trade are reverted back to its earlier level. The net result may be loss of consumer's satisfaction and worsened allocation of resources. It is, therefore, suggested that if at all necessary, an optimal tariff should be used instead of a prohibitive one.

(5) Anti-dumping tariff

Dumping means exporting goods to foreign countries at a price lower than the price charged in the domestic market. There is a strong case for tariffs against dumping by the exporting countries. In case exporting countries indulge in dumping, the importing countries may take recourse to tariff protection. Dumping is a practice of setting the price of their products in the foreign markets much lower than that in the domestic market with a view to destroying the potential competition. Tariff can be used to neutralize the effect of dumping on the domestic industries.

The validity of this argument is, however, limited to the cases of intermittent and short-run dumping which can be most disturbing since it causes short-term fluctuations, malallocation of resources and may sometimes even prove disastrous. This argument does not apply to the persistently continuing dumping based on discriminating monopoly pricing because in that case, the exporting country is capable of charging different prices because of varying elasticities of demand in domestic and foreign markets. It will be rather in the interest of the importing countries not to impose tariffs, as its people would be able to consume larger quantities of goods at lower prices.

Other arguments

In addition to these arguments for tariff protection, there exist other cases in the economic literature that have been put under the category of 'nonsense' or 'fallacious' arguments. Some of these arguments are based on: (i) tariff for keeping

money in the country; (ii) tariff for higher money wages; (iii) tariff against cheap labour argument; (iv) tariff protection of the home market; and (v) tariff for equalizing cost of production.

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Check Your Progress

8. What is the core of the infant-industry argument for trade protectionism?
9. Mention the sub-segments of the import quota system.

3.5 TYPES OF AGREEMENTS

In this section, you will learn about the concept of trade agreements in international trade. The major focus will be on General Agreement on Tariffs and Trade and World Trade Organization.

3.5.1 General Agreement on Tariffs and Trade (GATT)

Although the challenges confronting developing countries primarily concern domestic policies and institutions, trade policies—narrowly defined—are still important in today's international economic landscape.

The General Agreement on Tariffs and Trade (GATT) was the outcome of the failure of the negotiating governments to create an International Trade Organization (ITO) following World War II. Negotiations on the charter of such an organization were concluded successfully in Havana in 1948, but the talks did not lead to the establishment of ITO because the US Congress was expected to refuse to ratify the agreement. Meanwhile, GATT was negotiated in 1947 by twenty-three countries—twelve industrial and eleven developing countries—before the ITO negotiations were concluded. As the ITO never came into being, GATT was the only concrete result of the negotiations.

GATT was a multilateral treaty laid down on agreed rules for conducting international trade. Since 1947, GATT has been the major focal point for the governments of industrial countries seeking to lower trade barriers. Although GATT was initially largely limited to a tariff agreement, over time and as average tariff levels fell, it increasingly came to concentrate on non-tariff trade policies and domestic policies that have an impact on trade. By the end of the Uruguay Round in 1944, 128 countries had joined GATT. Its basic aim was to liberalize trade and for forty-seven years it had been concerned with negotiating the reduction of trade barriers and with international trade relations. Overseeing the application of its rules is an important and continuing part of its activities.

Trade Negotiations under GATT

Eight major trade negotiations have taken place under the auspices of GATT. As a result of these negotiations, the tariff rates for thousands of items entering into the world commerce were reduced, or bound against increase. The Kennedy

Round negotiations alone reduced the average level of the world industrial tariffs by about one-third. The Tokyo Round negotiations produced some comprehensive agreements on tariff and non-tariff measures.

Non-Tariff Measures

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As the general level of tariffs declined in the post-World War II period, the distorting effects on world trade of non-tariff barriers became more pervasive. The Tokyo Round was different from earlier trade negotiations in as much as it sought to tackle the problem of these non-tariff barriers. The core of the Tokyo Round results consists of the binding agreements, or codes aimed at reducing and bringing these non-tariff measures under more effective international discipline.

Given its provisional nature and limited field of action, the success of GATT in promoting and securing the liberalization of world trade in over forty-seven years is incontestable. Continual reductions in industrial tariffs from an average of 40 per cent to less than 4 per cent alone helped achieve high growth rates in world trade—around 8 per cent a year on an average—during the 1950s and 1960s.

The rush of new members during the Uruguay Round demonstrated that the multi- lateral trading system, as then represented by GATT, was recognized as an anchor for development and an instrument of economic and trade reform.

A whole corpus of jurisprudence on trade matters evolved under the aegis of GATT. The WTO is, in large measure, built upon the strong foundation provided by GATT.

3.5.2 Functions and Objectives of WTO

The World Trade Organization (WTO) was established on 1 January 1995. The WTO is the embodiment of the Uruguay Round results and the successor to GATT. Seventy-six Governments became members of WTO on its first day. By December 2000, there were 142 members, thirty-four countries have observer status and there is a waiting list of twenty-eight members. Together they account for more than 90 per cent of the world trade. WTO administers the trade agreements negotiated by its members, in particular the General Agreements on Trade and Services (GATS), and Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreements. WTO builds on the organizational structure that had developed under GATT in the early 1990s.

The essential functions of WTO include:

(i) Administering and implementing the multilateral and plurilateral trade agreements which together make up WTO

(ii) Acting as a forum for multilateral trade negotiations

(iii) Seeking to resolve trade disputes

(iv) Overseeing national trade policies

(v) Cooperating with other international institutions involved in global policy making

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From GATT to WTO

During more than four decades of its existence, the GATT system expanded to include many countries. It evolved into a de facto world trade organization, but one that was increasingly fragmented as 'side agreements' or codes were negotiated among subsets of countries. It is a fairly complex and carefully crafted legal text which was extended or modified by numerous supplementary provisions. Until the Uruguay Round, however, no progress was made on agriculture, textiles and clothing. What finally allowed these sectors to be subjected to multilateral discipline was the establishment of rules for trade in services and enforcement of intellectual property rights (IPRs), as well as the creation of WTO. There are many differences between GATT and WTO, but the basic principles remain the same.

Basic Principles of WTO

WTO establishes a framework for trade policies; it does not define or specify outcomes. It is concerned with setting the rules of the trade policy game, not with the results of the game. For almost fifty years, key provisions of GATT outlawed discrimination among members and between imported and domestically produced merchandise. About forty councils, committees, subcommittees, bodies and standing groups or working parties functioned under WTO auspices in 2000, more than twice the number under GATT. Such bodies are open to all WTO members, but generally only the more important trading nations regularly send representatives for the meetings. The degree of participation reflects a mix of national interests and resource constraints. The least developed countries, in particular, tend not to be represented at these meetings; often they do not have delegations based in Geneva.

Five principles are of particular importance in understanding both the pre-1994 GATT and WTO: non-discrimination, reciprocity, enforceable commitments, transparency and safety valves.

3.5.3 Implication of WTO on International Marketing

World trade is defined as an agreement between two or more countries that operate their business in different part of the world. The business is done by importing and exporting of goods and services irrespective of the national boundaries.

International trade is possible because of five elements which are mentioned below

i. The agreement over sale of items
ii. The agreement over carriage of items
iii. The agreement over insurance
iv. the consent from the export and import authorities to fulfil legal formalities
v. The mode of payment as agreed upon by the buyer and the seller.

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The World Trade Organisation (WTO) regulates the international trade formulates tariffs globally and resolves conflicts among the member countries. the role of WTO in international marketing can be understood by the various functions of WTO. You were briefly introduced to these in the previous section, let's recapitulate the functions in terms of international marketing:

i. WTO facilitates the implementation, administration and operation of the agreement and also of the multilateral trade agreements between the nations. It also provides the Framework for the implementation, administration and operation of the multilateral trade agreements.

ii. WTO provides a forum for negotiations among the member countries concerning their multilateral trade relations in matters dealt with under the agreement

iii. WTO administers the understanding on rules and procedures governing the settlement of disputes.

iv. WTO administers trade policy review mechanism

v. WTO cooperates with International Monetary Fund (IMF) and with International Bank Of Reconstruction And Development (IBRD) and its affiliate agencies with an aim to achieve greater consistency in global economic policy making.

Apart from these WTO also helps in maintaining peaceful transboundary trade and it also helps in resolving the conflicts among participating countries. international trade cannot be imagined without the presence of WTO. All the participating nations are bound to abide by the protocols set by the WTO.

Being the only international organisation that deals with global rules of trade between nations, World Trade Organisation provides a framework for the conduct of international trade of goods and services. WTO specifies the rights and duties of the governments in the form of the set of multilateral agreements. In addition to the goods and services, it also covers a wide range of issues related to international trade, such as protection of intellectual property rights and dispute settlements. WTO also prescribes disciplines for governments in formulation of rules procedures and practices in these areas.

It also imposes discipline at the firm level in certain areas such as setting export prices at unusually low levels.

Thus, the basic objective of the system of international trade under the WTO is to ensure that international markets are open and their access is not interrupted by the abrupt and random imposition of import restrictions. As part of the Uruguay round the Governments of all the member countries have agreed upon improved access to markets of the member countries so that business enterprises are able to convert the concessions of trade into new business opportunities.

The emerging legal systems ensures not just the conferring of benefits on manufacturing industries and business enterprises but also it has to ensure creation

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of rights in their favour. The WTO also covers areas such as valuation of custom, pre shipment inspection services and import licensing procedures where in the emphasis has been laid on the transparency of the procedures so as to restrain their use as non-tariff barriers and other such matters which are of considerable interest to international business firms. The agreement also specifies rights of exporters and domestic procedures to initiate actions against dumping of foreign goods. The international business manager must develop a systematic knowledge of new opportunities and challenges of the multilateral trading system under the WTO.

3.5.4 India's Role in International Trade Theories

India is presently one of the most important players in the global economic scenario. The trade policies and the government reforms and inherent economics trends have attributed to its standing as one of the best destinations for foreign investments in the world. The technological and infrastructural development carried out across the country is also favouring the trade and economic sector in the years to come. The Government of India has been working on striking important deals with Governments of other nations like Japan, Australia and China to increase contribution towards the economic development of the country as well as growth in the global markets.

The total export from India stood at US $ 528.45 billion in the year 2019-20 while total import was estimated at US $ 598.61 billion according to the data from the Ministry of Commerce and Industry.

The estimated value of service sector export and import for the year 2019-20 stood at US $ 214.14 billion and US $ 131.4 1 billion respectively.

In the year 2020-21(till July 2020), the total export figures from India stood at US$ 141.82 billion and the total import was estimated at US $ 127.76 billion as per data from the Ministry Of Commerce and Industry.

India as well as the Government is keen to develop export sector so as to engage its young, well-educated and talented population. The aim is also to provide a global platform for locally produced goods.

Check Your Progress

10. What was GATT an outcome of?
11. When was the WTO established?

3.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The mercantilist theory of international trade is based on the principal assertion that government control of foreign trade is of paramount importance for ensuring the prosperity and military security of the state.

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2. Adam Smith in his magnus opus *The Wealth of Nations* (1776) attacked the theory of mercantilism and argued that countries differ in their ability to produce goods and services efficiently due to a variety of reasons.
3. Ricardo's theory was an improvement on the absolute cost advantage theory as it stated that trade occurs because of comparative cost advantage not absolute cost advantage.
4. The factor endowment theory was developed in the beginning of 20th century by two Swedish economists named Eli Heckscher and Bertil Ohlin. This theory was also known as the 'Factor Proportions Theory' but a majority of contemporary authors calls the theory either the 'Factor Endowment Theory' or the 'Heckscher-Ohlin Theory'.
5. The H-O model is an improvement on the classical theory particularly that of David Ricardo's comparative cost advantage theory, as it put the context and the rationale of the comparative cost advantage enjoyed by one country. Ricardo contended that comparative cost advantage was mainly due to the labour input difference while the H-O theory provided a wider and acceptable justification for comparative cost advantage which was due to not only labour but also on the account of other factor endowments such as an abundance of capital and land.
6. Vernon gives the following stages of a product life cycle:
   (a) New Product
   (b) Maturing Product
   (c) Standard Product
8. The core of the infant-industry argument is that in the initial stage of industrial growth of an economy, most industries are in their infancy, not mature enough to stand the competition from highly developed and well-established industries of the developed countries.
9. The import quota system in further divided into unilateral quota, tariff/customs quota, bilateral quota and mixing quota.
10. The General Agreement on Tariffs and Trade (GATT) was the outcome of the failure of the negotiating governments to create an International Trade Organization (ITO) following World War II.
11. The World Trade Organization (WTO) was established on 1 January 1995.

3.7 SUMMARY

- The mercantilist theory of international trade originated in England in the middle of the 16th century. The mercantilist theory of international trade is based on the principal assertion that government control of foreign trade is of paramount importance for ensuring the prosperity and military security of the state.

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- Adam Smith in his magnus opus *The Wealth of Nations* (1776) attacked the theory of mercantilism and argued that countries differ in their ability to produce goods and services efficiently due to a variety of reasons.
- According to David Ricardo, international trade occurs among countries as one country may enjoy a comparative cost advantage vis a vis another because countries differ in their stage of development and the resources that they endow. The very basis of international trade between countries is that they exchange goods and services in which they have comparative cost advantage with another country. This way, both countries gain from trade.
- The factor endowment theory was developed in the beginning of 20th century by two Swedish economists named Eli Heckscher and Bertil Ohlin. This theory was also known as the 'Factor Proportions Theory' but a majority of contemporary authors calls the theory either the 'Factor Endowment Theory' or the 'Heckscher-Ohlin Theory'.
- The Heckscher-Ohlin theory stresses that countries should produce and export those goods and services in which a country has abundant factor resources, i.e., land, labour and capital and should import those goods and services in which factor resources are scarce.
- New trade theory (NTT) suggests that a critical factor in determining international patterns of trade are the very substantial economies of scale and network effects that can occur in key industries.
- The International Product Life Cycle (IPLC) theory is a modern theory of international trade and was propounded by Raymond Vernon in 1966. Vernon wrote a series of essay explaining internationalization patterns of companies and organizations engaged in foreign trade.
- The much-advocated free trade policy did not really exist in its form and content on a universal scale. For some political and economic reasons, most countries had adopted a restrictive or protectionist trade policy at some point in the history of their foreign trade. In fact, world market conditions were hardly ever as perfectly competitive as required by the models of free foreign trade.
- GATT was a multilateral treaty laid down on agreed rules for conducting international trade. Since 1947, GATT has been the major focal point for the governments of industrial countries seeking to lower trade barriers.
- The World Trade Organization (WTO) was established on 1 January 1995. The WTO is the embodiment of the Uruguay Round results and the successor to GATT.
- During more than four decades of its existence, the GATT system expanded to include many countries. It evolved into a de facto world trade organization, but one that was increasingly fragmented as 'side agreements' or codes were negotiated among subsets of countries.

3.8 KEY WORDS

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- **International trade theories:** It help explain the characteristics of trade pattern of a trading country, and from those characteristics it can be deduced what, why, where and how countries actually trade.
- **GATT:** It was a multilateral treaty laid down on agreed rules for conducting international trade.

3.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the absolute cost advantage theory.
2. Why did Heckscher and Ohlin criticised the classical theories of international trade?
3. Briefly explain the New Trade Theory.
4. What is the country similarity theory?
5. List the different types of trade barriers.
6. Write a short note on GATT.
7. List the essential functions of the WTO.

Long-Answer Questions

1. Explain the mercantilist theory of international trade and criticisms against it.
2. Discuss the comparative cost theory and criticisms against it.
3. Assess the International Product Life Cycle theory.
4. Analyse the Arguments for Trade Protection.

3.10 FURTHER READINGS

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UNIT 4 INTERNATIONAL MARKET ENTRY STRATEGIES

NOTES

Structure

4.0 Introduction
4.1 Objectives
4.2 Basics of Different Entry Modes and Market Entry Strategies
4.3 Exporting
4.4 Contractual Agreements including Licensing
4.5 Franchising
4.6 Joint Ventures
4.7 Strategic Alliances
4.8 Wholly-owned Subsidiaries
4.9 Direct Investment and Manufacturing
4.10 Answers to Check Your Progress Questions
4.11 Summary
4.12 Key Words
4.13 Self Assessment Questions and Exercises
4.14 Further Readings

4.0 INTRODUCTION

Entering a foreign market is one of the most crucial decisions in international marketing. First impressions have a last impact on the customer and additionally and more importantly a lot of investment lies on the companies' backs. This is why market entry strategies need to be properly evaluated and analysed so that they match the companies' objectives and resources. In this unit, you will learn about the different entry modes and market entry strategies in international marketing.

4.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the different entry modes and market entry strategies
- Discuss the meaning of licensing and joint ventures
- Explain franchising in international markets
- Describe the concept of strategic alliances and wholly owned subsidiaries

4.2 BASICS OF DIFFERENT ENTRY MODES AND MARKET ENTRY STRATEGIES

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A firm, which would like to involve itself in international business, may look for its entry into the international market in several possible ways including exporting, licensing, franchising, or as a production firm with multinational plant locations. However, at any level of market entry the managerial trade-off lies between the extent of risk and operational control.

Low intensity modes of entry minimize risk, e.g., contracting with a local distributor requires no investment in the destination country market as the local distributor may own offices, have distribution facilities, sales personnel, or undertake marketing campaigns. Under the normal arrangement, whereby the distributor takes title to the goods or purchases them as they leave the production facility of the international company, there is not even a credit risk, assuming that the distributor has offered a letter of credit from his bank. At the same time, however, such an arrangement to enter a destination country may, while minimizing the risk factor, also minimize the control exercised by the international company, cutting it off from the information network. Operational controls can only be obtained through higher-intensity modes of market participation, involving investments in local executives, distribution, and marketing programmes.

Piggybacking

Many companies begin their internationalization opportunistically through a variety of arrangements that may be described as 'piggybacking', because they all involve taking advantage of a channel to an international market rather than selecting the country-market in a more conventional manner.

Exporting through existing services

Piggybacking is an interesting development. The method means that organizations with little exporting skill may use the services of one that has.

Bulk supply through consolidated orders

Another form is the consolidation of orders by a number of companies in order to take advantage of bulk buying. Normally such countries would be geographically adjacent or able to be served, say, on a common air route. The fertilizer manufacturers of Zimbabwe, for example, could piggyback with the South Africans for importing potassium from outside their respective countries. For example, the American breakfast cereal product Post, a leading US brand, entered the Mexican market via their subsidiary Kraft rather than direct from the US, thus leading to the rather odd situation of packs of breakfast cereals with English language packaging covered with stickers in Spanish.

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Supplying to varied locations

The most common form of piggybacking is to internationalize by serving a customer who is more international than the vendor firm. Thus, a customer requests an order, delivery or service in more than one country, and the supplier starts selling internationally in order to retain the customer, thereby increasing its penetration of the account. This is particularly common in the case of business-to-business companies and technology-oriented start-ups.

Go-to-market Strategy

The innovative concept of market entry strategy is based on moving with *consumer space* which indicates that foreign firms enter the destination market by developing adequate consumer awareness on the products and services prior to the launch. This strategy is followed largely by companies manufacturing fast-moving consumer goods and is termed as 'go-to-market' strategy. Go-to-market planning enables the firm to achieve higher margins, accelerated revenue growth and increased customer satisfaction through existing sales channels. An effective go-to-market strategy aligns products and services, processes, and partners with customers and markets to deliver brand promise, the desired customer experience, and tangible value. Go-to-market strategy services help technology suppliers overcome market challenges.

4.3 EXPORTING

A firm may organize indirect export through the intermediaries or export agents of the parent country. On the contrary, in direct exporting, foreign markets are reached by exporters through agents located outside their parent markets. Exporting is a low risk-low investment strategy wherein a company may minimize the risk of dealing internationally by exporting domestically manufactured products either by minimal response to inquiries or by systematic development of demand in foreign markets. Exporting activity requires small capital for a quick start. Exporting is also a good way to gain international experience. A major part of the overseas involvement of large firms is through export trade managed by the various channels involved in the process. The channels involved in direct and indirect exporting are listed in Table 4.1.

Table 4.1 *Export Channels*

Indirect Exporting	*Direct Exporting*
Broker	Representative
Manufacturer's Export Agent	Merchant Middlemen
Combination Export Manager	Company Sales Manager
Group Export Forum	Own Distribution Network
Domestic Middlemen	
Company-based Managers	

a. Indirect Exporting

Some companies, which occasionally carry out export activities, use the services of the **broker**. Brokers are the middlemen who bring buyers and sellers in contact for a negotiated commission or by charging a brokerage fee. They are just the trade facilitators and do not take the ownership of the product. These brokers operate in international markets independently and do not belong to any firm.

The **manufacturer's export agent (MEA)** may be an exclusive agent engaged by the firm to offer services as desired by the firm. MEAs are vested with the right to take marketing decisions on behalf of the firm, arrange negotiations and trade agreements and the delivery of the consignment to the buyer.

The Combination Export Manager (CEM) provides services over and above the broker and the MEA by way of taking over the entire export operations of a firm on a commission basis. The export operations involve a variety of activities like identifying the country, markets, analyzing consumer behaviour, product designing, technological improvements, competitive pricing, distribution, promotion, negotiations with the governments of countries, public relations and collecting marketing information.

Group export forums are associations of exporters who collectively manage exporting activities. These forums are recognized by the government of the parent country and provide admissible concessions on export activities like licensing, taxes and duties infrastructure.

Middlemen who have a base in the parent country of the exporting firm also function as one of the channels for indirect exports.

Company-based managers are the salaried personnel of the exporting firm and possess the responsibility of total export management.

b. Direct exporting

In direct exporting activities, the firm appoints its own export **representatives** for conducting the export operations in the concerned markets or countries.

The **Merchant Middlemen** are a type of intermediary based in foreign markets. they buy products on their own and resell them to the identified countries functioning with substantial **sales managers**. They may also take up export activities without involving any indirect channel. Such offices may also be networked as an effective **distribution channel** for a region in order to cater to identify countries thereof.

Documentation

Firms opting to enter international markets through exporting activities may choose to engage the goods listed under **open general license** which does not involve a heavy documentation process. However, the goods that are not controlled, regulated or prohibited by other government departments need to be reported to

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customs prior to export by means of **export declaration**. On the contrary regardless of their value, export of all goods that are controlled, regulated, or prohibited need to be supported by valid **permits, licenses, or certificates** required by the government departments or agencies that regulate the export of these goods.

Direct exporting is independent exporting

A firm also opts for direct exporting as a platform to enter into the destination country. This approach is the most ambitious and difficult as the exporting firm handles every aspect of the exporting process independently, from market research and planning to foreign distribution and collections. Consequently, a significant commitment of management time and attention is required to achieve good results. However, this approach may lead to maximum profits, higher control and long-term growth.

4.4 CONTRACTUAL AGREEMENTS INCLUDING LICENSING

There are several types of contractual agreements including patent licensing agreement, turn-key operation, co-production agreement, management contract and licensing.

The **Patent Licensing Agreement** is based on either a fixed fee or a royalty-based agreement and delivering managerial training on manufacturing and quality control process. The plant construction, personnel training, and initial production run on a fixed-fee or cost-plus arrangement and are covered under the turn-key operation agreement.

The **Co-production Agreement** was a popular practice among the Soviet-bloc countries, where plants were built and then paid for with part of the output.

In the Middle East, the **Management Contract** requires that an MNC provide key personnel to operate the foreign enterprise for a fee until the locals acquire the ability to manage the business independently.

Licensing

This is one of the common tools of franchising a firm to set quality and operational control standards. It is, therefore, a contractual agreement too. In the past, multinational companies used licensing for many reasons. One of the major reasons could have been to use the trade mark of the company. Licensing may be understood as one of the varieties of contractual agreements whereby a multinational firm makes available intangible assets such as patents, trade secrets, know-how, trademarks, and the company name to foreign companies in return for royalties or other forms of payment. Transfer of these assets is usually accompanied by technical services to ensure their proper use. It also helps in regulating the import and export

operations of firms in such countries or regions where trade restrictions prohibit the movement of products.

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Advantages of Licensing**:**

- Licensing is a quick and easy entry tool with little capital investment in the foreign markets.
- Some countries offer licensing as the only means of tapping the market.
- Licensing is also considered to be an effective tool for life extension of products during their stage of maturity in order of their life cycle.
- Licensing is a good alternative to start foreign production and marketing activity in a destination country which has economic inflation, shortages of skilled-labour, increasing domestic and foreign governmental regulation and restrictions, and severe international competition.
- Under the licensing arrangement periodic royalties are guaranteed, whereas shared income from investment fluctuates and remains risky.
- The company which has a strong domestic base can benefit through a licensing arrangement to develop customized products without expensive research.
- Licensing provides an alternative when exports are no longer profitable because of intense competition.
- Licensing can reduce transportation costs and help promote exports in non-competitive markets.
- One of the major advantages of licensing is the immunity over stringent political intervention as expropriation.

The economic liberalization policy envisages the de-licensing of goods and services (notified) for mutual business growth. Under contract manufacturing, a firm gets its products manufactured by an independent local firm as per the agreement. Such an export mechanism is chosen by firms typically where the marketing potential seems to be low and tariff walls high. Assembling involves the import of raw material and mechanical parts for manufacturing any product. Such an operation is usually labour intensive, despite high capital investment in business. This mode of entry into international marketing is advantageous in countries which do not impose heavy import duties and which encourage free exports. Assembling firms take the benefit of low wage rates by shifting labour intensive operations to the foreign market that results in a lower final price of the product. Largely, local laws of a country play a big role in the decision-making for setting up an assembling unit in a foreign country.

Technology Licensing Arrangement

Technology licensing is a contractual arrangement in which the licensor's patents, trademarks, service marks, copyrights, trade secrets, or other intellectual property

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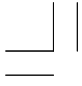
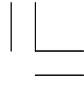
may be sold or made available to a licensee for compensation that is negotiated in advance between the parties. A technology licensing agreement usually enables a firm to enter a foreign market quickly, and poses fewer financial and legal risks than owning and operating a foreign manufacturing facility or participating in an overseas joint venture. In considering the licensing of technology, it is important to remember that foreign licensees may attempt to use the licensed technology to manufacture products in direct competition with the licensor or its other licensees.

4.5 FRANCHISING

Franchising is not a business in itself, but a way of doing business. It is essentially a marketing concept introducing an innovative method of manufacturing and distributing goods and services. Franchising is a business relationship in which the franchisor (the owner of the business providing the product or service) assigns to an independent entrepreneur (the franchisee) the legal right to manufacture, market and distribute the franchisor's goods or services using the brand name for an agreed period of time. The International Franchise Association defines franchising as a continuing relationship in which the franchisor provides a licensed privilege to do business, plus assistance in organizing training, merchandising and management in return for a consideration from the franchisee. Franchising has become popular because it allows a much greater degree of control over the marketing efforts in the foreign country. In franchising, product lines and customer services are standardized, two important features from a marketing perspective, though cultural differences might require adaptation. Franchising can offer people looking at self-employment a greater chance of success than starting their own businesses, but it is a path that many people are not aware is open to them. A franchisor's main ongoing commitment to his franchisees is to provide support. A support programme should be well defined prior to joining a given franchise group and is likely to cover areas such as staff issues, marketing and system compliance.

Four models of franchising:

- *Manufacturer-Retailer:* Where the retailer as the franchisee sells the franchisor's product directly to the public (e.g. Automobile dealerships).
- *Manufacturer-Wholesaler:* Where the franchisee manufactures and distributes the franchisor's product under license (e.g. Soft drink bottling arrangements).
- *Wholesaler-Retailer:* Where the retailer as the franchisee purchases products for retail sale from a franchisor wholesaler (e.g. Hardware equipment and automotive product stores).
- *Retailer-Retailer:* Where the franchisor markets a service, or a product, under a common name and standardized system, through a network of franchisees.

Product and trade name franchises

The first two categories cited above are often referred to as product and trade name franchises. These include arrangements in which franchisees are granted the right to distribute a manufacturer's product within a specified territory or at a specific location, generally with the use of the manufacturer's identifying name or trademark, in exchange for fees or royalties.

Business format franchise

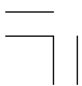
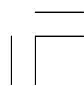
The business format franchise, however, differs from product and trade name franchises. This method implies the use of the franchisor's format, or a comprehensive system for the conduct of the business, including such elements as business planning, management system, location, appearance and image, and quality of goods.

There are many benefits of becoming a franchisee of which the major ones are listed below:

- The franchisor provides detailed consultation and training in operating the business as well as choosing locations for the business.
- The franchisee benefits from operating under the established brand image and reputation of the franchisor.
- The franchisees usually need less capital than they would if they were setting up a business independently because the franchisors, through their pilot operations and buying power, would have eliminated unnecessary expenses.
- The franchisor helps the franchisee obtain occupation rights to the trading location, comply with planning (zoning) laws, prepare plans for layouts, plan ergonomics and refurbishment, and provides general assistance in calculating the correct level and mix of stock for the opening launch of the business.
- The franchisee taps into the bulk purchasing power and negotiating capacity made available by the franchisor by virtue of the size of the franchised network.
- The franchisee has access to use of the franchisor's patents, trademarks, copyrights, trade secrets, and any secret processes or formulae.
- The franchisee has the benefit of the franchisor's continuous research and development programmes, which are designed to improve the business and keep it up-to-date and competitive.

Quality control is imperative

One of the drawbacks of franchising is the need for careful and continuous quality control. Such close supervision of the various aspects of distant operations requires well-developed global management systems and labour-intensive monitoring.

Inevitably, the relationship between the franchisor and franchisee must involve imposition of controls. These controls will regulate the quality of the service or products to be provided or sold by the franchisee to the consumer. As a lot of managerial skills are required, international franchising has been successful largely among those enterprises which have already had long experience with franchising at home.

Check Your Progress

1. What is the most common form of piggybacking?
2. List the channels of direct exporting.
3. What are the elements which are standardised in franchising?

4.6 JOINT VENTURES

A joint venture involves a partnership between two or more business firms interested in pooling their resources and expertise to achieve a common goal. The risks and rewards of the enterprise are also shared. The reasons for forming a joint venture may include business expansion, development of new products or moving into new markets, particularly overseas. The joint venture may offer more resources, increased capacity of production, enhanced technical expertise and established markets and distribution channels. Entry into an international market would be possible either as a wholly-owned subsidiary of any firm or as a joint venture. Joint ventures provide the best partner-like manner of obtaining foreign trade income when a firm chooses to begin a business relationship with a firm in the host country. The two partners could agree upon a contract setting out the terms and conditions of how this will work. Alternatively, joint ventures may be set up as a separate joint venture business, possibly a new company. A joint venture company can be a very flexible option wherein partners own substantial resources in the company, and agree on a managing strategy. Firms of any size can employ this concept to strengthen long-term relationships or to collaborate on short-term projects.

Benefits of a successful joint venture

- Access to new markets and distribution networks
- Increase in production capacity
- Risk sharing and controlling of process policies between business partners
- Working with specialized staff and technology

Pitfalls of joint ventures

Partnering in business may offer benefits but it can also be complex. It may take considerable time and effort to build the right relationship while operational problems may grow with the following ideological and functional discrepancies:

- The objectives of the venture are not clear and communicated among the partnering firms.
- There exists an imbalance in levels of expertise, investment or assets set into the venture by the different business partners.
- Coordination problems of cross-cultural issues and management styles affecting the functional integration and workplace co-operation.
- Lack of sufficient leadership and support in the early stages.

Cautionary steps

Success in a joint venture depends on thorough research and analysis of the aims and objectives. This should be followed up with effective communication of the business plan to everyone involved. International joint ventures are used in a wide variety of manufacturing, mining, and service industries and frequently involve technology licensing. The company looking for a joint venture invites foreign firms by issuing a regional or global invitation to share stock ownership in the new unit. However, the control of the unit depends on which company accepts a minority or a majority position. By and large, multinational companies prefer wholly-owned subsidiaries for effective control. A major potential drawback of joint ventures, especially in countries that limit foreign companies to minority participation, is the loss of effective managerial control. This can result in reduced profits, increased operating costs, inferior product quality, exposure to product liability, and environmental litigation and fines.

When firms decide to create a joint venture, the terms and conditions need to be set out in writing in a formal agreement, which should cover:

- the structure of the joint venture
- the objectives of the joint venture
- financial contributions, liabilities, distribution of profit, and other matters related to corporate finance and accounts
- protocol on transfer assets or employees in or out of the joint venture
- ownership of intellectual property created by the joint venture
- management and control of operational issues
- responsibilities, tasks and processes to be followed in production and operations activities
- protocol on managing liabilities, sharing of profits and losses
- policy and process of settlement of disputes between the partnering firms in the joint venture
- exit policies to bring the joint venture to an end, and cause and effect management at post-closure

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Global preferences

Smaller firms often want to access a larger partner's resources such as a strong distribution network, specialized employees, and financial resources. The larger company might benefit from working with a more flexible, innovative partner or simply from access to new products or intellectual property (IP). Joint ventures offer mutual advantages for domestic and foreign firms to operate in a global competitive business environment, sharing both capital and risk and by making use of mutual technical potentials. Japanese companies, for example, prefer entering into joint ventures with American firms as such arrangements help them to cross possible trade barriers. American firms, on the other hand, like to venture with Japanese firms to explore product innovation at low-cost Japanese manufacturing technology, and move fast to enter a wide Asian market. The joint venture in this ways helps both the international firms to utilize established channels and to outperform potentially tough competitors in respective countries.

A joint venture serves as a centre of resource appropriation and makes a foreign firm's entry into a new terrain easier than other modes. However, it should not be viewed as a handy vehicle to reap money without effort, interest or additional resources.

4.7 STRATEGIC ALLIANCES

Another way for a firm to enter into a foreign market is by creating a strategic alliance. A global strategic alliance is an agreement among two or more independent firms to cooperate for the purpose of achieving common goals such as a competitive advantage or customer value creation. Strategic partnerships may emerge in many forms including research and development consortiums, co-production alliances, co-marketing partnerships, cross-licensing and cross-equity arrangements. Such alliances do not result in the formation of a separate corporate entity; equity joint ventures form new strategic allies as legal entities to do specified business within given time limits. This strategy is more advantageous than a joint venture. In this process the business partners bring together the specific skills of production, marketing and control in order to maximize their profit and have a major stake in the international business scenario. Many organizations, particularly high-tech industries, have entered into strategic alliances with key players in the marketplace to maintain a competitive advantage. Strategic alliances are partial mergers, but have a comprehensive impact on the performance of the firm. They involve mutual dependence and shared decision-making between two or more separate firms. There are some important types of alliance that can be set up for optimizing business. These are:

- Technology-based alliances
- Production-based alliances

- Distribution-based alliances
- Resource-based alliances

The emergence of strategic alliances in Canada and other industrialized countries are related to economies of scale or scope, resource pooling, and risk and cost sharing among alliance partners. They include globalization of the world economy, systemic techno-logical change, and the growing acceptance of the view that competition, by itself, does not necessarily ensure optimum, innovation-led growth. While international alliances provide firms with strategic flexibility, enabling them to respond to changing market conditions, they can also be effective paths for achieving a global scale in enterprise operations along with mergers and acquisitions and green field investment. The driving forces behind international strategic alliances include cost economizing in production and research and development, strengthening market presence, and accessing intangible assets. In the recent trends of globalization, the practice of entering the international market through such alliances seems to be gearing up along with political support from developing countries. However, the companies having a larger share in the international market still reserve the right to entertain or not, any such alliances.

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Advantages of strategic alliances

- Organizational efficiency improves with the flexibility and informality in strategic alliances.
- Alliances developed strategically offer access to new markets and technologies.
- The risks and expenses are shared among the allies, reducing the impact of risk on the participating members.
- The alliance helps the partners to build their independent brands and manage retailing of goods and services.
- Alliances can take various forms, from simple research and development deals to heavy budget projects.

4.8 WHOLLY-OWNED SUBSIDIARIES

Multinational companies also plan to enter into a new international market establishing themselves in overseas markets by direct investment in a manufacturing or assembly subsidiary company. In view of the frequently changing economic, social and political conditions globally, these wholly-owned subsidiaries are highly risk averse. A wholly-owned subsidiary in manufacturing can involve investment in a new manufacturing or assembly plant or the acquisition of an existing plant (such as Coca-Cola Company purchases local bottling plants in developing countries). The presence of actual manufacturing operations helps support marketing activities. As manufacturing is established abroad through direct investment, parts and components are often exported from the home country.

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Besides manufacturing subsidiaries, establishing a sales subsidiary requires relatively low levels of capital investment which leads to low risk.

The parent ventures, which are managed by wholly-owned subsidiaries, are more successful than shared management ventures, where both companies, parent and subsidiary, contribute on operational strategies. Problems often arise in shared situations because managers of international ventures have communication problems and different attitudes regarding time, job performance and the desirability of change. Firms become multinational companies by setting up manufacturing or marketing subsidiaries overseas and transferring knowledge, which embodies its advantage from one country to another. That is, knowledge flows from headquarters to overseas subsidiaries. Venturing is serious business, requiring skill, patience and entrepreneurial flair. Most new ventures involve entering unfamiliar markets, employing unfamiliar technology, and implementing an unfamiliar organizational structure. An approach of particular promise is the new-style joint venture, in which a small company with vigour, flexibility, and advanced technology joins forces with a large company with capital, marketing strength and distribution channels. In order to determine the fit between the parent company and its subsidiaries, corporate strategists should evaluate the operational areas which include the critical success factors of the business, the parenting opportunities in the business, organizational attributes of the parent company, and the financial results.

4.9 DIRECT INVESTMENT AND MANUFACTURING

The company entering the foreign market invests in foreign-based manufacturing facilities. The company commits maximum amount of capital and managerial efforts in this mode of entry. The company can acquire a foreign manufacturer or facility, or build a new facility. Direct investment means that the company has control and significant stake in its operations in other countries. The complete form of participation in foreign countries is 100 per cent ownership, which can be established as a start-up, or can be achieved by acquiring local companies. Acquisition of companies in foreign countries is a fast way to enter a new market. It provides the company ready access to a product portfolio, manufacturing facilities, customers, qualified employees, local management, knowledge about local conditions and contact with local authorities.

The only way to get a foothold in a saturated foreign market is to acquire a manufacturing unit in the foreign market – there would overcapacity if a new manufacturing facility were set up. But, the acquiring company may not like the way the manufacturing unit is being run, and may impose its systems and practices

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on the acquired company. In many countries, 100 per cent ownership by foreign companies may not be permitted due to government restrictions.

In direct investment, the foreign investor almost completely controls the enterprise, which it cannot do in licensing or joint ventures. It is able to prevent leakage of proprietary information. The company is able to avoid tariff and non-tariff barriers. Cost of distribution is lowered. Being based in the local market, the company is more sensitive to local tastes and preferences. It is also easier now to establish links with local distributors. It is now in a better position to strengthen ties with the government of the host country. But direct investment is expensive and risky. If the venture fails, the foreign investor loses lot of money. And it faces the risk of expropriation, however minimal.

Check Your Progress

4. State a major potential drawback of joint ventures.
5. Mention the driving forces behind international strategic alliances.
6. What are the types of wholly-owned subsidiaries in manufacturing?

4.10 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The most common form of piggybacking is to internationalize by serving a customer who is more international than the vendor firm.
2. Representative, merchant middleman, company sales manager and own distribution network are channels of direct exporting.
3. In franchising, product lines and customer services are standardized.
4. A major potential drawback of joint ventures, especially in countries that limit foreign companies to minority participation, is the loss of effective managerial control. This can result in reduced profits, increased operating costs, inferior product quality, exposure to product liability, and environmental litigation and fines.
5. The driving forces behind international strategic alliances include cost economizing in production and research and development, strengthening market presence, and accessing intangible assets.
6. A wholly-owned subsidiary in manufacturing can involve investment in a new manufacturing or assembly plant or the acquisition of an existing plant (such as Coca-Cola Company purchases local bottling plants in developing countries).

4.11 SUMMARY

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- A firm, which would like to involve itself in international business, may look for its entry into the international market in several possible ways including exporting, licensing, franchising, or as a production firm with multinational plant locations. However, at any level of market entry the managerial trade-off lies between the extent of risk and operational control.
- Low intensity modes of entry minimize risk, e.g., contracting with a local distributor requires no investment in the destination country market as the local distributor may own offices, have distribution facilities, sales personnel, or undertake marketing campaigns.
- Many companies begin their internationalization opportunistically through a variety of arrangements that may be described as 'piggybacking', because they all involve taking advantage of a channel to an international market rather than selecting the country-market in a more conventional manner.
- The innovative concept of market entry strategy is based on moving with consumer space which indicates that foreign firms enter the destination market by developing adequate consumer awareness on the products and services prior to the launch. This strategy is followed largely by companies manufacturing fast-moving consumer goods and is termed as 'go-to-market' strategy.
- A firm may organize indirect export through the intermediaries or export agents of the parent country. On the contrary, in direct exporting, foreign markets are reached by exporters through agents located outside their parent markets.
- Licensing is one of the common tools of franchising a firm to set quality and operational control standards. It is, therefore, a contractual agreement too. In the past, multinational companies used licensing for many reasons.
- Franchising has become popular because it allows a much greater degree of control over the marketing efforts in the foreign country. In franchising, product lines and customer services are standardized, two important features from a marketing perspective, though cultural differences might require adaptation.
- Joint venture involves a partnership between two or more business firms interested in pooling their resources and expertise to achieve a common goal. The risks and rewards of the enterprise are also shared. The reasons for forming a joint venture may include business expansion, development of new products or moving into new markets, particularly overseas. The joint venture may offer more resources, increased capacity of production, enhanced technical expertise and established markets and distribution channels.

- Another way for a firm to enter into a foreign market is by creating a strategic alliance. A global strategic alliance is an agreement among two or more independent firms to cooperate for the purpose of achieving common goals such as a competitive advantage or customer value creation.
- Multinational companies also plan to enter into a new international market establishing themselves in overseas markets by direct investment in a manufacturing or assembly subsidiary company.
- The company entering the foreign market invests in foreign-based manufacturing facilities. The company commits maximum amount of capital and managerial efforts in this mode of entry. The company can acquire a foreign manufacturer or facility, or build a new facility.

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4.12 KEY WORDS

- **Piggybacking:** It is a method in which organizations with little exporting skill may use the services of one that has.
- **Licensing**: It may be understood as one of the varieties of contractual agreements whereby a multinational firm makes available intangible assets such as patents, trade secrets, know-how, trademarks, and the company name to foreign companies in return for royalties or other forms of payment.
- **Franchising**: It is a business relationship in which the franchisor (the owner of the business providing the product or service) assigns to an independent entrepreneur (the franchisee) the legal right to manufacture, market and distribute the franchisor's goods or services using the brand name for an agreed period of time.
- **Joint venture:** It involves a partnership between two or more business firms interested in pooling their resources and expertise to achieve a common goal.
- **Strategic alliance:** It is an agreement among two or more independent firms to cooperate for the purpose of achieving common goals such as a competitive advantage or customer value creation.

4.13 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the low intensity modes of entry in international markets.
2. What are the types of exporting?
3. Briefly explain the concept of wholly-owned subsidiaries and direct investment.

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Long-Answer Questions

1. Explain the contractual agreement of licencing.
2. Discuss the concept, types, and drawbacks of franchising.
3. Describe the concepts of joint ventures, its benefits and other aspects.

4.14 FURTHER READINGS

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BLOCK - II
INTERNATIONAL MARKETING RESEARCH, PRODUCT, PRICING POLICIES

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UNIT 5 INTERNATIONAL MARKETING RESEARCH

Structure

5.0 Introduction
5.1 Objectives
5.2 Concept of Marketing Research
  5.2.1 International Marketing Research
  5.2.2 Need for Marketing Research
  5.2.3 Approach to Marketing Research
  5.2.4 Scope of International Marketing Research
5.3 International Marketing Research Process
5.4 Market Surveys
5.5 Marketing Information System
5.6 Answers to Check Your Progress Questions
5.7 Summary
5.8 Key Words
5.9 Self Assessment Questions and Exercises
5.10 Further Readings

5.0 INTRODUCTION

Information is one of the most important elements of international marketing process. Detailed information regarding varied factors of the market not only helps the company assess its own capabilities for launching in the market but also assists in being prepared better for any thing that might adversely affect its operations. But researching the markets internationally becomes a complex task because it not only makes the data collection difficult but also requires proper understanding of the other factors relevant to the nuances of the specific markets. In this unit, you will learn about the steps in the marketing research process. You will also learn about the ways of conducting marketing surveys along with a discussion on the marketing information system.

5.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the concept of marketing research

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- Discuss the use of marketing research
- Describe the factors that affect the way customers make decisions
- Examine the steps of conducting marketing research
- Discuss the concept and ways of marketing surveys
- Explain the marketing information system

5.2 CONCEPT OF MARKETING RESEARCH

According to *Philip Kotler*, 'Marketing research is the systematic design, collection, analysis and reporting of data, and finding a solution relevant to specific marketing situation facing the company'. Marketing research is undertaken to guide managers in their analysis, planning, implementation and control of programmes to satisfy customers and organizational goals.

In the words of *Blankenship* and *Doyle,* marketing research is the collection and interpretation of facts that help marketing management to get products more efficiently into the hands of the consumer. Market research encompasses all information pertinent to this task, all the appropriate techniques.

This definition emphasizes the role of marketing research as a tool helpful to the marketing management. This, however, is a narrow definition as it does not specifically include services.

American Marketing Association (AMA) defines marketing research as 'the systematic gathering, recording and analysis of data about problems relating to the marketing of goods and services.' It may be noted that the definition (i) deals with a wider concept of marketing research as it includes all aspects of the marketing of goods or services and (ii) emphasizes that the data must be collected in a systematic manner enhance objectivity. In fact, objectivity is the most important requisite for good research on any subject.

G. Zaltman and P.C. Burger have criticized the AMA's definition of marketing research on the grounds that it does not include the pre-research analysis which is necessary to ascertain the type of information that should be collected, recorded and analysed. They state,

> 'Marketing research involves the diagnosis of information needs and the selection of relevant interrelated variables about which valid and reliable information is gathered, recorded, and analysed.'

It is evident that this definition emphasizes the diagnostic aspect of the information need. However, it does not explicitly mention the area of marketing within which the nature of information needs to be ascertained.

P. E. Green and D. S. Tull have defined marketing research as, 'the systematic and objective search for and analysis of information relevant to the identification and solution of any problem in the field of marketing.' This definition lays emphasis

on the two requirements of good research, namely, systematic search and objectivity in the collection and analysis of data. The definition gives a wider ambit to marketing research.

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From the above definitions the following fundamental characteristics of marketing research can be derived:

- Marketing research is an objective and systematized body of knowledge.
- It involves collection, recording, analysis, interpretation and reporting of some relevant information.
- It provides more efficient marketing of goods and services to consumers. It is concerned with problems relating to products, markets and methods of sales and distribution.
- It deals with present and potential consumers as well as the changing market environment.
- It provides regular and reliable information about the product, its market and the potential consumer to the management so as to chalk out appropriate marketing strategy.
- There can be both intra and extra resources for collecting information.
- It provides information for decision-making and to develop new knowledge.
- Marketing research is an attempt to find justified solutions to marketing problems.

