14th Revised Edition

INTERNATIONAL MARKETING

(Text and Cases)

Francis Cherunilam

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(Text and Cases)

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MEC (Master of E-Commerce)

MEC 2.5 International Marketing

M.Com.

MC 2.73 International Marketing

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Cochin,
June 21, 2016

Dr. Francis Cherunilam

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Contents

1. **International Marketing: An Introduction** 1 – 29

   Expansion of international market; global sourcing and production sharing; growing economic power of developing countries; international marketing; reasons for/motives of international marketing; international orientations; internationalisation stages; international marketing decisions; scope of marketing Indian products abroad, driving and restraining forces; participants in international marketing; future of international marketing.

2. **International Marketing Environment** 30 – 111

   Economic environment; social environment; political and government environment; demographic environment; technological environment; international trading environment; trade barriers; non-tariff barriers; commodity agreements; cartels; state trading; trading blocs and growing intra-regional trade; the EU; the Euro; SAARC; Indo-Sri Lanka, Free Trade Agreement; WTO; patents; UNCTAD, UNIDO; ITC; legal environment of business. Appendix 2.1: Multifibre Arrangement (MFA)

3. **MNCs and International Business** 112 – 123

   Definitions; organisational transformation; globalisation of business; dominance of MNCs; MNCs and international trade; merits of MNCs; demerits; perspectives; code of conduct; MNCs in India.

4. **International Marketing Intelligence** 124 – 136

   Information requirements; sources of information; international marketing information system and marketing research; phases of research project; methods of data collection; research agencies; problems in international research.

5. **Market Selection** 137 – 143

   Market selection process; determinants of market selection; market profiling; market segment selection.

6. **Market Entry Strategies** 144 – 162

   Licensing and franchising; exporting; contract manufacturing; turnkey contracts; fully owned manufacturing facilities; assembly operations; joint ventures; third country location; mergers and acquisitions; strategic alliances; counter trade; entry strategies of Indian firms.

7. **International Organisation** 163 – 168

   Built-in export department; separate export department; export sales subsidiary; international division; global organisation.

8. **Market Coverage Strategies** 169 – 172

   Concentrated marketing strategy; niche marketing; market segmentation and differentiated marketing strategy.

9. **International Product Decisions** 173 – 198

Product decisions; product; product mix; product life cycle; new product development; branding; packaging and labelling; business environment and product strategies; product strategies; product-communication strategies; globalisation vs. localisation.

10. **International Pricing** 199 – 225

Exporter's costs; pricing objectives; factors affecting pricing; pricing methods/ approaches; transfer pricing; dumping; steps in pricing; retrograde pricing; export price structure; export price quotations and inco terms; information requirements for pricing.

11. **International Distribution** 226 – 235

International channel system; direct exports; indirect exports; types of intermediaries; marketing environment and distribution strategies; international logistics.

12. **International Promotion** 236 – 249

Marketing environment and promotion strategies; major decisions in international marketing communications; communication mix; role of export promotion organisations; trade fairs and exhibitions; personnel selling in international marketing; problems in international marketing communication.

13. **Export Finance** 250 – 259

Payment terms; institutional finance for exports; Exim Bank.

Appendix 13.1: Letter of Credit and Financing of Foreign Trade.

14. **Export Risk Insurance** 260 – 266

Marine insurance; ECGC and export credit insurance.

15. **Quality Control and Pre-shipment Inspection** 267 – 272

Objectives of quality control; quality standards; methods of quality control and inspection; role of Bureau of Indian Standards; problems in maintaining quality for exports.

16. **Trade in Services** 273 – 278

Characteristics of services; restrictions.

17. **Technological Developments and International Marketing** 279 – 289

The death of distance: technology and competitiveness; e-marketing; components of global electronic supply chain; targeting the individual customer: beyond segmentation.

18. **International Negotiations** 290 – 295

4Cs of negotiation; stages of negotiation; prerequisites for effective negotiations; negotiating with regulators.

19. Trade Policy and Regulation of India 296 – 308

Trade strategy of India; economic policy liberalisations; foreign trade policy 2015-20; regulation and promotion of foreign trade; Foreign Trade (Development and Regulation) Act, 1992.

20. Export Promotion 309 – 324

Organisational set-up; incentives; production assistance/facilities; marketing assistance; import facilities for exporters; EOUs and EPZs and SEZs; export houses and trading houses; an evaluation.

21. Trade and BoP of India 325 – 341

Highlights of India's trade performance; determinants of exports; determinants of imports; major exports; major imports; direction of trade; services trade; balance of payments; problems of India's export sector.

22. Export Procedures and Documents 342 – 355

Preliminaries; inquiry and offer; confirmation of offer; export license; finance; production/procurement of goods; shipping space; packing and marking; quality control and pre-shipment inspection; excise clearance; customs formalities; exchange control formalities; insurance; shipping the goods; negotiation of documents; standardised and aligned pre-shipment documents; documents related to goods; documents related to shipments.

23. Some Issues in International Business 356 – 362

Business ethics; social responsibility of business; environmental issues; labour issues.

— Annexures 363 – 374

Import Substitution

Export Promotion Councils

GSP

GSTP

Devaluation

— Cases 375 – 400

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1

INTERNATIONAL MARKETING: AN INTRODUCTION

The marketing environment across the world has been becoming more and more global. It is true not only in the competitive and technological dimensions but also in the socio-cultural dimensions. In other words, the marketing environment is global for firms from national to local, including many tiny enterprises. Considering this fact, this author would define International Marketing as ***marketing in an internationally competitive environment, whether the market is home or foreign.***

As Thomas L. Friedman points out in the well-known *book* "*The World is Flat*", the technological revolution that was levelling the global economic playing field and enabling so many more people around the world to compete, connect, and collaborate has been ushering in a new phase of globalisation that would have a huge impact on economics, politics, and military and social affairs.

Globalisation, in fact, has implications not only for business but also for other organisations and individuals. The following two anecdotes expose this. Peter Drucker observes in the *Management Challenges for the 21st Century*: "No institution, whether a business, a university or hospital, can hope to survive, let alone to succeed, unless it measures up to the standards set by the leaders in its field any place in the world." The ramifications of globalisation, thus, is all pervasive.

As a result of the liberalisation and globalisation, the marketing environment across the world has been becoming more and more global.

As a result of the globalisation of even the domestic business environment, the major competition which many Indian firms encounter in the home market now, for instance, is from foreign firms – they now face a substantially growing competition from goods produced in India by MNCs and imports. In short, national markets are being internationalised/globalised by imports and foreign investment. Look at, for example, the competition which Nirma, whose market is almost entirely confined to India, is encountering. Its major