The information gathered by market research reduces the risk involved in marketing decisions. Marketing research is very useful in developing marketing strategies. It influences decisions on the pricing of the product and on channels of distribution, scale of advertising, etc. However, the information collected directly affects the planning of the product. For this reason, market research has been in great demand with firms making/marketing consumer goods, for example, confectionery, foodstuffs, cosmetics, soaps, etc. Marketing research is also used by firms producing branded goods and which are in competition with other brands. It helps them to know and maintain the popularity of their products among consumers.

5.2.1 International Marketing Research

The factors that affect the way customers make decisions are extremely complex. Since every person in the world is different, it is impossible to have simple rules that explain how buying decisions are made. Each customer approaches the process of decision making from a different angle. Marketing decisions depend on marketing information. This is widely accepted as essential in domestic marketing situations, but its collection and interpretation is problematic; thus it is less commonly used in international marketing. The sources used to acquire this information may be as simple as remembering information from past experience (i.e., memory) or the

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consumer may expend considerable effort to locate information from outside sources (e.g., Internet search, conversations with others, etc.). How much effort the consumer directs toward searching depends on such factors as the importance of satisfying the need, familiarity with available solutions, and the amount of time available to search. To appeal to consumers who are at the search stage, marketers should ensure that consumers can locate information related to their product. For example, for marketers whose customers rely on the Internet for information gathering, attaining high rankings in search engines has become a critical marketing objective.

International Marketing Research: An Introduction

Most international marketing decisions in international business are decided with the help of marketing research. Almost all tactical decisions require some amount of international market research. Researches have to be elaborate and effective for making any decision. However, the Internet can be good source for obtaining information that does not require validation of market. It is also a good source of doing a quick search. The Internet has emerged as a major source of providing the needed information for making decisions.

International marketing research facilitates marketers to make more informed decisions. International market research provides a clear picture of the market and based on the market situations marketers can tell what is occurring or what is likely to occur and offer alternatives from which choices can be made. An effective international market research may facilitate marketers in identifying multiple options for introducing new products /services or options of entering new markets. International marketing decisions may prove less risky if they are supported by market research.

However, marketers, especially in the international scenario, should be aware that marketing research is only one of the several tools for making marketing decisions.

5.2.2 Need for Marketing Research

Although conducting market research at the international level is important for gaining knowledge and for making marketing decisions, there is also the need to understand its limitations. All types of researches, whether for business, medical science, or the government are important for making decisions. There is also the risk that the results of these researches are wrong.

In one example, it has been noticed that between 1999 and 2002, many dot com companies failed because the information that was collected was not accurate and correct. This information was also not based on any scientific test. This happened because information was collected without the necessary controls. It has been observed in many cases that decisions may prove false and problematic if they are based on false/incorrect information. It is equally important to check if the sample sizes that many companies take in their surveys adequately cover most customers.

For obtaining the right and relevant results there is always the need to exercise strict control on how the information is collected. There are now many scientific methods that have been used in conducting market research. It is very important to know which method has been used to conduct research in international markets. But sometimes very structured and rigid controls may have a negative effect and, therefore, researchers should be very careful in adopting the right method to do the market research.

For example, in researches that require a sample of a large population of customers, it becomes difficult to control these kinds of sample sizes. Researchers should keep certain controls in place to define how many are in the sample as well as how the research is to be carried out (e.g., research design should be the same for all).

Large sample sizes result in an increase in cost and time. It is, therefore, essential to assess the benefits from the outcomes of the research in terms of the time and cost involved in carrying out the research. The trade-off for getting more relevant results is the increase in cost and time needed to carry out the research. So when it comes to doing research, marketers have to determine the balance between relevancy of the information obtained and the costs involved in carrying out the research.

A good market research is one whose results are strong indicators of what is happening now or might happen in the future. Results of a good market research should be relevant to the market situation.

Reassons to Undertake Market Research

There are three major reasons to undertake market research.

- ***Describe what is happening (Descriptive Research)***

  Descriptive research is a widely used approach of doing research on the international market. This is also the most popular form of market research in international markets. Descriptive research focuses on providing an accurate description and/or explanation for something that is happening in the market. For example, 'What segments/age groups are buying a particular brand?', 'What is a product's market share in a specific geographic region?', 'How many competitors is the company facing?' are some of the issues dealt with in descriptive research'.

- ***Exploratory Research: Examine something that is mostly unknown***

  To gain an insight into any issue, marketers do exploratory research. The basic difference between exploratory and descriptive research is in the research design. The exploratory approach in a research is an attempt to get information about some topic that is not well understood by the marketer. For example, a marketer may know about a new Microsoft web programme and technology for e-marketing a product, but he may not know much about the technology. Exploratory research works well when the marketer

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does not have an understanding about the topic or the topic is new, and it is hard to pinpoint the research direction.

- ***Causal Research: See how something affects something else***

  In this form of research, the marketer establishes a relationship between dependent and independent variables. This approach is used to test and understand different marketing scenarios. This is also a process of conducting an experiment. The design of causal research is highly structured and controlled. This kind of design is required for conducting experiments so that other factors do not affect those being studied. If causal research is performed well, the marketer may be able to use results to forecast what might happen if the changes are made. But in assessing markets, this kind of research should be used cautiously.

5.2.3 Approach to Marketing Research

The international marketing managers need to consistently monitor the forces which affect their international operations and for this purpose they need an understanding of the approaches and procedures of international marketing research. International marketing research in itself is very complex.

The process for international marketing research involves the first step as defining the international research problem and the research objectives. The next step which follows is to describe the different research approaches.

In the international marketing research, the results of the marketing research can be used for analysing and assessing market characteristics and trends in international buyer behaviour, research can be carried out for international product research, international distribution research, international promotion research and as well as international pricing research. This is also known as the 4 Ps approach of marketing research.

Actually, there are several approaches to marketing research. These approaches include surveys observations and experimentation and each one of these requires proficiency in critical thinking and inductive logic.

- Survey research: survey research is used to collect information and opinions about a product.
- Observation research: observation research involves directly monitoring consumers buying pattern.
- Experimentation: measures cause effect relationship between the product buying and several other variables such as package design, brand name, logo design, price, offers and various other factors.

The next step involves the next step involves determining the sources of information which can be either secondary data based as well as primary data based.

Marketing research approaches to collect primary data can be qualitative research as well as quantitative research approaches.

- Qualitative Research: Qualitative research has been particularly useful as the first step in studying international marketing research and following methods are used to conduct qualitative research:
  a. Focus group
  b. observation

  The constraint in this type of research approaches that responses of the respondents are usually affected by culture and individuals may respond differently.

  Another primary data approach is quantitative research
- Quantitative Research: It is more structured research approach and involves descriptive research approach such a survey research or causal research approaches such as experimentation. Quantitative research is carried out with help of
  a. content analysis
  b. survey research and
  c. experimental research

The constraint in quantitative research approaches sometimes there might be infrastructural problems.

5.2.4 Scope of International Marketing Research

Marketing research is concerned with the factors that are directly involved in marketing of goods and services, and it includes the study of the effectiveness of the marketing-mix, advertising strategies, competition and consumer behaviour. It not only helps in formulating strategies suitable for market intervention but also guides in perspective planning by analyzing information for future projections. Marketing research is largely carried out on the basis of a consumer market survey, that is, conducted by administering structured schedules or questionnaires in person or mailing them to sample respondents, organizing syndicate discussions, pilot tests, etc. All medium and large-scale companies engaged in consumer products marketing invariably allocate 0.5 per cent to 2 per cent of their net sales resources for conducting marketing research for future planning. Most capital goods-oriented companies invest a larger share in conducting marketing research. There are many decisions that are based on marketing research (analyzed via quantified data collected on vital market indicators). These are:

Product-Market Decisions

- Identifying market characteristics
- Product-mix research

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- Determining product sustainability
- Innovative product range
- Preferential and profitable positioning of products
- Distribution analysis
- Pricing strategies impact analysis
- Product testing–pilot studies
- Market share analysis
- Short and long range forecasting for price and demand of the product
- Sales trend analysis
- Competition pattern
- Consumer-behaviour analysis in reference to price, product-mix and comparative advantages over other products
- Assessment of impact advertising, and
- Analysis of gender preferences of products, etc.

Country Decision

- Entry Decision
- Financial Risk
- Legal risk
- Opportunities
- Production and marketing costs

Today, marketing research is done scientifically using effective statistical techniques. Of these, questionnaire structuring, area sampling and trend analysis are widely adopted techniques in marketing research. An effective information system would make the marketing research a more analytical, fact finding and prolific decision-making exercise. The scope for marketing research is very wide and experimented with identifying potential markets as well as determining the marketing-mix. There are many typologies, argued over by the marketing research scholars. However, the generally accepted framework details the scope of marketing research on both markets and the marketing-mix. However, marketing research orientation shifts according to different typologies.

Motivational research is very significant, and it studies the psychographics or qualitative perspectives of customer lifestyles. This is a continuum of new skills and ideas that are accredited to marketing research concepts and practices. Marketing research thus makes important contributions to the management by supporting decision-making to set objectives, developing an action plan, executing the plan and controlling its performance.

Check Your Progress

1. State the reason why marketing research has been in great demand with firms making/marketing consumer goods.
2. Why is marketing research is less commonly used in international marketing?
3. Mention two methods of conducting qualitative research.

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5.3 INTERNATIONAL MARKETING RESEARCH PROCESS

Research agency is a company offering market research services to clients, comprising a group of researchers and an administrative infrastructure. An agency may offer qualitative research, quantitative research, or both, increasingly supplemented by consultancy services, workshop facilitation and so on. Agencies vary in size from one or two individuals to several hundred people, though qualitative specialist agencies tend to be at the smaller end of this range.

Steps in the Marketing Research Process

As you have already learnt in the previous section, marketing research has two distinct dimensions that are governed by the exploratory, descriptive and casual approaches. Exploratory studies are based on primary data pertaining to identified samples focusing on a set of objectives. Such studies are generally woven around a hypothesis and attempt to generate new ideas to serve the objectives of the research. Descriptive marketing research tries to describe the magnitude and direction of the problem and brings out the output for a logical debate on the marketing managers' floor. A research plan determining data sources, methodology, tools, and sample design and data collection methods needs to be formulated after setting objectives. The data collection process has to be initiated from primary or secondary or both sources, normally by administering a checklist and questionnaire. The data should then be subjected to an appropriate analysis in view of the set objectives and its findings are thereafter presented in a draft report. International marketing research is processed in the following steps:

Step 1

Determine Management Level

• Corporate • Regional • Local

Step 2

Determine Type of Marketing Research

• Decision • Strategic • Tactical

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Step 3

Determine Information Requirements

• Primary • Secondary • Participatory

Step 4

Develop Research Design

• Identify Problem • Evolve Sampling Design • Identify Variables

• Design Research Instrument

Step 5

Examine Data Banks

• Pooled Categorized Sources • Generic Sources • Commercial Sources

Step 6

Collect Data

• Personal Interviews • Mail Questionnaires • Focus Groups

Step 7

Update Data Bank

• Revalidate Data • Collect Most-recent Data • Prune Obsolete Information

Step 8

Analyze Data

• Use Statistical Analysis • Test Results • Adjust to Models

Step 9

Present Report

• Exhibit Results from Visuals • Illustrate the Analysis Results

• Develop Executive Summary • List action Points for Managers

• Derive Most Appropriate Inferences

Step 10

• Integrate Results and Recommendations into Management Decision-making

It is necessary for a firm to have a clear perception on the research objectives as it is the guiding tool for the entire process of market research. Let us assume a multinational marketer is interested in finding out the potential market for a brand of yogurt in England and Thailand. The problem definition in the two countries will have to be stated differently. In the United Kingdom, yogurt might be primarily perceived by the consumers as a healthful and relaxing product to be used prior to retiring. In Thailand, the research would determine if yogurt would be considered mainly as an energy food to start the day. After the problem has been defined, the necessary information may be found and method to obtain it must be determined.

In some cases, the study may be confined to secondary data, that is, published information that has been collected elsewhere. Such data may be available free (for example, government statistics), for a price (for example, syndicated research findings), or through restricted distribution sources (for example, trade association statistics). Making decisions about operating a business in any country specifically requires information pertaining to political, financial and legal indicators. Besides these, data related to infrastructure, duty and taxes and general economic variables of the country are also required to be analyzed. Identifying the risk factors associated with operating a country-specific business in the international order is also a prerequisite of international marketing research. The product specific data is required to assess the market potential and profitability with reference to a specific country or region. The primary data is collected from the earmarked sample that also administers a questionnaire in person or through mail. However, it has been observed that mailing responses are often discouraging and do not exceed 20 per cent of the sample size. The secondary sources of data are the published statistics in internal reports, government publications, periodicals, books and commercial sources (like reports of the chamber of commerce, trade associations, quoted data from earlier research work, etc.) The methodology of study comprises identifying data sources, research approaches, tools, sampling design and data collection methods. This forms the principal component of a research plan.

An observation research approach is commonly used for formulating descriptive marketing research plans. The focus-group and participatory approaches are useful exercises for exploratory marketing research that do not have complete perspective results. The survey method has proved to be an effective research approach for exploratory studies for analyzing data. This makes use of quantitative methods leading to a distinctive analysis of factors and future projections. Experimental research attempts to study the impact on the control group through different applications of business models, checks, reformative goals and qualitative/ quantitative analysis methods to draw results. This approach is identified as one of the most scientific methods in relating a research approach with its results. However, a good marketing research approach needs to be characterized by the following qualities:

- Scientific method
- Originality and creativity
- Potential to use multiple methods for cross checking the emerging results
- Interdependence on analytical models and data sets
- Cost of research

A marketing research plan should comprise these qualities for drawing effective results and for preparing a useful document to be used for optimizing business propositions in any situation.

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5.4 MARKET SURVEYS

For conducting market research in international markets market surveys are an efficient and cost-effective way. Following are three different ways:

- Online surveys
- Omnibus surveys
- Online focus group

Let's discuss these methods, one by one.

i. Online surveys

Online surveys are the most cost-effective market research method used till date. This is a methodology which has proven to be effective in case of international market research where respondents are spread across wide geographic area across the world.

An organisation can collect feedback from its target audience with ease and in a very short span of time. The data can easily be collected for various purposes such as the customers feedback or prospects feedback or intermediary feedback or maybe a general survey from the population it has very few logistics requirement and almost negligible human interaction.

This is comparatively easier to administer in comparison to focus group or phone surveys.

The online survey can be conducted using any online platform and just by drafting the survey questions and programming them into the online platform, one can easily collect the data, a lot of fieldwork and analysis is already done through that online platform which saves time of the researcher.

ii. Omnibus survey

Omnibus surveys are conducted in a similar manner as the online surveys. Omnibus surveys share similar advantages as that of the online surveys. Omnibus surveys are different from the online surveys in the sense that they cover several topics instead of just one such as the respondent may ask to answer about the choice of educational institutions in first question and the factors affecting this choice as the second question, while next question may seek information about their daily routine.

Omni bus service are conducted in this manner because they include different questions for different purposes and at one go people may ask about different things so that the respondent is not approached again and again.

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iii. Online focus group

Online focus group are relevant in the context of international market research. Unlike traditional focus group studies where participants visit a focus group facility to participate and answer questions about a product or a service or a brand and the sponsors of the study sit in a waiting room behind a one way mirror, the online focus groups have nothing in common. Online focus group interviews are conducted on any of the video conferencing platforms and online focus group team or market research team can easily access people far and wide specially in case of international marketing research.

5.5 MARKETING INFORMATION SYSTEM

Marketing information is formally gathered, stored, analyzed and distributed to managers in accordance with their informational needs at regular intervals on a planned basis.

The marketing information system is built upon an understanding of the informational needs of marketing, and it supplies that information when, where and how the managers require it. Data are derived from the marketing environment and transferred into information that marketing managers can use in their decision making.

MIS has four components:

i. Collection of data from internal sources on continuous basis

ii. Collection of data from internal sources on ad-hoc basis

iii. Scanning of environment

iv. Marketing research

Let's discuss these components in this section.

i. Collection of Data from Internal Sources on Continuous Basis

MIS converts financial and transactional data like revenue of a product, customer or a distribution channel into a form that can be used by the marketing department to formulate its strategy. This is done by disaggregating the database of sales and assigning it to products and customers. Information like allocation of discounts, promotional and transport costs to products and customers are stored in the MIS. The detailed description of transactions with the customers and the associated costs allow marketers to carry out analysis of their marketing activities.

MIS can also be used to monitor the performance of salespeople. MIS keeps record of the revenues that a salesperson has generated and the profit that he has earned on his revenues. It also keeps a record of visits and calls he has made, and new accounts he has opened. It also records the revenues and profits

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that a salesperson has generated on each of the products and the customers that have been assigned to him. Such information helps managers in guiding the efforts of the salesperson, so that he is able to achieve company's targets. For example, a salesperson may be generating most of his revenue from his existing customers, but the company might be more interested in acquiring new customers. Therefore, the salesperson has to be directed to make more calls and visit more new customers than existing ones.

ii. Collection of Data from Internal Sources on Ad-hoc Basis

The data of customer transactions and associated costs can also be used for specific purposes. Management may look at how sales have reacted to a price increase or change in advertising copy. Capturing data on MIS allows specific analysis to be conducted when needed.

iii. Scanning of Environment

Environmental analysis whereby economic, social, demographic, legal and technological forces are monitored, is part of MIS. Economic, social, demographic, legal and technological forces govern the context within which the company, its suppliers and distributors and its competitors operate. A company should have a team of experts to scan the environment on a regular basis so that the company is not caught unaware when a change in the environment threatens to impact the company's operations adversely. It acts on an early warning system, and gives the company time to prepare to face the new future. For example, a company may learn about the government's intention to enforce new pollution norms, and it may set in motion a process that enables it to meet the new norms when they are finally enforced. Another company may see demographic changes of younger customers and dual-income families as huge opportunities and may set in processes to design new products and services for them. Environmental scanning gives time to companies to tackle their threats and harness their opportunities

iv. Marketing Research

Marketing research is concerned with the provision of information about markets and reaction of these to various product, price, distribution and promotion actions. Marketing research helps in designing an appropriate marketing mix—each component of the market mix should correspond exactly with what the customers want to buy and how they want to buy, which only marketing research can reveal. There are two ways in which marketing research can be conducted:

- Data is collected from external sources on a continuous basis –television audience is monitored to find out the programmes they are watching, and consumer panels are formed to record household purchases over time.
- Data is collected from external sources on ad hoc basis—survey is conducted to find out why a product is not meeting its revenue goals; an advertisement is shown to prospective customers to find out its usefulness

in triggering purchase, and a survey is conducted to find out if a brand meets its customers' emotional need of exclusivity.

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Check Your Progress

4. How are omnibus surveys different from online surveys?
5. State the understanding based on which the marketing information system is built.

5.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The information collected in marketing research directly affects the planning of the product. For this reason, it has been in great demand with firms making/marketing consumer goods, for example, confectionery, foodstuffs, cosmetics, soaps, etc.
2. Marketing decisions depend on marketing information. This is widely accepted as essential in domestic marketing situations, but its collection and interpretation is problematic; thus it is less commonly used in international marketing.
3. Qualitative research has been particularly useful as the first step in studying international marketing research and following methods are used to conduct qualitative research:
   c. Focus group
   d. Observation
4. Omnibus surveys are different from the online surveys in the sense that they cover several topics instead of just one such as the respondent may ask to answer about the choice of educational institutions in first question and the factors affecting this choice as the second question, while next question may seek information about their daily routine.
5. The marketing information system is built upon an understanding of the informational needs of marketing, and it supplies that information when, where and how the managers require it.

5.7 SUMMARY

- According to *Philip Kotler*, 'Marketing research is the systematic design, collection, analysis and reporting of data, and finding a solution relevant to specific marketing situation facing the company'. Marketing research is undertaken to guide managers in their analysis, planning, implementation and control of programmes to satisfy customers and organizational goals.

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- Marketing research is descriptive, exploratory, evaluator, predictive, converts data into information, is a continuous process, draws heavily from different disciplines, etc.
- Marketing research is very useful in developing marketing strategies. It influences decisions on the pricing of the product and on channels of distribution, scale of advertising, etc.
- The factors that affect the way customers make decisions are extremely complex. Since every person in the world is different, it is impossible to have simple rules that explain how buying decisions are made. Each customer approaches the process of decision making from a different angle. Marketing decisions depend on marketing information.
- Most international marketing decisions in international business are decided with the help of marketing research. Almost all tactical decisions require some amount of international market research.
- Although conducting market research at the international level is important for gaining knowledge and for making marketing decisions, there is also the need to understand its limitations. All types of researches, whether for business, medical science, or the government are important for making decisions.
- The process for international marketing research involves the first step as defining the international research problem and the research objectives. The next step which follows is to describe the different research approaches.
- Marketing research is concerned with the factors that are directly involved in marketing of goods and services, and it includes the study of the effectiveness of the marketing-mix, advertising strategies, competition and consumer behaviour.
- For conducting market research in international markets market surveys are an efficient and cost-effective way. Following are three different ways:
  - o Online surveys
  - o Omnibus surveys
  - o Online focus group
- The marketing information system is built upon an understanding of the informational needs of marketing, and it supplies that information when, where and how the managers require it. Data are derived from the marketing environment and transferred into information that marketing managers can use in their decision making.

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5.8 KEY WORDS

- **Marketing:** It is a human activity directed at satisfying needs and wants through an exchange process.
- **Research:** It is a problem-solving activity. It is an endeavour to discover, and develop knowledge aiming for progress.

5.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on reasons to undertake international marketing research.
2. What are the approaches to international marketing research?
3. Mention the market decisions which are based on marketing research.
4. What are the qualities which characterise a good marketing research approach?

Long-Answer Questions

1. Describe the international marketing research process.
2. What are the different types of international market surveys?
3. Discuss the components of marketing information system.

5.10 FURTHER READINGS

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UNIT 6 INTERNATIONAL PRODUCT POLICY AND PLANNING

Structure

6.0 Introduction
6.1 Objectives
6.2 Products: National and International
  6.2.1 The New Product Development
6.3 International Product Planning
  6.3.1 Customization and Product Adoption and Standardization
  6.3.2 Product Planning
6.4 International Market Segmentation
6.5 Influences on Marketing Plan and Budget
6.6 International Product Marketing and Marketing of Services
6.7 Answers to Check Your Progress Questions
6.8 Summary
6.9 Key Words
6.10 Self Assessment Questions and Exercises
6.11 Further Readings

6.0 INTRODUCTION

Product are the crux of why international marketing operations begin. Companies while deciding to cater to the audience of the new geographical regions have to keep in mind the audience characteristics and market forces operational in the area to make sure that their products and services are suitable to the location. This requires a robust planning system. Companies have different product strategies available to them to successfully operate in varied international markets. Understanding market segmentation and its proper implementation is also crucial aspect of international marketing. In this unit, you will learn about the concept of product planning, different product strategies, market segmentation and marketing plan.

6.1 OBJECTIVES

After going through this unit, you will be able to:

- Describe the concept of national, international and global products
- Discuss the elements of new product planning
- Explain the debate between standardization and adaptation

- Examine the different product strategies
- Assess the concept of market segmentation
- Discuss the concept of marketing plan and planning for marketing of services

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6.2 PRODUCTS: NATIONAL AND INTERNATIONAL

We should start by distinguishing between national product, international product, global product and brands. *A national product* for a company is one which is offered in a single national market. National products are made when a global company caters to the preferences and needs of a particular country/market. For example, Coca-Cola developed a non-carbonated ginseng-flavoured beverage for sale only in Japan and a yellow carbonated flavoured drink called Pasturina to compete with Peru's favourite soft drink, Inca-Cola. Sony and other Japanese consumer electronics companies produce a variety of products which are sold only in Japan.

International products are designed for multinational regional markets. A good example of an international product is the EURO product offered throughout Europe but not in the rest of the world. Renault was for many years a EURO product. When Renault entered the Brazilian market, it became a multi-regional product and over time, it gradually became a global product.

Global products are made for global markets. A truly global product is offered in the Triad, in every world region and in countries at every stage of development. Portable personal sound systems or personal stereos are a category of global products; and Sony is a global brand (although Sony also makes national products as mentioned earlier). Some of the other major global products/brands are Marlboro, Coke, Mercedes, Samsung.

6.2.1 The New Product Development

New products have to be developed by companies with utmost care. It is necessary to understand and accommodate the needs of consumers, counter competitive threats, ensure availability of post sales services and take into account the cost of marketing the product. Despite the risks involved, however, new product development is essential and companies need to make continuous efforts to develop new products, in order to beat competitors.

Factors Obstructing Growth of New Products

- Limited creativity and paucity of new (and eminently useful) product ideas
- Fragmented markets
- Social, economic and technological limitations
- Government policies and restrictions

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- Cost effectiveness of the process of new product development
- Resource crisis at various levels in the process, extending from the state of product development to launching in the market
- Overly extended product development and launching time, and
- Short product life cycle—meaning either rapid technological obsolescence or being displaced by better copy-cat versions.

New Product Development Process

The companies should strengthen their marketing network simultaneously while launching the new products. It has been observed that the failure of new products is often due to the lack of organizational teamwork. Thus, it is required to inculcate team behaviour in developing the new products and popularizing them in the test market segments. The results of the test markets may be further tested in the larger segments. The process of new product development is exhibited in Figure 6.1.

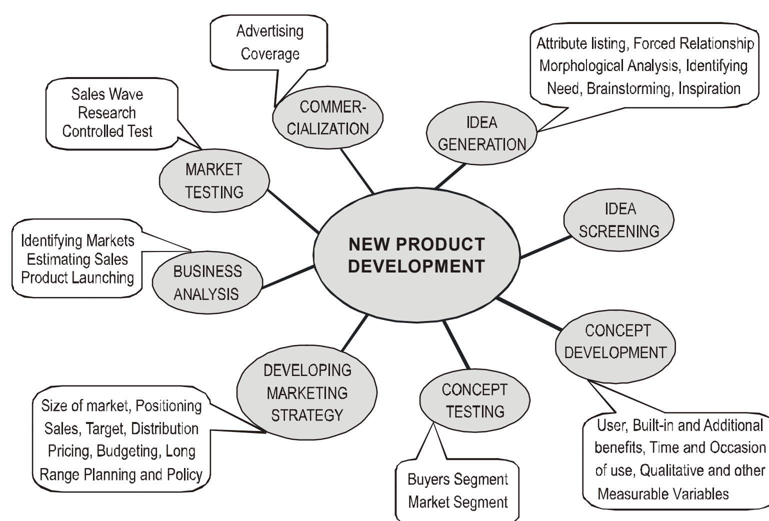

Fig. 6.1 *New Product Development Process*

It is essential that a company conducts brainstorming exercises for understanding the basic and secondary needs for the product, listing the product attributes, and identifying the forced relationship of other goods and services with the new product. Idea generation in the process of new product development is a major exercise. This technique calls for listing of all major attributes of the existing product and the needed attributes in order to improve the same product. The forced relationship of the new product with the existing accessories also need to be studied, e.g., developing a new television set may be related with the consumer need of a clock-cum-timer, multi-channel viewing on one screen, microphone attachment and a built-in video game.

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Such a forced relationship has to be identified by the company before launching the product. The morphological analysis calls for identifying the structural dimensions of a problem and examining the relationship among them. The need identification can be done by interacting with the potential and existing customers in a focus group meet. The industrial marketers can identify new product ideas working in association with the lead users of the product. However, brainstorming is also an important tool, which stimulates group creativity. In a brainstorming exercise, the following processes are developed:

- Welcome freewheeling and lateral ideas for better steering,
- Encourage maximum number of ideas and categorize their utility,
- Establish inter-relationship of ideas for an overall synergistic approach, and
- Understand that negative comments may be the stimuli for the birth of truly breakthrough ideas.

The basic purpose of this exercise is to generate a large number of ideas. These ideas need to be carefully screened in the interest of consumer satisfaction as well as the company's profit. In this process, the company should avoid the *Drop* and *Go* errors. The former attempts dismiss potentially good but undeveloped ideas, while the latter allows poorer ideas to move into the mainstream of commercialization. Hence the purpose of screening the idea needs to be understood carefully. It is advisable that every company develops its own idea-rating matrix on the basis of emerging ideas and their usefulness. Product ideas have to be turned into concepts, and product concepts can be turned into a brand concept. Concept testing calls for testing of these competing concepts with an appropriate group of target consumers. Concepts can be presented physically or symbolically. The consumers' response may be summarized and the strength of the concept may be judged across segments. The gap between consumer need and product performance may be checked, and modified thereafter. Such concept testing and product development methodology applies to any product or service. Business analysis includes sales projections as applicable to one-time purchase, frequently purchased or regularly purchased products. Estimates should also be made in relation to the tendency of first purchase, replacement purchase or repeat sales. Besides, the company should also assess the marketing costs and the profits from commercialising the product. The statement of such estimates may stretch across the regions, and years of sales (spatial and temporal) based on the following variables:

- Sales revenue
- Cost of the goods
- Gross margin
- Development costs
- Marketing costs

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- Allocated overheads
- Gross contribution
- Supplementary contribution
- Net contribution
- Discount contribution
- Cumulative discounted cash flow

The marketing testing can be done by using sales-wave research and controlled test marketing method. The sales wave research enables the company to estimate the repeat purchase rate where consumers spend their own money and choose this product over other competing brands. The controlled test marketing is conducted in a given territory of consumers across segments. Retailers and consumers in the vicinity thereof are identified and the consulting firm conducting research delivers the product to the selected outlets with total package of promotion. The responses of the consumers at the outlets can be collected in a structured questionnaire or fed directly in the computer. Such controlled test marketing allows the company to test the impact of retail response as well as the buying behaviour of the consumers. Commercialization of the product is a strategic decision in which the company should look into the appropriate time, market and consumer segment to launch the product. The company has to derive the geographical strategy with a keen eye on the crucial logistics administration. The time of launch of the product may be considered looking into three common choice—*maiden entry* or first look in the market, *parallel entry* with the similar or identical product of the competing brand and *late entry* when the firm delays positioning its product in the selected segment. The process of commercialising the product also prompts the adoption behaviour of the consumers. In conclusion there are five stages in the adoption process—awareness about the product, interest generated in using or adopting the product, evaluation of the product, trial of the product from the point of perceived use value and perceived price and final adoption of the product for use.

Check Your Progress

1. When is a national product for a company made?
2. What does the exercise of idea generation call for?
3. What are the aspects considered in the strategic decision of commercialization of the product?

6.3 INTERNATIONAL PRODUCT PLANNING

The main objective of all businesses is survival. Many companies have more aggressive objectives, such as growth, market share, profitability, etc. Company

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resources, such as finance and labour may restrict or encourage ambitions for company growth. All these factors influence whether and why companies choose to internationalize. In case of internationalization, there is also the need to do product planning as many companies like to introduce or simply like to extend their product and range of domestic market in the international market.

In reality, not all companies set out to be international. Experience suggests that many start with local markets, and some of these then develop into international markets, either proactively or reactively chasing opportunities in response to market leads. Others are set up as international concerns, or acquire companies with international operations.

Over time, some companies earn most of their income and or profit from outside their home markets. For example, Nike sells about 40 per cent of its goods outside the US. Overseas sales account for half of the business of its competitor Reebok.

In case of product planning there is always a trade-off between Standardization vs Customization approaches.

By mass-producing a standardized output, the firm can realize substantial unit cost reductions from experience curve and other scale economies. This planning can be applicable if consumers are similar in their tastes and preferences in countries where the company is introducing their products. But this approach can lead to failure if there are differences in consumer tastes and preferences. Thus, an international business's marketing function needs to determine when product standardization is appropriate and when it is not. Similarly, the firm's R&D function needs to develop globally standardized products when appropriate as well as products customized to local requirements when they are needed.

A critical aspect of the marketing function is identifying gaps. Developing new products requires R&D; thus the linkage between marketing and R&D. Specifically, new products should be developed with market needs in mind, and only marketing can define those needs for R&D personnel.

It is only through international marketing experience that firms can decide what kind of R&D is required to produce globally standardized or locally customized products. However, there is a close link between marketing and R&D. If there is a close link between R&D and product planning, then the success rate would also be high.

International product planning is derived from a company's global strategy, and built on its competitive scope and stance. There are various forms of global marketing strategies. Product planning can be done depending on the choices of global marketing strategy.

Generic product planning strategies can focus on all or some areas of the globe, and with all or some of the company's products. It does not seek to define specific strategies on a product-by-product or market-by-market basis. Rather it

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takes a 'macro' view examining the company's general global intentions. Jeannet and Hennessey (1998) define five options.

- **In case of complete globalization:** In this scenario, companies decide that all their businesses should compete globally, which is common with industrial companies like General Electric, Nokia and Siemens, which have customers throughout the world.
- **Selective globalization:** In this scenario, companies choose to target their foreign activity, and implement their global marketing activity by going global in selected product categories. For example, Coca-Cola has chosen not to sell its coffee drinks in all markets. Indeed, a few companies in consumer markets do offer all product lines in all the markets which they serve.
- **Regional specialization:** In this scenario, companies choose to focus on the key regions of the market. For example, for many years, Renault and Fiat focused on European markets.
- **Product niche specialization:** In this scenario, companies choose to globalize their strategy, but do not offer a wide range of products. In other words, they combine Porter's competitive strategy with a broad global reach. Many upmarket designer brands use this approach.
- **Unfocused globalization:** In this scenario, companies have no pattern of global development. They do not normally reflect a developed strategy, but rather reflect a piecemeal and opportunistic approach to development. Companies with a strategic mindset are unlikely to pursue this strategy.

Within these overall strategies, companies can choose between two other dimensions of global marketing strategy mentioned earlier—standardization and adaptation—within their chosen products and markets. At this stage, these strategies are "macro" in context—they reflect the "global" thinking, but not the local implementation.

Product Development Strategic Orientation

Some managers believe that the product is the most important element of a company's marketing mix, as it visibly represents the company in its markets. Indeed, Keegan stated that:

"To a very important degree, a company's products define its business. Every aspect of enterprise—including pricing, communication and distribution policies—must fit the product. A firm's customers and competitors are defined by the product it offers."

It could be argued that this is a product-focused, rather than a market-focused view of business. However, it reflects the reality for many businesses, especially in international markets where many work from the product out, seeking markets, rather than from the market in.

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Managing products in international markets build on the basic principles of managing products in domestic markets. These include the consideration of:

- Developing and launching new products
- Deciding which and how many products to offer
- Branding strategies for international markets
- Managing products over their life-cycles in different countries

Product development strategy is an approach to develop the framework to provide an orientation to a company's development projects as well as its development process. Out of so many strategies there is one strategy that can be adopted. Although nobody can say that the strategy that has been chosen is the right strategy for a company. But the selection of strategy should be done after taking into consideration the company's capabilities (strengths, weaknesses and core competencies), the competition's capabilities (strengths, weaknesses, core competencies and strategy), market needs and opportunities, goals and financial resources.

6.3.1 Customization and Product Adoption and Standardization

A product can have a bundle of attributes. For example, the attributes that make up a car include power, design, quality, performance, fuel consumption and comfort; the attributes of a hamburger include taste, texture and size; a hotel's attributes include atmosphere, quality, comfort, and service.

Products sell well when their attributes match consumer needs (and when their prices are appropriate). BMW cars sell well to people who have a high need for luxury, quality and performance, precisely because BMW build those attributes into its cars. If consumer needs were the same the world over, a firm could simply sell the same product worldwide. This is known as standardization.

Actually, however, consumer needs vary from country-to-country depending on culture and the level of economic development. In addition, a firm's ability to sell the same product worldwide is further constrained by the differing product standards of countries. Therefore, companies go for customization as well as adaptation. The following are the major differences across countries that force companies to go for customization:

i. Cultural Differences

Countries differ along a whole range of dimensions including social structure, language, religion and education. These differences have important implications for product development.

Culture differs in values and attitudes. For example, "hamburgers" do not sell well in Islamic countries, where Islamic law forbids the consumption of ham. The most important aspect of countries' cultural differences is probably the impact of tradition. Tradition is particularly important in foodstuffs and beverages.

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ii. Economic Differences

Just as important as differences in culture are differences in the level of economic development. Economic evaluation is complex. Some countries initially appear attractive, in terms of GNP per-capita and economic growth potential, but have large foreign debts.

The level of economic development of a country influences consumer behaviour. Firms based in highly developed countries such as the US tend to build extra performance attributes into their products.

Consumers in less-developed nations, where the preference is for more basic products, do not usually demand these extra attributes.

Consumers in the most advanced countries often shun globally standardized products that have been developed with the lowest common denominator in mind. They are willing to pay more for products that have additional features and attributes customized to their tastes and preferences.

Standardization Adaptation

A final element of global marketing activity is often stated to be the coordination of activities between different markets. Global firms seek to exploit (or leverage) strengths across different markets. They will not necessarily base their operations in the home country, but will choose the most appropriate place for their key activities. While local decisions may still be made on a market-by-market basis, there will be some coordination of these activities.

Through the management of these areas, global firms seek to gain competitive advantage in the marketplace. Thus, global marketing is often defined as being about:

- Scope (geography or size of markets)
- Coordination (transfer of knowledge, strategy, resources, etc.)
- Competitive advantage

Making effective international marketing decisions will actively consider all these elements. Internationally, good marketing management is about improving the company performance. Sadly, some companies operating internationally do not optimize their potential returns. They could benefit from more effective management of their international marketing activities.

What is ‘Standardization’?

The original Coca-Cola has a standardized name in global markets. McDonald’s has a common self-service operating system in international markets, and golden arches appear alongside the McDonald’s name in different languages. Clinique (Linique) cosmetics have a common positioning in international markets. IKEA has a standardized store format and core range. Marks and Spencer’s offer products from a standardized range. Intel chips are promoted consistently

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internationally, with the same logo and jingle. Cisco Systems' network routers are standardized, but able to work in all markets. Shell's aviation fuel must meet the international standards for this product in all their markets.

Finding the balance between standardization and adaptation is at the heart of effective international marketing decision-making. Companies with products which appeal to people in different international markets constantly have to review this balance. The cost issue benefits of standardization are important, but they must be balanced against local preferences.

What is 'Adaptation' or 'Customization'?

Products made and sold by Coca-Cola may have different names in different markets- Coca-Cola Light is called Diet Coke in the UK. In the case of other flavours, Fanta has different tastes and appearances in different markets and with different flavour options, such as with herbs in Germany. Also, Coca-Cola's Georgia coffee products are offered in some countries (such as Japan), but not in others (such as the UK). Their Minute Maid orange juice is available in supermarkets in the US, but harder to find in European retail markets, although it is commonly served on airlines.

Local adaptation of marketing activities can also create problems for marketers. People travel more and use international media or even seek information on the Internet. We watch global sports events, such as the Olympics or the World Cup. A company which presents its products and services in different ways will find that a lack of consistency confuses customers, or blocks the use of different media.

The extent to which marketing strategy and practice is standardized depends on a blend of three factors:

i. Market factors, including culture, lifestyles,income.
ii. Product factors, including the environment and legal influences on product use. Adaptation can be mandatory. For example, food, drugs and confectionery must meet Indian regulations and vice versa.
iii. Company factors, including the costs and returns from adaptation. Companies need to balance the benefits of standardization (the cost benefits and simplicity) against the likelihood of sales being increased if they modify the marketing activities to meet local needs more closely.

Reconciling global market strategy with standardization and adaptation confuses many people. Is Coca-Cola a global product, when it amends packaging for different markets? Cola-Cola has a global strategy but global products can be adapted locally within a consistent global strategy. So, the view of a global product as being one version of a product offered internationally is not correct.

International Marketing and the International Marketing Mix

Product or brand positioning is delivered through the marketing mix in both domestic and international markets. Marketing mix approach focuses specifically on four

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main elements—products, price, place and promotion—which are especially important in, or unique to, international marketing.

The central issue in managing the marketing mix is the extent to which the marketing mix should be standardized. Standardization may have many advantages for the company. Managers make standardization and adaptation decisions in many marketing areas. It is difficult to generalize what will be adapted and what will be standardized. However, many managers consider there to be a continuum, as shown in Figure 6.2.

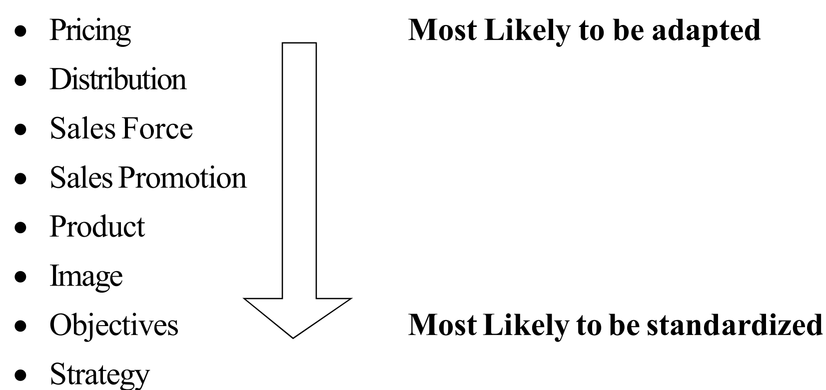

Fig. 6.2 *Extent to which Marketing Mix Can be Adapted or Standardized*

According to Figure 6.2, prices are most likely to be adapted, and strategy most likely to be standardized. Even gold and diamonds, which are essentially commodity products sold by quality, are likely to vary in price, from bazaars in Iran, to gold souks in Dubai, to Koenigsalle in Dusseldorf.

Product and Technical Standards

Standardization of global strategy (and other aspects of marketing activity) is more likely for industrial goods; consumer goods which are 'recent' development and consumer non-durables used or consumed outside the home (such as Coca-Cola or Lewis).

By contrast, those that are likely to be adapted are consumer non-durables, which are used in home. and consumer durables, which are linked to traditional values. So, kettles, coffee and sewing machines are likely to be adapted, but computers and videos are not. Food products in particular are likely to differ, as they reflect the cultural background.

Notwithstanding the forces that are creating some convergence of consumer tastes and preferences (at least among advanced, industrialized nations), Levitt's vision of global markets may still be a long way off due to national differences in product and technological standards.

Differing product standards mandated by governments can rule out mass production and marketing of a standardized product.

Differences in technical standards also constrain the globalization of markets. Some of these differences result from idiosyncratic decisions made at particular points in history, rather than government actions.

6.3.2 Product Planning

It is normally accepted that a product has achieved success when all investments made for its commercialization and development have been recovered and the product is still capable of providing satisfaction to consumers. The product must be capable of earning substantial revenues to recover the full investment that the company has put into it. The investments broadly include the cost of design, manufacturing and inventory, market research, sampling and logistics and physical distribution. The product manager has to ensure that the marketing programmes are designed to attain faster recovery of investments. It is rather impossible to enter the global market in the existing era of competition without proper product planning. The product launch must be carried out in an energetic and creative style with effective promotional packages. In planning for the product markets, it is essential to understand clearly the combinations of the expected margins and turnover in terms of volume, of the product. Quite often it is required to operate on volumes than looking for higher margins. This may provide the marketer opportunity for wide coverage of the market at low margins, which helps it to become the market leader as no competitors may be able to sustain at such low margins, due to economic problems associated with economies of scale. It is necessary to position the new products in the new segments carefully by building image of the brand, by means of a pre-launch publicity blitz, swamping the competitive pricing strategy would help the product to penetrate into the market against competing brands in the new segment. At the same time, it is required of the marketer to refresh the consumer behaviour periodically and reorient brand image in tune with the existing consumer segment by constantly building better communication strategies. The success stories of the product would help in carrying out such a process. Figure 6.3 exhibits the product planning strategy in the new and existing consumer segments.

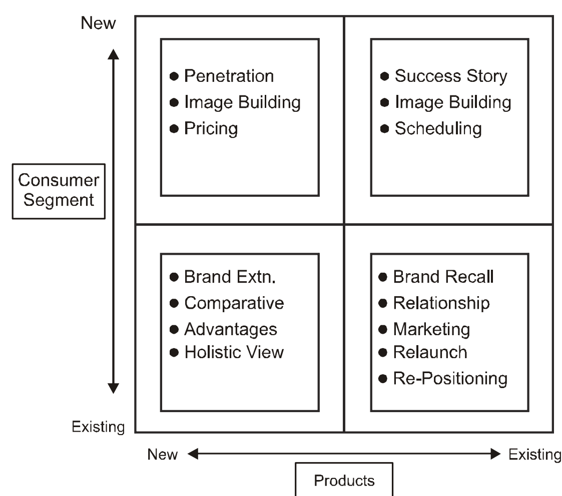

Fig. 6.3 Product Planning Strategy

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The high margin and low volume strategy will precipitate a distribution crisis for the company and may generate irrecoverable brand loss by allowing the consumer to switch to other brands that may provide satisfaction, as close substitutes. Conversely, it would be difficult for the company to survive the competition if it decides to sell its products at low margin (to gain the brand acceptance) but is unable to meet the supply requirements in the market. Hence, while introducing the new products in existing consumer segments, the company needs to take a holistic view and offer competitive price and quality new feature advantages to capture/enhance consumer preference for the brand. High profile companies enjoy the premium market of their product selling high volumes at higher margins. Companies looking to be the market leader and believing in operating with large volumes of products or extensive product line should plan on low margins and high volumes, while the star companies may adopt the policy of high margin-high volume. To achieve a sustainable market share in the existing market, large companies build strong consumer relations, brand recall strategies and reposition their product and brand periodically.

Product Portfolio Matrix

A good planning system must guide the development of strategic alternatives for the current businesses and new business possibilities of the company. It must also provide for management's review of these strategic alternatives and for the corresponding resource allocation decisions. The result is a set of approved business plans that represent the direction of the firm. This process starts with, and its success is largely determined by, the creation of sound strategic alternatives. The top management of a multi-business firm cannot generate these strategic alternatives. It must rely on the managers of its business ventures and on its corporate development personnel. However, top management can and should establish a conceptual framework within which these alternatives can be developed. One such framework is the portfolio matrix associated with the Boston Consulting Group (BCG). Briefly, the portfolio matrix is used to establish the best mix of businesses in order to maximize the long-term earnings of the firm. The portfolio matrix represents a real advance in strategic planning in several ways:

- It encourages top management to evaluate the prospects of each of the company's businesses individually and to set tailored objectives for each business based on the contribution it can realistically make to corporate goals.
- It stimulates the use of externally focused empirical data to supplement managerial judgement in evaluating the potential of a particular business.
- It explicitly raises the issue of cash flow balancing as management plans for expansion and growth.
- It gives managers a potent new tool for analyzing competitors and for predicting competitive responses to strategic moves.

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- It provides not only a financial but also a strategic context for evaluating acquisitions and divestitures.

As a consequence of these benefits, the widespread application of the portfolio matrix approach to corporate planning has sounded the deathknell of planning by exhortation, the kind of strategic planning that sets uniform financial performance goals across an entire company—15 per cent growth in earnings or 15 per cent return on equity—and then expects each business to meet those goals year in and year out. The portfolio matrix approach has given top management the tools to evaluate each business in context of its environment and its unique contribution to the goals of the company as a whole. It has enabled them to weigh the entire array of business opportunities available to the company against the financial resources required to support them. The portfolio matrix concept addresses the issue of the potential value of a particular business for the firm. This value has two variables: the potential for generating attractive earnings levels now and second, the potential for growth or, in other words, for significantly increased earnings levels in the future. The portfolio matrix concept holds that these two variables can be quantified. Current earnings potential is measured by comparing the market position of the business to that of its competitors. Empirical studies have shown that profitability is directly determined by relative market share. The concept of portfolio matrix developed by Boston Consultancy Group (BCG) is exhibited in Figure 6.4.

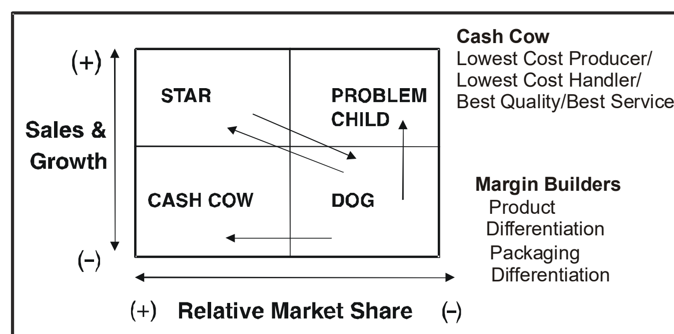

Fig. 6.4 *Product Portfolio Matrix*

- **Star:** High-growth market leaders are called stars. They generate large amounts of cash. The Star SBUs represent probably the best profit opportunity available to a company, and their competitive position must be maintained. If a star's share is allowed to slip because the star has been used to provide large amounts of cash in the short run or because of cutbacks in investment and rising prices (creating an umbrella for competitors), the star will ultimately become a dog. The ultimate value of any product or service is reflected in the stream of cash it generates net of its own reinvestment. For a star company, this stream of cash lies in the future growth. To obtain the real value, the stream of cash must be discounted back to the present at a rate equal to the return on alternative opportunities. It is the future payoff of the star that counts, not the present reported profit.

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- **Cash cow:** Cash cows are characterized by low growth and high market share. They are net providers of cash. Their high earnings, coupled with their depreciation, represent high cash inflows, and they need very little in the way of reinvestment. Thus, these companies generate large cash surpluses that help to pay dividends and interest, provide debt capacity, supply funds for research and development, meet overheads, and also make cash available for investment in other products. Thus, cash cows are the foundations on which everything else depends in the business. Technically, a cash cow has a return on assets that exceeds its growth rate. Only if this is true will the cash cow generate more cash than it uses.
- **Problem child:** Products in a market with a low share are categorized as problem child. Because of growth, these products require more cash than they are able to generate on their own. If nothing is done to increase market share, a problem child will simply absorb large amounts of cash in the short run and later, as the growth slows down, becomes a dog. Thus, unless something is done to change its perspective, a problem child remains a cash loser throughout its existence and ultimately becomes a cash trap. What can be done to make a problem child more viable? One alternative is to gain share increases for it. Because the business is growing, it can be funded to dominance. It may then become a star and later, when growth slows down, a cash cow. This strategy is an expensive one in the short run. An abundance of cash must be poured into a question mark in order for it to win a major share of the market, but in the long run, this strategy is the only way to develop a sound business from the question mark stage. Another strategy is to divest the business. Outright sale is the most desirable alternative. But if this does not work out, a firm decision must be made not to invest further in the business. The business must simply be allowed to generate whatever cash it can while none is reinvested.
- **Dogs:** Products with low market share positioned in a low-growth situation, are called dogs. Their poor competitive position condemns them to poor profits. Because growth is low, dogs have little potential for gaining sufficient share to achieve viable cost positions. Usually they are net users of cash. Their earnings are low, and the reinvestment required just to keep the business together eats cash inflow. The business, therefore, becomes a cash trap that is likely to regularly absorb cash unless further investment is rigorously avoided. An alternative is to convert dogs into cash, if there is an opportunity to do so.

Dimensions of Product Strategies

Product strategies specify market needs that may be served by different product offerings. The product strategies of the company are duly related to market strategies that eventually come to dominate both the overall strategy and the spirit

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of the company. Product strategies deal with matters such as number and diversity of products, product innovations, product scope, and product design. In this chapter, different dimensions of product strategies are expanded for their essence, significance, limitations if any, and their contributions to objectives and goals.

The implementation of product strategies requires cooperation among different groups: finance, research and development, the corporate staff, and marketing. This level of integration makes product strategies difficult to develop and implement. In many companies, to achieve proper coordination among diverse business units, product strategy decisions are made by top management. In some companies, the overall scope of product strategy is laid out at the corporate level, whereas actual design is left to business units. Such alternative is more desirable than other arrangements because it is difficult for top management to deal with the details of product strategy in a diverse company.

Each strategy is examined from the point of view of a business unit or profit centre. The term 'positioning' refers to placing a brand in that part of the market where it will receive a favourable reception compared to competing products. Because the market is heterogeneous, one brand is not enough to make an impact on the entire market. As a matter of strategy, therefore, a product should be matched with the consumer segment of the market in which it is most likely to succeed. The product should be positioned so that it stands apart from competing brands. Positioning tells what the product stands for, what it is, and how customers should evaluate it. Positioning is achieved by using marketing-mix variables, especially design and communication. Although differentiation through positioning is more visible in consumer goods, it is equally true of industrial goods. With some products, positioning can be achieved on the basis of tangible differences (e.g., product features); with many others, intangibles are used to differentiate and position products. There are different approaches to positioning, distinguished as in Table 6.4.

Table 6.4 *Product Positioning Strategies*

Product Positioning Strategies	***Features of the Strategies***
Positioning by attributes	Associating a product with an attribute or end user benefit
Positioning by functional variables like price and quality of the product	The price/quality attribute is so pervasive that it can be considered a separate approach to promotion
Positioning with respect to use or application	Associating the product with a use or application
Positioning by the product user	Associating a product with a user or a class of users
Positioning with respect to a product class	Positioning Caress soap as a bath oil product rather than as soap
Positioning with respect to a competitor	Making a reference to competition as in Avis´s now-famous campaign: 'We're number two, so we try harder.'

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Fabricators of consumer and industrial goods seek competitive distinction through product features—some visually or measurably identifiable, some cosmetically implied, and some rhetorically claimed by reference to real or suggested hidden attributes that promise results or values different from those of competitors' products. The offered product is differentiated, though the generic product is identical. The desired position for a product may be determined by:

- Analyzing product attributes that are salient to customers.
- Examining the distribution of these attributes among different market segments.
- Determining the optimal position for the product in regard to each attribute, taking into consideration the positions occupied by existing brands.
- Choosing an overall position for the product (based on the overall match between product attributes and their distribution in the population and the positions of existing brands).

Types of Positioning Strategies

Two types of positioning strategies may be identified as single-brand strategy and multiple-brand strategy. A company may have just one brand that it may place in one or more chosen market segments, or, alternatively, it may have several brands positioned in different segments simultaneously.

To maximize the benefits on the product with a single brand, a company must try to associate itself with a core segment in a market where it can play a dominant role. In addition, it may attract customers from other segments outside its core positioning area. The product positioning strategies have been illustrated in Figure 6.5.

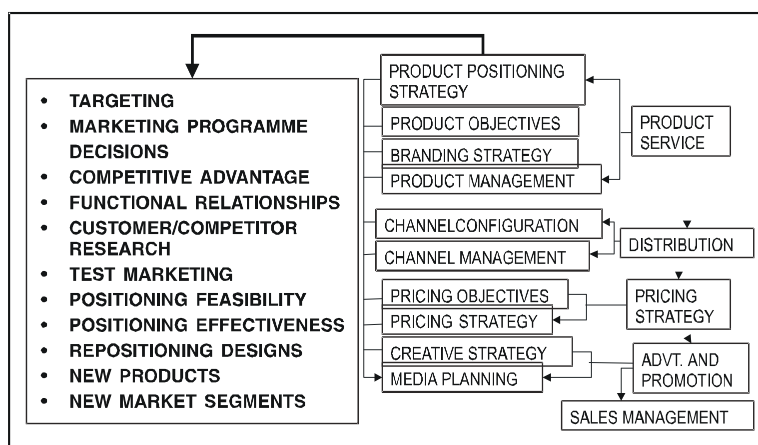

Fig. 6.5 Product Positioning Strategy

The relative strengths of the new entry and the established brand dictate which of the two positioning routes is more desirable. Although head-on positioning

usually appears risky, some companies have successfully carried it out. In addition, if a company already has a dominant position, its attempt to increase its market share by introducing an additional brand may invite antitrust action. Such an eventuality should be guarded against. On the other hand, there is also a defensive, or share maintenance issue to be considered here even if one has the dominant entry. A product with high market share may not remain in this position forever if competitors are permitted to chip away at its lead with unchallenged positions. As a strategy, the positioning of multiple brands, if properly implemented, can lead to increases in growth, market share and profitability.

Check Your Progress

4. What are the elements of trade-off in case of product planning?
5. What are the aspects whose understanding is essential in planning for the product markets?
6. Mention the variables of the potential value of a particular business for a firm.

6.4 INTERNATIONAL MARKET SEGMENTATION

A market segment refers to a group of countries that are alike in respect to their responsiveness to some aspect of marketing strategy. Market segmentation may be defined as a technique of dividing different countries into homogeneous groups. The concept of segmentation is based on the fact that a business cannot serve the entire world with a single set of policies because there are disparities among countries — both economic and cultural. An international marketer, therefore, should pick one or more countries as target markets. A company may not find it feasible to do business immediately with the entire spectrum of countries forming a segment. In that case, the firm may design its marketing programmes and strategies for those countries it does enter, and draw upon its experience with these countries in dealing with new markets.

Components of Strategic Marketing

Market segmentation is one of the prerequisites for planning marketing activities for any product. Segmenting, Targeting and Positioning (STP) are the three basic components of strategic marketing in modern times. Segmentation of market is a process of identifying the agglomeration of buyers, their wants, purchasing power, geographical locations, their buying attitudes and behaviour, to facilitate the targeting and positioning of the products. It is essential to identify the segmentation variables and developing profiles of the resulting segmentation for making decisions and also for marketing planning. Broadly, it can be stated that the market segments are the large groups within the market while a *niche* is a more narrowly defined group seeking for additional marketing benefits. There are many bases for segmenting

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the consumer markets, of which some are exhibited in Table 6.1. The territorial segmentation is done in terms of region—like countries, continents or sub-continent and the habitat identification is made as villages, towns, cities and metros spread geographically according to the size of the population. In the demographic category of segmentation the density of population, composition of population, family size, occupational distribution, level of education and population categories in terms of religion and other sects is considered. The psychographic variables of market segmentation consist of nationality of the consumers, their race whether black, white, Aryans, Dravidians or Buddhists. The social class of the consumers, viz., forward, backward or aboriginal class, is also used as a variable of market segmentation.

Table 6.1 *Bases and Variables for Segmenting Consumer Markets*

Geographic	***Demographic***	***Psychographic***	***Behavioural***
Territory	Density of population	Nationality	Product usage pattern
Habitat identity	Age	Race	Derived product benefits
Population size	Sex	Social class and clan	User status
Climate	Household patterns	Livelihood systems	Usage frequency
Flora and fauna	Income level	Personality groups	Brand loyalty
	Occupation	Influencing cultures	State of readiness
	Education		Attitude towards product
	Population categories		Personal preferences

Besides the above variables, the lifestyles of consumers and their personalities also provide ample information for segmenting consumer markets. In the behavioural variable category, apart from other variables, personal preferences have a substantial impact when it comes to identifying the consumer segments for the products.

Above all, the risk factor in penetrating into such market segment, involving the factor of brand loyalty among users, is also an important variable when it comes to decision-making for segmenting the market for industrial customers. In a given operational area for the company, the market for consumer goods and services can be segmented in five different forms as given below:

- One product in one market: micro consumer segmentation
- Different products in different markets: diffused segmentation
- All products in one market: specialized market segmentation
- One product in all the markets: product specialized market segmentation
- All products in all markets: absolute market segmentation or total coverage

Table 6.2 exhibits the corporate strategy to implement the segmentation process. A key factor in competitive success is focusing on little differences that give a marketing edge and are important to customers. Market segmentation matches consumer differences with potential or actual buying behaviour. It may

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prove more profitable to develop smaller market segments into a target segment. Primary market research is used to collect classification and descriptor variables for members of the target market. Segments are not defined until after collection and analysis of all relevant information. Multi-variate analytical techniques are used to define each segment and develop a scoring algorithm for placing all members of the target market into segments. The **classification variables** are used to classify survey respondents into market segments. Almost any demographic, geographic, psychographic or behavioural variable can be used to classify people into segments. Age, gender, income, ethnicity, marital status, education, occupation, household size, length of residence, type of residence, etc., constitute the **demographic variables** used for segmenting the market. The territorial determinants comprise city, state, pin code, census tract, district, region, metropolitan or rural location, population density, climate, etc. The **psychographic variables** include attitudes, lifestyle, hobbies, risk aversion, personality traits, leadership traits, magazines read, television programmes watched, and the brand loyalty, usage level, benefits sought, distribution channels used, reaction to marketing factors, may be defined as **behavioural variables** that influence the market segmentation process by the multinational companies. The **descriptors** are used to describe each segment and distinguish one group from the others. Descriptor variables must be easily obtainable measures or linkable to easily obtainable measures that exist in or can be appended to customer files.

Table 6.2 *Constituents of Market Segmentation Process*

Constituents	***Attributes of Market Segmentation***
Large size	Market must be large enough to warrant segmenting.
Differences	Differences must exist between members of the market and these differences must be measurable through traditional data collection approaches (i.e., surveys).
Responsive	Once the market is segmented, you must be able to design marketing communications that address the needs of the desired segments.
Accessibility	Each segment must be reachable through one or more media. Marketers must be able to get their message in front of the right market segments for it to be effective.
Multiple benefits	Segments must not only differ on demographic and psychographic characteristics, they must also differ on the benefits sought from the product.
Profitability	The expected profits from expanding markets and more effectively reaching buyer segments must exceed the costs of developing multiple marketing programmes, re-designing existing products and/ or creating new products to reach those segments.

Many of the classification variables can be considered as descriptor variables. However, only small portions of those classification/descriptor variables are readily available from secondary sources. The trick is to identify descriptor variables that effectively segment the market in the primary research effort, which are also available

or can be appended to individual customer records in customer databases. This allows the marketer to execute the market segmentation scheme developed in the primary research effort by applying it to existing customer and market information.

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Grouping of Countries

The countries of the world can be grouped using criteria similar to those used for domestic markets. A multinational company may group countries on the basis of a single variable like per capita GNP or geographic factors. Similarly, other variables like political system, religion and culture may also be considered as the criteria for grouping countries. The choice of an appropriate grouping technique will depend on the nature of products and services of the company.

Methods used by MNCs to Group Countries

The following methods are commonly used by multinational companies to group countries for developing appropriate business strategies:

- Economic status grouping
- Geographic grouping
- Political grouping
- Grouping by religion
- Cultural classification
- Multiple variable grouping
- Inter-market segmentation
- Portfolio approach

The grouping of the countries by **economic status** is a simple approach based on the GNP per capita ranks. Accordingly, the countries may be grouped into three categories of low income, middle income and high-income classifications. The fast-growing countries are defined as those that have an annual average growth rate above the median and the slow-growing countries grow less than the median. The grouping of countries with this criterion assumes that market behaviour is directly related to income. In the case of discrepancies of GNP per capita among the countries or a tie between two or more countries, the parameter of purchasing power might be considered by multinational companies in forming groups of countries. In these clusters each activity benefits from access to inputs produced by others located in the same area and to a pool of skills, infrastructure and business services. A sufficiently large market allows for extensive specialization, while each company is still able to exploit economies of scale. Furthermore, when manufacturers have access to a broad variety of specialized inputs their productivity improves, their costs are reduced and they can expand sales. As the market expands, room for more specialized producers is created with a further lowering of costs. The countries that form the consortium on the basis of economic factors may further lead to various business advantages through economic diplomacy.

Another common method followed by multinational companies in grouping countries is on the basis of their geographic position and possible networking. Many international companies organize worldwide operations on the basis of **geographically** determined regions like South East Asia, Far East, eastern, central and western European countries, Pacific and Caribbean countries. The proximity of the countries in such regions helps in establishing functional trade blocs, allowing activities to be monitored and controlled from predetermined locations. All countries in the Latin American region can be well managed by locating the business headquarters in Brazil on account of its centralized location and proximity of other countries in the group, which offers obvious locational advantages in terms of better transport and communication networking. Regional trade agreements are also made largely on the basis of the geographic locations of the countries, prime examples being APEC, ASEAN, NAFTA, CAFTA, MERCOSUR. These organizations possess regional economic characteristics and lead to common business arrangements. The process of forming market segmentation in an international marketplace has been exhibited in Figure 6.5.

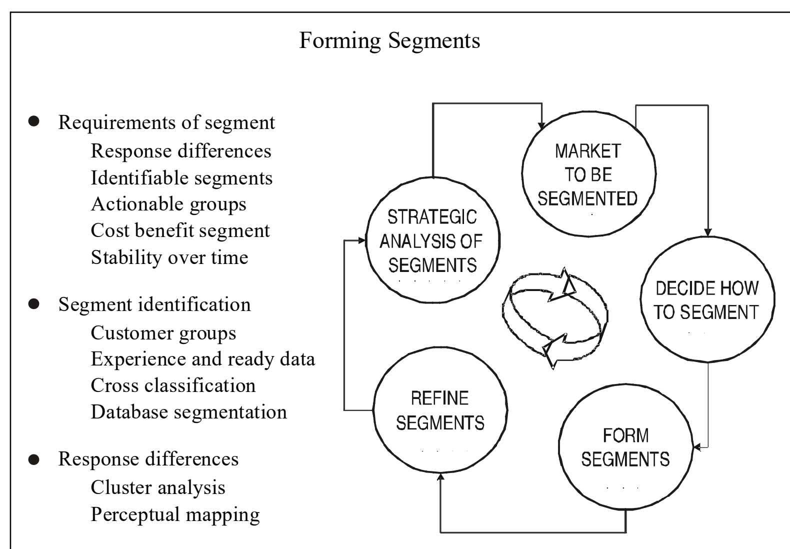

Fig. 6.5 *Market Segmentation*

Another way of grouping countries may be with reference to commonality in their **political systems** and diplomatic relations. Such consortium may refer to the countries of democratic republic, communist and post-communist governing systems, and monarchy. The international trading system has been shaped by a blend of SLEPT principles and pragmatic thinking for mutual benefits. Trade relations cannot be determined solely on the basis of simple grouping techniques consisting of economic, geographic proximity, political and technological convergence that are defined and agreed upon in a general sense. Practical considerations, politics and particular expressions of the national interest inevitably intervene to determine positions taken by governments. The reasons for this include reciprocity in trade liberalization negotiations, cooperation involving participation,

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expansion of trade and profit and entering into stronger international relations for protecting the economic interests of the country and the region against all odds.

Grouping the countries by **religion** constitutes an important factor of *realpolitik* in most of the predominant cultures and societies. Religion influences the lifestyles and also impedes liberal decision-making as it influences and determines the societal values to a large extent. The effect of religion on lifestyle is a relevant criterion for grouping the countries. For example, Islamic countries exhibit common consumer preferences for better trade alliances. Religious conglomeration of countries thus provides better scope for international relations.

Cultural grouping also makes sense since culture plays a significant role in developing lifestyle. Some societies are associated with the power distance attributes that refers to the degree of acceptable inequality. Societies where a few people make decisions that are followed by the large number of people may be termed as high-power distance groups, whereas societies where the decisions are made in a decentralized way may be referred to as cultures of low power distance. Some countries would like to play safe and avoid any risks. Countries with such dominating cultural behaviour may be grouped or otherwise the societies that possess high risk – high benefits culture may be constituted as a group. However, there are also cultures that exhibit the individualism and function in isolation. Alternatively, the **multiple variable approach** of grouping the countries attempts to combine countries with similar socio-economic and political perspectives into segments. However, it assumes that countries are indivisible and are heterogeneous.

In the recent segmentation approaches followed by some multinational companies, the consumers who are alike in different countries are formed into homogeneous segments. Such segments are called **inter-market** segments. This segmentation approach may be explained in reference to the pharmaceutical industry that caters to the common needs of the consumers of different countries for its innovative drug formulae. Similarly, Mercedes-Benz has a worldwide market niche among customers from the same class.

Besides there are some common characteristics of buyers across the countries that include deal makers, price seekers, loyalists, luxury-oriented and experimentalists. The deal makers are value oriented, price seekers exist mainly in competitive and developed markets, the brand loyalists are widespread and the consumers with luxurious values and innovators generally belong to the developed countries.

The **portfolio approach** of country grouping may be explained through a three-dimensional matrix comprising the factors of country potential, competitive strengths and risks. The country potential approach refers to the market potential for the product or services of the company in a given country based on all economic factors. The internal and external factors determine the competitive strength of the market. In a given country, the internal factors constitute the market share of the company, its resources and facilities, while the external factors include industry attractiveness and competition. The risk factor has a broad range of factors that include financial, political and business risk in a given country.

6.5 INFLUENCES ON MARKETING PLAN AND BUDGET

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A marketing plan is one of the most important documents that business should have.

The task of developing a domestic marketing plan is itself complex but it gets more complex if the organisation goes into international operations.

The international marketing plan has to be prepared at two levels:

i. at the country level and
ii. at the international level

Let's look at what these two levels mean:

i. At the country level the marketing plan is more like any domestic marketing plan it lays down the strength and weaknesses of the organisation and opportunities and threats faced by the organisation. It also lays down set of objectives along with their assumptions then the broad action plan is drawn along with the organisation structure and the control systems necessary for accomplishing the marketing plan.
ii. At the international level the international marketing plan is more than a major integration of the country plan it seeks to direct and co-ordinate the activities of the corporation on the international or global basis and also at the country level.

The corporation must decide the modes to obtain information and the gathered information is to be formalized into a marketing plan to provide guidance to each country manager.

There are several influences on the marketing plan as well as budget which can be summed up as follows:

i. Factors which influence the marketing plan and budget at company level are
   - Company's objective and history
   - Government policies which influence the firm's operations
   - Decision making policy
   - Various internal and external factors
ii. Factors which influence the marketing plan and budget at international level

Developing a marketing plan in the international context is far more difficult than planning at the domestic level. The marketing plan as well as the budget for international operations are affected by the following factors or decisions:

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- Commitment decisions include the reasons for entering the international market and the resources of the company combined with the strengths and weaknesses of the company also the objectives and philosophy of the company it also includes the country of reference.
- Area of operation decisions include decisions related to international environment local marketing environment marketing infrastructure market structure and demand financial need analysis overall suitability.
- Entry mode and operation decisions include deciding the mode of entry into international markets.
- Marketing mix strategy decisions related to product, pricing decisions, international promotions and distribution channels and the various functions performed by different members.
- Marketing organisation decisions, to bring the plan into action a proper marketing organisation has to be developed at the international level. The checklist includes among various other factors the type and nature of coordination between head quarter and international units, scheduling, performance evaluation through audits and preview of subsequent planning periods.

Thus, marketing plan is a crucial document for any business and itself it is influenced by the budget at hand. Several external factors such as competition, customers and economic performance have influence on the marketing plan and the budget along with this the internal factors such as business and company objectives.

6.6 INTERNATIONAL PRODUCT MARKETING AND MARKETING OF SERVICES

The fundamentals of marketing remain the same and are universally applicable, the flexibility of marketing decisions is limited by a variety of uncontrollable factors in international markets. This makes decision for international markets more complex compared to domestic markets the international firm has to take crucial decisions whether to use standard marketing strategy across countries or to adapt to suit the needs of different countries. The company has to modify the 4Ps in response to the environmental variables and these are often referred to as controllable factors the basic purpose of any marketing activity is to satisfy the customer's requirement in a manner better than the competitor the product related decisions become vital for success in international market as well.

As we know a product is anything that can be offered to the market to satisfy a want or need products that are marketed include physical products as well as services.

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The firm operating in the international market has to take several decisions for products as follows-

i. Product standardization versus adaptation
ii. Product launch for international markets
iii. Branding decisions in international markets

Let's discuss these briefly here one by one.

i. Product standardization versus adaptation

As you have already learnt in the previous sections, product standardization refers to marketing a product in the international market with slight changes except for some cosmetic changes such as modified packaging and labelling. Generally, products with high technological intensity such as heavy equipment, plant and machinery, microprocessors, hard disc, projectors are marketed as standardized product across the world and some of the consumer products which carry a global appeal like Coke or McDonalds are marketed as standardized products.

Product adaptation means making changes in the product in response to the requirements of the target market. It is also known as customisation. Keeping in mind the local consumption and requirements, the products for international markets are often customised. Adaptation of a product may vary from major modifications in the product to minor alterations in the packaging, logo, design, colour or brand name.

China has emerged as a global hub to manufacture goods to cater to various needs and preferences of customers in different countries. Sometimes product adaptation is necessary and mandatory due to Government regulations in a particular country.

ii. Product launch for international markets

Companies entering the international markets need to be innovative so as to maintain their market share and to launch new products in the international markets.

Depending upon the market and the product attribute a company may adapt one of the following strategies for launching its product in the international markets. It may follow the waterfall approach where products trickle down in the international market in a cascade like manner and are launched sequentially from one country then in the other and genera so on. A product is given sufficient time to customise in the foreign market before it is launched in another foreign market. The waterfall approach is more suitable for firms which have limited resources and find it difficult to manage multiple international market simultaneously. The other approach is known as the Sprinkler approach. Under this approach the product is simultaneously launched in various countries. The sprinkler approach of simultaneous market entry is preferred over waterfall approach when the competitive intensity of the market is very high with strong and several competitors and the life cycle of the product is very short.

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iii. Branding decisions in international markets

Branding decisions in international markets are again tough decisions.

In present times the mobility of the consumers is across the world. There is an increase of international travel. A brand serves as an effective tool in international marketing because the image of the brand crosses national boundaries very fast. A global brand should have a minimum level of geographical spread and turnover in various markets all over the world. Developing a Global brand requires lots of resources and commitment therefore most brands that have global reach target high income countries. Whereas low income countries often prefer unbranded generic products that fetch relatively much lower prices and are generally targeted to the lower end of the market.

Marketing of Services

For successful marketing of services in the international markets, a marketer first has to determine the nature and aim of service offering in these markets. There are three basic strategies to enter the foreign markets in service sector.

i. The first strategy is for the services that are delivered in support of or in combination with other products. The most suitable approach is to follow the path of those products. Small sized service marketers or companies can operate closely with the manufacturing firms of such products and can follow these manufacturing firms to the foreign markets where they are operating internationally. Such service companies can also follow a cluster of manufacturers in order to arrive at economies of scale in the international operations.

ii. The second strategy is for the service providers whose activities are independent of the products. Such service organisations should search for similar institutions or service firms in the international markets that are similar to those in the domestic markets. A management consultant with expertise in the field can also be of help in such service organizations find suitable markets internationally.

iii. The third strategy is for the service companies approaching the countries which are undergoing transition phase, which are fast developing and their infrastructural and other developments are in process. Such service companies can look out for developmental project in developed and underdeveloped countries and can become service providers in these projects.

Thus, depending upon the situation any of these three strategies or a combination of them can be adopted to market services internationally.

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The service companies entering the international markets have to be careful about two major barriers one is legal barrier and the other is cultural barriers.

As international trade in services is growing at a much faster pace than any other product the study of international marketing of services becomes all the more important today.

Check Your Progress

7. State the three basic components of strategic marketing in modern times.
8. What is the multiple variable approach of grouping countries?
9. Define the sprinkler approach to product launch in international markets.

6.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. National products are made when a global company caters to the preferences and needs of a particular country/market.
2. Idea generation in the process of new product development is a major exercise. This technique calls for listing of all major attributes of the existing product and the needed attributes in order to improve the same product.
3. Commercialization of the product is a strategic decision in which the company should look into the appropriate time, market and consumer segment to launch the product.
4. In case of product planning there is always a trade-off between Standardization vs Customization approaches.
5. In planning for the product markets, it is essential to understand clearly the combinations of the expected margins and turnover in terms of volume, of the product.
6. The portfolio matrix concept addresses the issue of the potential value of a particular business for the firm. This value has two variables: the potential for generating attractive earnings levels now and second, the potential for growth or, in other words, for significantly increased earnings levels in the future.
7. Segmenting, Targeting and Positioning (STP) are the three basic components of strategic marketing in modern times.
8. The multiple variable approach of grouping the countries attempts to combine countries with similar socio-economic and political perspectives into segments. However, it assumes that countries are indivisible and are heterogeneous.

9. Under the sprinkler approach the product is simultaneously launched in various countries. The sprinkler approach of simultaneous market entry is preferred over waterfall approach when the competitive intensity of the market is very high with strong and several competitors and the life cycle of the product is very short.

6.8 SUMMARY

- A national product for a company is one which is offered in a single national market. National products are made when a global company caters to the preferences and needs of a particular country/market.
- International products are designed for multinational regional markets.
- Global products are made for global markets. A truly global product is offered in the Triad, in every world region and in countries at every stage of development.
- New products have to be developed by companies with utmost care. It is necessary to understand and accommodate the needs of consumers, counter competitive threats, ensure availability of post sales services and take into account the cost of marketing the product. Despite the risks involved, however, new product development is essential and companies need to make continuous efforts to develop new products, in order to beat competitors.
- The companies should strengthen their marketing network simultaneously while launching the new products.
- It is essential that a company conducts brainstorming exercises for understanding the basic and secondary needs for the product, listing the product attributes, and identifying the forced relationship of other goods and services with the new product.
- The main objective of all businesses is survival. Many companies have more aggressive objectives, such as growth, market share, profitability, etc. Company resources, such as finance and labour may restrict or encourage ambitions for company growth. All these factors influence whether and why companies choose to internationalize.
- In case of product planning there is always a trade-off between Standardization vs Customization approaches.
- International product planning is derived from a company's global strategy, and built on its competitive scope and stance. There are various forms of global marketing strategies. Product planning can be done depending on the choices of global marketing strategy.
- Finding the balance between standardization and adaptation is at the heart of effective international marketing decision-making. Companies with

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products which appeal to people in different international markets constantly have to review this balance. The cost issue benefits of standardization are important, but they must be balanced against local preferences.

- A good planning system must guide the development of strategic alternatives for the current businesses and new business possibilities of the company. It must also provide for management's review of these strategic alternatives and for the corresponding resource allocation decisions.
- Product strategies specify market needs that may be served by different product offerings. The product strategies of the company are duly related to market strategies that eventually come to dominate both the overall strategy and the spirit of the company.
- Two types of positioning strategies may be identified as single-brand strategy and multiple-brand strategy.
- A market segment refers to a group of countries that are alike in respect to their responsiveness to some aspect of marketing strategy. Market segmentation may be defined as a technique of dividing different countries into homogeneous groups.
- The countries of the world can be grouped using criteria similar to those used for domestic markets. A multinational company may group countries on the basis of a single variable like per capita GNP or geographic factors. Similarly, other variables like political system, religion and culture may also be considered as the criteria for grouping countries. The choice of an appropriate grouping technique will depend on the nature of products and services of the company.
- The international marketing plan has to be prepared at two levels:
    i. at the country level and
    ii. at the international level
- Since decisions for international markets are more complex compared to domestic markets, the international firm has to take crucial decisions whether to use standard marketing strategy across countries or to adapt to suit the needs of different countries.
- For successful marketing of services in the international markets, a marketer first has to determine the nature and aim of service offering in these markets.

6.9 KEY WORDS

- **Positioning:** It refers to placing a brand in that part of the market where it will receive a favourable reception compared to competing products.
- **Market segmentation:** It may be defined as a technique of dividing different countries into homogeneous groups.

6.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. What are national product, international product, global product and brands?
2. List the factors obstructing the growth of new products.
3. Write a short note on the generic product planning strategies.
4. Mention the factors on which the extent to which marketing strategy and practice is standardized depends.
5. Briefly explain the product positioning strategies.
6. What are the factors or decisions which affect the marketing plan as well as the budget for international operations?
7. Write a short note on the three basic strategies to enter the foreign markets in service sector.

Long-Answer Questions

1. Explain the process of new product development.
2. Examine the major differences across countries that force companies to go for customization.
3. Describe the concept of product portfolio matrix.
4. Discuss the concept, methods and reasons for market segmentation.
5. Assess the various methods of grouping of countries in international marketing.

6.11 FURTHER READINGS

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UNIT 7 INTERNATIONAL PRICE POLICY

NOTES

Structure

7.0 Introduction
7.1 Objectives
7.2 International Price Policy: Overview
  7.2.1 Parameters for Pricing of Products in International Marketing
  7.2.2 Price and Non-Price Factors
7.3 Methods of Pricing
7.4 International Pricing Strategies Including Dumping
  7.4.1 Price Distortion
  7.4.2 Counter Trade
7.5 Answers to Check Your Progress Questions
7.6 Summary
7.7 Key Words
7.8 Self Assessment Questions and Exercises
7.9 Further Readings

7.0 INTRODUCTION

Pricing in the international markets may prove to be very volatile for companies. While making an entry into the foreign markets, it is very important that firms have a proper pricing strategy in place. All the major components while influence price determination should be carefully studied. There are different options available for companies to operate in international markets. In this unit, you will learn about the different elements of international price policy.

7.1 OBJECTIVES

After going through this unit, you will be able to:

- Describe the concept of pricing strategy
- Explain the major components which influence price determination
- Examine the price strategies in international markets
- Discuss the concept of price distortion and countertrade

7.2 INTERNATIONAL PRICE POLICY: OVERVIEW

Pricing strategy is an important part of international marketing. The starting point for all pricing decisions is to develop pricing objectives. Managements have two

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kinds of decisions to make. One is the level at which prices should be determined. The other is related to the specific objective or objectives to be pursued.

The following considerations will help the marketer to determine the best price in overseas market:

- What is the rationale of deciding the positioning and customer perception of its product and the method by which the firm wants to communicate to the international market?
- What is the rationale of export price match with product quality?
- What are the competitor's prices?
- Should market penetration or market-skimming pricing objectives be chosen in international markets?
- What are the discounts in trade, cash, quantity and allowances that the firm should offer in international markets?
- Should a price difference or a price discrimination strategy be chosen for the market segment.
- What is the product line pricing approach adopted? This should be communicated to customers.
- Is there a need to explore various pricing options that firms can exercise if the firm's costs increase or decrease? What kind of demand does the product have in the international market? Is it elastic or inelastic?
- Is there a need to assess the role of regulatory bodies/government, etc. as they may think that prices are unreasonable or exploitative?
- What kinds of anti-dumping laws are in force in foreign countries? Will these pose a problem?

Firm revenue is measured by domestic markets as well as in international markets. This is determined by the prices at which a product or a service is sold in these markets. But before deciding the prices in international markets, the market should be scanned. Market scanning includes an assessment of all of the factors that may affect the prices of the product or service. It has been seen that if the prices are very high, the product or service may not be competitive in international market. If the price is very low, international marketing may not be profitable or may result in a net loss.

Factsors Affecting International Pricing

The major components which influence price determination are costs, market demand, and competition. These affect the decision of the firm to enter the international market. Firms should make an analysis of these components before entering the international market and keep in mind the major objectives of the firm. An analysis of each component may result in international prices that are different from domestic prices.

NOTES

i. Market Demand

Market demand is determined by various factors. Per capita income is also a factor and good indicator to determine the purchasing power of consumers. But some global products have strong demand. Therefore per capita income may not be a very effective indicator in deciding the demand of these global products. For example, in case Levi's jeans sell in markets with low per capita income, it will not affect their selling price. Prices of these global products are determined not by per capita income but by strong demand of a product. Simplifying the product to reduce its selling price may be an answer for the exporter. The firm should also plan currency fluctuations and try to accommodate wild changes in the rupee, dollar and/or other foreign currency that may alter the affordability of its goods. The firm should anticipate the potential customers in various segments.

ii. Competition

The level and intensity of international competition differ as compared to the domestic market. In international marketing, there is the need to evaluate the competition's prices in various segments that have the potential to export.

If the nature of the market is highly competitive and there are many competitors, then the firm has to match their price with competitors' price. Sometimes, to establish their market share, the firm has to keep its prices below the market prices. This is known as under-pricing of the product or service. But in case of newly introduced products or services, firms may keep their prices higher. This may happen when the product is new and the number of competitors in the international market is less.

Key points in Pricing

The following are the key points that should be considered by marketer in international market to determine product's price:

- To establish the objectives and goals in international market
- To assess the actual cost of the product that has to be marketed
- To assess the final consumer price
- To scan, assess, monitor, and forecast the market demand and competition
- To consider modifying the product features and attributes in accordance to international price
- To assess 'non-market' costs that include tariffs and customs fees

To the consumer, this is the price at which the product is available and sold on the store shelves. To the producer, this price has to represent a fair return so as to maintain sufficiently high discount levels and rates of support for all the intermediaries in the distribution channel, from importer, if different, to wholesaler and retailer.

Added to this, uncertainties over foreign exchange, political controls over pricing, problems of parallel exporting and importing and problems related to payment that may include counter trade, and the magnitude of the pricing problem in the international context becomes clearer. International pricing strategy is an important component of the overall international marketing mix.

7.2.1 Parameters for Pricing of Products in International Marketing

Pricing products or services in international marketing is not an easy decision.

While setting the price the marketing managers keep in mind three parameters cost, demand and supply and economic, legal and political conditions.

i. Cost represents the baseline for setting the price full stop the cost represents the floor price beyond which price cannot be dropped.
ii. Demand and supply for a marketing manager the upper limit is demonstrated by demand and supply conditions as they exist in the market demand conditions are interpreted from the market conditions and the consumer behaviour where as the supply conditions are interpreted by an analysis of the competition. the price charged by competitors and the attributes and qualities sold by the competitors set the supply parameters.
iii. Economic legal and political conditions

    The parameters outside the market forces which influence the price structure are represented as economic legal and political conditions. The countries where IEA economic policies are directed by the government the economic and political conditions have an important bearing on price structures.

Legalities lengthen any process and complicate therefore influencing the price structure more the legal constraints more the price charge from the customer in an effort to pass the increase in cost towards the customer.

The parameters and the process for pricing remains the same but when firm enters the international markets new dimensions are added to the pricing decisions.

When organisation enters new market in the international marketing area it is open to absolutely new set of characteristics and each market stands out as a separate entity this influences the parameters of pricing. Along with that a product's position on the life cycle curve and the firm's position on firm's life cycle curve also effects and adds to the complexities of the pricing decisions in the international markets.

Firm's life cycle

In international marketing operations, the firm may start as export marketing venture and move up to international marketing to multinational marketing and finally to the global marketing and at each stage the position of the firm on its lifecycle curve

emphasizes the influence it will bear on the pricing decisions in the international markets.

Product's life cycle

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Right from the introduction to the decline stage strategies change and each strategy has an impact on the pricing policy. The product may be launched with skimming price or penetrating price policy but over a period of time it has to look into the price cuts and product line pruning.

7.2.2 Price and Non-Price Factors

One of the ways of classifying factors which affect pricing of the products is the categorisation of price and non-price factors. While the price factors refer to the cost-based determination of price of the products, the non-price factors include elements which are not directly price based but affect the pricing of the product:

Non-Price Factors

Factors other than price may be important in analyzing buying situations. Buyers may be willing to pay a premium price to gain other advantages or, be willing to forgo certain advantages for lower prices. Other important factors are quality, uniqueness, availability, convenience, service, and warranty. In an attempt to recover from intense price competition, fast food chains are marketing value menus of higher-priced items. These value strategies include the quality of the food, user friendly service, and attractive dining facilities. Value-mapping is a useful technique of analyzing how buyers perceive the offerings of different brands. One approach is to first develop the map based on managers' opinions, followed by obtaining value perceptions from a sample of consumers.

Certain buying situations may reduce the importance of price in the buyer's choice process. The price of the product may be a minor factor when the amount is small compared to the importance of the use. Examples include infrequently purchased electric parts for home entertainment equipment, batteries for appliances, and health and beauty aids bought during a vacation. The need for important but relatively inexpensive parts for industrial equipment is another situation that reduces the role of price in the buyer's purchase decision.

7.3 METHODS OF PRICING

There are various strategies which firms follow in fixing price in international markets:

i. Price Discrimination
ii. Strategic Pricing
iii. Predatory pricing
iv. Experience curve pricing

First, we examine the case for pursuing price discrimination, and charging different prices for the same product in different countries. Second, we look at strategic pricing. Third, we briefly review some of the regulations that limit a firm's ability to charge the prices it would prefer in a country.

i. Price Discrimination

In an international context, price discrimination exists whenever consumers in different countries are charged different prices for the same product.

By pricing to meet the demand of each individual buyer, a seller can realize a high average price and total profit. To illustrate, the prices of many durables are negotiable, which leads to different prices being charged to each buyer (e.g., homes and automobiles).

Two conditions are necessary for profitable price discrimination.

First, the firm must be able to keep its national markets separate. If it cannot do this, individuals or businesses may undercut its attempt at price discrimination by engaging in arbitrage. Arbitrage occurs when an individual or business capitalizes on a price differential for a firm's product between two countries by purchasing the product in the country where prices are lower and reselling it in the country where prices are higher.

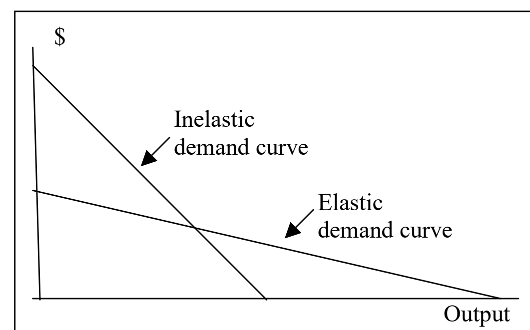

Fig. 7.1 *Elastic and Inelastic Demand Curves*

In price discrimination, there are different price elasticities of demand in different countries. Based on these differences of price elasticity, a firm should identify its scope of maximization of profit. The price elasticity of demand can be defined as a measure of the responsiveness of demand for a product to changes in price.

Demand is said to be elastic when a small change in price produces a large change in demand; and when large changes in price produce little change in demand, it is said to be inelastic. Elastic and inelastic demand curves are illustrated in Figure 7.1. As a rule, for reasons that will be explained below, a firm can charge a higher price in a country where demand is inelastic.

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The determinants of demand elasticity

Income levels, inequalities in income distribution, competitive conditions, living standards, etc are factors that determine the elasticity of demand for a product in a given country. In case of higher inequality in income levels, price elasticity tends to be greater (more elastic) in countries with low-income levels.

The reason for this is that consumers with limited incomes tend to be very price conscious; they have less to spend, so they look much more closely at price.

With regard to competitive conditions, in general the more competitors there are the greater the consumers' bargaining power as also the likelihood that consumers will buy from the firm that charges the lowest price.

Thus, a large number of competitors cause high elasticity of demand. In such circumstances if a firm raises its prices above that of its competitors, consumers will switch to the competitors products.

The opposite is true when a firm faces few competitors. When competitors are limited, consumers' bargaining power is weaker and price is less important as a competitive weapon. Thus, a firm may charge a higher price for its product in a country where competition is limited than in a country where competition is intense.

ii. Strategic Pricing

Price strategy depends upon three main factors—characteristics of product and nature of its demand, philosophy of the management and market characteristics. A single set of prices would not suit all markets.

There are various reasons which might makes prices different for different markets, such as political influence, buying capacity, financial and import facilities and total market turnover.

The concept of strategic pricing has two important aspects, which we will refer to as predatory pricing and experience curve pricing.

Firms should be aware that sometimes anti-dumping regulations may apply in case of both predatory pricing and experience curve pricing. Once we have reviewed predatory and experience curve pricing, we will look at anti-dumping rules and other regulatory policies.

iii. Predatory pricing

A firm uses predatory pricing as a competitive weapon to drive weaker competitors out of a national market. Prices can further be enhanced if competitors have left the market, and the firm can earn high profits. But this approach of adopting predatory pricing can work very effectively only when firm has adequate surplus and a very profitable position.

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An example is the printing of books published in the US in Asia to be sold at a lower price in the developing countries of Asia. The margins of profit may vary from market to market.

However, there is nothing wrong in making higher margins in some export markets and lower ones in others, provided there is an overall profit in export business. European and Japanese do it more often than Americans.

Many Japanese firms have been accused of pursuing this strategy. The argument runs like this: Because the Japanese market is protected from foreign competition by formal trade barriers, Japanese firms can charge high prices and earn high profits at home.

They then use these profits to subsidize aggressive pricing overseas, the aim of which is to drive competitors out of those markets. Once this has occurred, the Japanese firms' raise their prices.

iv. Experience curve pricing

As a firm builds up its accumulated production volume over time, unit costs fall due to experience effects. Learning effects and economics of scale underlie the experience curve.

Price comes into the picture, since aggressive pricing (along with aggressive promotion and advertising) is a way to build up accumulated sales volume rapidly and thus move down the experience curve. Firms further down the experience curve have a cost advantage vis-à-vis firms further up the curve.

Many firms pursuing an experience curve pricing strategy on an international scale, set low prices worldwide in an attempt to build global sales volume as rapidly as possible, even if this means taking large losses initially.

Such a firm believes that several years in the future, when it has moved down the experience curve, it will be making substantial profits and, moreover, has a cost advantage over its less-aggressive competitors.

Regulatory impact on Pricing

Firms' abilities to engage in either price discrimination or strategic pricing may be limited by national or international regulations.

Most important, a firm's freedom to set its own price is constrained by anti-dumping regulations and competition policy.

Every nation has government regulations that influence pricing practices. In some countries there are maximum and minimum prices that can be charged to customers. Minimum price can protect local companies from more efficient international competitors because of a floor on prices that can ensure a profit for national firms.

Check Your Progress

1. What are the two kinds of decisions managements have to make in relation to developing pricing objectives?
2. What are the factors on which the price strategy dependent on?
3. When is the only position in which the approach of adopting predatory pricing effective?

7.4 INTERNATIONAL PRICING STRATEGIES INCLUDING DUMPING

In order to understand the issue of pricing completely, it is important to look at the concepts of transfer pricing, prize escalation, competition policy and dumping.

i. Transfer Pricing

Transfer pricing is set when one company sells goods to another company, but both companies have common ownership. Transfer pricing includes cost methods, market price methods, negotiation or even simply using an arbitrary figure. The basic objective of using transfer pricing may be to maximize after-tax revenue by setting transfer prices that reduce the total tax paid.

Effect of transfer pricing

The tax structure varies internationally. Different countries have different tax structures. Multinationals operate in several countries and, therefore, they have to face different tax structures. They adopt transfer pricing to reduce or even eliminate tax liabilities. Although most countries have tax laws to prevent transfer pricing behaviour, firms may adjust the results of transactions to approximate those that would be negotiated between independent firms. This arm's length principle is set out in Article 9 of the Organization for Economic Cooperation and Development Model Tax Convention.

Example: A transnational firm in Country A produces a shirt for ₹ 50. It sells the shirt to another part of the corporation in Country B for ₹ 150, which is the transfer price. The shirt is then retailed at ₹ 350 in Country B. Gross profit to the corporation is ₹ 300 (₹ 350 – ₹ 50): ₹100 of the profit (₹150 – ₹ 50) is earned in Country A, and ₹ 200 (₹ 350 – ₹ 150) is earned in Country B. Assuming tax rates are 20 per cent in Country A, and 50 per cent in Country B, the taxes paid by the corporation are ₹ 20 (₹ 100 * 20 per cent) in Country A and ₹ 100 (₹ 200 * 50 per cent) in Country B for a total tax liability of ₹ 120. The profit after-tax is ₹180 (₹ 300 – ₹ 120).

If the transnational company changes the transfer price from Country A to Country B from ₹ 150 to ₹ 300, the gross profit remains the same at ₹ 300. But, profit in Country A is now ₹ 250 (₹ 300 – ₹ 50) and in Country B, ₹ 50 (₹ 350 – ₹ 300). Taxes paid in Country A are ₹ 50 (₹ 250 * 20 per cent), and in Country B are ₹ 25 (₹ 50 * 50 per cent) for a total tax liability of ₹ 75. The after-tax profit has now increased to ₹ 225 (₹ 300 – ₹ 75), although production costs have not changed.

ii. Dumping

As you have already learnt in Units 2 and 3, in international trade, dumping generally occurs when one country exports a significant amount of goods to another country at prices much lower than in the domestic market. Dumping also occurs whenever a firm sells a product for a price that is less than the cost of producing it. In most cases, this is associated with selling a stock with little regard for price.

Both predatory pricing and experience curve pricing can run afoul of anti-dumping regulations. Companies may only be interested in the short term. For them, 'dumping' maybe a feasible strategy, but it is one which almost always invites a political response. Most regulations, however, define dumping vaguely.

For example, a country is allowed to take anti-dumping actions against an importer under Article 6 of GATT so long as the two criteria are met: sales at 'less than fair value' and 'material injury to a domestic industry'.

The problem with this terminology is that it does not indicate what fair value is. The ambiguity has led some to argue that selling abroad at prices below those in the country of origin, as opposed to below cost, is dumping.

From the perspective of international business, the important point is that anti-dumping rules set a floor under export prices, which limit a firm's ability to pursue strategic pricing. The rather vague terminology used in most anti-dumping actions suggests that a firm's ability to engage in price discrimination also may be challenged under anti-dumping legislation.

The WTO agreement allows governments to act against dumping where there is genuine ("material") injury to the competing domestic industry. In order to do that, the government has to be able to show that dumping is taking place, calculate the extent of dumping (how much lower the export price is compared to the exporter's home market price), and show that dumping is causing injury or is threatening to do so.

GATT (Article 6) allows countries to take action against dumping. The Anti-dumping Agreement clarifies and expands Article 6, and the two operate together. They allow countries to act in a way that would normally break the GATT principles of binding a tariff and not discriminating between trading partners. Typically, anti-dumping action means charging extra import duty on the particular product from the particular exporting country in order to bring its price closer to the 'normal value' or to remove the injury to the domestic industry in the importing country.

NOTES

There are different ways of calculating whether a particular product is being dumped heavily or only lightly. The agreement narrows down the range of possible options. It provides three methods to calculate a product's 'normal value'. The main one is based on the price in the exporter's domestic market. When this cannot be used, two alternatives are available—the price charged by the exporter in another country, or a calculation based on the combination of the exporter's production costs, other expenses and normal profit margins. The agreement also specifies how a fair comparison can be made between the export price and what would be a normal price.

Calculating the extent of dumping on a product is not enough. Anti-dumping measures can only be applied if the dumping is harmful to the industry in the importing country.

Therefore, a detailed investigation has to be conducted according to specified rules first. The investigation must evaluate all relevant economic factors that have a bearing on the state of the industry in question. If the investigation shows that dumping is taking place and domestic industry is being hurt, the exporting company can raise its price to an agreed level in order to avoid anti-dumping import duty.

iii. Competition Policy

Most countries have introduced various regulations to promote competition and to restrict monopoly practices. These regulations are primarily to limit the prices a firm can charge in a given country.

For example, during the 1960s and the 1970s the Swiss pharmaceutical manufacturer, Hoffmann-LaRoche, had a monopoly on the supply of Valium and Librium tranquilizers. In 1973, the British Monopolies and Mergers Commission, which is responsible for promoting fair competition in Great Britain, investigated the company.

The commission found that Hoffmann-LaRoche was overcharging for its tranquilizers and ordered the company to reduce its prices by 35 to 40 per cent. Hoffman-LaRoche maintained unsuccessfully that it was merely engaging in price discrimination. Similar actions were later brought against Hoffmann-LaRoche by the German cartel office and by the Dutch and Danish governments.

iv. Price Escalation

Price escalation can be defined as the difference between the domestic price and the target price in international markets. This difference is due to the application of duties, dealer margins and/or other transaction costs. Most of the time, frequent and remarkable increases in a product's price due to transportation, duty and distributor's margins are added to the product's former factory price. In addition, tariffs are levied on freight, invoice fees, port fees, insurance and documentation to arrive at a figure called 'CIF' (Cost, Insurance and Freight).

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The basic structure of price escalation

- Duty is levied on CIF
- First markup is on the CIF plus duty value
- Second markup is on the CIF plus duty plus first markup
- Dealer markup is on the CIF plus duty plus first markup plus second markup.

Here is a simple example**:**

FOB	=	₹ 10,090
Freight, etc.	=	₹ 2,862
CIF	=	₹ 12,952
20 per cent duty on $12,952	=	₹ 2,590,
Enters market at value of	=	₹ 15,542
10 per cent Dist markup on ₹ 15,542	=	₹1,553;
Enters dist. chain at value of	=	₹ 17,095
25 per cent dealer markup on ₹ 17,095	=	₹ 4,295
Total retail price of 212 per cent of original FOB		₹ 21,390

7.4.1 Price Distortion

Price distortion can be defined as the situation where by prices of commodities deviate from the equilibrium or ruling prices due to several disturbances of the market system such as government interventions in economic activities or the exchange rates or the foreign currency selected by the exporting and importing firms.

Price distortion measures the gap between marked price and market prices. The occurrence of distortions implies that market prices can deviate from fundamental value. The price distortion leads to mis pricing of financial contracts relative to the fundamental value.

7.4.2 Counter Trade

In recent years, many exporters have been forced to finance international transactions by taking full or partial payment in some form other than money. A number of alternative finance methods, known as *countertrade,* are widely used. In a countertrade transaction, product flows in one direction to a buyer in a sale; a separate stream of products and services is also created which often flows in the opposite direction. Countertrade usually involves a seller from the developed country and a buyer in a developing country; for example, the countries in the former Soviet bloc have historically relied heavily on counter-trade. This approach, which reached a peak in popularity in the mid-1980s, is now used in some 100 countries. Within the former Soviet Union, countertrade flourished in the 1990s, following the collapse of the central planning system.

As one expert notes, countertrade flourishes when there is a short supply of hard currency. Exchange controls may stop a company from expatriating earnings; the company may be forced to spend money in the country for products that are then exported and sold in third-country markets. Historically, the single-most important driving force behind the proliferation of countertrade was the decreasing ability of developing countries to finance imports through bank loans. This trend resulted in debt-ridden governments pushing for self-financed deals.

Today, several conditions affect the probability that importing nations will demand countertrade. First condition is the value of the transaction; the higher the value, the greater the likelihood that countertrade will be involved. Second, the availability of products from other suppliers can also be a factor. If a company is the sole supplier of a differentiated product, it can demand monetary payment. However, if competitors agree to deal in a countertrade basis, a company may have no choice but to agree or risk altogether losing the sale. Overall, the advantages to non-market and developing economies are access to expertise and technology in the short term, and creation of hard currency export markets in the long term.

One category of countertrade is discussed here. Barter falls into one category; the mixed forms of countertrade, including counter-purchase, compensation trading, offset and cooperation agreements belong to a separate category. They are distinct from barter because money or credit forms a part of the transaction.

Barter

The term barter describes the least complex and oldest form of bilateral, non-monetized countertrade. Simple barter is a direct exchange of goods or services between two parties. Both partners calculate a rough shadow price for products flowing in each direction, although no money is involved. A simple barter transaction is generally for less than one year for avoiding problems in fluctuations in price. However, for certain transactions, the exchange may span months or years, with the provisions of the contract permitting adjustments in the exchange ratio for handling world price fluctuations. At times, companies take help from barter specialists from outside. For example, New York-based Atwood Richards engages in barter in all parts of the world. Generally, however, there is direct distribution between trading partners, with no intermediary included. During the Soviet era, for example, General Electric sold a turbine generator to Romania. For payment, GE Trading Company accepted $150 million in chemicals, metals, nails, and other products that it then sold to the world market. One of the high-profile companies involved in barter deals is PepsiCo, which did business in the Soviet and post-Soviet market for more than twenty years. In the Soviet era, PepsiCo bartered soft drink syrup concentrate for Stolichnaya vodka, which was, in turn, exported to the United States by the PepsiCo Wines & Spirits subsidiary and marketed by M. Henri Wines. In the post-Soviet market economy in the Commonwealth of Independent States, barter is not allowed.

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Check Your Progress

4. State the basic objective of using transfer pricing.
5. What does the occurrence of price distortions imply?

7.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The starting point for all pricing decisions is to develop pricing objectives. Managements have two kinds of decisions to make. One is the level at which prices should be determined. The other is related to the specific objective or objectives to be pursued.
2. Price strategy depends upon three main factors—characteristics of product and nature of its demand, philosophy of the management and market characteristics.
3. The approach adopting predatory pricing can work very effectively only when firm has adequate surplus and a very profitable position.
4. The basic objective of using transfer pricing may be to maximize after-tax revenue by setting transfer prices that reduce the total tax paid.
5. The occurrence of distortions implies that market prices can deviate from fundamental value.

7.6 SUMMARY

- Pricing strategy is an important part of international marketing. The starting point for all pricing decisions is to develop pricing objectives. Managements have two kinds of decisions to make. One is the level at which prices should be determined. The other is related to the specific objective or objectives to be pursued.
- Firm revenue is measured by domestic markets as well as in international markets. This is determined by the prices at which a product or a service is sold in these markets. But before deciding the prices in international markets, the market should be scanned.
- The major components which influence price determination are costs, market demand, and competition. These affect the decision of the firm to enter the international market.
- There are various strategies which firms follow in fixing price in international markets:

v. Price Discrimination
vi. Strategic Pricing
vii. Predatory pricing
viii. Experience curve pricing

NOTES

- In order to understand the issue of pricing completely, it is important to look at the concepts of transfer pricing, prize escalation, competition policy and dumping.
- Price distortion can be defined as the situation where by prices of commodities deviate from the equilibrium or ruling prices due to several disturbances of the market system such as government interventions in economic activities or the exchange rates or the foreign currency selected by the exporting and importing firms.
- In recent years, many exporters have been forced to finance international transactions by taking full or partial payment in some form other than money. A number of alternative finance methods, known as *countertrade,* are widely used. In a countertrade transaction, product flows in one direction to a buyer in a sale; a separate stream of products and services is also created which often flows in the opposite direction.

7.7 KEY WORDS

- **Price discrimination:** It is a product pricing strategy in which consumers in different countries are charged different prices for the same product.
- **Transfer pricing:** It is when one company sells goods to another company, but both companies have common ownership.
- **Price escalation:** It can be defined as the difference between the domestic price and the target price in international markets.
- **Price distortion:** It can be defined as the situation where by prices of commodities deviate from the equilibrium or ruling prices due to several disturbances of the market system.
- **Countertrade transaction:** In such transactions, product flows in one direction to a buyer in a sale; a separate stream of products and services is also created which often flows in the opposite direction.

7.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are factors affecting international pricing.

2. List the key points that need consideration for determination of product price in international markets.
3. Write a short note on countertrade.

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Long-Answer Questions

1. Explain the methods of pricing.
2. Describe the different international pricing strategies.

7.9 FURTHER READINGS

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NOTES

UNIT 8 INTERNATIONAL DISTRIBUTION AND LOGISTICS PLANNING

Structure

8.0 Introduction
8.1 Objectives
8.2 Distribution: Definition and Importance
  8.2.1 Channel Marketing: Direct and Indirect Channels
  8.2.2 Factors Involved in Distribution Systems
8.3 International Logistics Management and Modes of Transportation
8.4 International Packaging
8.5 Answers To Check Your Progress Questions
8.6 Summary
8.7 Key Words
8.8 Self Assessment Questions And Exercises
8.9 Further Readings

8.0 INTRODUCTION

Distribution, packaging, and labelling within the boundaries of a nation is very different from conducting operations across borders. Considerations about the legalities, finances as well as necessities is important while making decisions about international distribution. Critical decisions about the channel length, members and their roles and their management has a great bearing on the operations. Firms trying to succeed in the foreign markets should made prudent decisions and make efficient structures of business so that their profit margins are not affected drastically as well as their losses and risks are minimized. In this unit, the different aspects of international distribution and logistics planning will be discussed.

8.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain distribution and related factors involved in international marketing
- Describe the selection of distribution strategy
- Explain the type of international channel members and their roles
- Discuss the concept of international logistics and modes of transportation
- Examine the functions of international packaging

8.2 DISTRIBUTION: DEFINITION AND IMPORTANCE

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An essential part of a firm's marketing mix is the formulation of its distribution strategy. This is a process by which a firm chooses the right strategy for delivering its product to the consumer.

The process of international distribution involves all activities related to time, place and ownership, and utilities for industrial and ultimate consumers. The selection, operation and motivation of effective channels of distribution are crucial factors for gaining advantages in the international markets. Availability of channels depends on culture and tradition.

Distribution channels are the link between producers and customers. This link is called direct distribution when a firm deals directly with the foreign firm and indirect distribution when another firm in the foreign country serves as an intermediary.

Developed countries have more distribution channels. Changes in the current structure can be introduced only in response to changes in the economic environment. There are a number of intermediaries involved in international distribution either directly or indirectly.

Distribution System

Figure 8.1 illustrates a typical distribution system consisting of a channel that includes a wholesale distributor and a retailer. If a firm manufactures its product in a particular country, it can sell directly to the consumer, to the retailer or to the wholesaler.

The same options are available to a firm that manufactures outside the country. Alternatively, this firm may decide to sell to an import agent, who then deals with the wholesale distributor, the retailer or the consumer.

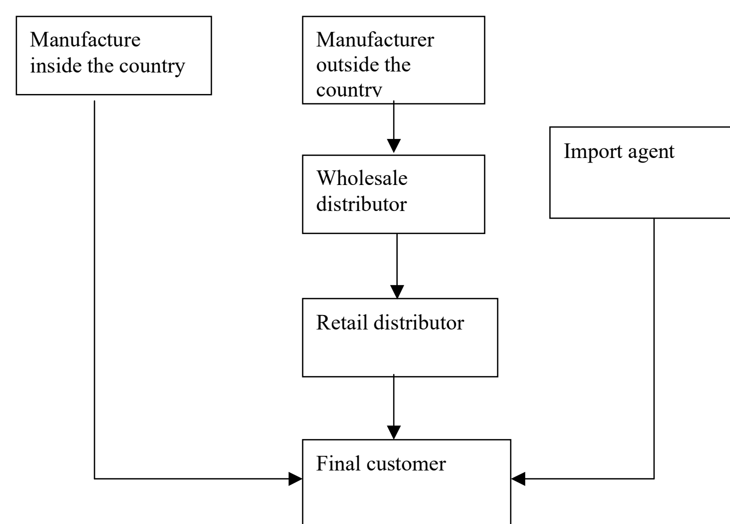

Fig. 8.1 A Distribution System in International Marketing

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8.2.1 Channel Marketing: Direct and Indirect Channels

A marketing channel can be defined as a method of getting a product to the customer's (the end-user's) hand. Direct sales and sales through a reseller are the commonly used methods in a channel. A direct sale happens via the phone, the Net or mail. An indirect channel sale typically refers to sales through a reseller. A reseller can order directly or from a wholesale distributor. The marketer would sell to a wholesale distributor who in turn would sell to multiple resellers (there are two tiers between the marketer and the end-user, hence the term "two-tier" distribution).

Which Channel to Use?

There is always a question about which channel to choose—direct or indirect. Companies have the option of using both and this is happening more and more especially with the popularity of the Internet. But companies should avoid getting involved in channel conflict.

Channel conflict happens mostly when the vendor and the reseller, or different reseller types (retail, VAR, mail order, Internet) compete for the same business.

To minimize conflict in channels, a marketer can take the following steps:

- Segment the products in different markets (different products are sold through different reseller types or channels).
- Identify and set up exclusive or limited territories.
- Adopt the approach of selling directly at a higher price than the average street price.
- Set up different promotions for different resellers, rotating them so they all have advantages at different times
- Set up reseller levels—reward higher margins and support for higher authorization (the resellers choose whether they can be competitive).
- Set up a process to determine if a customer has worked with a reseller prior to taking the business directly (so you do not steal the business that they cultivated), etc.

In international marketing, while doing channel selection, marketers should be aware that there are many ways by which channel conflict can be reduced. But the key is to be aware that it could exist and that it could have short and long-term ramifications. It is also important that you keep your reseller satisfied and ensure that your revenue targets are met.

Direct and Indirect Channels

The question of choosing direct, indirect or both channels of distribution are often determined by the following:

- **Ability to recruit resellers:** If there is difficulty in the distribution of a product or in finding resellers, then the direct channel should be selected.

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- **Product type:** If the product that the firm has introduced in the international market requires a lot of training, installation and support, firms may go directly until its resellers are trained and certified. Or, if the firm has a large enough sales force, it may opt for the direct channel. However, if the firm has sales people to only cover the largest number of customers, say ten sales people to cover the top 100 customers, but not enough to cover the middle 5,000 customers, the firm may wish to use resellers to cover the middle market. It may then segment the product line; one for direct and one for resellers.
- **Market dynamics:** As the market technology changes and products that once to required support become easier to use, and customers know what they want, firms may go direct (like Dell which started with a modest model as people needed support).
- **Price point**: High-end premium quality consumer products (such as expensive cookware, the best vacuums, etc.) are sometimes sold directly (and usually person-to-person) since the benefits (which are real, but not always obvious) must be sold. However, this does not mean that high-priced products cannot be sold via the same channel (boats, aircraft, million dollar SFA products, etc.).
- **Customer requirements:** Some customers require a direct relationship with the vendor to ensure that their needs are met. In some cases, when an account insists on going directly, the reseller can still earn a bounty for delivering the qualified, pre-sold lead.
- **Ability to manage resellers:** Much of the decision to go directly or indirectly is also dependent on the companies' ability to understand how the channel functions, how to come up with a competitive programme and manage the reseller programmes and relationships.

The final decisions on direct or indirect channels of distribution are based on the firm's business model and how it addresses the questions above.

8.2.2 Factors Involved in Distribution Systems

One major issue which affects channel decision in international marketing is of coping with differences among countries. These differences, as described earlier, exist because of diversity. There are three major differences in channel decisions—retail concentration, channel length and channel exclusivity.

i. Retail concentration

Retailers are companies that sell only to consumers. There is considerable diversity in the nature and size of retailers from one nation to another. Geographical factors are important considerations in retail concentration. Retail systems may be concentrated if size and diversity is less but if size and diversity are large, then the retail system will be more fragmented.

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It is easy to operate for many firms in concentrated systems and few retailers can have a major share of the market. In Germany, for example, four retail chains control 65 per cent of the market for food products.

In neighbouring Italy, retail distribution is fragmented, with no chain controlling more than 2 per cent of the market.

There is a tendency for greater retail concentration in developed countries. Three factors that contribute to this are the increase in car ownership, the number of households with refrigerators and freezers, and the number of two-income households.

All these factors have changed shopping habits and facilitated the growth of large retail establishments located away from traditional shopping areas.

ii. Channel length

International marketers utilize various channel patterns in serving their target customers. Marketers must decide upon the length and breadth of the channel.

In a channel length, there are a number of intermediaries between the product (and manufacturer) and the consumer. Channel length also depends on the number of intermediaries. Direct marketing is an example of very short channel length.

The number of import agents, wholesalers and retailers makes up the channel length. Normally, industrial product channels are shorter (involving fewer levels of intermediaries) than those for consumer goods.

Industrial goods are often technically complex, expensive and sold in large volumes to individual customers, favouring direct distribution.

The choice of a short or long channel depends on the marketing strategy of a firm. There is a wide choice of possible alternatives: road, rail, water (inland and coastal), pipeline and air.

What works for a firm is the only important consideration. Product, industry and distribution characteristics have a bearing on this. However, to be effective, the firm has to do something different from its competitors.

The reason for this is simple economics. It is very expensive to have and maintain a fragmented retail system. Also, it is problematic for firms to make contact with each individual retailer. Imagine, for example, a firm that sells toothpaste in a country where there are 50,000 small retailers. To sell directly to the retailers, the firm would have to build a huge sales force. This would be very expensive, particularly since each sales call would yield a very small order.

Imagine, however, that there are 50 wholesalers in the country that supply retailers not only with toothpaste but also with all other personal care and household products. Since these wholesalers carry a wide range of products, they get bigger orders with each sales call.

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Thus, it becomes worthwhile for them to deal directly with the retailers. Accordingly, it makes economic sense for the firm to sell to the wholesalers and for the wholesalers to deal with the retailers.

Value addition is what is offered by members of distribution channels in terms of service to the customer. The customer will appreciate and welcome this to the extent of recognizing its value in a premium price.

It is obvious that countries with fragmented retail systems will have long channels of distribution. The classic example is Japan, where there are often two or three layers of wholesalers between the firm and retail outlets. In contrast, in countries such as UK, Germany and the US where retail systems are far more concentrated, channels are much shorter. When the retail sector is very concentrated, it makes sense for the firm to deal directly with retailers, cutting out wholesalers.

A relatively small sales force is required to deal with a concentrated retail sector, and the orders generated from each sales call can be large. Such circumstances tend to prevail in the US, where large food companies sell directly to supermarkets rather than going through wholesale distributors.

Efficiencies are being sought in this area. Worldwide, the trend is towards shorter distribution channels and closer links, if not direct relationships, with the active participants in the channel.

iii. Channel exclusivity

An exclusive distribution channel entry of outside firms is very difficult. Shelf space in the US supermarkets is an example of channel exclusivity.

This happens because retailers prefer to carry the products of long-established manufacturers of foodstuffs with national reputations rather than gamble on the products of unknown firms.

Exclusivity in a distribution system varies between countries. Japan's system is often held up as an example of a very exclusive system. In Japan, relationships between manufacturers, wholesalers and retailers often go back decades.

Many of these relationships are based on the understanding that distributors will not carry the products of competing firms. In return, the distributors are guaranteed an attractive compensation by the manufacturer.

As many US and European manufacturers have learned, the close ties that result from this arrangement can make it difficult to access the Japanese market.

Instead of trying to enter in the traditional way, i.e., via the existing distribution channels, some western companies have been successful in Japan because they have short-circuited the traditional Japanese system and gone directly to the Japanese consumer instead.

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Going directly is clearly a trend in Western markets and provides the manufacturer with the ability to take back more control of the product and the level of services offered to customers.

Check Your Progress

1. What are crucial factors for gaining advantages in the international markets?
2. What is the key consideration to be aware of while doing channel selection in international marketing?

8.3 INTERNATIONAL LOGISTICS MANAGEMENT AND MODES OF TRANSPORTATION

Logistics involves *coordination* of the movement and storage of raw materials or inputs and outputs in order to meet customer demand in the right place and at the right time and at the lowest cost. It is, therefore, concerned with analysis of cost efficiency and feasibility of various modes of transport and temporary storage facilities required for movement of goods to their destination safely and with no or minimal materials lost during transit.

Logistics cost is estimated to be between 10–25 per cent of the landed cost of an international product. Therefore, its management is significant for increasing speed and efficiency and minimizing or reducing cost. Further, for an international company, different units/subsidiaries are widely dispersed in different countries with dissimilar environment; and sourcing for raw materials and also marketing of final products require different plans and strategies. Due to all these, logistics management becomes more complex.

Formulation of international logistics strategy is significant also because of the various problems which are involved in it. Problems can be of a general nature or of specific types. General problems relate to the long distances which imply more time and higher cost, changes in the exchange rate leading to foreign exchange exposure, and, in many cases, poor transport network.

Specific problems vary from one country to another. Mode of transport, warehousing facilities, packaging and labelling requirements, etc., differ from country to country. MNEs should be aware of these specific problems of the countries where they have operations (units and subsidiaries) or from where raw materials and inputs are to be sourced or where the markets exist.

To put all these together, specific issues to be addressed by logistics management are:

- Scheduling the arrival of materials and other inputs;
- Warehousing and inventory control including strategic choice and international warehousing facilities;

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- Production scheduling and monitoring of the progress of products through manufacturing process;
- Packaging, transportation and final delivery to customer;
- Choice of transport mode based on critical examination of various alternative modes of transport available in relation to customer need (speed and frequency of delivery, reliability of delivery date, convenience of collection, etc.,);
- Transport cost analysis—costs include freight charges, insurance, intermediate handling and storage (warehousing), special packaging cost, documentation expenses, spoilage rates, stockholding costs and interest on capital block as goods in transit.

Transportation Modes

In international logistics management, transportation is the most important issue or factor. In international transportation, the primary focus is on two modes of transport—ocean and air. The other modes—rail, road and motor carrier and also pipeline—are of importance in some regions like EU, but they are not commonly used for international movement of goods. The use of these modes is also dependent on the level of infrastructure of a country—extensiveness and efficiency of road system and rail network. In many non-triad countries, the infrastructure is poor and therefore, the use of these modes is limited by the general level of development in the country.

Ocean transport is the most commonly used mode of transportation for movement of all bulk cargoes in international business. This is also cheap compared to other modes. Air transport, which is the costliest, is mostly used for precious (gold, silver, diamond) and perishable (fresh flowers, fruits, vegetables) goods which are also light cargo. In sea transport, two types of carriers are used—break-bulk or containerized vessel which provides liner service, i.e., a pre-designed fixed route; the other is bulk carrier, also described as chartered vessel, which carries bulk cargo like iron ore, non-ferrous metal concentrates, fertilizers, etc.

Choice of Transport Mode

In deciding the ideal or optimal transport mode, we have considered three factors or criteria: speed or time, cost and liability or predictability. The fourth factor can be called a non-economic factor. This also has to be considered because this puts a constraint on free choice of transport mode or carrier.

Time or *speed,* i.e., the period between departure and arrival of a carrier can vary significantly. So one question is pertinent here: how quickly is delivery required? A number of factors determine the answer to this. One factor is perishability of the product. Exotic flowers from South America are flown to the US because

those cannot survive a sea voyage. Another factor is how soon the goods are needed to replenish stock. Cars from Japan are sent to the US by ship because the voyage time, with proper planning, does not affect delivery of cars stock with local dealers.

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To take care of the speed or time factor, companies are now coordinating their global supply chain to reduce the time taken to get the goods through the production cycle to the customers.

Cost or expenses associated with shipping is a major determining factor in deciding international transportation mode. Since, air freight is much more costly than sea freight, choice of air transport must be economically justifiable. Besides low volume precious and perishable goods, an MNE may use air shipments only when time is a critical factor and/or the product has high value. For example, if the company has purchased expensive watches in Zurich for its speciality outlets in New York and San Francisco, the watches may be flown to the retailers. On the other hand, if the merchandise is bulky or the cost of air freight is a significant proportion of the value of the product, it will be sent by sea. For example, automobiles are exported by ship as are bulk commodities like oil, coal, iron ore, etc.

Reliability or *predictability* of the transport mode is the third important factor. Both air and water transportation are generally reliable, but they are subject to the vagaries of nature. Bad weather can disrupt the functioning of the airport, inadequate seaport facilities can create congestion and cause delay in loading and unloading of cargo. Due to the big difference in delivery time between the two modes, the choice of a particular mode is sometimes obvious. If a company needs to have a package delivered tomorrow, it will be sent by air. But if a company wants to clear merchandize from the warehouse today but international customer does not require it for the next 60 or 90 days, it will be sent by sea. Also, certain carriers or shipping companies/lines are more reliable than others, and an MNE will use its experience in determining which companies to choose for delivery. Reliability is particularly important for air shipment where the difference of one day can significantly affect the saleability of a product.

Non-economic factors—which are actually the *policy factors*—also sometimes influence the choice of international transportation mode. In US, for example, all government cargo must use national flag carriers whenever available. In India also, exporters and importers are required to use Indian flag vessels of the Shipping Corporation of India (SCI) as far as possible. Many other governments own or subsidize their carriers, and there is pressure on MNEs to use these carriers when doing business with these companies. These factors should be taken into account by companies when formulating transportation strategy because this mostly affects freight competitiveness and, therefore, cost effectiveness of business.

8.4 INTERNATIONAL PACKAGING

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Packages have always served a practical function—that is, they hold the contents together and protect goods as they move through the distribution channel. Packaging is also a container for promoting the product and making it easier and safer to use.

Functions of Packaging

The critical functions of packaging include containing, protecting and promoting products as well as facilitating the storage, use and convenience of the products. A fourth function of packaging that is becoming more important now is to facilitate recycling and reduce environmental damage.

- **Containing and protecting products:** The most obvious function of packaging is to contain products that are liquid, granular, or otherwise divisible. Packaging also enables manufacturers, wholesalers, and retailers to market products in specific quantities, such as grams.

  Physical protection is another obvious function of packaging. Most products are handled several times between the time they are manufactured, harvested or otherwise produced and the time they are consumed or used. Many products are shipped, stored and inspected several times between production and consumption. Some, like milk, need to be refrigerated. Others, like beer, are sensitive to light. Still others, like bandages and medicines need to be kept sterile. Packages protect products from breakage, evaporation, spillage, spoilage, light, heat, cold, infestation, and many other conditions.

- **Promoting products:** A package differentiates a product from competing products and may associate a new product with a family of other products from the same manufacturer.

  Packages use designs, colours, shapes, and materials to try to influence consumers' perceptions and buying behaviour. Packaging has a measurable effect on sales. Appropriate packaging has been shown to improve sales by as much as 50 per cent.

- **Facilitating storage, use and convenience:** Wholesalers and retailers prefer packages that are easy to ship, store, and stock on shelves. They also like packages that protect products, prevent spoilage or breakage, and extend the product's shelf life.

  Consumers' requirements for storage, use and convenience cover many dimensions. Consumers are constantly seeking items that are easy to handle, open, and reclose, although some consumers want packages that are tamperproof or childproof. Consumers also want reusable and disposable packages.

Some firms use packages to segment markets. Different size packages appeal to heavy, moderate and light users. Packaging convenience can increase a product's utility and therefore, its market share and profits.

- **Facilitating recycling and reducing environmental damage:** One of the most important packaging issues today is compatibility with the environment. Some firms use their packaging to target environmentally concerned market segments.

Labelling

The label is an integral part of a package. Labelling can be generally seen in the form of persuasive labelling or informational labelling. While persuasive labelling is mainly concerned with the theme for promotion or the logo, informational labelling focusses on providing information to the customer. Persuasive labelling does not give much importance to information whereas informational labelling ensures that the customers are more knowledgeable about the product and its usage after the purchase.

Check Your Progress

3. Mention some of the specific problems of international logistics.
4. What are the factors considered for choosing mode of transport in international logistics?
5. What is persuasive and informational labelling?

8.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The selection, operation and motivation of effective channels of distribution are crucial factors for gaining advantages in the international markets.
2. While doing channel selection in international marketing, the key is to be aware that it could exist and that it could have short and long-term ramifications. It is also important that you keep your reseller satisfied and ensure that your revenue targets are met.
3. Specific problems of logistics including mode of transport, warehousing facilities, packaging and labelling requirements, etc., differ from country to country.
4. In deciding the ideal or optimal transport mode, we have considered three factors or criteria: speed or time, cost and liability or predictability. The fourth factor can be called a non-economic factor.

5. While persuasive labelling is mainly concerned with the theme for promotion or the logo, informational labelling focusses on providing information to the customer.

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8.6 SUMMARY

- An essential part of a firm's marketing mix is the formulation of its distribution strategy. This is a process by which a firm chooses the right strategy for delivering its product to the consumer.
- Distribution channels are the link between producers and customers. This link is called direct distribution when a firm deals directly with the foreign firm and indirect distribution when another firm in the foreign country serves as an intermediary.
- A marketing channel can be defined as a method of getting a product to the customer's (the end-user's) hand. Direct sales and sales through a reseller are the commonly used methods in a channel. A direct sale happens via the phone, the Net or mail. An indirect channel sale typically refers to sales through a reseller.
- Logistics involves coordination of the movement and storage of raw materials or inputs and outputs in order to meet customer demand in the right place and at the right time and at the lowest cost. It is, therefore, concerned with analysis of cost efficiency and feasibility of various modes of transport and temporary storage facilities required for movement of goods to their destination safely and with no or minimal materials lost during transit.
- Packages have always served a practical function—that is, they hold the contents together and protect goods as they move through the distribution channel. Packaging is also a container for promoting the product and making it easier and safer to use.
- The label is an integral part of a package. Labelling can be generally seen in the form of persuasive labelling or informational labelling.

8.7 KEY WORDS

- **Distribution strategy:** It is a process by which a firm chooses the right strategy for delivering its product to the consumer.
- **Marketing channel:** It can be defined as a method of getting a product to the customer's (the end-user's) hand.
- **Logistics:** It involves coordination of the movement and storage of raw materials or inputs and outputs in order to meet customer demand in the right place and at the right time and at the lowest cost.

8.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. What are types of channels for distribution in international marketing?
2. List the steps which can be taken to minimize conflict in channels.
3. What are the aspects considered while selecting between direct, indirect or both channels?
4. What are the specific issues to be addressed by logistics management in international marketing?
5. Write a short note on the functions of packaging and labelling.

Long-Answer Questions

1. Explain the aspects of major differences in channel decisions.
2. Discuss transportation as the most important aspect of international logistics management.

8.9 FURTHER READINGS

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BLOCK - III
INTERNATIONAL PROMOTIONAL STRATEGIES, FOREIGN MARKET

NOTES

UNIT 9 INTERNATIONAL PROMOTIONAL STRATEGIES

Structure

9.0 Introduction
9.1 Objectives
9.2 Communications Process
    9.2.1 Principles of Communication
9.3 Promotional Strategy: Planning Process
9.4 Status of Promotion and Promotion Appeals
    9.4.1 Media Selection
9.5 Public Relations and Publicity, Personal Selling, Sales Promotion and Direct Marketing
9.6 Advertising
    9.6.1 Standardization vs Adaptation in International Advertising
    9.6.2 Media Decisions
9.7 E-Marketing
9.8 Answers to Check Your Progress Questions
9.9 Summary
9.10 Key Words
9.11 Self Assessment Questions and Exercises
9.12 Further Readings

9.0 INTRODUCTION

International marketing has a very wide scope. It operates on a really large scale and involves variables of communication which are different from region to region. If the companies do not plan their promotional strategies in the international markets well, the ramifications can be huge. With the increasing use of the internet and digital media, while it is getting easier to connect with people across the world, and understand the nuances of different culture and audience for product, companies now have very little room to make mistakes or act ignorantly since people have increased access to all kinds of information now. In this unit, you will learn about the importance of communication in international marketing, the process and

principles of communication. This will be followed by general principles to be followed for planning promotional strategies along with the a discussion on different types of promotional tools available with international marketers.

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9.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the communication process in marketing
- Discuss the principles of effective communication
- Describe the steps involved in planning promotional strategies
- Examine the different strategies of promotion
- Assess the concept of advertising and decisions involved in them
- Discuss the concept of e-marketing

9.2 COMMUNICATIONS PROCESS

The task of communication is not to get one's ideas across to the other party. The real purpose of communication is to elicit the desired response from the target audience. Eloquence, sophistication and suave demeanour are pleasing to the communicator but serve absolutely no purpose in changing attitudes and behaviour of the target audience.

The target audience looks for conviction in the communicator. The target audience feels that if the communicator himself/herself does not believe in the idea, he/she has no right to preach. The intent of the communicator is more important to the audience. The communicator should be focused on the interests of the target audience. However, shoddily made an advertisement may be or, however, clumsy may a speaker be, the audience will sit up and take note when they hear their interests being discussed. It is what an advertisement or a speaker says that matters to the audience and not really how he/she says it. Especially, in situations where one individual talks to another individual or a group, effectiveness of communication is directly dependent on the intent, knowledge and conviction of the communicator. Most reticent of people became verbose when they are knowledgeable and convinced about an idea.

The world of communication has for long been concentrating on polishing the medium of communication, like speech and advertisement and somewhere down the line ignored the content that the message was supposed to carry. The audience too has been impressed with the slickness of the ad and the eloquence of the speaker but the message never really registered in their mind. The purpose of communication is to elicit the desired response from the target audience.

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The Process of Communication

Customers go through a complex chain of mental events from the time they see or hear an advertisement until they decide to make or not make a purchase. For marketing communication to succeed, two processes must take place in the customers' minds. First, what the customers saw, heard, learned, thought or felt while exposed to the advertisement must be processed and stored in memory; and second this stored information in the customers' minds must be retrieved at the crucial moment when a customer faces a purchase decision. For an advertisement to be successful, a customer must have the motivation, the ability and the opportunity to process and store the information in the advertisement and retrieve the information when the customer is about to make a purchase decision. Therefore, the customer exposed to an advertisement must be interested in the advertisement, knowledgeable enough to understand it and free from distractions of other stimuli. Also, the mental processes must occur with sufficient intensity or effort and must be focused towards the advertised brand.

Because the chain of events that marketing communications must stimulate is so complex, a wide variety of communication methods have to be used. This means using the whole range of communication methods – advertising, publicity, sponsorship and sales promotion. Or it may mean using several advertising media or different avenues within one media. The idea is to get the message across to the customers in a forceful way so that they are able to process the message and store it. Relying on a single source is dangerous as the customers may just miss the message unless they are in a state of heightened awareness because they want to make a purchase decision and is actively scouting for brands in the category that the advertised brand belongs to.

Companies that rely solely on television advertising face the problem of customers not being able to connect an advertisement with the brand it promotes. This particularly happens with advertisements that customers find engrossing. Since the intensity of customers' involvement in the advertisement is high, all their focus is on processing and storing the interesting setup, message or storyline in the advertisement and they miss the name of the advertised brand. Viewers often associate very popular advertisements with some other competitor brand of the same category. The company thus ends up promoting a rival brand. Viewers mistakenly attributed a popular advertisement for Eveready Energizer batteries to Duracell, Eveready's main competitor. In such situations, customers process and store the advertisement with sufficient intensity but in the wrong direction. A second communication method, if used, will set the direction right. So a packaging that uses the images of the advertisement or a radio advertisement that uses the jingle, music or the message of the television advertisement will help the customers retrieve the message and link it to the advertised brand.

Companies frequently use less expensive radio or print advertisement to reinforce expensive television advertising. The main vehicle is television advertising

and hence the total campaign becomes expensive. But a reverse sequence can also achieve the same purpose. Television advertisements can be used to supplement radio or print advertisements. Since the staple promotion vehicle will be the less expensive radio and print advertisements, the total campaign cost would be lesser but the effectiveness would be same or even more.

9.2.1 Principles of Communication

Marketers want the attention of their target customers. Customers are largely ignoring unsolicited advances from marketers. Customers are facing pressures from more urgent quarters of life and it would be naïve to believe that they would be willing recipients of whatever marketers have to tell them through their promotional efforts. The customer's attention is at premium and marketers will have to understand customer's psychobiology of attention to be able to get their messages across to him. The following are the principles of communication in terms of marketing.

- **People are hardwired to fight for survival.** If marketers want customers to act in a certain manner they will have to tell consumers the consequences of their not acting in that particular manner. If a retailer wants consumers to buy during a sales promotion, he should clearly communicate the difference in price between during sales and after sales period. And this difference should be big enough to get the consumer thinking about the amount of money he will lose if he did not buy now. Marketing communication should force the consumer to think for himself and take action in self-defence. If a company is launching a new or an improved product, it should let consumers know the consequences of not owning that product. Marketing communication can become scary but if a company is running 'true' sales or it has launched a 'genuine' new product, it should want its consumers to benefit from these. But if the threat does not turn out to be real even once, consumers will forever stop trusting the company's communications. No person will take kindly to being scared for nothing.
- **People are naturally competitive.** People play games to win trophy. If there was a trophy for everyone, most of us would not be interested in a game. Make your product hard to get. Communicate that not everyone can have your product even if they want to because the company has limited number of products that it will sell in a limited time frame. Ensure public competition for your product. Advertise a short sales period and a steep price decline. Advertise a new product launch with a deadline date for purchase. A company can devise games for their advertisements and websites and tempt customers to play them for the rewards offered on winning.
- **Do not let distractions cloud the main message.** A company's multiple messages from multiple vehicles will draw less-than-optimum customer attention on each one of them. Consumers reserve limited attention for a company's message and if this is spread too thin over many messages,

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attention on any one of them will not reach the threshold to prompt an action. A company should be running one core message at any one time. If a company is running an advertisement campaign for a new product launch, it cannot be running a sales promotion scheme or publicizing some act of good corporate citizenship simultaneously. A company should decide the response it wants to elicit from its customers and design and run an appropriate dominant message to get the desired response. The conventional wisdom of inundating customers with multiple messages from multiple vehicles in the hope that at least some will stick, does not work. Nothing sticks.

- **People want to feel engaged.** One of the most important factors for gaining and sustaining attention is engaging people's emotions. Plain advertisement will never engage customers. The product and messages about it should have more relevance than the benefits it provides. The messages could be about issues that are of interest to the consumers. If the company uses a celebrity to endorse its products, the celebrity should be personally interested in some cause that the consumers are interested in. Independent of the themes running in advertisements, companies can promote causes dear to its customers. The idea should be to form some sort of a joint endeavour between the company and its consumers to help the cause.

Check Your Progress

1. State the real purpose of communication.
2. What are the two process that must take place in the customer's minds for marketing communication to succeed?

9.3 PROMOTIONAL STRATEGY: PLANNING PROCESS

Promotion is a form of corporate communication that uses various methods to reach a targeted audience with a certain message in order to achieve specific marketing objectives. Like most marketing decisions, an effective promotional strategy requires the marketer to understand how promotion fits with other pieces of marketing especially in product, distribution, pricing, and target markets. It is important to know that marketers should not work in a vacuum when making promotion decisions. Rather, the overall success of a promotional strategy requires input from others in impacted functional areas.

Promoting Product/Service in International Market

Adopting the right kind of promotional strategies is the most crucial issue of entering markets of many countries. The prime objective of any promotion strategy is to make consumers aware of all features of the product or service in various market

segments. The buying decisions of consumers are based on the awareness of product features and related characteristics. For most firms, an effective promotion strategy is an approach by which they can disseminate information about the products or services. Dissemination of the right kind of information will positively influence their decisions about buying the product or service and convince them to use its services. Promotion is an effective tool to achieve this goal.

Market promotion always requires an effective assessment of the international market. This can be done through careful planning. There is a need for detailed planning of the final product and services. Marketers have at their disposal a number promotional strategies through which they can communicate with whomsoever they need to. The main promotional channels are:

- Advertising
- Sales Promotion
- Publicity and public relations
- Direct Marketing
- Personal Selling

Each of these has its advantages and disadvantages, and its relevance and effectiveness have to be analysed in relation to a given set of circumstances.

Promotion is more complex while operating across international boundaries, so it is not surprising that companies make mistakes. They make mistakes in domestic markets too!

Newspaper articles and textbooks often feature mistakes made by major companies in dealing with their promotional programmes in international markets.

To rectify these mistakes, it is advisable for firms to take certain steps in developing their promotional strategies in international market. Let's discuss these in the following paragraphs.

Planning Promotional Campaigns

Based on current trends in international marketing, the following issues require focused planning for promotional campaign by any organization.

1. Establishing Identity

In developing a promotional image, the first requirement is developing identity. Identity and image are not similar in promotional strategies. Identity is what firms really are. Image is how others see the firm. Identity includes characteristics like facilities, location, price, and attractions.

2. Deciding on Product

Deciding on the product that has to be communicated through promotion is also an important part of the promotional strategy. A product theme should be derived

from the identity of the product. Product themes can be defined as one main idea or message that the firm wants to communicate with promotional efforts.

3. Identifying Target Audience

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There is also the need to identify and contact target audience in promotion strategies. Target audience may be defined as the set of people that the firm wants to reach with its product/service information. The target audience may be identified as local or non-local visitors, repeat or first-time visitors, families or singles, and young or old. Different groups in the target audience have different needs.

For example, as a part of target audience we may say that senior citizens needs are different from those of young adults. When firms are developing their messages, they should address some of these needs.

4. Establishing Objectives

There is also the need to establish specific objectives based on what a firm wants the outcome of its strategy to be.

5. Developing Message Content

There are two types of information that firms can use:

- Informative
- Persuasive

6. Evaluation

Promotion strategies need to be periodically evaluated. Otherwise creating and implementing a promotional strategy can drain a firm's resources. An evaluation should assess the progress that the firm has made towards meeting its established objectives. Generally, it is good to wait one year after implementing the strategy to see if it works because promotional effects can be cumulative. The firm should always be ready to make changes.

Firms should also focus on following issues in their promotional strategies in international markets:

(A) Target Audience

- Promotional campaigns affect more than just the consumers who purchase the product or service. These could be suppliers, intermediaries, the government, local community, bankers and creditors, media organizations, shareholders, and employees.
- Research to determine a multi-market target audience is required as firms become more internationally involved.
- Corporate image advertising should be conducted.
- Umbrella campaigns must also be made.
- Global image campaigns must be done.

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Campaign Objectives

- Global objectives
- General guidelines and control for broad-based campaigns (consistency of message)
- Regional objectives
- Local objectives
- Specific and measurable targets (awareness, image, market share) for individual markets
- The budget

Audience Characteristics

- The strategy is to reach the intended target audience with the minimum of waste.
- Marketing strategist needs to know the following:
  - o Media distribution (number of copies).
  - o Media audience composition.
  - o Advertising exposure.
  - o Advertising perception.
  - o Consumer response.

(B) Market Segmentation

The macro view of the number of markets the company wishes to serve provides the foundation for market segmentation process by defining the generic market promotion strategy options. However, managers should remember what Tom Peters said—"Markets never buy anything. Only customers buy". In other words, selecting countries is a broad brush approach; choosing market segments is getting closer to understanding the details of market behaviour. Through market segmentation, the firm tries to get close to buyer behaviour to develop appropriate marketing programmes.

Accordingly, the first step in the focused market segmentation process is to identify and define groups of customers with common needs within their chosen markets. Segmentation in international markets is based on similar variables as in segmentation in domestic markets.

Geography, demography and culture (the 'who they are' factors) have been important segmentation variables in international markets.

- Geographical factors, such as regional patterns of behaviour and zones of influence, such as the British Commonwealth, were important features in the past, as they indicated common behaviour patterns.

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- Demographic factors, such as age patterns, income distribution, etc. have relevance in most markets to enable media targeting and to set price levels.
- Cultural values will identify problems in acceptance of products, but as the 'global village' concept extends, these are becoming less obvious in many product categories.

Increasingly, marketers are using geo-demographic, psychographic, benefit, lifestyle and behavioural dimensions (the 'how they act' factors) in international market segmentation.

Although segmentation across markets is complex because of the problems in gathering comparable market data, there are attempts to find segments with common profiles across different countries. For example, the geo-demographic research agency, Experian, has established a Global MOSAIC segmentation base, which seeks to evaluate different segment types across different markets.

The potential for segmentation based on factors other than national geographic criteria has been studied by academics since the early 1980s, when Theodore Levitt explored the concept of globalization. He identified the potential for global segments, as markets developed common requirements such as consumers seeking variety. This results in demand for sate and sushi in European markets, and pizza and pasta in Asian markets. Further, he commented that markets exist for high quality products at low prices the world over.

(C) Positioning

Positioning is the process of creating and sustaining a unique, distinctive and favourable impression of a product or service in the minds of customers. This implies that companies position products. Actually, all they can do is help consumers to position them. Marketers cannot manipulate people's thinking.

There are two extremes of positioning which translate across international markets. These are **high touch**—based on image and service, and which are high involvement purchases. For example, American Express is well known for their charge card and travel services. Their global positioning is based on high levels of customer service, especially in relation to credit cards. This indicates a solution to a common problem—most travellers fear that they will lose their money while travelling.

The other extreme is **high tech** positioning, which relies on product features, and the fact that buyers seek technical information on these attributes. Intel positions itself on the value that consumers derive from the Intel experience. Nokia and Ericsson have traditionally focused on these areas, but are increasingly moving towards high touch positioning.

Nike is widely known as a global player. Its corporate strategy was always based on finding capital and cheap labour in other countries. It grew to national dominance in the US in the 1970s taking the share of Adidas and Puma, the previously dominant European companies. It developed its international sales in the 1980s and 1990s, based on the 'Just Do It' brand mantra, and a close link with high profile sports personalities. These were chosen for local relevance—each country features sports characters to whom local people can relate.

A second key player in this market was Reebok, which started as a UK-based company, which targeted women who used the shoes for aerobics. The owner of the Reebok brand in the US decided to expand into the male market. This was and subsequently done in other countries too.

Nike and Reebok rely on the link to sporting heroes. While Nike focuses on mass appeal sports, Reebok concentrates on tapping important, but more localized sports, such as cricket in the UK, handball in Scandinavia and baseball in Japan.

Nike thus went from a US domestic strategy, to a global strategy. Their target segment and position is consistent in all its markets, although it is locally interpreted. Reebok has changed target segments over time, in gender, geography and interests. Now, they do not target Nike in a head-to-head battle, as they have chosen to focus on smaller niches in various sports markets. Each, thus, has its own market space, and faces different competitors.

(C) Market Targeting

Targeting is the process of selecting which and how many market segments should be served. This choice reflects company objectives and strengths, and reviews the attractiveness of segments, in terms of market growth, size, extent and intensity of competition.

Keegan identifies three global targeting strategies which are consistent with his model of standardization and adaptation.

- **Standardized or undifferentiated global marketing**, which is the same marketing mix in a mass market worldwide.
- **Concentrated global marketing**, which involves selling the same product with the same marketing mix, but focused on a small segment of the market.
- **Differentiated global marketing**, which involves offering a range of different marketing mixes to two or more markets.

These targeting strategies reflect at a micro level the macro decisions on competitive strategy and market coverage which is at the heart of international marketing decisions.

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Check Your Progress

3. State the prime objective of promotional strategies.
4. Who are the parties which get affected by promotion strategies?
5. What is high touch positioning?

9.4 STATUS OF PROMOTION AND PROMOTION APPEALS

Advertising appeals are the communication strategies used by the advertisers and marketers to gain the attention of the target audience and persuade them to purchase or adopt an idea. Marketers have to identify an appeal of theme that produces the desired response from the target audience.

There are three types of appeals namely rational appeal, emotional appeal and moral appeal.

(i) Rational appeal

Rational appeal relates to the audience's self-interest or logic or to the benefits they would get by using a particular product or brand. It demonstrates how the product would produce the desired benefits to the user. Messages showing quality of a product, economic value of a product or performance of the product, all use rational appeals. Most of the industrial products and financial products use Rational appeal.

(ii) Emotional appeal

Emotional appeal attempts to stir up emotions of the target audience, it is the most widely used appeal. Emotions used range from negative to positive but the ultimate aim is to lead the target audience to purchase or motivate them for desired action.

Advertisers may use emotional appeals ranging from joy, humour, fear, guilt, love, affection or patriotism. Advertisers claim that emotional appeals attract more attention and create more belief than any other appeal. Promotional campaigns using emotional appeals are more likely to be liked and remembered by the target audience. Emotional appeal is generally used for consumer goods category.

(iii) Moral appeal

Moral appeal refers to audience's sense of right and wrong. Moral appeals often urge people to support social causes or respond in an ethical manner. Some social appeals are also used which seek behavioural changes in the target audience by promoting a social cause in the society especially for the betterment of the society. Moral appeals are used to promote social cause or goods which are undesirable but required for a better society.

These appeals help the marketer or the advertiser to build up the message content relevant to the product and the target audience.

9.4.1 Media Selection

The major steps involved in selection of the advertising media are as follows:

Let's discuss these steps one by one.

(i) Decision on reach, frequency and Media impact

To select the media the advertiser must decide upon the reach and frequency required of the medium which can achieve the specified advertising objectives.

Reach is the measure of the percentage of people in the target market who are exposed to the advertisement campaign during a given period of time.

Frequency it is the measure of how many times an average person in the target market is exposed to the advertising message.

The advertiser must also decide on the required media impact. Media impact is the qualitative value of message exposure through a given medium.

Advertisers need to choose media that would engage the consumers rather than simply reach them.

(ii) Selecting among major media types

The media planner knows the reach, frequency and impact of each of the major media types. The major media types are television, the internet, newspaper, direct mailers, magazine, radio, social media and outdoor media. The advertisers can select from a wide collection of new digital medium as well. Also, medium available through cell phone and other digital devices with reach consumers directly. Each medium has its own advantages and disadvantages. Media planners consider several factors while selecting the media. The advertisers need to select the media that would effectively and efficiently present the advertising message to the target audience. Broadly, three factors which are important to be considered at this point of time are impact of the medium, message effectiveness of the medium and cost of the medium.

(iii) Selecting specific media vehicles

The media planner must select the best media vehicle. A media vehicle can be defined as the specific media within each general media type, such as television vehicles may include different TV channels such a Star TV, Sony, or Zee. The media planners must compute the cost per thousand people reached by a vehicle. The media planner should also consider the cost of producing advertisements for different media such as the newspaper advertisement or a print advertisement may cost very less but making audio visual advertisements for television may be very costly. While selecting media vehicles the media planner must balance between the media cost and the media effectiveness.

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(iv) Deciding on media timings

The advertiser must also decide about the scheduling of the advertisement over a period of time. The advertiser has to select the pattern of the advertisement. They may select continuity or pulsing pattern for the advertisement. Continuity means scheduling the advertisements evenly within a given period while Pulsing means scheduling advertisements unevenly over a given period of time.

Check Your Progress

6. Which type of advertising appeal is used by most of the industrial and financial products?
7. What is frequency when it comes to promotion media?

9.5 PUBLIC RELATIONS AND PUBLICITY, PERSONAL SELLING, SALES PROMOTION AND DIRECT MARKETING

In this section, you will learn about some of the popular methods of promotions in international marketing.

Public relations refer to the management promotion strategy undertaken with the purpose of ensuring goodwill of the organization and for building a trustworthy and reliable relationship with the public. Public relations' focus is on customers, markets as well as channels of distribution. Public relations include under its ambit activities like publicity, publications, charities, lobbying, corporate advertising and seminars etc. Publicity, as mentioned here, is a tool within the ambit of public relations which refers to the communication to the news media information about the organization, product or services without explicitly paying for the advertising space or time. Public relations and publicity are the conventional methods for sales promotion. But today marketers talk more of integrated marketing communication because simple publicity without effective communication does not conform to modern marketing, national or international.

Personal Selling

Personal selling is a two-way *personal communication* between a company representative and a potential customer. Personal selling in international marketing or business is commonly understood as salesmanship outside the home country or in the host countries.

Personal selling should be generally used under certain market situations. For industrial buying or large volume purchases characterized by large financial involvement, personal attention or personal selling is recommended. Personal selling has also been found to be effective when the market is concentrated or when a

salesperson has to develop certain degree of confidence in the potential customer before sale. Effectiveness of personal selling also depends on the product type. For example, personal selling mostly works well with high unit value and infrequently purchased products. Such products usually require a demonstration and are custom-made or tailor-made to an individual's and special need.

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Sometimes, personal selling methods may have to be modified for particular markets. Avon is a good example. Avon is able to use door-to-door selling in the US and Latin America, but the company has not found this practice suitable in some cultures. Asians, for example, are wary of strangers; because of this, Avon's sales representatives stop at the homes of friends and relatives. Neighbourhood parties sponsored by Avon (and communicating through these) are modified personal selling techniques which seem to work well in Asia. The same approach has been tested by the company in Germany also. In France, the prohibition of door-to-door selling has compelled Avon to shift to direct-mail sales.

An extension of personal selling in international marketing is international business negotiation. For marketing of industrial products, personal negotiation between the buyer and the seller companies is quite common. Negotiations are often done by teams rather than individuals. A research group observed 138 American, 54 Chinese, 42 Japanese and 38 Korean businesspeople in a two-person buyer-seller negotiation simulation. Negotiations between Americans involved use of more problem-solving bargaining strategies which positively influenced negotiation outcomes. In negotiations between Chinese, better results were derived from more competitive strategies.

In Japanese and Korean negotiations, buyers achieved better economic gains than sellers. In all four cases, country cultures influenced negotiations and negotiators became more satisfied with negotiation outcomes if partners were rated more attractive.

Sales Promotion

Sales promotion refers to any consumer or trade programme of limited duration that adds tangible value to a product or brand. So, sales promotion is temporary in nature. Not being self-sustaining, its function is to supplement advertising, personal selling and publicity. Sales promotion is more effective when a product is first introduced in a market. It can also be successfully used for existing products which are highly competitive and standardized. In such cases, sales promotion helps to gain extra or incremental competitive advantage.

Sales promotion techniques can be many and varied. The more common ones in use are: coupons, games, contests, price-offs, sweepstakes, demonstration premiums, samples and money refund offers. A combination of these can be, and sometimes is, used in the same campaign. When Kellogg's extended its business overseas, it had to enlighten consumers in South and Central America, the Middle East and Asia about dry cereal and cold breakfasts. To popularize this new eating

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habit, Kellogg's used samples and demonstrations in conjunction with a strong advertising campaign. To regain market share in Japan, Procter & Gamble distributed 1.5 million diaper samples of improved Pampers. Each diaper box also had a picture of a little bear. Parents could get baby items by saving/collecting the required number of bears.

Direct Marketing

Direct marketing is a form of promotion or marketing which integrates separate marketing mix elements to sell directly to both consumers (individuals) and other businesses bypassing retail stores and personal sales calls. The use of direct marketing is growing fast in different countries because of increased use of computer data bases, credit cards, toll-free numbers and also changing lifestyles. Today, it is used widely by consumers and business-to-business categories from industrial organizations to banks to airlines to non-profit organizations. Since the customer responds directly to the international company which makes an offer, factors like communication, distribution and sales have to be properly organized. Direct marketing uses a wide spectrum of media including direct mail, telephone, broadcast including television and radio and print including newspaper and magazine. The infrastructure of a country must be developed sufficiently to handle direct mail which is the most popular type and form of direct marketing.

Telemarketing is extensively used for direct marketing. Telemarketing, however, is not as developed in many countries as it is in the US. Limited availability of telephonic access to households is one reason. Privacy laws are another factor. *Cold calling* (unsolicited sales calls) is also under scrutiny in many countries in the name of consumer protection and privacy. In Germany, it is even more restrictive. The country prohibits cold calls on the grounds of privacy invasion, and this even applies to an insurance salesperson's call for a visit.

Advertising also comes under the promotional tool and is in fact one of the most important tools. But it requires a lengthy discussion and is therefore discussed separately in the following section.

Check Your Progress

8. List some of the common sales promotion techniques.
9. What are the media used in direct marketing?

9.6 ADVERTISING

Advertising is an impersonal form of promotion that is delivered through selected media outlets that, under most circumstances, require the marketer to pay for message placement. Advertising has long been viewed as a method of mass promotion in that a single message can reach a large number of people. But, this

mass promotion approach presents problems since many exposed to an advertising message may not be within the marketer's target market and, thus, may be an inefficient use of promotional funds. However, this is changing with new advertising technologies and with the emergence of new media outlets that offer more options for targeted advertising.

Advertising also has a history of being considered a one-way form of marketing communication where the message receiver (i.e., target market) is not in a position to immediately respond to the message (e.g., seek more information). This too is changing. For example, in the next few years, television viewers will be able to click a button to request more details about a product that they have seen on their favourite TV programme. In fact, it is expected that, over the next 10–20, years advertising will move from a one-way communication model and become one that is highly interactive.

Another characteristic that may change as advertising evolves is the view that advertising does not stimulate immediate demand for the product advertised. That is, customers cannot quickly purchase a product they see advertised. But as more media outlets allow customers to interact with the messages being delivered, the ability of advertising to quickly stimulate demand will improve. The importance of advertising can be judged by the spending on advertising. By one estimate, worldwide spending on advertising exceeds (US) $400 billion. This spending in many countries is mostly on media outlets, such as television, radio and newspapers.

Organizations differ on the role advertising plays. Some organizations may spend less on advertising and, instead, spend on other promotion options such as personal selling through a sales team. For some smaller companies, advertising may be on a very small scale, consisting of occasional advertisements and small ads in the classified section of a local newspaper.

Managing Advertising Decisions

Delivering an effective marketing message through advertising requires many different decisions as the marketer develops his advertising campaign. Small campaigning for advertising, which involve little creative effort may be handled by one or a few people in the firm itself. This can also be managed by the Internet. The Internet has especially empowered small businesses to manage their advertising decisions.

But for larger campaigns of advertising, different kinds of skills are required and such advertising may not be easily handled by a single person. While larger companies manage some advertising activities within the company, they are more likely to rely on the assistance of advertising professionals, such as advertising agencies, to help bring their advertising campaign to market.

9.6.1 Standardization vs Adaptation in International Advertising

Most of the time, large and multinational organizations prefer to go for standardization in advertising. The reasons are as follows:

Merits of Standardization

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- Allows multinationals to maintain a consistent image and identity throughout the world.
- Minimizes confusion among consumers who travel frequently.
- Allows a singly coordinated advertising campaign across different markets.
- Results in considerable savings in media costs, advertising costs, and advertising illustrative materials.

Some Standardization Generalizations

- Low product involvement
- Products not culturally sensitive
- Centralized decision making

Products Suitable for Standardized Advertising

- Luxury products
- High-tech products
- Experiential products
- Favourable country image products

The support for global advertising is threefold. First, it has significant economic advantages. Standardized advertising lowers the costs of value creation by spreading the fixed costs of developing the advertisements over a large number of countries.

Second, there is the concern that creative talent is scarce and hence that one large effort to develop a campaign will produce better results than forty or fifty smaller efforts.

A third justification for a standardized approach is that many brand names are global. With a substantial amount of international travel today and considerable overlap in media across national borders, many international firms want to project a single image to avoid confusion caused by local campaigns that conflict with each other.

This is particularly important in regions such as Western Europe, where travel across borders is as common as travel across state lines in the US.

Localized Advertising:

Localized advertising is preferred by organizations due to the following factors:

Local Environment Determinants

- Cultural environment
- Economic conditions

- Legal conditions
- Competition
- Advertising infrastructure
- Consumer profile
- Image of the country of origin

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Firm Environmental Determinants

(Managerial and Financial Characteristics)

- Corporate strategy
- Internal culture
- Decision-making authority
- Financial condition of organization
- Nature of product

Intrinsic Determinants

- International advertising objectives
- Relationship between multinational advertiser and advertising agencies
- Creative strategies
- Media strategies
- Other elements of communication mix
- Support activities and barriers

A spectrum of various degrees of localization is influenced by the presence or absence of the local firm and intrinsic determinants.

There are two main arguments against globally standardized advertising. Due to cultural diversity, it is extremely difficult to develop a single advertising theme that is effective worldwide. Messages directed at the culture of a given country may be more effective than global messages.

Second, country differences in advertising regulations may effectively block the implementation of standardized advertising.

Dealing with country differences

Given the arguments for and against the feasibility of globally standardized advertising, the question arises as to whether it might be possible to capture some of the benefits of global standardization while recognizing differences in countries' cultural and legal environments. Some firms have been experimenting with this.

A firm may select some features for all its advertising campaigns and localize other features. By doing so it may be able to save on some costs and build international brand recognition and yet customize its advertisements to different cultures.

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9.6.2 Media Decisions

The major channels that are involved in media decisions are as follows:

- Print publications providing global coverage with regional language and content editions
- Pan-regional radio, television and the Internet.

The following are the important global media characteristics

- Targetability
- Client-compatible editorial
- Editorial quality

Who advertises in the global media?

- Airlines, financial services as well as telecommunication, automobile, and tobacco companies

The Promotional Message

- Based on customer habits and motivations, that is, know what are consumers really buying and why.

The following are the factors in developing the message:

- Diffusion of the product or service into the market
- Criteria on which customers evaluate the product
- The product's positioning
- The idea is to have a world brand
- A product that is manufactured, packaged and positioned the same way around the world
- Localize international symbols with regional or country area themes and personalities

The Media Campaign Approach

- What type of outside services to use?
- How to establish decision-making authority?
- Outside services chosen by their quality of coverage
- The value of outside expertise
- Creative development skills
- Specialty marketing knowledge
- Conflict in the use of mega-agencies
- Conflict of interest when two competitors are represented by the same agency

Decision-Making Authority

- Centralized or decentralized decisions about advertising
- Centralization= scale, synergy, consistency
- Decentralization= proximity, flexibility, sensibility
- Overall organizational goal to continually improve advertising quality at the local level
- Coordinated decentralized approach to pan-regional campaign development
- Strong central control
- Knowledge of local markets

Measuring of Advertising Effectiveness through:

- Typical effectiveness-testing techniques
- Pre-testing of copy appeal and brand recognition
- Post-testing of product or brand recognition
- Measuring campaign's impact on sales
- Sales increases and sales pattern changes
- Increases in consumer awareness and recall

Most commonly, advertisements are placed through an appropriate advertising media. Each advertising media, has its own methods for accepting advertisements. These are based on different advertising cost structures (i.e., what it costs marketers to place an ad), different requirements for accepting ad designs (e.g., size of the ad), the different ways placements can be purchased (e.g., direct contact with media or through third-party seller), and different time schedules (i.e., when the ad will be run). Understanding the nuances of different media is the role of a media planner, who looks for the best media match for a client and also negotiates the best deals.

Media planning is a process of selecting media time and space to disseminate advertising messages in order to achieve marketing objectives. Media planning facilitates firms to determine which media to use—television programmes, newspapers, bus-stop posters, in-store displays or banner ads on the Web. It also helps firms in deciding when and where to use media in order to reach the desired audience.

The media planner's role can be that of a brand contact. Instead of focusing solely on what medium is used for message dissemination, media planners also pay attention to the creation and management of brand contact. Brand contact is any planned and unplanned form of exposure to and interaction with a product or service. Television commercials, radio ads, and product sampling are major examples of planned forms of brand contact. Word of mouth contact is generally regarded as an unplanned brand contact—advertisers normally do not plan for word-of-mouth contact. From the consumer's perspective, however, unplanned

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forms of brand contact may be more influential because they seem to lack the kind of manipulation that advertising is sometimes deemed to use.

The brand contact perspective shows how the role of media planners has expanded. First, media planners have moved from focusing only on traditional media to now focusing on integrating traditional media and new media. New media—cable and satellite television, satellite radio, business-to-business e-media, consumer Internet, movie screen advertising and videogame advertising—is playing an increasingly significant role.

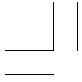
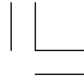
Secondly, it has been observed that media planners are making more use of product placements, currently, in lieu of advertising insertions. Advertising insertions, like print ads or television commercials, are made separately from the content and are inserted into it. The ads are distinct from the articles or TV programmes, and not a part of them. As a result, the ads seem intrusive. In contrast, product placement (also called brand placement or branded entertainment) blends product information with the content itself. Whether content is a television programme, movie, video game or any other form of entertainment, product placement puts the brand message into the entertainment content.

Finally, the role of media planners has expanded as media planners have moved beyond planned messages to take advantage of unplanned messages as well. While planned messages are what advertisers initiate, like an ad, press release or sales promotion, unplanned messages are often initiated by people and organizations other than the advertisers themselves. Word of mouth, both online and offline, is one form of unplanned message. Although advertisers have little direct control over the flow of unplanned messages, they can facilitate such a flow.

Media objectives are also based on two key components: target audience and communication goals. The target audience component of the media objectives defines *who* the intended target of the campaign is. The communication goals component of the media objectives defines *how much* of the audience the campaign intends to reach and how many times it will reach them. In short, media objectives are a series of statements that specify what exactly the media plan intends to accomplish. The objectives represent the most important goals of brand message dissemination, and they are the concrete steps to accomplish marketing objectives.

9.7 E-MARKETING

E marketing or electronic marketing or online marketing refers to the marketing conducted with the help of internet. E marketing is the process of marketing products and brands using internet through computers and mobile devices medium. E marketing encompasses all the activities of business conducts via internet with the aim of attracting new business, retaining current business and also developing its brand identity.

Advantages of e-marketing are

- Ability to target customers at a much faster and cheaper rates
- reduction of marketing cost through automation of electronic media
- nearly real time interactions between the marketer and the customer
- One to one marketing experience
- access to customer data
- Wide geographic reach

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Types of e-marketing or online marketing are as follows

- Search engine optimisation (SEO)
- Paid advertising
- Email marketing
- Social media marketing
- Mobile marketing

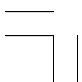
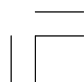
Online marketing or e marketing is rapidly growing in the world and it is becoming increasingly popular in the Indian subcontinent too. The scope of e marketing broad too, the four major online marketing domains are B2C business to consumer, B2B business to business, C2C consumer to consumer and C2B consumer to business.

Check Your Progress

10. State the two main arguments against globally standardized advertising.
11. Why is it that unplanned forms of brand contact may be more influential from the consumer's perspective?

9.8 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The real purpose of communication is to elicit the desired response from the target audience.
2. For marketing communication to succeed, two processes must take place in the customers' minds. First, what the customers saw, heard, learned, thought or felt while exposed to the advertisement must be processed and stored in memory; and second this stored information in the customers' minds must be retrieved at the crucial moment when a customer faces a purchase decision.

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3. The prime objective of any promotion strategy is to make consumers aware of all features of the product or service in various market segments.
4. Promotional campaigns affect more than just the consumers who purchase the product or service. These could be suppliers, intermediaries, the government, local community, bankers and creditors, media organizations, shareholders, and employees.
5. High touch positioning is an extreme of positioning which is based on image and service, and which are high involvement purchases.
6. Most of the industrial products and financial products use Rational appeal.
7. Frequency it is the measure of how many times an average person in the target market is exposed to the advertising message.
8. Sales promotion techniques can be many and varied. The more common ones in use are: coupons, games, contests, price-offs, sweepstakes, demonstration premiums, samples and money refund offers.
9. Direct marketing uses a wide spectrum of media including direct mail, telephone, broadcast including television and radio and print including newspaper and magazine.
10. There are two main arguments against globally standardized advertising. Due to cultural diversity, it is extremely difficult to develop a single advertising theme that is effective worldwide. Second, country differences in advertising regulations may effectively block the implementation of standardized advertising.
11. From the consumer's perspective, however, unplanned forms of brand contact may be more influential because they seem to lack the kind of manipulation that advertising is sometimes deemed to use.

9.9 SUMMARY

- The task of communication is not to get one's ideas across to the other party. The real purpose of communication is to elicit the desired response from the target audience. Eloquence, sophistication and suave demeanour are pleasing to the communicator but serve absolutely no purpose in changing attitudes and behaviour of the target audience.
- Customers go through a complex chain of mental events from the time they see or hear an advertisement until they decide to make or not make a purchase. For marketing communication to succeed, two processes must take place in the customers' minds.
- Like most marketing decisions, an effective promotional strategy requires the marketer to understand how promotion fits with other pieces of marketing

especially in product, distribution, pricing, and target markets. It is important to know that marketers should not work in a vacuum when making promotion decisions. Rather, the overall success of a promotional strategy requires input from others in impacted functional areas.

- Adopting the right kind of promotional strategies is the most crucial issue of entering markets of many countries. The prime objective of any promotion strategy is to make consumers aware of all features of the product or service in various market segments.
- Advertising appeals are the communication strategies used by the advertisers and marketers to gain the attention of the target audience and persuade them to purchase or adopt an idea. Marketers have to identify an appeal of theme that produces the desired response from the target audience.
- There are three types of appeals namely rational appeal, emotional appeal and moral appeal.
- Public relations and publicity are the conventional methods for sales promotion. But today marketers talk more of integrated marketing communication because simple publicity without effective communication does not conform to modern marketing, national or international.
- Personal selling is a two-way *personal communication* between a company representative and a potential customer. Personal selling in international marketing or business is commonly understood as salesmanship outside the home country or in the host countries.
- Sales promotion refers to any consumer or trade programme of limited duration that adds tangible value to a product or brand. So, sales promotion is temporary in nature. Not being self-sustaining, its function is to supplement advertising, personal selling and publicity. Sales promotion is more effective when a product is first introduced in a market.
- *Direct marketing* is a form of promotion or marketing which integrates separate marketing mix elements to sell directly to both consumers (individuals) and other businesses bypassing retail stores and personal sales calls.
- Advertising is an impersonal form of promotion that is delivered through selected media outlets that, under most circumstances, require the marketer to pay for message placement. Advertising has long been viewed as a method of mass promotion in that a single message can reach a large number of people.
- E marketing or electronic marketing or online marketing refers to the marketing conducted with the help of internet. E marketing is the process of marketing products and brands using internet through computers and mobile devices medium.

9.10 KEY WORDS

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- **Promotion:** It is a form of corporate communication that uses various methods to reach a targeted audience with a certain message in order to achieve specific marketing objectives.
- **Advertising appeals:** These are the communication strategies used by the advertisers and marketers to gain the attention of the target audience and persuade them to purchase or adopt an idea.
- **E-marketing:** It refers to the marketing conducted with the help of internet.

9.11 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the importance of communication in marketing.
2. What are the main channels of promotion?
3. Briefly explain the promotion or advertising appeals.
4. What are the steps involved in media selection when it comes to promotional strategies?
5. Write short notes on public relations, publicity, sales promotion and direct marketing.
6. List the problems a firm may face in communicating internationally.
7. How has the role of media planners expanded as per the brand contact perspective?

Long-Answer Questions

1. Explain the principles of effective communication.
2. Discuss the issues which require focused planning for promotional campaign by any organization.
3. Describe target audience, market segmentation, position and targeting in case of international promotions.
4. Examine the standardization and adoption debate in international advertising.

9.12 FURTHER READINGS

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UNIT 10 FOREIGN MARKETS AND EXPORT MARKETING PROCESS

Structure

10.0 Introduction
10.1 Objectives
10.2 Choosing Appropriate Mode of Operations
10.3 Issues Related to Exports
10.4 Processing an Export Order
10.5 Export Contract
10.6 Export Pricing and Costing
10.7 EXIM Policies
10.7.1 Export-Import (EXIM) Policy – 2002-2007
10.7.2 Export-Import (EXIM) Policy – 2009-2014
10.7.3 Foreign Trade Policy 2015-20
10.8 Answers to Check Your Progress Questions
10.9 Summary
10.10 Key Words
10.11 Self Assessment Questions and Exercises
10.12 Further Readings

10.0 INTRODUCTION

Foreign market operations are usually not very easy to handle given the scale of operations and the differences originating from operating business different geographical regions. The firms must be very thorough in their market research and analysis and identify all the risks and issues of concern and assess how much their own business are equipped to handle these situations. One these are properly evaluated, based on their objectives and company's needs, they can choose the appropriate mode of foreign market operations.

In the export procedures, one of the most important concepts of interest in the export order processing. This is a combination of many different steps which must be followed diligently to ensure that the export process is smooth, efficient and successful.

Countries and their national policies have a significant bearing on how export procedures and operations are manifested and regulated in the country. A good knowledge of these policies is fundamental to the export operations.

In this unit, the concept of choosing the mode of foreign market operations, the issues of concerns related to exports, stages of export order processing, export pricing and the EXIM policies are discussed.

10.1 OBJECTIVES

After going through this unit, you will be able to:

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- Discuss the appropriate mode of foreign market operations
- Examine the issues of concern in relation to exports
- Describe the stages of export order processing
- Explain the basics of export pricing
- Discuss the recent EXIM and Foreign Trade Policies

10.2 CHOOSING APPROPRIATE MODE OF OPERATIONS

One of the most strategic decisions to be taken in international marketing is the mode of entering any foreign market a company may decide to do the total manufacturing of the product domestically and export the finished products to the foreign market or on the other hand a company main manufacture the product to be marketed in any foreign market in the foreign country itself.

These entry strategies may also be called as the mode of operations in international marketing. Since, you have already learnt about these strategies in an earlier unit. We will only briefly recapitulate these in this section.

i. Licensing of franchising

Licensing and franchising involve minimum level of commitment of resources and effort on the part of the international market these are the easiest ways of entering the foreign markets.

As an entry strategy licensing and franchising does not any capital investment or requirement of knowledge and marketing strength in foreign markets. By earning royalty income, it provides an opportunity to exploit research and development already committed to by the licensee company. Licensing reduces risk of exposure to government interventions because the licensee is typically a local company that can provide leverage against government action.

ii. Exporting

Exporting is the most traditional mode of entry into any foreign market. It is very common. Exporting is an appropriate strategy to follow when the volume of business is not large enough to justify production in the foreign market or when cost of production in the foreign market is too high or market is characterized by production bottlenecks such as infrastructural problems or when there is a political and other risk of investment in the foreign country or when company has no permanent interest in the foreign market. Exporting is an attractive mode of entry particularly

when underutilized capacity exists with the exporting firm. There are two modes of export indirect exporting and direct exporting.

iii. Contract manufacturing

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Contract manufacturing means when a company goes international by the help of contract with a foreign firm.

The main advantage of contract manufacturing is that company does not have to commit any resources for setting up production facilities. it is also free from risk of investing in a foreign land and idle production capacity is readily available in the foreign country and it enables the international marketer to start immediately and in certain cases cost of product obtained by contract manufacturing is much lower than that manufactured by the international firm.

The disadvantages of contract manufacturing are – there is less control over manufacturing process and risk of developing potential competitors.

It is more suitable in the cases of high technology-based products.

iv. Management contract

Under management contract the company is providing only the management know how and does not have any equity stake in the organization being managed. This means in a management contract the supplier brings together a team of skilled people who provide an integrated service to the client without entering the risk and benefit of ownership. Thus, management contracting is a low-risk method of getting into a foreign market and it starts the earning right from day one. The arrangement is especially attractive in the case when contracting firm is given an option to purchase some shares in the managed company within a stated period.

The turnkey contract are common in the international business specially in the area of supply and commissioning of big plants such as oil refinery, steel mills, cement and fertilizer plants. A turnkey operation is an agreement by the seller to supply a buyer with facility fully equipped and ready to be operated by the buyer's people who are also trained by the seller. The term is often used in fast food franchising when the franchisor agrees to select a store site, builds store, equips it, train the franchisee and employees and sometimes arranges for the financing as well. Many turnkey contracts involve government as well as public sector. A turnkey contractor may subcontract different parts of phases of the project.

v. Assembly operations

The establishment of assembly operations represent a mix of exporting and overseas manufacturing.

Assembling the product meant for foreign market and in the foreign market itself has the cost advantage and certain other advantages too such as import duty is generally lower on parts and components as compared to the finished products.

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vi. Fully owned manufacturing facilities

Companies with long term and substantial interest in the foreign markets usually established fully owned manufacturing facilities. Establishment of manufacturing facilities abroad has several advantages it provides the firm with complete control over production and quality. It does not have the risk of developing potential competitors as may be the case in case of licensing and contract manufacturing. Wholly owned manufacturing facility has several disadvantages also as the cost of production is high in foreign land there may also be problem such as restrictions regarding type of technology and non-availability of skilled labour, production bottleneck due to infrastructural problem and if the market size is small a separate production unit for the market may be uneconomical.

vii. Joint ventures

Joint ventures are again very important foreign market entry as well as growth strategy specially for the firm with deficiencies in resources technology and marketing most of the Indian firms use this strategy also several pharmaceutical companies like Ranbaxy, Lupine, Dr Reddy's Lab have used the same route to enter the foreign markets.

Joint ventures can be of following types

a. Sharing of ownership and Management in an enterprise
b. Licensing of franchising agreements
c. Contract manufacturing
d. Management contracts

viii. Countertrade

Countertrade is a form of international trade in which export and import transactions are directly linked with each other. The import of goods is paid for by export of goods instead of money payments. Countertrade refers to attempt to dispense with currency transactions.

Counter trade takes place in several forms such as barter transactions, buy back agreements compensation deals, counter purchase agreements to name a few.

ix. Mergers and Acquisitions

Mergers and Acquisitions are very important market entry strategy. Mergers and Acquisitions are also used for growth strategy they may be used to acquire new technology.

x. Strategic alliance third country location

Strategic Alliance provides enormous scope for the Indian business firms who want to enter the international business or those who wish to expand their

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international operations it is particularly important for all types of technology acquisitions and overseas marketing. The strategic alliance is indeed a very important international marketing strategy employed by several of the Indian organisations operating in the international markets.

Check Your Progress

1. What is the most traditional mode of entry into any foreign market?
2. When is management contracts especially attractive?
3. Define turnkey operation.

10.3 ISSUES RELATED TO EXPORTS

In this section, you will have a look at the different issues of concern in relation to exports.

Language

Currently, English has by and large been accepted as an international language for international trade. There is also a need for export professional to acquire fluency in this language. Fluency in English is also an important factor in making export business more effective. There is also a need for developing and conversing in the terminology peculiar to a particular industry, sector or an area of commerce. If in some countries like China, Japan and others, where there are few English-speaking persons, translators and interpolators may help in developing effective and potential relations with the trading partners. There are a wide range of interpreting and translating services available in India. These services may be explored and utilized as and when the need arises.

Culture

Exporters may find completely diverse religious, social and business culture in the international market. Therefore, it is also equally important to understand the cultural perspectives of clients.

Although one cannot possibly become an expert on every set of differing social, cultural and commercial values, one may learn the major cultural aspects of different markets in international business like the attitude to dress, alcohol and drugs, religious festivals and aspects of social etiquette, factors that are considered important in personal perceptions (e.g., religion, caste, education, wealth, political affiliations and age). Before entering into overseas markets, it is good to gain some cultural understanding of the business clients by contacting one or more ethnic business organizations, chambers of commerce and social groups within the exporter's own capital city. Some academic institutions have agencies devoted to a particular region, for example, the Indian Institute of Foreign Trade, New Delhi, India.

Understanding the Risks in International Trade

It is not possible to eliminate risks from export transactions. The development of export markets must be regarded as a long-term investment and companies should not expect an immediate return on the time and capital they invest. Banks, accountants, export consultants and government agencies can advise on ways of minimizing financial risks and exporters are encouraged to use external advice to supplement their own skill base. A risk management strategy developed as part of an export business plan will help identify risks in export business and provide a strategy to minimize and handle those risks should they occur.

While selling abroad, the firm may face any of the following risks:

(i) Credit risk
(ii) Currency risk
(iii) Carriage risk
(iv) Country risk

To a great extent, these risks can be insured by taking appropriate steps. Credit risk against the buyer can be covered through an irrevocable letter of credit from the overseas buyer. For this purpose, an appropriate policy from the Export Credit and Guarantee Corporation of India Ltd can also be obtained. The ECGC also covers country risks. The exporter should obtain forward cover from the bank authorized to deal in foreign exchange in regard to currency risks, i.e., possible loss due to adverse fluctuations in exchange rate. Alternatively, a firm can obtain export order in Indian rupee. A marine insurance policy from the general insurance companies will cover carriage risk, i.e., possible loss of cargo in transit.

The internationalization boom proved important for international market analysis, for adopting right kinds of marketing strategies at the entry level by multinational companies in emerging markets. It is important for companies to do a comprehensive market analysis before making an entry into the foreign market. The following factors are important to consider:

Financial risks

- ***Failure to pay:*** The exporter should be aware of the international payment terms ranging from totally secure (payment before the goods are dispatched) to minimum security (dispatch the goods and wait for payment). Which particular term should be used has to be negotiated between the buyer and the seller when entering into a contract.
- ***Cash flow:*** Export will have a significant effect on the cash flow cycle of a business. It is not always possible to negotiate payment in advance or immediately after shipment. This may lead to a considerable delay in receiving payment for goods and result in a cash flow problem. Alternatively, if favourable terms are available, export can have a very positive effect on the cash flow cycle.

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- ***Foreign currency risk:*** If export contracts are written in foreign currencies, fluctuations in rates of exchange can result in financial loss. This risk can be avoided by quoting in Indian rupee or in American dollar. If this is not acceptable to the overseas buyer, forward exchange cover can be taken from the bank.
- ***Inadequate working capital:*** Exporters may need additional working capital to purchase the raw materials and other components they require to produce goods for export. Access to adequate pre-shipment finance is crucial to export success. There are risks involved in over-borrowing and firms must ensure that they can fully service the additional borrowings export may entail.

Intellectual property risks

Inexperienced exporters are vulnerable to the risk of losing intellectual property. The legal systems in some countries do not afford the same level of protection for intellectual property rights, as so many developed countries do. The cost of patenting a product or registering a trademark internationally can be substantial, as can the defence of patents or trademarks if they are infringed upon. Exporters should also ensure that their product does not infringe upon the intellectual property rights of other companies already operating in the marketplace.

Increased insurance claims

Transport over long distances with repeated handling can increase the risk of cargo damage. Freight forwarders can advise on the best methods of packing and transporting to prevent damage and reduce the risk of claims. Unethical trading partners may use spurious claims to achieve a discount on price. In such circumstances, it is advisable to obtain inspection certificates from cargo surveyors to prove quality standards at the point of loading. Given the increasing trend towards litigation, exporters are now more vulnerable to product liability claims in the overseas market. Exporters must consider the difficulty of obtaining adequate product liability insurance and the cost of such cover. It is also important to consider the warranty, continuing technical update of products, spare parts supplies, servicing of equipment, etc., which may be required to support export sales. All these factors will affect the ongoing market acceptance of the product or service and its price in the marketplace.

Inadequate resources

A business seeking to enter the international marketplace must ensure that it has adequate resources, including raw materials, components and human and financial resources to meet the export requirements. If these resources are not available and part of the export work needs to be subcontracted, the business runs the risk of losing control of quality or of spending time and money on constant supervision.

Check Your Progress

4. List the risks any firm may face while selling abroad.
5. What is the risk of inadequate working capital?

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10.4 PROCESSING AN EXPORT ORDER

It is a requirement that first the export order should be acknowledged, and then it should be carefully examined in terms of items, specification, pre-shipment inspection, payment conditions, special packaging, labelling and marketing requirements, shipment and delivery date, marine insurance, documentation, etc. A formal confirmation should be sent to the buyer if all these conditions are satisfactory. Otherwise, before confirming the order, a clarification should be sought from the buyer. After confirmation of the export order immediate steps should be taken for procuring/manufacturing the export goods.

Why is an Export Order Processed?

An export order has to be processed to meet the requirements of materials required by the importers. The export order must be processed as expeditiously as possible so that the buyers can receive the materials on time, as per their delivery schedules and also conforming to the specifications stipulated by them.

Parties, Acts and Publications Involved

An exporter should consult the most important Acts/publications in connection with the processing of an export order. The Imports and Exports Control Act (1947), now replaced by the Foreign Trade (Development and Regulation) Act, Custom Act, 1962, Carriage of Goods by Sea Act, 1924, the Foreign Exchange Regulations Act, 1973, schedule of charges of goods in respect of the port of shipment, Handbook of Export Promotion, and Export-Import Policy and Handbook of Procedures (1992-97) should be consulted.

The main parties involved in this processing are the exporter, the buyer, the negotiating bank, the shipping company, the insurance company, the Reserve Bank of India, the Chief Controller of Imports & Exports (Director General of Foreign Trade), the Controller of Customs, the port commissioners, and the clearing and forwarding agents.

Stages of Processing an Order

The following are the stages of processing an export order:

First stage: The exporter should scrutinize the export order with reference to the terms and conditions of the contract. This is the most crucial stage. All subsequent actions and reactions will depend on the terms and conditions of the

NOTES

export contract. It should be ensured that the contract has been entered into in accordance with the prevalent export promotion policies of the country and the foreign exchange regulations. The export order must specify the mode of payment in unmistakable terms.

The clearance of the excise authorities has to be obtained. This can be done in two ways. The first way is to make payment of the excise duty at the time of removing the export consignment from the factory and file a claim for rebate of duty after exportations of goods. The second way is secure clearance under bond. This involves entering into a bond under such terms and conditions as the Collector of Customs may decide. When the export goods are removed from the factory, a debit entry for excise duty is made in the bond account of the exporter. This obligation is discharged after exportation of the goods. The exporter has to prepare two important documents: AR-4 Form and the Gate Pass Form. Form GP-I is used when the export goods are to be removed under claim for rebate of duty and Form GP-2 is to be predated when the goods are to be removed under bond. If the exporter wishes, the central excise officer can make physical verification at the factory and seal the packages. For this purpose, a prescribed supervision fee has to be paid. In this case, AR-4 Form has to be used.

The other authority, which is to be approached immediately at this stage, is the Export Inspection Agency for conducting quality control and reshipment inspection. An inspector is deputed by the Inspection Agency to inspect the export consignment. If the goods conform to the prescribed specifications, an inspection certificate is issued. The goods are dispatched to the port of shipment and the railway receipt is obtained.

Second stage: As soon as the export order has been confirmed, preparations for the dispatch of goods are started. A 'delivery note' (in duplicate) is sent to the factory manager. This note should contain the description of the goods as has been given in the export order, along with a copy of the instructions given by the importer. The date by which the goods must be manufactured, the date by which the necessary formalities must be completed, the requisite time margins to be given must be clearly intimated to the works manager.

***Third stage*:** This stage involves the role of the Development Commissioner of Foreign Trade Zones (FTZs)/Export Processing Zones (EPZs), and the Federation of India Export Organizations. Once an exporter has been registered, the registration shall remain valid for five years. Registered exporters have to submit quarterly reports about export made by them.

Fourth stage: After the goods have been dispatched to the port town, the works manager sends a 'dispatch advice' to the Export Department. Soon after, an application is sent to the insurance company for marine insurance cover. The insurance policy is obtained in duplicate. At this stage, formalities in relation to floor regulations, canalization, certificate origin, ECGC cover and consular invoice,

wherever necessary, should be completed. Thereafter, the Export Department should send the following documents to its clearing and forwarding agents along with detailed instructions.

There are three types of shipping bills, namely:

- Shipping bill for free goods
- Dutiable shipping bill
- Drawback shipping bill

The shipping bill must be prepared according to the category of the export goods. The shipping bill with requisite number of copies (usually five copies) is submitted to the Export Department of Customs House along with documents from serial no. 1. The shipping bill for 'free' goods is processed in the following manner:

- Deposited in box
- Dealt by receiving clerk
- Dealt by distributing clerk
- Checked and passed by appraiser
- Okayed by Principal Appraiser

Fifth stage: The clearing and forwarding agent takes delivery of the consignment from the railways and arrange for its storage in the warehouse. Thereafter, he prepares the requisite copies of the shipping bill.

In case of processing of 'dutiable/drawback' shipping bill, apart from the first six steps mentioned above, the bill has to go through the following additional persons: (1) Pass examiner; (2) Duty calculator; (3) Accounts clerk dealing with deposit account or cash, and (4) Cashier for duty receipt. In case drawback is involved, the shipping bill would also require to be passed by the Drawback Appraiser, with an endorsement on the duplicate shipping bill or original, where necessary, for holding the drawback examination of the export goods in the docks.

Sixth stage: After the shipping bill has been passed by the customs, the clearing and forwarding agent presents the port trust copy of the shipping bill to the shed superintendent of the port trust and obtains the carting order for bringing the export cargo in the transit shed for physical examination. Thereafter, in the case of shed cargo, the dock challan is prepared. Where the shiploads override, the dock charges are indicated on the shipping bill itself, and therefore, no separate dock challan is prepared. The following details are given in the dock challan: (1) Consignee's name and address; (2) Vessel's name; (3) Port of destination; (4) Exporters name; (5) Marks and number of packages (these must be given in the shipping bill); (6) Gross weight; (7) Measurement in cubic metres or weight in metric tonnes; (8) Port charges payable; and (9) Other details as required.

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The dock challan is processed in the following manner:

- Placed in the receiving box
- The port commissioner's shipping charges calculated and checked by the clerk
- Deposited with the cash clerk
- Dock challan released by distributing clerk to the clearing and forwarding agent

Seventh stage: The passed shipping bill, including the dock challan in case of overside cargo are carried by the authorized licensed courier accompanying the goods for making the cargo ready for shipment after finally being passed by port commissioners and the custom shed staff. For shed cargo in dock, the following steps are taken: (1) Gate warden checks the documents, registers and permits entry of cargo into the dock; (2) The export shed writer accepts dock challan and cart ticket; (3) The receiving clerk issues unloading slip for cargo from lorry after checking its condition. (4) The supercargo arrangers unload cargo from lorry; (5) The writer registers the dock challan in manifest and sends it to the customs preventive officer for endorsement; (6) The preventive officer examines and checks the contents, weight, etc. of the goods and if in order makes an endorsement 'Let Ship' on the duplicate copy of the shipping bill, and the dock challan is finally signed by the customs divisional officer; (7) The port commissioner writes in the shed register the details and releases the dock challan; (8) The supercargo takes over control of the cargo shipment. In case of overside cargo, the cargo is shipped accompanied by a boat note and the shipping bill is then registered with the customs for which a pass is issued.

Eighth stage: The ship's export clerk calls for the cargo from the shed or boat and after loading prepares the mate's receipt. The ship's captain or his agent signs the mate's receipt. It is then delivered to the port commissioner's shed. The clearing and forwarding agent pays the port charges and takes delivery of the mate's receipt. In the case of overside shipment, the mate's receipt is directly given to the clearing and forwarding agent. It is then presented to the preventive officer for certifying the fact of shipment on all copies of the shipping bill, original and duplicate of AR4A/AR4 Form, and all other documents that need post-shipment endorsement from the Preventive Officer. The mate's receipt is presented to the shipping company and the requisite number of copies or the bill of lading (usually two negotiable and about a dozen non-negotiable copies) are obtained by the clearing and forwarding agent.

Ninth stage: The clearing and forwarding agent forwards the following documents to the exporter:

- Full set of bill of lading, COB together with required number of non-negotiable copies
- Export promotion copy of the shipping bill

NOTES

- AR-4A/ AR-4 Form (duplicate copy)
- One copy of the commercial invoice duly attested by the Customs Department
- Original export order
- Original letter of credit
- Railway concession form duly attested by the customs.

Tenth stage: As soon as the exporter receives the above documents from the clearing and forwarding agent he completes the remaining formalities. The negotiating bank transmits the duplicate copy of the GR Forms to the Exchange Control Department of the Reserve Bank of India.

The original copy of the bank certificate, along with attested copies of the commercial invoice, is returned to the exporter. The duplicate copy of the bank certificate is forwarded to the office of the Director General of Foreign Trade in the area. The exporter is paid the value of the export consignment against the abovementioned documents.

Check Your Progress

6. Mention the parties involved in export order processing.
7. What are the types of shipping bills?

10.5 EXPORT CONTRACT

The contract to buy and sell goods is the starting point of international trade. Around the sales contract revolves a series of connected but distinct relationships, including the transport arrangement and cargo insurance, to an international trade transaction; the rules and practices concerning such contract may vary considerably from one situation to another, depending not only on the legal system involved, but also on the types of agreement concluded between the trading partners. Some of these differences, as well as new developments at the international level to harmonize rules on international trade contracts, are discussed in the following sections.

Export order is a document communicating decisions of a foreign buyer to purchase certain item(s) from an exporter. It specifies the description of item(s), their quantity and quality specifications, unit price, delivery terms, shipping marks, insurance requirement, and requirements as regards labelling, packaging and packing, payment terms, pre-shipment inspection requirements, documents required, and so on.

Export agreement refers to the offer by the exporter and its acceptance by the buyer. It is defined as exchange of promises by the parties to the agreement, i.e., every promise and every set of promises forming consideration for each other. In case of an export agreement, the promise of the exporter is to supply goods as

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per quality specifications and other terms and conditions negotiated with the buyer of the goods. The promise of the buyer is to make payment to the exporter when he/she supplies the goods as per the terms and conditions of the export order. The exporter conveys this promise when he/she sends the 'offer to sell' to the buyer. The buyer conveys his /her promise by conveying his/her acceptance to the offer and communicating it to the exporter. Thus, the exchange of offer by the exporter and its acceptance by the buyer represents the conclusion of an agreement between the exporter and the buyer. This agreement, called the export agreement, could be written in a proper legal format or it could be well be evidenced by the exchange of letters between the parties.

Export contract can be understood within the framework of the definition of the term contract as defined under the contract law. Accordingly, contract is defined as an agreement enforceable by law. An agreement would be treated as a contract if it is made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void. Thus, the export agreement would also be treated as an export contract if it meets the essential requirements of the contract. On the basis of the above discussion, it can be stated that the terms 'export order', export agreement and export contract essentially signify the same thing, that is, the decision of a foreign buyer to buy specified item(s) from an exporter on the agreed terms and conditions.

Terms and Conditions of an Export Order

The terms and conditions of an export order would vary from order to order depending on the nature of product, parties involved, and so on.

But the following are the standard clauses of an export order:

- Product and its description
- Product specifications as regards its quality
- Price: FOB/CFR/CIF etc., as per Incoterms, 2000
- Quantity
- Payment terms: D/A, D/P, Letter of Credit, Advance Payment, etc.
- Delivery schedule: Time Period; partial/complete dispatch
- Mode of shipment: Air/ Sea/Road/ Post
- Type of shipment: Direct/Transshipments
- Inspection
- Labelling, packing and marking requirements
- Insurance—By exporter/importer
- Documents required
- Escalation clause: Sharing of increase in cost

- Force majeure clause: Clause providing for excuse of non-performance due to acts of God
- Arbitration clause: Clause for settlement of dispute
- Fines/penalties
- Applicability of law

Offer and Acceptance

An international sales contract comes into being when one party—the exporter—makes an offer and the other—the importer—accepts it. The offer and the acceptance have to match for the agreement to be formalized. The exporter, for example, sends out his quotation on a standard form incorporating his general conditions. The importer then possibly accepts the offer, but sends his reply on a form referring to his own standard purchasing conditions. The two sets of conditions— those of the exporter and those of the importer—may differ on various points. Under most legal systems, it will be considered that no enforceable agreement has come into being in a case such as this.

Forms of Contract

In general, export agreements do not have any particular form, although the precise requirements vary from one country to another. In many countries, a legally binding contract arises from an agreement between the exporters and the importers and can be manifested in many different ways—their agreement may be a formal document, a series of telexes, an exchange of messages between computers, a telephonic conversion or simply an oral agreement during contract at a trade fair. In certain other countries, however, for instance, in the East European countries, contracts must normally be written documents.

Format and Contents of an Export Contract

What is indeed important is not so much the format as the contents of a contract spelling out terms and conditions on which the contract is based, but the specific terms and conditions pertaining to the product/products that are subject matter of sale/purchase and the general terms and conditions.

In the first group, quality and specifications of the product are to be included. These would naturally differ from product to product. What is essential is that in the contract, detailed and careful description should be given about the characteristics, design and specifications of the product. As far as general conditions are concerned, the standardized position can be a good guide, but it is essential that the exporter and the importer do understand the implications of each of the standardized conditions and agree to them in the standardized form after duly considering the pros and cons of every condition. Some important general terms and conditions, which usually get incorporated into export contracts/orders—either

NOTES

explicitly or implicitly—and which are desirable for the parties to deliberate upon with a view to arrive at agreed positions are discussed below:

- **Formation or conclusion of a contract:** In case of a written agreement, a contract would be reached if both parties agree on it. In case of a constructed contract, if one party has sent a telex, telephone or any other kind of message, saying that the terms and conditions as referred to in such and such telex are acceptable, then the contract would be deemed to be entered into. It is desirable that the finally parties exchange reconfirmation messages to avoid all kinds of ambiguities.
- **Assignment:** In case the intention of any one of the parties is to assign one's own rights and obligations set out in the contract to some other party, the best course then would be to make such an arrangement. Unless it is specifically done, there would be difficulties at a later stage.
- **Pre-shipment inspection:** It is in the interest of both the parties into a contract to arrange for the pre-shipment inspection of goods for quality, quantity and/or price. This would be helpful at various stages particularly for securing payment or making claims on the carrier or the insurance company. Once the arrangement has been agreed upon and the inspection agency identified, it is the duty of the exporter, unless a contrary position has been mutually agreed upon the parties, to take up the inspection work. The exporter has to provide all necessary facilities and cooperation to the inspection agency. The contract should clearly indicate as to which party is going to bear the cost of inspection.
- **Product description and specifications:** It is the duty of the exporter to ensure that the product is in conformity with the standards and specifications agreed upon. The sample approved by the importer should match the product supplied.
- **Quantity:** The number of products should be indicated in specific terms. If the quantity of goods delivered by the exporter is less than the quantity indicated in the contract, the importer then has the right to refuse to take the delivery. However, if the importer accepts the short consignment, then he/she is bound to pay for the actual quantity delivered to him/her. If the consignment is larger than the quantity indicated in the contract, the importer may accept only the quantity contracted and may refuse to accept the excess. However, if the importer accepts the excess, then he/she is bound to pay for the excess.
- **Quality:** The goods delivered by an exporter should be in conformity with the contract. Unless the contract specifically mentions that the goods to be supplied may be second hand, all supplies have to be of new and of unused goods only. If the quality of goods is at variance with the contracted quality, then the importer can reject the goods and claim damages. Alternatively, the importer can negotiate with the exporter

that he would accept goods only if the price is reduced by a specific margin.

- **Packing, marking and labelling:** An export contract should indicate clearly the requirements specially insisted upon by the importer with regard to packing, marking and labelling. All the items entail costs which have to be borne by the exporter and that is why the position in regard to special requirements should be clear from the very beginning. The usual understanding in regard to 'reasonable' packing, in contrast to special stipulations set out by the importer, is that the exporter shall provide such packing as is required to prevent damage or deterioration of goods during transit to their final destination and it would be strong and protective enough to withstand rough handling during transit and exposure to vagaries of temperatures, salt and precipitation during transit and open storage.

  All packages have to be clearly marked and labelled as required in the contract. In case of marking, information that has to be indicated on each package should be in easily readable ink, giving the name of the consignee, contents of the package including name of the product, net and sometimes also weight and country of origin.
- **Incoterms, price and total value:** The contract should indicate clearly the price and the total value. The price would of course depend upon the terms of delivery and for this purpose incoterms are usually used.
- **Taxes, duties and other charges:** Who would bear which tax depends very much on how the prices are quoted and herein inctoterms become relevant.
- **Delivery period:** It is important that contracts clearly indicate stipulations with regard to delivery period. There should be no vagueness on this issue. Expressions, such as immediate and prompt should as far as possible be avoided to describe the delivery period, as they give rise to ambiguities. In case of payment of L/C, if the expiry period is expressed in terms of months and not precise dates, the expiry date is determined by taking into account the date on which the exporter received first information of the L/C either from the issuing or from the advising bank.

  In case of late deliveries not involving L/C mechanism of payment, the importer can insist upon the payment to be made by the exporter by way of liquidated damages a sum equivalent to a certain percentage of the contract price for every week of delay. However, acceptance or no acceptance of the late delivery is an option of which the importer can take advantage. It is perfectly open to the importer not to accept late deliveries at all and exercise the option of rejecting the contract.
- **Acceptance:** In transactions other than those involving payment by the L/C, the importer would be deemed to have accepted the goods only

NOTES

when he has reasonable time and opportunity to examine them to determine whether they are in conformity with the contract.

- **Transfer of risk:** Incoterms define the point at which risk passes on from the exporter to the importer. Unless otherwise agreed between the parties, the risk passes on to the exporter when the goods are handed over to the first carrier for transmission to the importer.
- **Mode of payment:** The contract should clearly indicate the mode of payment, whether it is an L/C or a Documentary Collection (D/C) or Document on Acceptance (D/A) and other details, in particular terms, currency, amount, etc. in each case.
- **Documents:** It is important that the exporter supplies to the importer all essential documents pertaining to a contract and its execution. Some important documents are as follows:
  - o All other essential negotiable and non-negotiable documents in particular
  - o Bill of lading
  - o Commercial invoice and its other variations
  - o Packing list
  - o Insurance documents
  - o Certificate of origin

  These documents should be supplied expeditiously. In fact, the documents must travel faster than the goods.
- **Guarantee and warranties:** This clause in a contract should clearly provide the details of guarantees and warranties and the period over which they will be operative. This clause is usually on the following lines:

  'The contractor warrants that everything to be furnished hereunder shall be free from all defects and faults in materials, workmanship and manufacture and is consistent with the established and generally accepted standards for material of the type ordered, and in full conformity with the specifications, drawing or samples, if any, shall, if operable operate properly. The warranty shall apply to inspection of payment for and acceptance of the goods, but shall expire except in respect of complaints notified to the contractor prior to such date, months and after delivery or months after their arrival at the ultimate destination, whichever shall be sooner.'
- **Redress and liquidated damages:** The contract should provide for specific remedies with respect to different contractual defaults, in particular with regard to the quantum and manner of calculations of liquidated damages.

- **'Force majeure' and frustration:** Sometimes, performance of a contract becomes impossible because of occurrence of certain unforeseen and uncontrollable events, e.g., war, civil disturbance, natural calamity, economic upheavals, etc. Such situations are called 'act of God', 'frustrating events', 'failure of presupposed conditions' or 'force majeure'.

  It is important that the export contract contains a clause providing for such eventualities, specifying clearly the type of events that would be covered by the term and if necessary the manner of recognition of such eventualities including, if necessary, remedies and procedures.

  The International Chambers of Commerce (ICC) has prepared a model contract clause on 'Force Majeure and hardship'. If the intention of the parties of a contract is that the ICC model clauses should be applicable to a given contract, then they should specifically mention this in the following words. 'The Force Majeure (Exemption, Clause of the International Chambers of Commerce (ICC Publication No.421) is hereby incorporated in this contract.' The ICC Publication mentioned above has enumerated the following impediments as the one in respect of which the 'Force Majeure' clause will be applicable: war, whether declared or not, civil war, riots and revolutions, act of piracy, acts of sabotage; natural disasters such as violent storms, cyclones, earthquakes, tidal waves, floods, destruction by lightning; explosions, fires, destruction of machines of factories and of any kind of installations; boycotts, strikes and lockouts of all kinds, go-slows, occupation of factories and premises and work stoppages which occur in the enterprise of the party seeking relief; acts of authority, whether lawful or unlawful, apart from acts for which the party seeking relief has assumed the risk by virtue of other provisions of the contract.

  If not mentioned in the contract, impediment does not include lack of authorizations of license of entry, residence permits, or of approvals required for performance of the contract and to be issued by a public authority of any kind whatsoever in the country of the party seeking relief.

- **Third party claims and indemnities:** If an exporter is supplying some goods or items in which the intellectual property rights in the nature of 'patent' or 'copyright' do exist, then that fact must not only be disclosed but a suitable clause should be incorporated in the contract. In the absence of such disclosure or clause, the importer would be exempted from any liability or claim made by any third party, in case the importer is required to indemnify the former of all such expenses.

- **Settlement of disputes and applicable law:** There is indeed no single, uniform, well-integrated and comprehensive international law which can

NOTES

be applicable to all aspects of international sales contracts except for some specific aspects, however, as mentioned earlier, standard practices and codes are developed by the International Chambers of Commerce. If an export contract specifically refers to those standard codes, then provisions as set out in those codes apply. However, if the contracts do not refer to standard codes, then provisions as set out in those codes apply. However, if the contracts do not refer to standard codes, nor they have specific clauses on issues discussed above, then the possibility of difference of opinion leading to dispute may crop up.

For settling disputes one can either go to the courts or may choose to resort to arbitration. It is important that export contracts include appropriate clauses indicating how the disputes are going to be resolved. If any one of the parties decides to go to a court of law, then the question arises whether it is the courts of law of the exporter's country or those of the importer's country, that have this jurisdiction. The general practice has so far been that, unless in the contract itself the jurisdiction aspect has been clearly spelt out, the law of that country with which the agreement is most closely connected will apply. In the case of an export contract, it is the country of exporter which is most closely connected with the agreement because it is in that country that the goods are to be assembled and put on board the ship and therefore the jurisdiction will be with the exporting country's courts of law. In international trading transactions, parties normally do not like to go to courts and instead decide to go to arbitration. The fact that disputes are to be settled by resorting to arbitration should be clearly stated in the contract, inter alia indicating whether arbitration in accordance with ICC rules or the rules set out by the UN Commission on International Trade Law will be applicable.

Check Your Progress

8. When does an export come into being?
9. List the ways in which export contracts can be manifested.
10. When is pre-shipment inspection particularly helpful?
11. What are frustrating events?

10.6 EXPORT PRICING AND COSTING

One of the most important determinants of business success is the determination of the right price. Charging of the right price depends upon number of factors like nature of other elements of marketing mix, nature of market including demand and competitive situations, the price has to be consistent with other elements of the marketing mix. At the same time price have to be responsive to the demand too.

Cost is one of the most important considerations in export pricing.

Export prices in a similar manner to domestic prices are determined by the cost and the demand and supply conditions as well as competitive conditions are considered.

The cost and supply conditions dictate the minimum on the floor price the exporter must charge while the demand and competitive conditions determine the maximum price of the ceiling price which he can charge.

Pricing for export market is more complex and difficult than for the domestic market.

Export pricing has to accommodate the trade practices and regulations of the overseas market as well. It should also take into account the additional cost involved in respect of packaging, labelling, marking, transportation, storage, coverage of export risk, export incentives such as duty drawbacks may also influence the export prices. Export pricing involves careful consideration and incorporation of several factors.

Types Of Cost Involved In Export Marketing

There are broadly two types of cost involved in export marketing namely

i. production cost

ii. selling and delivery cost

Let's discuss these briefly here.

i. Production cost are of two types fixed cost and variable cost:

Fixed cost: Fixed cost are costs which remain fixed irrespective of the level of production such as investment and land building plant and machinery.

Fixed cost is the cost which also remains the same over a range of output which means that the total fixed cost remains same whether there is no production at all or when the production is at the maximum capacity.

Variable Cost: Variable cost are the costs which vary with the variation in the level of output and include cost of factors such as labour material etc. all the average variable cost per unit may remain same for different levels of output but the total variable cost will vary with the level of production.

ii. Selling and Delivery Cost

Besides the production cost there are several other costs which an exporter must consider and sometimes it becomes important than the production cost. The selling and delivery costs include cost of holding the stocks, packing, transportation, documentation, pre shipment inspection, insurance and marketing costs such as cost of advertising, personal selling etc.

NOTES

Selling and delivery cost may also be divided into fixed and variable cost.

Variable cost also known as direct cost or primary cost because they vary directly with the variations in the level of production. Cost which cannot be directly apportioned to any product such as cost of plant maintenance, lighting arrangements etc are called indirect cost.

Check Your Progress

12. What dictates the minimum and maximum price which an exporter can charge for a product?
13. List the constituents of selling and delivery cost.

10.7 EXIM POLICIES

In this section, you will learn about the different important EXIM policies in the last two decades.

10.7.1 Export-Import (EXIM) Policy – 2002-2007

The following are the highlights of the EXIM policy 2002-07:

- The EXIM Policy for 2002-07 which came in effect on 1st April, 2002 was the first policy which had to be formulated keeping in view all the commitments India had made under the WTO. In 2001, all quantitative restrictions on imports were removed.
- **SEZ:** Offshore Banking Units (OBUs) were permitted in SEZs. Detailed guidelines were worked out by RBI to help some of our cities emerge as financial nerve centers of Asia. Units in SEZ were permitted to undertake hedging of commodity price risks, provided such transactions were undertaken by the units on stand-alone basis. This would impart security to the returns of the unit. It had also been decided to permit External Commercial Borrowings (ECBs) for tenure of less than three years in SEZs. The detailed guidelines were worked out by RBI. This was to provide opportunities for accessing working capital loan for these units at internationally competitive rates**.**
- **Agriculture**

  Export restrictions like registration and packaging requirement were removed on Butter, Wheat and Wheat products, Coarse Grains, Groundnut Oil and Cashew to Russia. Quantitative and packaging restrictions on wheat and its products, Butter, Pulses, grain and flour of Barley, Maize, Bajra, Ragi and Jowar had already been removed on 5th March, 2002.

  Restrictions on export of all cultivated (other than wild) varieties of seed, except Jute and Onion, removed. To promote export of agro and agro

NOTES

based products, 20 Agri export zones had been notified. In order to promote diversification of agriculture, transport subsidy was to be available for export of fruits, vegetables, floriculture, poultry and dairy products. The details were worked out in three months. 3% special DEPB rate for primary & processed foods exported in retail packaging of 1 kg or less.

- **Cottage and Handicraft**

  An amount of Rs. 5 crores under Market Access Initiative (MAI) had been earmarked for promoting cottage sector exports coming under the KVIC. The units in the handicrafts sector can also access funds from MAI scheme for development of website for virtual exhibition of their product. Under the Export Promotion Capital Goods (EPCG) scheme, these units would not be required to maintain average level of exports, while calculating the Export Obligation. These units were entitled to the benefit of Export House status on achieving lower average export performance of Rs. 5 crore as against Rs. 15 crores for others. The units in handicraft sector were entitled to duty free imports of an enlarged list of items as embellishments up to 3% of FOB value of their exports.

- **Towns of Export Excellence:**

  With a view to encouraging further development of centers of economic and export excellence such as Tirupur for hosiery, woolen blanket in Panipat, woollen knitwear in Ludhiana. Common service providers in these areas ware entitled for facility of EPCG scheme. The recognized associations of units in these areas would be able to access the funds under the Market Access Initiative scheme for creating focused technological services and marketing abroad. Such areas would receive priority for assistance for identified critical infrastructure gaps from the scheme on Central Assistance to States. Entitlement for Export House status at Rs. 5 crores instead of Rs. 15 crores for others.

- **Leather Exports:** Duty free imports of trimmings and embellishments upto 3% of the FOB value hitherto confined to leather garments extended to all leather products.

- **Textiles:** Sample fabrics permitted duty free within the 3% limit for trimmings and embellishments. 10% variation in GSM was allowed for fabrics under Advance Licence. Additional items such as zip fasteners, inlay cards, eyelets, rivets, eyes, toggles, velcro tape, cord and cord stopper included in input output norms. Duty Entitlement Passbook (DEPB) rates for all kinds of blended fabrics permitted. Such blended fabrics to have the lowest rate as applicable to different constituent fabrics.

- **Gem & Jewelry:** Customs duty on import of rough diamonds was reduced to 0%. Import of rough diamonds is already freely allowed. Licensing regime for rough diamond was abolished. This was done to help the country emerge as a major international centre for diamonds. Value addition norms for export

NOTES

of plain Jewelry reduced from 10% to 7%. Export of all mechanized unstudded Jewelry allowed at a value addition of 3 % only. Having already achieved leadership position in diamonds, now efforts were to be made for achieving quantum jump on Jewelry exports as well. Personal carriage of Jewelry allowed through Hyderabad and Jaipur airport as well.

- **Electronic Hardware:** The Electronic Hardware Technology Park (EHTP) scheme was modified to enable the sector to face the zero duty regime under ITA(Information Technology Agreement)-1. Net Foreign Exchange as a Percentage of Exports (NFEP) positive in 5 years. No other export obligation for units in EHTP. Supplies of ITA I items having zero duty in the domestic market to be eligible for counting of export obligation.
- **Chemicals:** All pesticides formulations to have 65% of DEPB rate of such pesticides. Free export of samples without any limit. Reimbursement of 50% of registration fees for registration of drugs.
- **Project Exports:** Free import of equipment and other goods used abroad for more than one year.
- **Facilities to Status Holders:** The status holders were eligible for the License/Certificate/Permissions and Customs clearances for both imports and exports on self-declaration basis. Fixation of Input-Output norms on priority; Priority Finance for medium- and long-term capital requirement as per conditions notified by RBI; Exemption from compulsory negotiation of documents through banks. The remittance, however, would continue to be received through banking channels; 100% retention of foreign exchange in Exchange Earners' Foreign Currency (EEFC) account; Enhancement in normal repatriation period from 180 days to 360 days.
- **Neutralizing high fuel costs:** Fuel costs to be rebated by it in Standard Input Output Norms (SIONs) for all export products. This would enhance the cost competitiveness of our export products.
- Setting up of "Business Centre" in Indian missions abroad for visiting Indian exporters/businessmen.
- **ITPO portal** to host a permanent virtual exhibition of Indian export product.
- **Focus LAC** (Latin American Countries) was launched in November, 1997 in order to accelerate our trade with Latin American countries. This had been a great success. Focus Africa was proposed to be launched. The first phase of the Focus Africa programme was to include 7 countries namely, Nigeria, South Africa, Mauritius, Kenya, Ethiopia, Tanzania and Ghana. The exporters exporting to these markets were given Export House Status on export of Rs.5 crore.
- **Links with CIS** countries to be revived. We have traditional trade ties with these countries. In the year 2000-01, our exports to these countries

NOTES

were to the extent of US$ 1082 million. In this group, Kazakhstan, Kyrgyzstan, Uzbekistan, Turkmenistan, Ukraine and Azerbaijan were to be in special focus in the first phase.

- **North Eastern States**, Sikkim and Jammu & Kashmir: Transport subsidy for exports to be given to units located in North East, Sikkim and Jammu & Kashmir so as to offset the disadvantage of being far from ports.
- **Re-location of industries:** To encourage re-location of industries to India, plant and machineries would be permitted to be imported without a license, where the depreciated value of such relocating plants exceeds Rs. 50 crores.
- **A new 8 digit commodity classification** for imports was adopted from 1st April 2002. This classification would also be adopted by Customs and DGCI&S; shortly. The common classification to be used by DGFT and Customs would eliminate the classification disputes and hence reduce transaction costs and time. Similarly, Ministry of Environment and Forests was given the duty to finalize the guidelines to regulate the import of hazardous waste.

  Reduction of the maximum fee limit for electronic application under various schemes from Rs. 1.5 lakh to Rs. 1.00 lakh. Same day licensing introduced in all regional offices.
- **Customs:** Adoption and harmonization of the 8 digit ITC(HS) code. The percentage of physical examination of export cargo had already been reduced to less than 10 percent except for few sensitive destinations. The application for fixation of brand rate of drawback was finalized within 15 days.
- **Banking:** Direct negotiation of export documents to be permitted. This would help the exporters to save bank charges. 100% retention in EEFC accounts. The repatriation period for realization of export proceeds extended from 180 days to 360 days. The facility is already available to units in SEZ and exporters exporting to Latin American countries. (however, these facilities were made available to status holders at that time)
  a) Import/Export of samples to be liberalized for encouraging product up gradation.
  b) Penal interest rate for bonafide defaults to be brought down from 24% to 15%.
  c) No penalty for non-realization of export proceeds in respect of cases covered by ECGC insurance package.
  d) No seizure of stock in trade so as to disrupt the manufacturing process affecting delivery schedule of exporters.
  e) Foreign Inward Remittance Certificate (FIRC) to be accepted in lieu of Bank Realization Certificate for documents negotiated directly.

NOTES

f) Optional facility to convert from one scheme to another scheme. In case the exporter is denied the benefit under one scheme, he was entitled to claim benefit under some other scheme.

g) Newcomers to be entitled for licenses without any verification against execution of Bank Guarantee.

h) *Duty Exemption Entitlement Certificate (DEEC) book was abolished*. Redemption on the basis of Shipping bills and Bank Realization Certificates.

i) *Withdrawal of Advance License* for Annual Requirement (AAL) scheme as problems were encountered in closure of AAL and the significance of scheme considerably reduced due to dispensation of DEEC. The exporters can avail Advance License for any value. Mandatory spares to be allowed in the Advance License up to 10% of the CIF value.

j) Duty Entitlement Passbook (DEPB): Value cap exemption granted on 429 items to continue, No Present Market Value (PMV) verification except on specific intelligence, Same DEPB rate for exports whether as CBUs or in CKD/SKD form, Reduction in rates only after due notice. DEPB for transport vehicles to Nepal in free foreign exchange. DEPB rates for composite items to had lowest rate applicable for such constituent.

- **Export Promotion Capital Goods (EPCG):** EPCG licenses of Rs. 100 crore or more to had 12-year export obligation period with 5-year moratorium period. Export Obligation fulfilment period extended from 8 years to 12 years in respect of units in agri-export zones and in respect of companies under the revival plan of BIFR. Supplies under Deemed Exports to be eligible for export obligation fulfilment along with deemed export benefit. Re-fixation of EO in respect of past cases of imports of second-hand capital goods under EPCG Scheme.

10.7.2 Export-Import (EXIM) Policy – 2009-2014

The third five-year EXIM Policy (2002–07) which coincided with the Tenth Five Year Plan, and which was valid up to March 2007, was terminated mid-length and replaced with the Foreign Trade Policy with effect from August 2004 up to 31 March 2009 on the assumption of power by the UPA Government. The Foreign Trade Policy (2009– 14) was effective from 1 April 2009 up to 31 March 2014.

Aims and Objectives

The country witnessed a robust growth in exports in the last five years mainly on account of the twin objectives, set out in the first Foreign Trade Policy 2004–09,

namely (i) to double the country's percentage share of global merchandise trade within five years, and (ii) use trade expansion as an effective instrument of economic growth and employment generation. The exports in the last five years registered more than two-fold increase from USD 63 billion in 2003-04 to USD 168 billion in 2008-09, thereby increasing our share in global merchandise trade to 1.45 per cent in 2008 from 0.83 per cent in 2003 (WTO estimates). Our share of global commercial services exports too rose from 1.4 per cent to 2.8 per cent during the same period. On the employment front, nearly 14 million jobs were created directly or indirectly as a result of augmented exports during the period.

The year 2009, however, witnessed one of the most severe global recessions in the post-war period which affected almost all the countries and hitting all the major economic indicators of industrial production, trade, capital flows, unemployment, per capita investment and consumption. Consequently, the WTO and the IMF have estimated a projected global trade decline by 9 per cent and over 11 per cent in volume terms. India has not been an exception to the unprecedented economic slow-down faced by the entire world.

To arrest and reverse the declining trend of exports and to provide additional support especially to those sectors which have been hit badly by recession in the developed world, and also to double our share in global trade by 2020, the Foreign Trade Policy 2009 –14 came up with short term and long-term objectives. The short-term objective of the Policy was to achieve an annual export growth of 15 per cent with an annual export target of USD 200 billion by March 2011, while for the remaining three years, i.e. up to 2014 the annual export growth of 25 per cent per annum was envisaged. Besides, it was aimed to double our exports of goods and services by 2014. The long-term objective of the Policy was to double India's share in global trade by 2020. To meet these objectives of achieving the projected target, a mix of the following policy measures were be adopted by the government:

- Fiscal incentives
- Institutional changes
- Procedural rationalization
- Enhanced market access across the world and diversification of export markets
- Improvement in infrastructure related to exports
- Bringing down transaction costs
- Providing full refund of all indirect taxes and levies
- Goods and Services Tax (GST) to rebate all indirect taxes and levies on exports

NOTES

10.7.3 Foreign Trade Policy 2015-20

The Foreign Trade Policy (FTP) 2015-20 was unveiled by Ms Nirmala Sitharaman, Minister of State for Commerce & Industry (Independent Charge), Government of India on April 1, 2015. Following are the highlights of the FTP:

- FTP 2015-20 provides a framework for increasing exports of goods and services as well as generation of employment and increasing value addition in the country, in line with the 'Make in India' programme.
- The Policy aims to enable India to respond to the challenges of the external environment, keeping in step with a rapidly evolving international trading architecture and make trade a major contributor to the country's economic growth and development.
- FTP 2015-20 introduces two 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.
- Duty credit scrips issued under MEIS and SEIS and the goods imported against these scrips are fully transferable.
- For grant of rewards under MEIS, the countries have been categorized into 3 Groups, whereas the rates of rewards under MEIS range from 2 per cent to 5 per cent. Under SEIS the selected Services would be rewarded at the rates of 3 per cent and 5 per cent.
- Measures have been adopted to nudge procurement of capital goods from indigenous manufacturers under the EPCG scheme by reducing specific export obligation to 75per cent of the normal export obligation.
- Measures have been taken to give a boost to exports of defense and hi-tech items.
- E-Commerce exports of handloom products, books/periodicals, leather footwear, toys and customised fashion garments through courier or foreign post office would also be able to get benefit of MEIS (for values up to INR 25,000).
- Manufacturers, who are also status holders, 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.
- A number of steps have been taken for encouraging manufacturing and exports under 100 per cent EOU/EHTP/STPI/BTP Schemes. The steps include a fast track clearance facility for these units, permitting them to share infrastructure facilities, permitting inter unit transfer of goods and services,

permitting them to set up warehouses near the port of export and to use duty free equipment for training purposes.

- 108 MSME clusters have been identified for focused interventions to boost exports. Accordingly, 'Niryat Bandhu Scheme' has been galvanised and repositioned to achieve the objectives of 'Skill India'.
- Trade facilitation and enhancing the ease of doing business are the other major focus areas in this new FTP. One of the major objective of new FTP is to move towards paperless working in 24x7 environment.

Check Your Progress

14. What was the change in customs duty in case of rough diamonds under the EXIM 2002-07?
15. Till when was the EXIM policy 2002-07 valid?
16. What were the two new schemes introduced under the FTP 2015-20?

10.8 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Exporting is the most traditional mode of entry into any foreign market. It is very common.
2. The management contract arrangement is especially attractive in the case when contracting firm is given an option to purchase some shares in the managed company within a stated period.
3. A turnkey operation is an agreement by the seller to supply a buyer with facility fully equipped and ready to be operated by the buyer's people who are also trained by the seller.
4. While selling abroad, the firm may face any of the following risks:
   (i) Credit risk
   (ii) Currency risk
   (iii) Carriage risk
   (iv) Country risk
5. Inadequate working capital: Exporters may need additional working capital to purchase the raw materials and other components they require to produce goods for export. Access to adequate pre-shipment finance is crucial to export success. There are risks involved in over-borrowing and firms must ensure that they can fully service the additional borrowings export may entail.
6. The main parties involved in this processing are the exporter, the buyer, the negotiating bank, the shipping company, the insurance company, the Reserve

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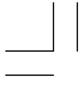
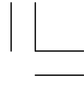
Bank of India, the Chief Controller of Imports & Exports (Director General of Foreign Trade), the Controller of Customs, the port commissioners, and the clearing and forwarding agents.

7. There are three types of shipping bills, namely:
    - Shipping bill for free goods
    - Dutiable shipping bill
    - Drawback shipping bill
8. An international sales contract comes into being when one party—the exporter— makes an offer and the other—the importer—accepts it. The offer and the acceptance have to match for the agreement to be formalized.
9. Export contracts can be manifested in many different ways—their agreement may be a formal document, a series of telexes, an exchange of messages between computers, a telephonic conversion or simply an oral agreement during contract at a trade fair.
10. Pre-shipment inspection would be helpful at various stages particularly for securing payment or making claims on the carrier or the insurance company.
11. Sometimes, performance of a contract becomes impossible because of occurrence of certain unforeseen and uncontrollable events, e.g., war, civil disturbance, natural calamity, economic upheavals, etc. Such situations are called 'act of God', 'frustrating events', 'failure of presupposed conditions' or 'force majeure'.
12. The cost and supply conditions dictate the minimum on the floor price the exporter must charge while the demand and competitive conditions determine the maximum price of the ceiling price which he can charge.
13. . The selling and delivery costs include cost of holding the stocks, packing, transportation, documentation, pre shipment inspection, insurance and marketing costs such as cost of advertising, personal selling etc.
14. Customs duty on import of rough diamonds was reduced to 0%. Import of rough diamonds is already freely allowed. Licensing regime for rough diamond was abolished. This was done to help the country emerge as a major international centre for diamonds.
15. The third five-year EXIM Policy (2002–07) which coincided with the Tenth Five Year Plan, and which was valid up to March 2007, was terminated mid-length and replaced with the Foreign Trade Policy with effect from August 2004 up to 31 March 2009 on the assumption of power by the UPA Government.
16. FTP 2015-20 introduces two 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.

10.9 SUMMARY

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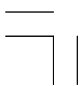
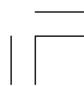
- One of the most strategic decisions to be taken in international marketing is the mode of entering any foreign market a company may decide to do the total manufacturing of the product domestically and export the finished products to the foreign market or on the other hand a company main manufacture the product to be marketed in any foreign market in the foreign country itself.
- The different issues of concern in relation to exports include language and culture.
- While selling abroad, the firm may face any of the following risks:
  - (i) Credit risk
  - (ii) Currency risk
  - (iii) Carriage risk
  - (iv) Country risk
- It is a requirement that first the export order should be acknowledged, and then it should be carefully examined in terms of items, specification, pre-shipment inspection, payment conditions, special packaging, labelling and marketing requirements, shipment and delivery date, marine insurance, documentation, etc.
- An export order has to be processed to meet the requirements of materials required by the importers. The export order must be processed as expeditiously as possible so that the buyers can receive the materials on time, as per their delivery schedules and also conforming to the specifications stipulated by them.
- There are ten stages of processing an export order.
- It can be stated that the terms 'export order', export agreement and export contract essentially signify the same thing, that is, the decision of a foreign buyer to buy specified item(s) from an exporter on the agreed terms and conditions.
- Export pricing has to accommodate the trade practices and regulations of the overseas market as well. It should also take into account the additional cost involved in respect of packaging, labelling, marking, transportation, storage, coverage of export risk, export incentives such as duty drawbacks may also influence the export prices. Export pricing involves careful consideration and incorporation of several factors.
- The EXIM Policy for 2002-07 which came in effect on 1st April, 2002 was the first policy which had to be formulated keeping in view all the commitments India had made under the WTO. In 2001, all quantitative restrictions on imports were removed.

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- The third five-year EXIM Policy (2002–07) which coincided with the Tenth Five Year Plan, and which was valid up to March 2007, was terminated mid-length and replaced with the Foreign Trade Policy with effect from August 2004 up to 31 March 2009 on the assumption of power by the UPA Government.
- FTP 2015-20 provides a framework for increasing exports of goods and services as well as generation of employment and increasing value addition in the country, in line with the 'Make in India' programme.

10.10 KEY WORDS

- **Export order:** It is a document communicating decisions of a foreign buyer to purchase certain item(s) from an exporter.
- **Export agreement:** It refers to the offer by the exporter and its acceptance by the buyer. It is defined as exchange of promises by the parties to the agreement, i.e., every promise and every set of promises forming consideration for each other.

10.11 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on language and culture as barriers in export functions.
2. What are some of the important documents essential to an export contact and its execution?
3. Write a short note on 'Force Majeure and hardship' in export contracts.
4. What are the broad categories of export costs?

Long-Answer Questions

1. Explain the different types of modes of operations or modes of entry in international marketing.
2. Discuss the factors of market analysis which are important to consider before making an entry into foreign markets.
3. Describe the various stages involved in the processing of an export order.
4. Examine some of the important general terms and conditions, which usually get incorporated into export contracts/orders—either explicitly or implicitly.
5. Explain the EXIM policy 2002-07.
6. Discuss the Foreign Trade Policy 2015-20.

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10.12 FURTHER READINGS

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UNIT 11 EXPORT MARKETING DOCUMENTATION

Structure

11.0 Introduction
11.1 Objectives
11.2 Significance of Export Documentation
 11.2.1 The Statutory Control
 11.2.2 Declaration Forms
11.3 Major Documents
11.4 Answers To Check Your Progress Questions
11.5 Summary
11.6 Key Words
11.7 Self Assessment Questions And Exercises
11.8 Further Readings

11.0 INTRODUCTION

Export activities consists of participation of world players. There are also critical issues involved in relation to the proper transport and storage of goods as well as payments. These basic factors themselves are very sensitive in nature and since long distance and longer periods are involved in export functions, it is important that the fundamental elements and terms and conditions are specified in clear fashion. Therefore, export marketing documents are very important to the entire export procedure. It is not just legal evidence but also the very basis of the beginning of the process itself. In this unit, the export marketing documentation and its elements will be discussed. This will include a study of different commercial documents, export declaration forms as well as legal regulatory documents.

11.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the different documents used in export marketing
- Describe the legal regulatory documents in export marketing

11.2 SIGNIFICANCE OF EXPORT DOCUMENTATION

Documentation plays a crucial role in the execution of an export contract. In fact, the process of documentation begins when the order is placed by the foreign buyer with the exporter. The formalities as regards various documents relate to

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pre-shipment inspection, origin of the goods, central excise, and exchange control and customs clearance of the export shipment. The documentation in relation to negotiation of documents for realization of export proceeds is referred to as post-shipment export documentation.

An exporter is required to deal with various documents both at the pre-shipment and post-shipment stages to complete the export transaction. These documents are important as they are used (i) as an evidence of shipment and title of goods, and (ii) for obtaining payment. The shipment is represented by the set of documents once the goods have been cleared by the customs for their transportation to the importer. These documents are of vital interest to both the exporter and the importer. The importer needs them to claim peaceful and legal possession and delivery of the goods in his country; the exporter needs them to claim payment for the shipment.

The documentary requirements are both regulatory and operational in nature, and necessary documents should be prepared to comply with the rules and regulations of the exporting and importing country. Moreover, these requirements are different for different types of products. When exporting for the first time, the exporter should therefore, always find out from the buyer the documents required by him/her for the import of the product.

Accuracy and completeness are of paramount importance in documents covering export shipments. Whether two or ten copies of invoice are required by the buyer, the same should be supplied as the buyer probably has some reasons for it. Minor discrepancies in the documents, which look harmless sometimes, assume menacing form either in the data themselves or in typing. If changes are to be made, they should not be done with an eraser, or cut out with an ink pen as these only arouse the suspicion that the documents have been tampered with. If any alteration or addition has been made by an authority issuing the documents, the exporter should ensure that the same has been endorsed by it properly under the signatures of the person issuing the documents only. If the documents are not correct, or if they are not filled in correctly, the importer may not be able to obtain the delivery of the goods. This may appear to be very trivial but any lapse of this kind may result in difficulties and penalties for the importer.

The main purpose of the documents accompanying a shipment is to provide a specific and complete description of the goods so that they can be assessed correctly for duty purposes and that they meet the import licensing requirements or import quota restrictions imposed on the goods for clearance purposes. If there are any discrepancies in the documents, and /or the required documents are not produced, the shipment may not be allowed for import or may even be confiscated by the customs department of the importing country.

The documentation work should be handled by the professionals in this field. Large export firm have their separate export documentation departments headed by the documentation managers. Small exporters can however take the services of the clearing and forwarding agent to prepare the shipment documents.

The exporter should also develop the habit of scrutinizing the documents for any possible errors or discrepancies and if there are any, rectify them before sending them to the importer.

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11.2.1 The Statutory Control

An essential feature of an export transaction is that it involves the inflow of foreign exchange. In case there is a need to use imported inputs then there is an outflow of foreign exchange as well. Besides, there are many other transactions which involve remittance in foreign exchange such as participation in trade fairs, sales tours, subscription for trade magazines, advertisements in foreign media, payment of agency commission, etc. These transactions are known as current account transactions and are undertaken as a part of the regular export business. Besides, there may also be some capital account transactions involving investment of foreign funds on a long term basis. It is imperative that the exporter should understand the regulations relating to the dealings in foreign exchange. These regulations are known as exchange control regulations.

FEMA and Exchange Control Regulations

Foreign Exchange Management Act, 1999 is the basis of legal framework for Foreign Exchange Management Act (FEMA). The buying and selling of foreign exchange for undertaking current account transactions have been fully liberalized and made convertible by this Act.

Exchange control regulations have been framed by the Reserve Bank of India (RBI), being the Exchange Control Authority of India. These regulations have been framed in terms of the provisions of the Foreign Exchange Management Act, 1999. This Act has come into force with effect from 1.6.2000.

Foreign Exchange Management (Current Account Transactions) Rules, 2000 are issued by government of India. These were notified vide Notifications GSR. 381(E) dated May 3, 2000, S.O. 301(E) dated March 30, 2001 and GSR.608 (E) dated September 13, 2004. These were amended from time to time. The last amendment to the G.S.R is vide Notification No., G.S.R. No.412 (E) dated July 10, 2006 notifying certain relaxations on current account transactions in public interest.

Foreign Exchange Management Act (FEMA) deals with inbound as well as out-bound investments. Indian Rupee is partly convertible. It is convertible on ‘current’ account and non-convertible on ‘capital’ account. For practical purposes, rupee is already almost fully convertible.

Under the Foreign Exchange Management Act, 1999 (FEMA) in lieu of FERA, which has come into force with effect from June 1, 2000. In this act, all transactions that involve foreign exchange transaction have been taken into consideration. These transactions have been classified either as Capital or Current

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Account transactions. Current account transactions have been defined as "All transactions undertaken by a resident that do not alter his assets or liabilities outside India are current account transactions". In terms of Section 5 of the FEMA, persons are free to buy or sell foreign exchange for any current account transaction except for those transactions on which Central government has imposed restrictions, vide its Notification referred to above.

The various exchange control rules and regulations relating to the export of goods and services are as follows:

1. Foreign Exchange Management (Current Account Transactions) Rules, 2000.
2. Foreign Exchange Management (Export of Goods and Services) Regulations, 2000.
3. Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2000

You must be aware that the policy regarding exports from the country is formulated by the Director General of Foreign Trade, Government of India, Ministry of Commerce, New Delhi. While the physical movement of goods exported is regulated by the Customs Authorities, the RBI, Exchange Regulation Act, it is concerned about the realization of the Foreign Exchange Regulation Act, it is concerned about the realization and repatriation export proceeds to India within the prescribed period and in the prescribed manner. For further details and clarifications, exporters are advised to refer to the Exchange Control Manual (1993 Edition) as amended from time to time and/or approach any Office of the Reserve Bank or Authorized Dealers (Banks).

11.2.2 Declaration Forms

In terms of Sec. 18 of the Foreign Exchange Regulation Act (FERA) 1973 and Rule 5 of the Foreign Exchange Regulation Rules, 1974, every exporter must declare to the prescribed authority in the prescribed form the full export value of the goods that are exported to any place outside India other than Nepal and Bhutan. The forms contain an undertaking that the exporter will deliver to the Bank named in the form, the Foreign Exchange representing the full export value of the goods on or before the due date for payment or six months from the date of shipment whichever is earlier in the manner prescribed in Rule 9 of the Foreign Rules, 1974. This is a legally binding one and failure to fulfill it would attract the penal provisions of FERA, 1973. The Export Declaration Forms act as a vital link between the agencies (Customs/ Post Office) under whose supervision goods leave India and the agencies (Authorized Dealers and the RBI) which monitor the realization of Foreign Exchange proceeds of the exported goods.

Types of Export Declaration Forms

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At present there are four types of Export Declaration Forms in use. All exports, other than the ones exempt from declaration, must be declared on an appropriate form as indicated below:

(a) GR Form is used for export to all countries made otherwise than by Post.

(b) PP Form is used for exports to all countries by Parcel Post.

(c) VP/COD Form is used for exports to all countries by Parcel Post under arrangements to realize proceeds through postal channels on a 'value payable' or cash on delivery basis.

(d) SOFTEX Form is used in the place of GR Form when computer software is exported in the non-physical Form.

The Export Declaration Forms are printed by the RBI. The forms bear printed serial numbers.

Check Your Progress

1. What is post-shipment export documentation?
2. List examples of current account transactions.

11.3 MAJOR DOCUMENTS

Definition

Commercial documents, also known as shipping documents, enable the importer and the exporter to discharge their obligations under an export contract. In specific terms, these documents ensure that the exporter makes shipment of the goods in accordance with the requirement of the contract and that the importer makes payment for the goods shipped in the manner mentioned in the contract. When the goods are shipped by the exporter, he has a set of documents, which entitles him or its legal holder (e.g., agent, importer, and bank) to a compensation by insurance, in the unlikely event of damage or loss of the goods.

For a consignment under c.i.f., the contracts, which are a set of commercial documents, comprising Commercial Invoice, Bill of Lading/ Airway Bill/ Post Parcel Receipt/ Insurance Policy, Certificate and Bill of Exchange. In addition to these documents, a particular shipment may necessitate additional commercial documents such as packing list, certificate of inspection, certificate of quality, etc. It must be noted that for receiving payment from the importer, additional documents, satisfying the regulatory needs in the importing country, will have to be obtained by the exporter and sent to the importer. Let us discuss various commercial documents.

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Types of Commercial Documents

1. **Commercial Invoice**: This is the first basic document and the only complete document amongst all commercial documents required for the shipment. Besides fulfilling the obligation under the export contract, the exporter needs this document for a number of other purposes including: (i) obtaining export inspection certificate, (ii) getting excise clearance, (iii) getting customs clearance, and (iv) securing incentives. Thus, this document is prepared at both the pre-shipment and post-shipment stages.

   Commercial Invoice is a document of contents that gives details of goods sent by the exporter. It is a statement of accounts, which must contain identification marks and numbers, description of goods and quantity of goods.

   Every shipment has identification marks, which identify the cargo with various documents. These are private marks, which are made on the packages. These marks could be either in the form of symbols (say, a star, triangle, rectangle, etc.) or numerical. Similarly, every package under a shipment is numbered, i.e., serial numbers are mentioned on every consignment.

   Commercial Invoice must describe the goods shipped by the exporter. The description of goods must correspond completely with the description given in the contract of the letter of credit.

   The second function of the Commercial Invoice is that it acts as the seller's bill given to the buyer. As a bill, it must contain the name and the address of the buyer, unit price, amount and authorized signatures with destination. Unless required by the buyer, the total invoiced value should be net of any commission or discount. In other words, it should be the viable amount of goods, as per the trade terms. Sometimes, a contract requires a detailed breakup of the amount to be recorded on the invoice, to enable the customs authority in the importing country to calculate import duty.

   The name and the address given in the Commercial Invoice should be the same as given in the export contract or the letter of credit, as the case may be. Under the letter of credit, if not specified, the Commercial Invoice must be made out in the name of the applicant of the credit. As in the case of quantity to be recorded on the invoice, the amount should neither be less nor more than the stipulated amount in the contract or the letter of credit. The only exception is that if the contract or the letter of credit permits part-shipment, an individual invoice can be less than the total amount.

   The Commercial Invoice also sets forth the terms of sale (i.e., fob/cif/cfr, etc., mode and date of shipment and terms of payment. It can also serve as a packing list and a certificate of origin. A packing list shows the details of goods contained in each pack of the shipment. If the law of an importing country does not require a separate certificate of origin issued by a third

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party, it can be self-certified by the exporter on the Commercial Invoice. The format of the Commercial Invoice is devised by the exporters, in accordance with the requirement of their business.

2. **Bill of Lading:** A bill of lading is a receipt for goods shipped on board a vessel, signed by the person (or his/her agent) who commits to carry them. It states the conditions in which the goods are delivered to (and received by) the ship. Though this is not the actual contract which is inferred from the action of the shipper or ship owner in delivering or receiving the cargo, it forms an excellent evidence with regard to the terms and conditions of the contract. It is a document of title given to the goods and it is this title which is the subject of the contract between the buyer (importer) and the seller (exporter). It is considered the most important commercial document in international trade and is used to control delivery of the goods transported by sea.

   Types of bill of lading

   There are several types of bills of lading and the most common among these include:

   (i) On-board bill of lading: Under the Carriage of Goods by Sea Act 1971 (Hague-Visby Rules), the ship owner could be asked to provide the shipper with the bills of lading, in order to ensure the shipping of the goods. Due to this reason, most of the bill of lading forms are printed as shipped bills. These shipped bills affirm that that they are apparently shipped in good order and condition. This validates the presence of goods on the ship.

   This is considered the most preferable receipt by the shipper as it affirms that the goods are on board. In addition to this, it diminishes the possibility of a dispute among the bankers or consignee, consequently facilitating the financial settlement of the export sale.

   (ii) Shipment bill of lading: This bill of lading is bereft of the word 'shipped'. It reiterates the submission of the goods to the ship owner. The cargo could be in the ship owner's dock, warehouse, transit shed or even at a dry port/CFS/ICD. Therefore, this bill is different from the shipped bill. This means that unless a provision has been made in the contract, the buyer under a CIF or CIR contract should not consider this bill for an eventual financial settlement with the bank. Except for special circumstances, the agents will definitely refrain from handling 'received bills' for their clients. This arises where the word 'shipped' does not appear on the bill of lading. It merely confirms that the goods have been handed over to the ship owner and are in his or her custody. The cargo may be in his or her dock, warehouse or transit shed, or even inland such as at a dry port/CFS/ICD, etc. This bill, therefore, does not have the same meaning as a 'shipped' bill and the buyer

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under a CIF or CFR contract need not accept such a bill for ultimate financial settlement through the bank unless provision has been made in the contract. Forwarding agents will invariably avoid handling 'received bills' for their clients unless special circumstances obtain.

(iii) ***Clean bill of lading:*** All bills of lading state that the goods are apparently shipped in good order and condition. In case this statement is not in accordance with the ship owner, then the bill of lading is referred to as 'clean' or 'unclaused'. Clean bills of lading help the ship owner affirm his liability of the cargo mentioned in the bill. This bill of lading is preferred by the banks for the purposes of financial settlement Clean bill of lading. Each bill of lading states: 'in apparent good order and condition', which of course refers to the cargo. If this statement is not modified by the ship owner, the bill of lading is regarded as 'clean' or 'unclaused'. By issuing clean bills of lading, the ship owner admits his or her full liability of the cargo described in the bill under the law and his or her contract. This type is much favoured by the banks for financial settlement purposes.

(iv) ***Claused bill of lading:*** If the ship owner disagrees with the terms and conditions delineated in the bill of lading, then he or she is authorized to add a clause to it, thereby labelling the bill as 'unclean', 'foul' or 'claused'. Recurring types of such clauses include inadequate packing, wet or stained cartons, unprotected machinery, damaged crates and missing cartons. Thus, the clause 'shipped on deck at owner's risk' can be regarded as claused under this heading. This type of bill of lading is generally not approved by the banks.

Other types of bill of lading are: Stale bill of lading, Through bill of lading, Groupage and House bill of lading, Transshipment bill of lading, Negotiable and non-negotiable bill of lading, Container bill of lading, Combined transport bill of lading, Straight bill of lading, Negotiable FIATA Combined Transport Bill, FIATA Multi-modal Transport Bill of Lading (MTBL), etc.

Functions of Bill of Lading: The bill of lading has four functions. Broadly, it is a receipt for the goods shipped, that is, a transferable document to the goods. It enables the holder to demand the cargo, the evidence of the terms of the contract of affreightment but not the actual contract. It is a quasi-negotiable instrument.

Once the shipper or his/her agent becomes aware of the schedules of a particular trade, through the medium of sailing cards or some form of advertisement, he or she communicates with the ship owner with a view to booking cargo space on the vessel or the container. Once the satisfactory arrangements are concluded, the shipper forwards the cargo. At this stage, it is important to note that the shipper always

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makes the offer by forwarding the consignment, while the ship owner either accepts or refuses it. Furthermore, it is the shipper's duty, or that of his or her agent, to supply the details of the consignment. Generally, this is done by completing the shipping company's form of bill of lading, which is followed by the signing of the number of copies requested, by the shipping company.

Once the goods are received on board the ship, the bill of lading is dated and signed by or on behalf of the carrier, usually by the Master of the ship or his or her agent, and stamped 'freight paid' or 'freight payable at destination' as appropriate. If the cargo is in good condition and everything is in order, no endorsement will be made on the document and it can be termed as 'clean' bill of lading. On the contrary, if the goods are damaged or a portion of the consignment is missing, then the document will be suitably endorsed by the Master or his or her agent and the bill of lading will be considered 'claused' or 'unclean'. The complete set of bills of lading is then returned to the exporter (seller) for a timely dispatch to the importer (buyer). The buyer must have a negotiable bill of lading, with which he or she can clear the goods at the port of destination.

Bills of lading are made out in sets and the number varies according to the trade. Generally, the number of sets are two or three – one of which is forwarded immediately and another by a subsequent mail in case the first is lost or delayed, together with a number of non-negotiable copies for office and filing use. In some trades, coloured bills of lading are used to distinguish the original (signed) bills from the copies which are purely meant for recording purposes. The reverse of the bill of lading bears the terms and conditions of the contract of carriage. The clauses on most of the bills of lading are similar in effect, if not in wording.

A shipper sells the goods through the letter of credit, which entails the terms and conditions decreed by the bank. If the shipper wishes to obtain payment of his or her invoice before the consignee obtains the goods, then he or she needs to pass the full set of original bills to his or her bank and ultimately the bank arranges for a presentation to the consignee against payment.

The ship owner or his/her agent at the port of destination will require one original bill of lading to be presented to him or her before the goods are handed over. Furthermore, he or she will also require payment of any freight due, in case this is not paid at the port of shipment. When one of a set of bills of lading is presented to the shipping company, the other bills in the set lose their value.

In the event of the bill of lading being lost or delayed in transit, the shipping company will allow delivery of the goods to the person claiming

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to be the consignee, provided he or she gives a letter of indemnity. This is normally countersigned by a bank and it relieves the shipping company of any liability, should another person eventually come along with the actual bill of lading.

Many bills of lading are consigned 'to order' and in such situations are endorsed, usually on the reverse, by the shipper. If the consignee is named, the goods will only be released to him or her, except in the case if he or she transfers his or her right by endorsement subject to the respective bill of lading.

3. **Airway Bill:** In an air carriage, the transport document is known as the airway bill (AWB). This document constitutes the prima facie evidence pertaining to the contract of affreightment, receipt of goods and the conditions of carriage. This document, therefore, performs the triple functions which includes a forwarding note for the goods, receipt for the goods tendered and authority to obtain delivery of goods. By itself, AWB is not a document of title, nor is it a transferable document. However, AWB can be converted into a transferable document, by which it can be transferred to a third party by endorsement like B/L. But, by and large, the business and commercial practice does not treat AWB as a document of title.
4. **Post Parcel Receipt:** Post parcel receipt (PPR) merely validates the receipt of the goods exported through postal channels to the buyer. It does not substantiate the title of the goods. The parcel is consigned to the consignee named in the contract between the importer and the exporter. The consignee can identify himself with the postal authorities at the destination and obtain delivery of the goods.
5. **Insurance Policy or Certificate:** Cargo Insurance Policy (also called marine insurance policy) provides protection to cargo owners in the unlikely event of loss or damage to cargo in transit. This loss or damage is caused by accidents, which cannot be known in advance and against which no protection is possible. These may be caused by natural calamities as well as by accidents. It is, therefore, necessary that the risk of loss or damage to the cargo be minimized by obtaining a suitable insurance cover from an insurance company.
6. **Bill of Exchange:** Bill of exchange or draft is an instrument in writing which encapsulates an unconditional order, signed by the makes. It decrees a certain person to pay a specific amount of money to a person or to the bearer of the instrument. Furthermore, the person to whom it is addressed is required to pay either on demand or at a fixed time in future.

   Bill of exchange (B/E) is an important commercial document, which bridges the time gap between the shipment of goods and the receipt of sales amount. This document is prepared by the exporter and given to the bank along with the other shipping documents for securing the sale amount. In this sense, B/E is attached to the other documents, which will be given to the importer

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only after he has honoured the B/E either by an actual payment or by undertaking to make a payment in the near future.

7. **Combined Transport Document:** CTD is a document for multi-modal movement of the goods in container. The movement is carried out by more than one mode, e.g., rail and ship. The Foreign Exchange Dealers Association of India (FEDAI) has brought out brochure No. 081 and 082 to facilitate export of goods in containers from specified inland centers in India. A CTD provides an alternative to establishing a series of separate and non-uniform contracts for each segment of the total transport process. It is acceptable for negotiation under L/C.

Legal Regulatory Documents

Legal Regulatory documents may be divided into two categories, that is, documents needed in the exporting and those required in the importing countries. Let us first discuss the regulatory documents needed in India.

i. Legal Documents for Exports from India

Regulatory export documents are of two types, namely the documents needed for different kinds of registrations of the firm, and documents which are specific to a shipment.

The first category includes the applications and supporting documents required for obtaining (i) Importer–Exporter Code Number valid for the firm's life-time, and (ii) Registration-Cum-Membership Certificate, (RCMC) from the relevant Export Promotion Council, Commodity Board, Development Authority, etc., valid for a specified time period. RCMC is strictly not a legal requirement for exporting from India, but is needed for claiming some of the important export incentives.

The application of the Importer–Exporter Code Number (IEC) is to be made in the prescribed form to the Regional Licensing Authority.

RCMC is obtained from the concerned registering authority, which may either be an Export Promotion Council, or Commodity Board or a Development Authority. Application is to be made on the prescribed form available with the registering authority.

In the second category are the documents, which an exporter or his agent has to prepare for the shipment of goods. These documents are:

1. Foreign Exchange Regulations that require that all exports other than exports to Nepal and Bhutan shall be declared on the following forms:
    - **(a) GR Form/SDF Forms:** GR Form is supposed to be filled in at places where operations are handled manually at the ports. At all other ports, SDF forms are required to be filled in. It is to be filled in duplicate for all exports in physical form other than by post.

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(b) **PP Form:** This form it is required to be filled in duplicate for all exports to all countries by post parcel, except when made on 'value payable' or 'cash on delivery' basis.

(c) **VP/COD Form:** This form is supposed to be filled in a copy for exports to all countries by post parcel under arrangement to further the proceedings through postal channels on 'value payable' or 'cash on delivery' basis.

(d) **SOFTEX Form:** It is required to be prepared in triplicate for export of computer software in non-physical form.

All these documents serve the purpose of monitoring the realization of sales amount by the exporter in a stipulated manner.

2. For goods that are subjected to the Export Trade Control Policy of the Government of India, documents in the form of application are specified. On the basis of that, the concerned authorities will grant documents, such as either an export license or an export permit. License or permission is generally given on the customs document known as the shipping bill. In many cases, specific permission may have to be obtained from particular government ministries/departments, in which case the exporter has to apply on his letterhead.
3. For a number of products under the Export Act, (Quality Control and Inspection) 1962 and various other regulations, it is obligatory for an exporter to obtain Export Inspection Certificate from the notified agencies. To acquire this certificate, the exporter has to apply through a document called intimation for inspection along with supporting documents (commercial invoice, technical specifications, etc.) to an Export Inspection Agency. Thereafter, a certificate of inspection is issued, which along with the other documents is submitted to the customs authorities, before the permission to ship goods is given.
4. Under the Indian Customs Act, goods cannot be loaded on board the carriers, unless permission from the customs authorities has been obtained. This permission is accorded on a document prescribed by the customs authorities. If the goods are sent by sea or by air, this document is referred to as the Shipping Bill. And in case the goods are exported by land or by rail, then it is called Application for Export. Post parcel consignment requires custom declaration form to be filled in.

(ii) Legal Documents for Imports

Let us now discuss some of the well-known documents needed in the importing countries because of the legal necessity. These documents are obtained by the exporter to be sent to the importer.

1. **Consular invoice:** Usually issued on the specified form, it is signed and stamped by the local consulate of the country to which goods are exported.

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2. **Customs invoice:** It is also made out on a specified form prescribed by the customs authority of the importing country. The details mentioned in the document will enable the customs authority of the importing country to levy and charge import duty.
3. **Legalized/visaed invoices:** These invoices constitute a sworn affidavit by the exporter about the authenticity and the accuracy of the sale. These could be sworn before the appropriate consulate or the chamber of commerce, as the case may be, which will ultimately approve of them.
4. **Certified invoice:** This is the self-certified invoice by the exporter which pertains to the origin of the goods.
5. **Certificate of origin**: This certificate is issued by independent bodies, such the Chamber of Commerce on a prescribed form.
6. **GSP certificate of origin:** Goods which get the benefit of preferential import duty treatment in countries which implement the Generalized System of Preferences, should be accompanied by the GSP Certificate of Origin. This certificate is given on the forms prescribed by the importing countries.
7. **Health/veterinary/sanitary certificates:** These certificates are needed in a number of countries, certifying that the goods are for human consumption.

Check Your Progress

3. What are clean bills of lading?
4. Define a post parcel receipt.
5. State the triple functions of airway bills.

11.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The documentation in relation to negotiation of documents for realization of export proceeds is referred to as post-shipment export documentation.
2. There are many other transactions which involve remittance in foreign exchange such as participation in trade fairs, sales tours, subscription for trade magazines, advertisements in foreign media, payment of agency commission, etc. These transactions are known as current account transactions and are undertaken as a part of the regular export business.
3. Clean bills of lading help the ship owner affirm his liability of the cargo mentioned in the bill.
4. Post parcel receipt (PPR) merely validates the receipt of the goods exported through postal channels to the buyer. It does not substantiate the title of the goods. The parcel is consigned to the consignee named in the contract between the importer and the exporter. The consignee can identify himself with the postal authorities at the destination and obtain delivery of the goods.

5. The Airway Bill performs the triple functions which includes a forwarding note for the goods, receipt for the goods tendered and authority to obtain delivery of goods.

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11.5 SUMMARY

- Documentation plays a crucial role in the execution of an export contract. In fact, the process of documentation begins when the order is placed by the foreign buyer with the exporter.
- An essential feature of an export transaction is that it involves the inflow of foreign exchange. In case there is a need to use imported inputs then there is an outflow of foreign exchange as well.
- Exchange control regulations have been framed by the Reserve Bank of India (RBI), being the Exchange Control Authority of India. These regulations have been framed in terms of the provisions of the Foreign Exchange Management Act, 1999. This Act has come into force with effect from 1.6.2000.
- Commercial documents, also known as shipping documents, enable the importer and the exporter to discharge their obligations under an export contract.
- Commercial Invoice is a document of contents that gives details of goods sent by the exporter. It is a statement of accounts, which must contain identification marks and numbers, description of goods and quantity of goods.
- A bill of lading is a receipt for goods shipped on board a vessel, signed by the person (or his/her agent) who commits to carry them. It states the conditions in which the goods are delivered to (and received by) the ship.
- In an air carriage, the transport document is known as the airway bill (AWB). This document constitutes the prima facie evidence pertaining to the contract of affreightment, receipt of goods and the conditions of carriage.
- Bill of exchange or draft is an instrument in writing which encapsulates an unconditional order, signed by the makes. It decrees a certain person to pay a specific amount of money to a person or to the bearer of the instrument.
- Legal Regulatory documents may be divided into two categories, that is, documents needed in the exporting and those required in the importing countries.

11.6 KEY WORDS

- **Commercial documents:** Also known as shipping documents, these are documents enable the importer and the exporter to discharge their obligations under an export contract

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- **Commercial Invoice:** It is a document of contents that gives details of goods sent by the exporter.
- **Bill of lading:** It is a receipt for goods shipped on board a vessel, signed by the person (or his/her agent) who commits to carry them.
- **Airway Bill:** In an air carriage, the transport document constitutes the prima facie evidence pertaining to the contract of affreightment, receipt of goods and the conditions of carriage.
- **Bill of exchange:** It is an instrument in writing which encapsulates an unconditional order, signed by the makes.

11.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the important types of export declaration forms?
2. Mention the categories of export exempt export declarations.
3. Why is documentation needed in import–export business?
4. What are the functions of commercial invoice?
5. Write a short note on bill of exchange.
6. Briefly discuss the legal regulatory documents needed in the export business.

Long-Answer Questions

1. Discuss the disposal of export documentation form.
2. Describe the concept of bill of lading and its types.

11.8 FURTHER READINGS

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BLOCK - IV
FOREIGN TRADE POLICY, INTERNATIONAL FINANCIAL INSTITUTIONS

NOTES

UNIT 12 FOREIGN TRADE POLICIES

Structure

12.0 Introduction
12.1 Objectives
12.2 Major Foreign Trade Policy Schemes
 12.2.1 Export Promotion Capital Goods Scheme
 12.2.2 Duty Exemption/Remission Schemes
 12.2.3 Gem and Jewellery Promotion Scheme and Diamond Import License
 12.2.4 Special Economic Zones (SEZs)
 12.2.5 Free Trade Warehousing Zones (FTWZ)
 12.2.6 Star Export Houses
 12.2.7 Deemed exports
 12.2.8 Agri Export Zones
 12.2.9 Target Plus Scheme
12.3 Answers to Check Your Progress Questions
12.4 Summary
12.5 Key Words
12.6 Self Assessment Questions and Exercises
12.7 Further Readings

12.0 INTRODUCTION

The Foreign trade policy of a nation is like its scheme of operation in the world marketplace. The nuances of the foreign trade policy of any country are affected by the objectives that the specific economies are trying to achieve. These must be crafted with the nation's interest in mind but also should be considerate to not loose out on the appeal in the world market. In the previous unit, you have learnt about the recent EXIM and Foreign Trade Policies. In this unit certain special schemes of foreign trade policy will be discussed.

12.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the export promotion capital goods duty exemption and gems and jewellery schemes
- Discuss the schemes of SEZs, FTWZ and Star export houses

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12.2 MAJOR FOREIGN TRADE POLICY SCHEMES

In this section, you will learn about some of the important trade policy schemes running in India. Bear in mind, some of these aspects have already been mentioned under the Foreign Trade Policy mentioned in Unit 11.

12.2.1 Export Promotion Capital Goods Scheme

Under the Export Promotion Capital Goods Scheme, capital goods, both new and second hand, may be imported. The import of second-hand capital goods under the scheme shall be subject to such conditions as prescribed in the *Handbook of Procedures (Vol.I).* Import of computer system may also be covered under the EPCG Scheme.

Import of Concessional Duty

Capital goods (CG) including jigs, fixtures, moulds and dies, along with value of the license may be imported at a concessional rate of customs duty subject to an export obligation to be fulfilled over a period of time. The period for fulfilment of the export obligation shall be reckoned from the date of issue of the import license. For calculation of the Net Foreign Exchange (NFE) earned on exports, the value of all the licences shall be deducted from the FOB value of exports made by the person. However, the value of freely transferable Special Import Licences, EPCG licences and the value of licences surrendered during the validity of licence shall not be deducted.

Eligibility

(a) Under the Scheme, manufacturer, exporters, merchant exporters, tied to supporting manufacturer(s) and service provides are eligible to import capital goods.

(b) If the license under the zero duty schemes has actually been utilized for import of value in excess of or less than 10 per cent of the CIF value of the license, license shall be deemed to have been enhanced/reduced by that proportion. Export obligation shall accordingly be enhanced/reduced as per the actual utilization of the license.

12.2.2 Duty Exemption/Remission Schemes

Duty Exemption Schemes enable duty-free import of inputs and remission required for export production. Duty Exemption Schemes consist of:

1. Advance Authorization
2. Duty Free Import Authorization (DFIA)

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A Duty Remission Scheme enables post export replenishment/remission of duty on inputs used in export product. Duty Remission Schemes consist of:

i. Duty Entitlement Passbook Scheme (DEPB)

ii. Duty Drawback (DBK) Scheme

12.2.3 Gem and Jewellery Promotion Scheme and Diamond Import License

Indian gems and Jewellery sector is one of the largest in the world as it contributes to around 29 % of the global jewellery consumption. India is one of the largest diamonds cutting and polishing centre in the world. India is the most preferred country in terms of gems and Jewellery export.

The Gems and Jewellery Export Promotion Council (GJEPC) undertakes several promotional activities including joint participation in the international jewellery shows, sending and hosting trade the liaison and sustained image building exercise.

The Government of India is aiming at USD 80 billion in jewellery exports over the next five years from 2019.

Gems and Jewellery export promotion council was set up in the year 1966 for promoting gems and Jewellery exports from the country. The council arranges for vital market information to the members regarding rates of import duties, trade and tariff regulations, foreign trade enquiries and other information about jewellery fair and exhibition, time to time the various roles played by GJEPC are-

- **Trade facilitator:** the council promotes the Indian gems and Jewellery industry in the international market it organises various international jewellery shows and undertakes image building exercise with the help of advertisements publications and audio visual means.
- **Advisory role:** The council also aids better interaction and understanding between trade and the government counsel takes up relevant issues with the government agencies connected with the exports.
- **Nodal agency for Kimberley process certification scheme:** It acts as nodal agency for Kimberley process certification scheme. The Indian government works closely to implement and oversee the Kimberley process certification scheme in the council has been appointed as a nodal agency in India under the Kimberley process certification scheme.
- **Training and research:** The council runs institutes that provide training in all aspects of manufacturing and design in many cities such as Mumbai, Delhi, Surat and Jaipur these training programs are being conducted to ensure that the Indian industry achieves the highest level of technical excellence.

- **Publication:** The counsel publishes many brochures, statistical booklets, trade directories and a bi monthly magazine Solitaire International which is distributed internationally as well as to its members.

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Diamond import license

The Diamond Imprest Licence shall carry an export obligation fixed in the inverse ratio of 65% of replenishment that is if the licence is issued for CIF value of US $ 65 the FOB value of export obligation shall be US $ 100. At the time of redemption the actual entitlement of licensee shall be recalculated with reference to the replenishment rates admissible for the corresponding export products. Due to such recalculation if the entitlement of the licence holder comes to more than US $ 65 as mentioned in the example the licensing authority shall issue a REP licence for a value equivalent to whatever is in excess of US $ 65 for import of rough diamonds. Diamond Imprest Licence for import of rough diamonds or the materials imported against this shall be freely transferable after the export obligation has been fulfilled. The holder of the diamond impress licence for import of cut and polished diamonds shall achieve a minimum value of 10%. While discharging export obligation the quantity of cut and polished diamonds imported against such licence shall be accounted for in the caratage.

The cut and polished diamonds exported for discharge of export obligation need not necessarily be the same cut and polished diamonds imported.

Under this licence policy permits mixing of the diamonds with other diamonds. The holder of the diamond impress licence shall be eligible for import of cut and polished diamond is not exceeding one fourth of 1 carat or 25 cents in weight. such licences for the import of cut and polished diamonds, goods imported against licence shall be subjected to actual user condition and will not be transferable even after completion of exports.

The entitlement of Diamond Imprest Licence for import of cut and polished diamonds well be exhausted within the same year of its issuance and shall not be allowed to carry forward to the next year. Before clearance of the first consignment of import the licence shall execute with the licensing authority Bank of Guarantee, Legal Undertaking, Joint Legal Undertaking as the case may be. However, no Bank of Guarantee, Legal Undertaking, Joint Legal Undertaking shall be required to be executed where specified export obligation has been fulfilled before making any imports.

An application for diamond impress licence may be made to the licensing authority concerned along with the declaration given name and address of the exporter's banker, certificate from the exporter's banker to the effect that realisation of export proceeds against export made by the exporter are not outstanding for a period of more than 6 months.

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12.2.4 Special Economic Zones (SEZs)

Special Economic Zones (SEZ) are growth engines that can boost manufacturing, augment and generate employment. The private sector has been actively associated with the development of SEZs. The SEZs require special fiscal and regulatory regime in order to impart a hassle-free operational regime encompassing state of the art infrastructure and support services. The Government of India had announced a Special Economic Zone scheme in April, 2000 with a view to provide an internationally competitive environment for exports. The objectives of special economic zones include making available goods and services free of taxes and duties supported by integrated infrastructure for export production, expeditious and single-window approval mechanism and a package of incentives to attract foreign and domestic investments for promoting export-led growth.

At present there are eleven functioning SEZs. While seven zones have been set up by the Central Government, four by the private/joint/state sector. Approval have been given for setting up thirty-five new SEZs in the private/ joint/State sector as on April, 2005.

Special Economic Zone (SEZ) is a specifically delineated duty-free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs. Goods and services going into the SEZ area from DTA shall be treated as exports and goods coming from the SEZ area into DTA shall be treated as if these are being imported. SEZ units may be set up for manufacture of goods and rendering of services.

SEZ has been put under the administrative control of the Development Commissioner. All activities of the SEZ unites within the zone, unless otherwise specified, including export and re-import of goods have been permitted through self-certification procedure.

For development, operation and maintenance of infrastructure facilities in SEZs, the developer shall be eligible for the following entitlements.

Incentives and Facilities to SEZ

The following benefits/incentives are available to SEZ developers and SEZ units in Special Economic Zones and are categorized as follows.

Incentives and facilities available to SEZ developers

- Exemption from customs/excise duties for development of SEZs for authorized operations approved by the BOA.
- Income tax exemption on income derived from the business of development of the SEZ in a block of ten to fifteen years under Section 80-IAB of the Income Tax Act.
- Exemption from minimum alternate tax under Section-115 JB of the Income Tax Act.

- o Exemption from dividend distribution tax under Section 115 O of the Income Tax Act.
- o Exemption from Central Sales Tax (CST).
- o Exemption from Service Tax (Section 7, 26 and Second Schedule of the SEZ Act).

Export and Import of Goods

SEZ units may export goods and services including agro-products, partly processed goods, sub-assemblies and components except prohibited items of exports in ITC (HS). The units may also export by-products, rejects, waste scrap arising out of the production process. Export of Special Chemical, Organisms, Materials, Equipment and Technologies (SCOMET) are subject to fulfilment of the conditions indicated in the ITC (HS) Classification of Export and Import items. SEZ units, other than trading/ service unit may also export to Russia Federation in Indian Rupees against repayment of State Credit/Escrow Rupee Account of the buyer, subject to the RBI clearance, if any.

An SEZ unit may import/procure from the DTA without payment of duty all types of goods and services, including capital goods, whether new or second hand, required by it for its activities or in connection therewith, provided they are not prohibited items of imports in the ITC (HS). However, any permission required for import under any other law shall be applicable. Goods include raw materials for making capital goods for use within the unit. The units are also permitted to import goods required for the approved activity, including capital goods, free of cost or on loan from clients.

SEZ units may procure goods required by it without payment of duty, from bonded warehouse in the DTA set-up under the Policy and/or under Section 65 of the Customs Act and from International Exhibitions held in India.

SEZ units, may import/procure from DTA, without payment of duty, all types of goods for creating a central facility for use by units in SEZ. The central facility for software development can also be accessed by units in the DTA for export of software.

A SEZ may be set up in the public, private, or joint sector or by a state government.

12.2.5 Free Trade Warehousing Zones (FTWZ)

The Government of India (GoI) had announced in the Foreign Trade Policy 2004–09 to set up Free Trade and Warehousing Zones (FTWZ) to create trade-related infrastructure to facilitate the import and export of goods and services with freedom to carry out trade transactions in free currency.

Positioning of FTWZ

- Logistics and distribution centre

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- Provides 'Free Zone' environment
- Enables efficient operational environment for trade facilitation
- Integrates various aspects of logistics operations
- Provision of high-quality infrastructure

Relevant Laws

- Principally governed by the SEZ Act, 2005 and SEZ Rules, 2006.
- 100% FDI is permitted in development and establishment of FTWZ.
- FTWZ is a deemed foreign territory and all equipment and materials sourced from the Domestic Tariff Area will be considered as imports by the FTWZ and vice versa.
- Minimum size of the warehousing stipulated at 1 lakh sq mtrs.
- All benefits available to the special economic zones shall be applicable to the FTWZs.
- The FTWZ shall be under the administrative control of the Development Commissioner (DC).

Benefits of the FTWZ

Fiscal and regulatory benefits

- **Tax benefits:** Income tax (Section 80IA) and service tax exemptions for developers and users of the zone—reduces logistics costs for users of the zone.
- **Duty deferment benefits:** Custom duty deferment benefits for products requiring longer storage time.
- **Excise duty exemptions:** Excise duty exemption for products sourced from the domestic markets, including goods, spares, DG sets, and packing materials.

Infrastructure benefits

- **Single product storage facilities:** Assist in meeting specific warehousing requirement for each product category, for example, different sections for storage of tea, coffee, etc.
- **Shared equipment:** Ability of users to save on capital investments by leasing equipment provided by the zone.

Administration benefits

- **Delivery time:** Reduction in custom clearance time and better logistics connectivity leading to improved delivery time.
- **Support facilities and effective management:** Provision of efficient management services and international expertise along with support facilities such as banking, and insurance.

Other benefits

- Export oriented
- FDI inflow
- Employment potential
- Competitiveness of industries
- Attractiveness of support/ancillary industries
- Boost to all-round economic activity

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12.2.6 Star Export Houses

A star export house is an Indian exporter who has excelled in international trade and successfully achieved a certain minimum amount of export performance in two out of three financial years. For obtaining star export house status, the exporter involved in export of goods or services must have a valid IE code (import export code). Once being recognised as star export house the exporters enjoy various benefits and privileges under the star export house benefit scheme.

To obtain the one-star export house status the achieved export performance of FOB or FOR value should be US $ 3 million. For export performance of 25 million dollars, status of Two-star export house is achieved, for three-star export house status a performance of US $100 million, for four-star export house US $ 500 million and export performance of US $ 2000 million for the status of five-star export house must be achieved.

The above export performance is to be achieved in the current plus previous three financial years.

The Star export House certificate or the status holder certificate is valid for 5years from the date of issuance of the certificate. For renewal of the certificate application has to be filed before the expiry of existing validity period.

On being recognised as a star export house, the exporter enjoys various benefits and privileges as under:

- Authorisation and customs clearance for both imports and exports may be allowed on self-declaration basis.
- Exemption from furnishing of bank guarantee for Schemes under Foreign Trade Promotion, unless specified otherwise.
- Input-output norms maybe fixed on priority within 60 days by the Norms Committee.
- Exemption from compulsory negotiation of documents through banks. Remittance or receipts, should however be received through banking channels.
- Two star and above export houses are permitted to establish export warehouses as per Department of Revenue guidelines.

- Three star and above export houses are permitted to get benefits of Accredited Clients Programme, as per the guidelines of Central Board of Excise and Customs.
- Status holders would be entitled to preferential and priority treatment while handling of consignments by concerned agencies.
- Status holders are eligible to export freely exportable items on free of cost basis for export promotion subject to an annual limit of Rs.10 lakhs or 2% of average annual export realisation during preceding three licensing years, whichever is higher.
- Exporters involved in manufacturing would be eligible to self-certify their goods as origination from India.

12.2.7 Deemed exports

Deemed exports refer to those transactions in which goods as supplied do not leave the country, and payment for such supplies are made in India, either in Indian rupees or in free foreign exchange. Thus, 'deemed exports' do not take place in the form of physical exports outside the country.

Categories of Supply

The following categories of supply of goods by main/sub–contractors are regarded as 'deemed exports', under FTP, provided that the goods are manufactured in India:

(a) Supply of goods against Advance Authorization/Advance Authorization for annual requirement/DFIA.

(b) Supply of goods to EOUs, STPs, EHTPs or BTP.

(c) Supply of capital goods to holders of authorizations under the EPCG Scheme.

(d) Supply of goods to projects as financed by multilateral or bilateral agencies/ funds as notified by the Department of Economic Affairs (DEA), MoF under International Competitive Bidding (ICB) in accordance with the procedures of those agencies/funds where legal agreements provide for tender evaluation without including customs duty.

(e) Supply and installation of goods and equipment (single responsibility of turnkey contracts) to projects as financed by multilateral or bilateral agencies/ funds as notified by DEA, MoF under ICB, in accordance with the procedures of those agencies/funds which may have been invited and evaluated on the basis of Delivered Duty Paid (DDP) prices for goods manufactured abroad.

(f) Supply of capital goods, in unassembled/disassembled condition, as well as plants, machinery, accessories, tools, dies, and such goods which are used for the purpose of installation, till the stage of commercial production, and spares to the extent of 10 per cent of FOR value to fertilizer plants.

(g) Supply of goods to any project or purpose in respect of which, the MoF, by a notification, permits the import of such goods at zero customs duty.

(h) Supply of goods to power projects and refineries, not covered above.

(i) Supply of marine freight containers by 100 per cent EOU (domestic freight container manufacturers) provided that the said containers are exported out of India within 6 months or such further period as permitted by customs.

(j) Supply to projects as funded by UN agencies; and supply of goods to nuclear power projects through competitive bidding as opposed to ICB.

Benefits of Deemed Exports

Deemed exports are eligible for the following benefits, as may be specified for each category of supply:

(a) Special imprest licence

(b) Deemed Exports Drawback Scheme

(c) Refund of terminal excise duty; and

(d) Special import licence at the rate of 6 per cent of the FOR value (excluding all taxes levies).

Benefits of deemed exports shall be available only if the supply is made under procedure of ICB.

To conclude, deemed exports are beneficial to Indian foreign trade because they are a valuable source of foreign exchange. In these transactions, the payment is received before the goods are delivered. Due to this attribute of deemed exports, the government has made the import of inputs for such purposes duty-free.

12.2.8 Agri Export Zones

With the primary objective of boosting agricultural exports from India in the year 2001 Government of India announced a policy of setting up Agri export zones (AEZ) across the country. The central Government has sanctioned 60 AEZs comprising about 40 agricultural commodities. These AEZs are spread across 20 states in the country.

Objectives

The objective of setting up Agri Export Zones was to convert the efforts made by various Central and State Governments for increasing export of agricultural commodities from India.

The AEZ takes a comprehensive approach of a particular product located in a geographic area for the purpose of developing and sourcing raw materials, their processing, their packaging and leading to final exports.

The major components of this comprehensive concepts are as follows:

i. Cluster approach of identifying the potential products and geographical region in which these products are grown

ii. Adopting an end-to-end approach of integrating the entire process right from the stage of production till it reaches the consumption stage

iii. Integration of the activities of various agencies connected with the department of the product

The benefits estimated from the establishment of Agri export Zones are as follows:

- Backward linkages with market-oriented approach
- Product acceptability and its competitiveness abroad as well as in the domestic market
- Value addition to basic agricultural produce
- Bring down cost of production through economy of scale
- Better price for agricultural produce
- Improvement in product quality and packaging
- Promote trade related research and development
- Increase employment opportunities

12.2.9 Target Plus Scheme

The objective of the Target Plus scheme is to accelerate growth in exports by rewarding Star Export Houses which have achieved a quantum growth in exports. High performing Star Export Houses are entitled for a duty credit based on incremental exports, substantially higher than the general annual export target fixed. All Star Export Houses which have achieved a minimum export turnover in free foreign exchange of Rupees 10 crores in the previous licensing year are eligible for consideration under the target plus scheme. The entitlement under this scheme would be contingent on the percentage incremental growth in a FOB value of exports in the current licensing year over the previous licensing year.

Check Your Progress

1. Under the Export Promotion Capital Goods Scheme, how is the value of Net foreign Exchange earned on exports calculated?
2. What does the duty exemption scheme consist of?
3. List the objectives with which the SEZ scheme was announced in April 2000.
4. Why were the Free Trade Warehousing Zones set up?
5. Why are deemed exports considered beneficial to Indian foreign trade?
6. What is the approach behind Agri Export Zones?

12.3 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. For the calculation of the Net Foreign Exchange (NFE) earned on exports, the value of all the licences shall be deducted from the FOB value of exports made by the person. However, the value of freely transferable Special Import Licences, EPCG licences and the value of licences surrendered during the validity of licence shall not be deducted.
2. Duty Exemption Schemes consist of:
   - Advance Authorization
   - Duty Free Import Authorization (DFIA)
3. The Government of India had announced a Special Economic Zone scheme in April, 2000 with a view to provide an internationally competitive environment for exports. The objectives of special economic zones include making available goods and services free of taxes and duties supported by integrated infrastructure for export production, expeditious and single-window approval mechanism and a package of incentives to attract foreign and domestic investments for promoting export-led growth.
4. Free Trade and Warehousing Zones (FTWZ) to create trade-related infrastructure to facilitate the import and export of goods and services with freedom to carry out trade transactions in free currency.
5. Deemed exports are beneficial to Indian foreign trade because they are a valuable source of foreign exchange. In these transactions, the payment is received before the goods are delivered.
6. The AEZ takes a comprehensive approach of a particular product located in a geographic area for the purpose of developing and sourcing raw materials, their processing, their packaging and leading to final exports.

12.4 SUMMARY

- Under the Export Promotion Capital Goods Scheme, capital goods, both new and second hand, may be imported.
- Duty Exemption Schemes enable duty-free import of inputs and remission required for export production. Duty Exemption Schemes consist of:
  1. Advance Authorization
  2. Duty Free Import Authorization (DFIA)
- The gems and Jewellery export promotion council (GJEPC) undertakes several promotional activities including joint participation in the international jewellery shows, sending and hosting trade the liaison and sustained image building exercise.

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- The Government of India had announced a Special Economic Zone scheme in April, 2000 with a view to provide an internationally competitive environment for exports. The objectives of special economic zones include making available goods and services free of taxes and duties supported by integrated infrastructure for export production, expeditious and single-window approval mechanism and a package of incentives to attract foreign and domestic investments for promoting export-led growth.
- The Government of India (GoI) had announced in the Foreign Trade Policy 2004–09 to set up Free Trade and Warehousing Zones (FTWZ) to create trade-related infrastructure to facilitate the import and export of goods and services with freedom to carry out trade transactions in free currency.
- A star export house is an Indian exporter who has excelled in international trade and successfully achieved a certain minimum amount of export performance in two out of three financial years.
- Deemed exports refer to those transactions in which goods as supplied do not leave the country, and payment for such supplies are made in India, either in Indian rupees or in free foreign exchange.
- The objective of setting up Agri Export Zones was to convert the efforts made by various Central and State Governments for increasing export of agricultural commodities from India.
- The objective of the Target Plus scheme is to accelerate growth in exports by rewarding Star Export Houses which have achieved a quantum growth in exports.

12.5 KEY WORDS

- **Trade policy:** It refers to the set of policies which govern the external sector of its economy.
- **Special Economic Zone (SEZ):** It is a specifically delineated duty-free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs.
- **Star export house:** It is status given to an Indian exporter who has excelled in international trade and successfully achieved a certain minimum amount of export performance in two out of three financial years.
- **Deemed exports:** It refers to those transactions in which goods as supplied do not leave the country, and payment for such supplies are made in India, either in Indian rupees or in free foreign exchange.

12.6 SELF ASSESSMENT QUESTIONS AND EXERCISES

NOTES

Short-Answer Questions

1. Write a short note on the trade philosophy in India.
2. List the roles played by Gems and Jewellery export promotion council.
3. What are the different categories of stars under the Star Export house Scheme?

Long-Answer Questions

1. Discuss the concept and benefits of SEZs and FTWZs.
2. Explain the components and benefits of Agri Export Zones.

12.7 FURTHER READINGS

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UNIT 13 FOREIGN EXCHANGE AND FOREIGN CURRENCY

NOTES

Structure

13.0 Introduction
13.1 Objectives
13.2 Introduction and Organization of Foreign Exchange Market
13.3 Exchange Rate Policy and Management
13.3.1 Determining and Forecasting Foreign Exchange Rates
13.4 Currency Arbitrage and Triangular Arbitrage
13.5 Forward Market
13.6 Futures Market
13.7 Foreign Currency Options
13.8 Answers to Check Your Progress Questions
13.9 Summary
13.10 Key Words
13.11 Self Assessment Questions and Exercises
13.12 Further Readings

13.0 INTRODUCTION

Businesses in the international markets are dependent on foreign currency and foreign exchange market. Therefore, understanding of the fundamental aspects of foreign exchange market is crucial. But how are the exchange rates determined in the foreign markets? In the history of the world, there have been many changes in the ways, countries have participated in the world markets and controlled and regulated their currencies with respect to other foreign currencies. There are benefits and drawbacks of different exchange rate regimes and many different factors which affect these rates. The foreign exchange rates have a bearing on the national income as well as the national currencies. In this unit, you will learn about the concept of foreign exchange markets, the determination and estimations of the exchange rates. Further, you will also learn about the different futures, options and forward exchange markets.

13.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the concept of foreign exchange and major players in the market
- Describe the exchange rate determination and its predictions
- Explain the concepts of forward exchange, futures and options markets

13.2 INTRODUCTION AND ORGANIZATION OF FOREIGN EXCHANGE MARKET

NOTES

Every sovereign nation has its own currency. Theoretically, the monetary unit of a country can be exchanged with any other currency of any other country. Most international financial transactions involve an exchange of one currency for another. The ratio in which they are exchanged or prices in terms of each other are known as Exchange rates.

Countries when they trade with each other require money flows. Foreign exchange markets provide the mechanism for exchanging different monetary units for each other. If the currency is widely accepted as in the case of US dollar, it can pay in its own currency. Actually, dollars remain in circulation among international traders for years before they are exchanged for goods or assets. Such currency in circulation with traders constitutes an interest-free loan with an unstated time of maturity from the rest of the world to the USA. Sometimes the nationals of one country may prefer to hold financial assets in a foreign country or denominated in a foreign currency, because domestic currency may be subject to variable and high inflation, rendering it a poor store of value. Secondly, foreign currency balance may reduce risks; and finally, foreign currency assets help hedge anticipated foreign currency liabilities. Actually, the efficiency of the international financial system and its degree of integration with individual sovereign financial systems depends to a large extent on how cheaply and quickly foreign exchange transactions can be affected.

Purpose and Organization

The foreign exchange market encompasses all transactions involving the exchange of different monetary units for each other. Its purpose is to facilitate transfer of purchasing power denominated in one currency into another, that is to trade one currency for another. It acts as an intermediary for individual buyers and sellers. The foreign exchange market links financial activities in different currencies. The foreign exchange market is not a physical place. It is a network of banks' dealers and brokers who are dispersed throughout the leading financial centres of the world. Currency transactions are channelled through the worldwide interbank or wholesale market in which banks trade with each other. In the spot market, currencies are traded for immediate delivery within two business days, while in the forward market contracts are made to buy and sell currencies for future delivery.

Trading is in currencies of high-income countries which are in great demand and whose governments impose a few restrictions on currency trade. The predominant currency is the US dollar. The limit of convertibility inhibits the use of currencies of developing countries.

Trading in currencies takes place in foreign exchange markets. The primary function of foreign exchange markets is to facilitate trade and investment. There is no specified physical location where traders get together to exchange currencies. It is an over-the-counter market. Traders are located in the major international banks around the world. The foreign exchange markets are highly sophisticated and complex forwards and options are now the stock in trade. They are worldwide in scope and world's slickest. Foreign exchange markets are screen-based, genuinely international and open for business 24 hours a day. There are a large number of buyers and sellers and prices adjust rapidly and smoothly. In the foreign exchange market, investors can trade very large amounts without moving the price. Foreign exchange markets are the largest components of the financial markets in the world. They are relatively free of regulations. Central banks lay down only capital standards and voluntary codes of conduct. There are no regulations for investor protection or transparency.

Leading foreign exchange markets in London (accounting for a quarter of the business done), Tokyo, New York, Frankfurt, Zurich, Paris, Amsterdam, Toronto and Milan are well-connected and exchange rate changes have an immediate impact. However, only a fraction of the turnover in foreign exchange markets reflects the customer's foreign exchange needs. About 5 per cent relates to underlying trade flows and another 13 per cent to capital flows. The rest is the dealing that banks do among themselves. In most foreign exchange transactions, both the buyer and seller are money centre banks. Their operations are heavily oriented towards the specialized activities of the leading financial centres. Their currency exchanges produce present or future exchanges of deposits. The foreign exchange market is largely a wholesale market accounting for 90 per cent of the total value of foreign exchange transactions.

13.3 EXCHANGE RATE POLICY AND MANAGEMENT

By definition, the exchange rate is the rate at which currency of a country can be exchanged for another. In simple words, it is the price of one currency in terms of another. When an Indian citizen imports a Mercedes car from the US, he/she will have to pay the Mercedes company in US dollars ($) and not in Indian rupees (INR). So the importer will have to acquire US dollars from the exchange market for the purpose of making the payment for the imported car. The price of the US dollar in terms of the Indian rupee is given in the exchange market. To acquire US dollars, the person will have to exchange the Indian currency for the US dollar in the exchange market. The price that the Indian citizen pays for each US dollar is the rupee-dollar exchange rate. The exchange rate is determined for different currencies in the exchange market and made public through the news media.

Having explained the meaning of the exchange rate, we turn to the question: *How is the foreign exchange rate determined?* There is no simple answer to the above question. The method of exchange rate determination has been changing over time. It also depends on whether the foreign exchange market is free or controlled and whether the government adopts a fixed or a flexible exchange rate policy. The issue of whether the exchange rate should be determined by the market or be fixed by the government is a controversial one. In practice, most countries have adopted both free and flexible exchange rate policies at some stage in their economic growth.

13.3.1 Determining and Forecasting Foreign Exchange Rates

In recent years, global interdependence has increased to an unprecedented degree. Changes in one nation's economy are rapidly transmitted to that nation's trading partners. These fluctuations in economic activity are reflected almost immediately in fluctuations of currency values. These changes in exchange rates expose all firms engaging in export import operations, as also multinationals with integrated cross border production and marketing operations. It would be useful for all of them to be aware of the various factors that influence exchanges rates. Through a study of these factors and the trend of movements in the value of a particular currency, an experienced businessman may be able to forecast the possible future movement of that currency. This will enable him (i) to estimate his risk and (ii) to make an informed, prudent decision regarding whether it would be worthwhile for him to undertake the risk or not. The factors determining exchange rates can be classified into two categories: (i) Primary determinants (ii) Secondary determinants.

I. Primary Determinants

The different primary determinants are:

Demand and supply

Demand and supply of a particular currency are the most important factors affecting its exchange rate. The supply of foreign exchange to a banking system comes from the export of goods and services; inflow of foreign capital through foreign direct investment and portfolio investment; profits, interest, dividend and other incomes earned and repatriated to the country by investors abroad; money spent by foreign travellers; expenditure incurred by those involved in foreign diplomatic missions and other international organizations in India; foreign bilateral and multilateral aid, foreign grants and gifts; repayment of loans and interest payments by foreigners; etc. The demand for foreign exchange comes from the import of goods and services; outflow of capital through foreign direct investment and portfolio investment; profits, interest, dividend and other incomes earned by foreigners/corporate bodies and repatriated to their country; Indian travellers going abroad for education, medical treatment; pleasure, etc.; expenditure incurred by embassies abroad; bilateral loans/ aids granted to other countries; subscription payment to international organizations;

grants and gifts to other friendly countries; repayment of foreign loans and interest payment; etc.

All these transactions can be classified in three classes:

(1) Purchases and sales for trading purposes

(2) Speculative deals by professional dealers

(3) Protective movements by substantial holders

Multinational corporations have certain protective movements in place for their funds to avoid losses. In general, if a country has an import surplus, the exchange rate is likely to depreciate; and in case of export surplus, it is likely to go up.

At this stage, it might be worthwhile to discuss something about speculative transactions. Speculation involves a conscious assumption of risks. Speculators take a definite view about currency movements and take an open position. They buy or sell currencies according to their estimates of what the future exchange rate is likely to be from those who want to sell or buy currencies to hedge or to eliminate the speculative element in their transactions. For example, if the bulls expect the dollar to go up, they purchase dollars forward at current prices to sell later at higher rates. If bears expect the dollar to go down, they sell forward at current rates to purchase later at a lower price. Accounts are usually settled by payment of differences. A person can choose to behave like a hedger in some cases and like a speculator for some currencies. Thus, there is no watertight compartment between hedgers and speculators. The significance of speculation is that speculators create pressures in the market and may ultimately affect the spot rate as well. Speculative transactions are not permitted in India.

Domestic economic policies

Policies affecting the internal purchasing power of the currency concerned or, in other words, the relative inflation rates, also affect exchange rates. A country with a rate of inflation higher than other countries may witness a decline in the value of its currency relative to other currencies, and vice versa. It is based on the Purchasing Power Parity theory (PPP) formalized by Gustav Cassel. The PPP theory maintains that exchange rates will tend towards the point at which their international purchasing power is equal. Since inflation erodes a currency's purchasing power, the difference between the inflation rates in two countries will determine how far one currency erodes in terms of the other, i.e., how exchange rates move. There are two questions that arise in this context: (1) which is the base year when purchasing powers were equal? The choice of the base year is arbitrary in most cases and can make a big difference to the PPP analyst (2) what is the right way to measure inflation in two countries? Price indices, either of consumer prices or wholesale prices, may not be a good measure as they cover items which are not internationally traded.

There is yet another aspect which affects exchange rates – the increasing importance of capital flows between various countries. As a result, exchange rates

are affected not only by the movements of goods. Thus, PPP as a determinant of exchange rates has proved inadequate in explaining exchange rate movements in the short term. In part, this is because it ignores the importance of transport, insurance and other costs in assessing the relative costs of goods. But at the same time, the inclusion of relative costs and prices of non-traded goods in the measurement of domestic inflation rates makes a comparison between these inflation rates unreliable in determining the exchange rate equilibrium given that capital flows can influence short term exchange rate values. Nevertheless, PPP theory has been shown to have more validity in predicting the long term movements of exchange rates. Countries that persistently experience relatively high inflation rates eventually also experience depreciation in the value of their currencies on the foreign exchange market under a floating exchange rates regime.

II. Secondary Determinants

The various secondary determinants are as follows:

(a) **Interest rate differentials:** Foreign exchange markets and exchange rates are quite sensitive to movements in interest rates. This is because financial markets are becoming more closely linked due to (i) the growing interest in international investment, (ii) the elimination or constraints on the mobility of capital to a large extent, and (iii) more rapid means of communication. Most investors would like to move their funds from a country having lower interest rates to a country having higher interest rates. Such funds are usually termed 'hot money'.

(b) **Expectations and other psychological factors:** Very often, these factors have a considerable influence on the exchange rates. Capital Flights or short term capital movements provide an obvious example. The expectations of corporate finance managers, foreign exchange traders and potential speculators do have a profound influence on the exchange rates. These expectations again depend on various factors like the country's economic policy and economic development including balance of payments, the discovery of new resources, political stability, movements of capital etc. The behaviour of the major participants in the foreign exchange market may make the exchange rate move differently from that determined by economic fundamentals because of their 'instinct'. Arbitrage and speculative transactions also cause movements in exchange rates, albeit in opposite directions.

(c) **Political events:** Events such as a change in the government can have a dramatic impact on the exchange rate even before any change in the government policies actually takes place. This occurs on the assumption that changes will be made because of previous experience with the particular party, or because of certain stated intentions in their pre election platform. Again, political stability induces confidence in the investors, and encourages capital inflow into the country. This has the positive effect of strengthening

the currency of the country. On the other hand, if the political situation in the country is unstable, it makes the investors withdraw their investments. The resultant outflow of capital from the country weakens the currency. News of political disturbance in different parts of the world often causes the US dollar to appreciate as investors buy dollars, seeking a safe haven for the money in the world's largest economy.

(d) Central Bank's intervention: The foreign exchange market is of great importance to central bankers because of the impact exchange rates have on a country's balance of payments and its competitive position in world markets. Hence, very often, central banks find it necessary to intervene in or influence market conditions or exchange rate movements.

Central Bank intervention has two kinds of effects:

i. Ordinary supply and demand effect – the same impact on exchange rate as a purchase or sale by any other market participant

ii. In addition, Central Bank Intervention (CBI) or its absence may have a continuing influence on market expectations. Through the timing and visibility of their operations, monetary authorities provide indirect information about official attitudes towards current exchange market conditions although market participants may interpret them in different ways while taking their own decisions whether to buy or sell a currency.

Since 1973, central banks have intervened in foreign exchange markets in varying degrees and for different reasons. One important objective has been to seek to counter disorderly markets. There is no precise definition of disorderly trading, but indications include: (1) share fluctuation in the exchange rates, (ii) reluctance of bank traders to make two way markets, (iii) a distinct widening in the bid office spreads, and (iv) a tendency for rate movements to accumulate in one direction. And even when there is agreement about what constitutes market disorder, there may be differences of opinion over what to do about it.

To conclude, the following points may be stressed:

(a) Intervention should not try to hold a fixed line of resistance against fundamental trends.

(b) Intervention purchases should never be pushed to such a point that the resultant domestic money supply is affected.

(c) Intervention is not the final cure. It should be seen as a makeshift measure to gain time until fundamental factors or adjustment policies produce results.

(d) Coordinated intervention does affect the exchange rates of particular currencies. For example, the dollar went up in the first week of January 1992 in expectation of a coordinated action.

(e) The authorities cannot know what the right exchange rate is but they can diagnose when an exchange rate is excessively out of line and has to be corrected.

Can We Forecast Exchange Rates?

It is possible to do so but it is difficult. The factors that influence exchange rates are numerous and they act in an extremely complex, interactive and proactive manner. Moreover, those who participate in the market and actually move the exchange rates do not always have the theoretical and statistical equipment or the inclination for in depth analysis that theorists often attribute to them.

Recent experience with exchange rates suggests that the following forces should shape one's forecasts about exchange rates:

i. Expectations about future money supplies: If there is a probability of rapid growth in money supply, that nation's currency will suffer a decline in its value.

ii. Expectations about governmental policies: If there is heavy taxation or a confiscation of private assets, there will be a flight of foreign currency from that country and the domestic currency's value with decline. This factor is important as flows of funds are now a more potential force in determining currency rates than economic fundamental exchange controls. Preventing the conversion of one currency into other currencies will lead to a similar outcome. For instance, once the French President promised sweeping egalitarian reforms in his election campaign, the value of the French franc fell from 4.2 to 5 and later to 5.6 to a US$.

iii. Reactions to official exchange market intervention: If speculators believe that the officials have the will and resolve to stabilize the exchange rate in question, they will act in a way to stabilize themselves. But if the announcement or evidence of official defense of a weak currency looks like last minute desperation, it may exacerbate the pressure on that currency.

Exporters can also subscribe to forecasting services that prove either long-term predictions of general trends or short-term trading advice. Two such services are Rothschild in London and Citibank in New York.

Such redemption is usually on a first come first serve basis.

A bondholder wishing to redeem his entire holding or a portion thereof would be required to give notice of his request for early redemption to the Registrars by 1 November of the concerned calendar year.

Requests for early redemption by an individual are considered only if the bonds have been held by him at least for one year from the date of allotment of the bonds/transfer of bonds in his name as the case maybe.

13.4 CURRENCY ARBITRAGE AND TRIANGULAR ARBITRAGE

NOTES

The opportunities for currency arbitrage are restricted to interbank transactions and are available for a very brief duration. Currency arbitrage occurs when a price discrepancy exists in the foreign exchange market that permits a gain to be made by a party working against the bid-ask spread.

Two-Point Currency Arbitrage

Two-point locational arbitrage occurs when two currencies are involved and a price difference between markets is great enough to provide a gain for arbitrageurs who can respond. The example illustrates the arbitrage transaction in the spot market:

Spot Rates	*Bid* $/£	*Ask* $/£
New York	1.3972	1.3992
London	1.3982	1.4002

The quotation shows that the pound is cheaper in New York as compared to London and should be bought in New York and sold in London making a gain of 10 points. Buy at 1.3982 in New York and sell at 1.3992 in London. The difference tends to be eliminated by competition between the two centres leaving a small difference to cover transaction costs.

Triangular Arbitrage

Opportunities for triangular arbitrage arise if two currencies are quoted against each other at a rate that differs from the cross rate. Since three currencies are involved, it is called three-point triangular arbitrage.

Example: Three currencies are chosen: Dollar, DM and Yen.

Assume in New York:

DM 1.3972-82 per dollar

In London ¥62.4096-105 per DM

¥87.2009-19 per dollar

The mark-dollar cross rate that gives the dollar cost of buying, marks by buying yen first is:

$$¥\frac{87.2009}{\$} \times \frac{DM}{62.4096} = DM1.3972/dollar$$

This is better than DM1.3982/dollar if DM are purchased directly with dollars. The difference between the two rates is 10 points which illustrates how profitable triangular arbitrage can be. The gain per dollar is:

$$\$1 \times ¥\frac{87.2009}{\$} \times \frac{DM}{62.4096} = \frac{\$}{DM1.3982}$$

To seize that gain in the triangular arbitrage, the transactions would have to be in millions of currency units which would have a net effect on the arbitrageurs' currency position.

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13.5 FORWARD MARKET

The forward market in India is active up to six months where two-way quotes are available. Forward exchange market refers to buying and selling currencies to be delivered at a future date. Forward exchange transactions involve an agreement on a price today for settlement at some date in the future. Forward rates apply to transfer of demand deposits with value dates three or more business days in the future. They are always quoted with reference to spot rates because they are traded at either a premium or discount to spot exchange in the interbank market. Forward rates are quoted in terms of the premium or discount to be added to the spot rate which is quoted in two numbers, the bid price and ask price. The bid and ask spread will always widen with the forward horizon.

Calculation of the Forward Exchange Rate

The forward rate is calculated with the help of covered interest parity condition. The formula to calculate forward exchange rate is:

$$f = \frac{(r^* - r)s}{(i + r)} + s$$

where f is the one year forward rate quotation in foreign currency per unit of domestic currency,

s is the spot quotation in foreign currency per unit of domestic currency,

r is one year domestic interest rate and

r* is one year foreign interest rate.

To obtain three-month forward rate, the annualized three month interest rate has to be divided by 4; and to calculate six-month forward exchange rate, the six-month interest has to be divided by 2. The forward premium or discount is given by the formula:

$$\frac{F - S}{S} \Omega r^* - r$$

taking the terms as defined above.

Whether a foreign currency will be quoted at a premium or discount, with respect to domestic currency, depends on interest rates. According to Covered Interest Parity (CIP), if the domestic interest rate is higher than the foreign interest rate, then the domestic currency will be at a forward discount by an equivalent percentage. If the domestic interest rate is lower than the foreign interest rate, the currency will be at a forward premium by an equivalent percentage. According to Grabbe, 'The interest parity theorem is an arbitrage condition relating the discount

or premium on forward exchange to the term structure of interest rates on financial assets denominated in the two currencies involved in an exchange rate.'

Value dates are usually in multiples of 30 days, and popular forward periods are 30, 90 and 180 days. Value dates are negotiable for a suitable price. Normally, interbank forward contract maturities are of less than 30 days. At the other end are one-year contracts. The advantage of a forward market is that an exchange rate is negotiated and the required currency need not be bought until they are needed, say in 30 days.

The forward transaction is sometimes called outright forward to distinguish it from spot transaction. By contrast, transactions involving forward exchange in the interbank market usually take the form of swap transactions. Market-making banks trade among themselves in the form of swaps which involves both spot and forward contracts. A swap is the spot sale of a foreign currency with a simultaneous agreement to repurchase it at some date in the future. There is also a 'forward' swap that involves trading one forward contract for another forward contract of different maturity.

The difference between the sale price and repurchase price is the swap rate. It is estimated that in foreign exchange trading, 2/3 of the transactions are spot, 1/3 swap and a small percentage, 2 per cent outright forwards.

The forward exchange rate and the volume of forward transactions are determined by the actions of arbitrageurs, traders and speculators. If they believe that the current spot rate is overvalued, they may sell spot which results in a depreciation of the currency. If interest rates do not change, then both the spot and forward rates depreciate. On the other hand, if there is a belief that the currency is overvalued forward, it will be sold forward leading to depreciation of the forward as well as spot rates. Arbitrage ties the spot and forward rates via the covered interest parity condition (CIP).

13.6 FUTURES MARKET

A number of factors have coalesced in the early 21st century to promote free trade across distance and political boundaries. Political advances promoting free trade include reduction or elimination of restrictive tariffs, capital controls and subsidization of local businesses. Technical advances include reduced transportation costs promoted by containerization of products for ocean shipping, and advanced telecommunication systems lead by the emergence of the World Wide Web. Thus, today's modern corporation frequently conducts business outside its native country and, in the process, earns revenues or incurs liabilities denominated in currencies apart from their native currency. In the process, these corporations may become exposed to the risk that foreign exchange rates are unpredictable and can fluctuate in adverse directions. These uncertainties may make it difficult to manage current cash flows, plan future business expansion or to succeed in a competitive market environment.

Meaning of exchange futures

Futures in exchange are transferable future contracts that specify the price at which a currency can be bought or sold at a future date. Currency futures contracts are legally binding and counterparties that are still holding the contracts on the expiration date must trade the currency pair at a specified price on the specified delivery date. Currency future contracts allow investors to hedge against foreign exchange risk. Because currency futures contracts are marked-to-market daily, investors can exit their obligation to buy or sell the currency prior to the contract's delivery date. This is done by closing out the position. The prices of currency futures are determined when the contract is signed, just as it is in the forex market, only and the currency pair is exchanged on the delivery date, which is usually sometime in the distant future. However, most participants in the futures markets are speculators who usually close out their positions before the date of settlement, so most contracts do not tend to last until the date of delivery.

13.7 FOREIGN CURRENCY OPTIONS

Options, like futures, are also derivatives. An option is a legal contract, which gives the holder the right to buy or sell the underlying asset, at a specified price, on a specified date. Although it gives the holder the right to buy or sell the underlying asset, he is not obligated to do so. This is the basic difference between option and futures. In futures, the holder is obligated to sell or buy the underlying asset according to the nature of contract entered into by both the parties.

Two parties are involved in the options contract, a buyer and a seller. The buyer who buys an option takes a long position. The seller who sells an option takes a short position, i.e., he writes the option and is the writer of the option. The buyer is the holder of the option. Physical certificates are not created when options are written.

Book keeping entry is the form of transaction in option trading. The underlying assets of the options are; selected agricultural products, foreign currencies and stocks.

1. Call option

It gives the buyer the right to buy (call away) a specified underlying asset from the option writer at a specific price at any time up to or on a specific date. If it is in the case of stocks, the contract consists of the:

- Name of the company whose shares can be bought
- Number of shares to be bought (lot size)
- Exercise price or strike price of the shares at which the shares can be bought
- Expiration date, i.e., the date at which the right to buy expires
- Premium or purchase price

NOTES

It can be explained clearly with an example. Consider 'B' and 'C' who are willing to sign a call option contract. 'B' is the buyer of the call option and 'C' is the writer of the call option. If we take the underlying asset as a share, then this contract allows B to buy 100 ICICI Bank shares for₹400 at any time during the next three months. Assuming that ICICI Bank share is selling at ₹ 350 per share on NSE, 'B' thinks that the share price will rise in future. However, 'C' has a different opinion and believes that its stock price will not rise above ₹400 during the next three months. If the price increases above ₹400, 'B' can call the shares, which means that he has the right to buy 100 ICICI Bank shares. At the same time, if the price falls below ₹400, he has the option of not exercising the option, i.e., he may not buy the stock. What he loses is only the premium, which he paid to the writer of the call option.

2. Put option

A put option gives the right to sell the underlying asset at the specified price on or before the specified date. For example, X is a farmer who is not certain about the prices of apples which are now ₹400-500 per box. He fears that the price of apples would fall below ₹ 300 per box. The dealer too is not sure of the price, but is willing to have the deal because in his opinion, the price would remain between ₹ 320-350. The dealer writes the option and the farmer buys it. The contract states that the dealer is willing to buy apples per box at ₹ 300 after three months. At the same time, if the farmer gets a better price, he may not sell the apples. To compensate, the dealer asks for a token money and the farmer pays it. If the farmer does not sell the apples, the token money is a loss to him but he can sell the apples at a better price in the market.

The farmer has no obligation to sell. However, the dealer has the obligation to buy, if the apples are sold to him.

In the above example, the farmer would sell the apples only if the price falls below ₹ 300. He can walk out of the deal if the prevailing price is above ₹300 and he can sell it in the open market. Thus, puts have the following salient features.

- A put owner has the right to sell an asset at a certain price within the specified period of time.
- Put owner who is the buyer of the put, is not obligated to sell. He has the choice to exercise his right to sell.
- The seller of the put, i.e., the writer of the put has an obligation to buy.
- Puts are very similar to having a sell position on an asset.

This can be further explained with the help of a stock market example. Assume that ICICI Bank stock is selling at ₹390 and X purchases August put option with the strike price of ₹ 400; thus paying a premium of ₹10. The option will be exercised on the expiry date if the spot price of ICICI Bank stocks on that date is less than ₹ 400.

Since the options are cash-settled, the put holder receives the difference on exercising the option. In case the price of ICICI stock is more than ₹ 400, the put holder may not exercise the option and would rather sell it at a higher price in the open market.

3. Currency Option

Currency option is a contract that grants the holder the right, but not the obligation, to buy or sell currency at a specified exchange rate during a specified period of time. For this right, a premium is paid to the broker, which will vary depending on the number of contracts purchased.

Assets of the Option

The asset that can be bought and sold with an option is called an underlying asset or underlying. Options are written on the following assets:

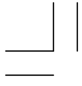
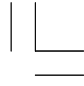
- Stocks
- Stock Indices
- Foreign currencies
- Commodities
- Options on the futures

Check Your Progress

1. Who are a majority of participants in the futures markets?
2. State the basic difference between options and futures.
3. What does the indications of disorderly trading include?

13.8 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Most participants in the futures markets are speculators who usually close out their positions before the date of settlement, so most contracts do not tend to last until the date of delivery.
2. Although options give the holder the right to buy or sell the underlying asset, he is not obligated to do so. This is the basic difference between option and futures. In futures, the holder is obligated to sell or buy the underlying asset according to the nature of contract entered into by both the parties.
3. The indications of disorderly trading include: (1) share fluctuation in the exchange rates, (ii) reluctance of bank traders to make two way markets, (iii) a distinct widening in the bid office spreads, and (iv) a tendency for rate movements to accumulate in one direction.

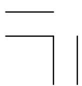
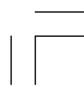
13.9 SUMMARY

NOTES

- The ratio in which currency of one country is exchanged with another is called the exchange rate.
- The foreign exchange market is a network of bank's dealers and brokers who are dispersed throughout the leading financial centres of the world.
- The factors determining exchange rates can be classified into two categories: (i) Primary determinants (ii) Secondary determinants
- Recent experience with exchange rates suggests that the following forces should shape one's forecasts about exchange rates: expectations about future money suppliers, governmental policies, and reactions to official exchange market intervention.
- The opportunities for currency arbitrage are restricted to interbank transactions and are available for a very brief duration. Currency arbitrage occurs when a price discrepancy exists in the foreign exchange market that permits a gain to be made by a party working against the bid-ask spread.
- A market where the purchase and sales of currencies are contracted in the present for receipts and delivery in future is called a 'forward market'.
- Currency futures contracts are legally binding and counterparties that are still holding the contracts on the expiration date must trade the currency pair at a specified price on the specified delivery date.
- Options, like futures, are also derivatives. An option is a legal contract, which gives the holder the right to buy or sell the underlying asset, at a specified price, on a specified date.

13.10 KEY WORDS

- **Foreign exchange market:** It comprises all foreign exchange traders who operate through an electronic network of banks, corporations and individuals trading in one currency for another.
- **Exchange rate:** It is the relative price of one currency in terms of another.
- **Crawling peg regime**: It means periodic as often as daily national currency devaluations of pre-announced magnitude.
- **Currency arbitrage:** It occurs when a price discrepancy exists in the foreign exchange market that permits a gain to be made by a party working against the bid-ask spread.
- **Forward market:** It refers to a market where the purchase and sales of currencies are contracted in the present for receipts and delivery in future is called a 'forward market'.

- **Futures:** In exchange, these are transferable future contracts that specify the price at which a currency can be bought or sold at a future date.
- **Option:** It is a legal contract, which gives the holder the right to buy or sell the underlying asset, at a specified price, on a specified date.

13.11 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Briefly explain the purpose and organisation of foreign exchange markets.
2. Write short notes on currency appreciation, depreciation devaluation and revaluation.
3. What is arbitrage in foreign exchange markets?
4. List the forces which should shape one's forecasts about exchange rates.

Long-Answer Questions

1. Explain the concept of forward exchange rates.
2. Describe the types of foreign currency options.
3. Assess the categories of factors determining exchange rates.

13.12 FURTHER READINGS

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UNIT 14 INTERNATIONAL FINANCIAL INSTITUTIONS AND LEGAL AND ETHICAL ISSUES IN INTERNATIONAL MARKETING

Structure

14.0 Introduction
14.1 Objectives
14.2 International Financial Institutions
14.2.1 IMF
14.2.2 IBRD-World Bank
14.2.3 International Finance Corporation
14.2.4 Organization for Economic Cooperation and Development (OECD)
14.3 Legal and Ethical Issues in International Marketing
14.3.1 Nature of International Business Disputes and Proposed Action
14.3.2 Legal Concepts and International Dispute Settlement Machinery
14.3.3 Ethical Consideration in International Marketing and Marketing Communications
14.4 Answers to Check Your Progress Questions
14.5 Summary
14.6 Key Words
14.7 Self Assessment Questions and Exercises
14.8 Further Readings

14.0 INTRODUCTION

When conducting marketing activities in the international arena, companies need a strong infrastructural system rely on. There are requirements related to having a platform for interactions with multiple parties, regulations to ensure that the developing countries are not at loss in terms of negotiation as well as funds to conduct large volume of activities. There are many different international financial institutions which are engaged in facilitating international trade. In this unit, you will learn about institutions like IMF, World Bank, IFC and OECD.

International marketing activities also need make sure that they are being governed by certain basic legal regulations so that chances of exploitation and disputes are minimized. Further in case disputes do arise, there is also a need for dispute handling mechanisms to act as resolution mechanism for member countries. There are also certain ethical issues which come into play when international

marketing is concerned. In the latter section of this unit, you will learn about the legal and ethical issues in international marketing.

14.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the meaning of IMF
- Discuss the origins and functions of World Bank
- Describe the role of IFC
- Explain the organization, structure and membership of OECD
- Discuss the legal issues in terms of international disputes in international marketing
- Assess the ethical issues in international marketing

14.2 INTERNATIONAL FINANCIAL INSTITUTIONS

In this section, you will learn about some of the important international financial institutions like the IMF, World Bank, OECD and IFC.

14.2.1 IMF

The internationalization of financial and monetary systems allowed the countries to institutionalize the capital flows and control mechanisms. The framework of the institutional system was initially worked out at Bretton Woods, New Hampshire, in 1944 and envisaged a common fund that would be independent, objective, and an essentially automatic force, subject to broad political constraints and the limits of predetermined financial resources. Accordingly, the International Monetary Fund and the World Bank were established in 1944. The Bretton Woods negotiations aimed preventing the mistakes that were made by the countries in the past and to set new goals for economic prosperity on the following lines:

- Each country should exercise the liberty towards developing and implementing macro-economic policies for achieving full employment
- Free-floating exchange rates to be abandoned in view of the repercussions thereof observed during the period of Great Depression
- To evolve a stronger monetary system that would recognize the exchange rates of both national and international concern

Role of IMF

The IMF is responsible for ensuring the stability of the international monetary and financial system of international payments and exchange rates among national currencies that enables trade to take place between countries. The Fund seeks to promote economic stability and prevent crises; to help resolve crises when they

do occur; and to promote growth and alleviate poverty. It employs three main functions envisaged as surveillance, technical assistance and lending, in order to meet these objectives. Surveillance is the regular dialogue between the Fund and members to offer policy advice. Generally once a year, the Fund conducts in-depth appraisals of each member country's economic situation. It discusses with the country's authorities the policies that are most conducive to stable exchange rates and to a growing and prosperous economy. Contemporarily, surveillance covers a wide range of economic policies, although the emphasis given to each policy area varies according to each country's individual circumstances. The surveillance agenda of the Fund specifically includes the exchange rate, monetary and fiscal policies of the member countries, structural policies in developing countries primarily oriented towards economic growth and debt management. The macro issues of the agenda constitute international trade, labour market, assessment of risk and crisis management and reforms in the power structure. The surveillance agenda of the fund included the financial sector issues, following a series of banking crisis in both the industrial and developing countries. In the wake of financial crises and in the context of member countries undergoing transition from a planned to a market economy, institutional issues about the central bank independence, financial sector regulation, corporate governance, and policy transparency and accountability have also become increasingly important to the global watch agenda of the Fund.

Stabilization has always been one of the domains of the Fund. Its core policy aims at reducing trade deficit, especially the volume of imports by way of curbing aggregate demand. A trade deficit can be brought down by devaluating the local currency of a country that may result in the increase in production for exports. Consequently, the imports become more expensive, but they can gradually be tapered off to a minimum requirement. In this process, some complications emerge such as slow take-off of exports, increase in the domestic prices and reduction in the purchasing power and aggregate demand. Fiscal and monetary austerity contributes to lower GDP growth, perhaps slower rate of inflation and reduction in imports. Inflation may also be a significant issue of the Fund, but it is often less amenable to policy control. The financial programming in accordance with the status of balance of payments, fiscal and monetary accounts of the country are used as performance criteria by the Fund.

There are some inflationary and contracting side-effects that perpetuate in the institutional reforms strategy in the fiscal and monetary sector of the countries. International institutions like IMF and World Bank need to evaluate the reactions of implementing monetary solutions to rescue the falling economies. A core responsibility of the IMF is to provide loans to countries experiencing balance-of-payments problems. This financial assistance enables countries to rebuild their international reserves, stabilize their currencies, continue paying for imports, and restore conditions for strong economic growth. Unlike development banks, the IMF does not lend for specific projects. The volume of loans provided by the IMF has fluctuated significantly over time. The oil shock of the 1970s and the debt crisis of the 1980s were both followed by sharp increases in IMF lending. In the

1990s, the transition process in Central and Eastern Europe and the crises in emerging market economies led to further surges in the demand for IMF resources.

Non-subsidized loans are provided through four main facilities:

- Stand-by Arrangements (SBA)
- the Extended Fund Facility (EFF)
- the Supplemental Reserve Facility (SRF)
- the Compensatory Financing Facility (CFF)

The IMF also provides emergency assistance to support recovery from natural disasters and armed conflicts, in some cases at subsidized interest rates. The Fund created Special Drawing Rights (SDR) in 1969 as the resources providing short-term benefits to the countries were not adequate. SDRs have been analogized as paper gold, as the SDR special account entry into the IMF books was designed to provide additional liquidity to support the growing global trade requirements. The SDR is an international reserve asset, to supplement the existing official reserves of member countries. These drawing rights are allocated to member countries in proportion to their IMF quotas. The SDR also serves as the unit of account of the IMF and some other international organizations and its value is based on a basket of key international currencies.

14.2.2 IBRD-World Bank

As mentioned earlier, International Bank for Reconstruction and Development, or the World Bank was set up at the same time as the IMF in July 1944. The World Bank is concerned with assisting its member countries to achieve sustained economic growth. It functions as an intermediary for the transfer of financial resources from the more developed to the less developed countries.

Objectives: The World Bank was created with the following objectives:

(1) To help in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including –
   a. the restoration of economies destroyed or disrupted by war,
   b. the reconservision of productive resources to peace-time needs,
   c. the encouragement of the development of productive facilities to peace-time needs, and
   d. encouragement of development of productive facilities and resources in less-developed countries.

(2) To promote private foreign investment by means of—
   a. guarantees or participations in loans and other investments made by private investors and
   b. to supplement private investment when private capital is not available on reasonable terms.

(3) To promote the long range balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging long

term international investment thereby assisting in raising productivity, the standard of living and conditions of labour in their territories.

(4) To encourage loans made or guaranteed so that the more useful and urgent projects will be dealt with first, and

(5) To conduct its operations so as to bring about a smooth transference from a war-time to peace-time economy.

The World Bank's capital is too small to provide for the development needs of the entire world. It has therefore set up a number of subsidiary organisations for more finance.

Thus, the Bank was intended to serve as an essential adjunct to the IMF and in particular to ensure a high and stable level of international investment with a view to promoting the maintenance of a high level of international trade and thus of production and employment.

Membership and Organisation: Every member of the IMF is also a member of the World Bank. Any country acquiring the membership of the IMF, automatically becomes member of the World Bank.

Each member of the World Bank has capital subscription that is similar to its quota in the Fund. The member's subscriptions also measure roughly its voting power. In June 1991, 155 countries were members of the Bank. The World Bank is managed in the same way as the IMF, except the head officer of the Bank is called the *President*. The *Governors* and *Executive Directors* of the two organisations are frequently the same men women.

Functions: The functions of the World Bank are as follows:

(1) *It grants long-term and medium-term loans:* One of the early objectives of the World Bank was to aid reconstruction of war-torn nations, the job is not a matter of history. After an initial period of two years in which the Bank concentrated its loans on Europe's reconstruction needs, the Bank turned its attention to developing countries. Loans are of two types—*Reconstruction* and *Development*.

(2) The Bank gives loans to member governments or to private enterprises. In the latter case the Bank demands a guarantee from the Government, the Central Bank and similar organisations of the region in which the project is to be undertaken. Loans are granted on a basis of sound financial and economic analysis; the project must produce an acceptable rate of return.

(3) The Bank gives technical advice to the borrowers and for this purpose engages experts.

(4) *Economic and Social Research:* In the field of economic and social research the World Bank conducts research projects and undertakes smaller research studies. World Bank Staff working papers are of great interest among professional economists. The bank undertakes annually a comprehensive analysis of economical and social situation in the developing countries with

a view to assess the situation and make the decisions relating to development. The World Development Report (Annual) deals with fundamental problems currently facing the developing countries.

(5) The Bank promotes foreign investments by guaranteeing loans made by other organisations. The Bank's duty is to supplement and not to supersede the flow of private risk capital.

(6) The World Bank's capital is too small to provide for the development needs of the entire world. It has therefore set up a number of subsidiary organisations for further finance.

14.2.3 International Finance Corporation

The International Finance Corporation (IFC) was established in 1956 with the specific purpose of financing private enterprise. It is an affiliate of the IBRD.

Organization structure

Only members of the World Bank can become members of IFC. The Board of Governors of IBRD also constitute the Board of Governors of IFC, but it is a separate entity with funds kept separate from those of IBRD.

The power of IFC is vested in the Board of Governors, which normally meets once a year and is responsible for the general operations. The president of IBRD is the Ex-Officio chairman of the Board of Directors of IFC. The day-to-day operations are conducted under the direction of the Executive Vice-President.

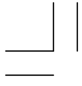
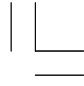
Functions

The purpose of IFC is to boost economic development by promoting growth of private enterprise in member countries, especially in the less developed regions, thus supplementing the actions of the IBRD. The IFC therefore:

(i) Invests in private enterprise in member countries in association with private investors and without government guarantee, in cases where sufficient private capital is not available on reasonable norms

(ii) Seeks to draw together investment opportunities, private capital-domestic and foreign–into productive investments in member countries

IFC makes advances in the form of long-term loans or invests in the equity shares in a wide variety of productive private enterprises in developing countries. It particularly encourages joint ventures between developed and developing countries, the technical skill available with the former combining with the resources available with the latter. The project which IFC proposes to assist should be an economically viable unit and beneficial to the economy of the member country. Generally, the financial assistance from IFC for a unit would not be less than $1 million and 50 per cent of the total investment of the enterprise. In case of investment by equity contribution, it does not exceed 25 per cent of the share capital. The interest charged on advances depends upon the proposal and stature of the borrower.

Resources

The resources of IFC consist of capital contributed by its members and accumulated reserves. It can also borrow from the World Bank for the purpose of lending an amount equal to four times its unimpaired subscribed capital and surplus. IFC charges market rates for its products and does not accept government guarantee.

The cumulative commitments of IFC as on 30 June 2002 amounted to more than $ 34 billion in 2,825 companies in 138 developing countries. In addition, it provided $ 20.9 billion through syndication. The total commitment in financial year 2002 amounted to $ 3.6 billion in 204 projects in seventy-five countries.

Since 1959, India has received $ 1.97 billion by way of direct assistance from IFC and $ 0.48 billion by way of syndication. The total assistance provided by IFC to India amounted to $ 2.44 billion. As of 2018, IFC's committed portfolio in India is over $6 billion. The bulk of the investment has been in the form of long-term loans with a maturity period of seven to nine years. Investments have been mostly in the areas of power, iron and steel, automobiles, chemicals, petrochemicals, cement and shipping.

IFC had a slack beginning as much of its aid was concentrated in Latin and Central American countries. But recently it has branched out its area of operations and many developing countries are benefiting out of it. India has also received significant assistance from IFC.

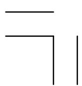
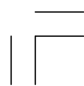
14.2.4 Organization for Economic Cooperation and Development (OECD)

The Organisation for Economic Co-operation and Development (OECD) is an international organization that works to build better policies for better lives. Their goal is to shape policies that foster prosperity, equality, opportunity and wellbeing for all. It draws on almost 60 years of experience and insights to better prepare the world of tomorrow. It currently has 37 countries from across the globe as member nations. Together with governments, policy makers and citizens, it works on establishing evidence-based international standards and finding solutions to a range of social, economic and environmental challenges. From improving economic performance and creating jobs to fostering strong education and fighting international tax evasion, it provides a unique forum and knowledge hub for data and analysis, exchange of experiences, best-practice sharing, and advice on public policies and international standard-setting.

Origin

In 1948 an Organisation for European Economic Cooperation (OEEC) was formed. This was to run the Marshall Plan financed by the US to help the war-torn European continent. Later on in 1960, the US and Canada joined the OEEC members to form and sign a convention for OECD. This was brought into force on 30 September 1961.

Other countries joined in, starting with Japan in 1964. Today, 37 OECD member countries worldwide regularly turn to one another to identify problems,

discuss and analyse them, and promote policies to solve them. The track record is striking. The US has seen its national wealth almost triple in the five decades since the OECD was created, calculated in terms of gross domestic product per head of population. Other OECD countries have seen similar, and in some cases even more spectacular, progress.

So, too, have countries that a few decades ago were still only minor players on the world stage. Brazil, India and the People's Republic of China have emerged as new economic giants. The three of them, with Indonesia and South Africa, are Key Partners of the Organisation and contribute to its work in a sustained and comprehensive manner. Together with them, the OECD brings around its table 39 countries that account for 80% of world trade and investment, giving it a pivotal role in addressing the challenges facing the world economy.

Organizational Structure

The OECD Council is the organization's overarching decision-making body. It is composed of ambassadors from member countries and the European Commission, and is chaired by the Secretary-General. It meets regularly to discuss key work of the organization, share concerns and take decisions by consensus. Once a year, the OECD Council meets for the Ministerial Council Meeting, which brings together heads of government, economy, trade and foreign ministers from member countries to monitor and set priorities for work, discuss the global economic and trade context, and delve further into issues such as the budget or the accession process.

Check Your Progress

1. When were the IMF and World Bank established?
2. Why was the SDR created?
3. What is the membership of the World Bank?
4. State the purpose of IFC.
5. Why was the OEEC formed?

14.3 LEGAL AND ETHICAL ISSUES IN INTERNATIONAL MARKETING

In this section, you will learn about the legal and ethical issues in relation to international marketing.

14.3.1 Nature of International Business Disputes and Proposed Action

International disputes refer to the serious disagreements between different countries engaged in trade on matters related to territory, maritime rights, and human rights, to name just a few. These disagreements related to the increasingly complex business in the globalized environment.

International disputes are not limited to two or multiple parties disagreeing actively. This is because they may also be due to declarations made unilaterally by one nation that are not acknowledged or accepted by other countries.

If these international disputes are not addressed and resolved, they could lead to bigger problems of global proportions, such as animosity and hostility between and among countries, tense international relations, or, worse, armed conflicts and wars.

Resolving International Business Disputes

International trade and business face a lot of risks. This is the reason why local businesses establish their own sets of risk management strategies. International businesses are at risk of being embroiled in disputes and so they should also come up with ways to manage this risk. One way to do that is to pay attention to their dispute resolution measures.

Before you can start resolving an international business dispute, however, it is important to first have a full understanding of what the dispute is all about. Several types of international business disputes have been identified.

Types of International Business Disputes

Dispute due to sale of goods or commodities including issues like payment problems, quality of the product, issues of product quantity, Pricing or costing issues, issues related to transportation or logistics, consisting of the conditions on delivery of commodities or products; Other contractual provisions or conditions, including their presentation or their vagueness in a contract.

Clearly, these disputes can be easily minimized or avoided if the contracts are prepared appropriately, eliminating any vagueness or ambiguity. Everything should be set out clearly in order to avoid confusion.

14.3.2 Legal Concepts and International Dispute Settlement Machinery

There are three principal methods of resolving international trade disputes:

i. Litigation
ii. Arbitration
iii. Conciliation

Let's discuss these briefly here.

i. Litigation is a method by which the disputing parties' resort to a court established by law. the litigation is initiated and completed according to the rules of the court which exist to ensure the proper conduct of the litigation. The court adjudicates only on the basis of issues which the parties present to it and upon the evidence, the parties choose to address. Litigation is a costly, time consuming and very inconvenient method. It adversely affects the long-term commercial interest of the parties.

ii. Arbitration is a written agreement to submit present or future disputes or differences to arbitration and whether arbitrator is appointed or not arbitration is the voluntary submission of disputes not to a court but to a sole arbitrator or arbitral tribunal selected by the parties or designated by a third party who is nominated by the contracting parties to make such appointment. Arbitration is a quasi-judicial proceeding and an out of court settlement of the commercial dispute. contracting parties to make such an appointment.

iii. Conciliation is a process by which third party at the instance of the contracting party seek to bring the parties together in an amicable compromise without having any powers of decision. Conciliation as one of the mechanisms of Alternative Dispute Resolution, ADR for amicable, quick and informal resolution of commercial disputes is receiving wide recognition by the business community.

14.3.3 Ethical Consideration in International Marketing and Marketing Communications

Ethics refers to conducting a business with morals. It is based on cultural value system and the accepted norms of doing business in every society. The ethical norms are based on broadly accepted guidelines which flow from religion philosophy and legal system of the land. Global managers often face several ethical problems therefore understanding of ethical norms and rules becomes essential for any smooth operation of global business.

Ethics is the study of decision making within a framework of a system of moral standards the individual conduct of right and wrong is called ethical behaviour. Moral code of conduct is not only compatible with the laws but also confirm to the set of moral principles which are expected to be followed in all social groups.

It is often seen that managers face the ethical dilemmas but using frameworks well laid down by the Management theory test can help them resolve or make suitable decisions while resolving the ethical dilemmas.

Two Normative Framework commonly used by managers are Utilitarian theories and Deontology or formalism some other frameworks for resolving ethical dilemma such as eternal law, distributive justice and personal liberty are also taken into consideration.

Major ethical and unethical activities which have a bearing on international trade are listed below:

- **Selling products less in demand in home countries**

  When products reach maturity or experience a decline in demand in the home countries or the developed markets the firms try and sell them in the markets of less developed countries (LDC).

- **Selling prohibited products in LDC markets**

  In some cases, drugs and chemicals prohibited in the developed countries due to their harmful effects are sold in less developed countries.

- **Selling products likely to be misused**

  Products developed to be used in an environment may be used incorrectly by users due to lack of knowledge or scarcity of resources. If such misuse can be foreseen then marketing of such products is unethical in such markets.

- **Restrictive trade policies**

  Restrictive trade policies adopted by certain governments have been labelled as unethical by other countries and governments especially in the case of international trade. Applying high import tariffs and non-tariff barriers are some of the examples of restrictive trade practices in international trade.

- **Dumping**

  Dumping occurs when good produced in one country are offered for sale at a very low price and large quantities in the international markets.

- **Counterfeiting**

  When one firm infringes the patent or copyright of the other firm especially in the case of luxury products. The counterfeit product are usually produced in less developed countries.

- **Grey marketing**

  Grey marketing arises when goods are imported and sold through market distribution channels which are not authorised by the manufacturer. Grey marketing occurs mainly due to significant differences in the market price of the same product in different countries, which may be due to exchange rate or other tariffs.

Check Your Progress

6. What may happen if international disputes are not addressed or resolved?
7. Define conciliation.
8. What is grey marketing?

14.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The International Monetary Fund and the World Bank were established in 1944.
2. The Fund created Special Drawing Rights (SDR) in 1969 as the resources providing short-term benefits to the countries were not adequate.
3. Every member of the IMF is also a member of the World Bank. Any country acquiring the membership of the IMF, automatically becomes member of

the World Bank. Each member of the World Bank has capital subscription that is similar to its quota in the Fund. The member's subscriptions also measure roughly its voting power.

4. The purpose of IFC is to boost economic development by promoting growth of private enterprise in member countries, especially in the less developed regions, thus supplementing the actions of the IBRD.
5. In 1948 an Organisation for European Economic Cooperation (OEEC) was formed. This was to run the Marshall Plan financed by the US to help the war-torn European continent. Later on, in 1960, the US and Canada joined the OEEC members to form and sign a convention for OECD.
6. If international disputes are not addressed and resolved, they could lead to bigger problems of global proportions, such as animosity and hostility between and among countries, tense international relations, or, worse, armed conflicts and wars.
7. Conciliation is a process by which third party at the instance of the contracting party seek to bring the parties together in an amicable compromise without having any powers of decision.
8. Grey marketing arises when goods are imported and sold through market distribution channels which are not authorised by the manufacturer.

14.5 SUMMARY

- The internationalization of financial and monetary systems allowed the countries to institutionalize the capital flows and control mechanisms. The framework of the institutional system was initially worked out at Bretton Woods, New Hampshire, in 1944 and envisaged a common fund that would be independent, objective, and an essentially automatic force, subject to broad political constraints and the limits of predetermined financial resources. Accordingly, the International Monetary Fund and the World Bank were established in 1944.
- The IMF is responsible for ensuring the stability of the international monetary and financial system of international payments and exchange rates among national currencies that enables trade to take place between countries.
- A core responsibility of the IMF is to provide loans to countries experiencing balance-of-payments problems. This financial assistance enables countries to rebuild their international reserves, stabilize their currencies, continue paying for imports, and restore conditions for strong economic growth. Unlike development banks, the IMF does not lend for specific projects.
- The World Bank is concerned with assisting its member countries to achieve sustained economic growth. It functions as an intermediary for the transfer of financial resources from the more developed to the less developed countries.

- The Bank was intended to serve as an essential adjunct to the IMF and in particular to ensure a high and stable level of international investment with a view to promoting the maintenance of a high level of international trade and thus of production and employment.
- The International Finance Corporation (IFC) was established in 1956 with the specific purpose of financing private enterprise. It is an affiliate of the IBRD.
- The purpose of IFC is to boost economic development by promoting growth of private enterprise in member countries, especially in the less developed regions, thus supplementing the actions of the IBRD.
- The resources of IFC consist of capital contributed by its members and accumulated reserves.
- The Organisation for Economic Co-operation and Development (OECD) is an international organization that works to build better policies for better lives. Their goal is to shape policies that foster prosperity, equality, opportunity and wellbeing for all.
- The OECD brings around its table 39 countries that account for 80% of world trade and investment, giving it a pivotal role in addressing the challenges facing the world economy.
- International disputes are, by definition, major disagreements between two or more countries on matters such as territory, maritime rights, and human rights, to name just a few.
- The dispute could arise from the issues on Product quality and quantity; Pricing or costing issues; Payment issues, such as the conditions and modes of payment, as well as the timing of these payments; Transportation or logistics, including the conditions on delivery of commodities or products; Other contractual provisions or stipulations, including how they were presented in a contract. Often, disputes arise due to vague stipulations and references on written contracts.
- There are three principal methods of resolving international trade disputes:

  (i) Litigation (ii) Arbitration (iii) Conciliation
- Ethics is the study of decision making within a framework of a system of moral standards the individual conduct of right and wrong is called ethical behaviour. Moral code of conduct is not only compatible with the laws but also confirm to the set of moral principles which are expected to be followed in all social groups.

14.6 KEY WORDS

- **Special Drawing Rights:** It is an international reserve asset, to supplement the existing official reserves of member countries.

- **World Bank:** It functions as an intermediary for the transfer of financial resources from the more developed to the less developed countries.
- **International disputes:** It refers to major disagreements between two or more countries on matters such as territory, maritime rights, and human rights, to name just a few.

14.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. How has the focus of IMF changed since its establishment?
2. List the main facilities through which non-subsidized loans are provided by the IMF.
3. Write a short note on SDRs.
4. What are international disputes and the principal methods involved in them?
5. Mention some of the unethical practices seen in international marketing.

Long-Answer Questions

1. Discuss the role of IMF.
2. Describe the objectives and functions of the World Bank.
3. Explain the membership, resources and development activities of the IFC.
4. Discuss the origin, membership and organizational structure of OECD.

14.8 FURTHER READINGS

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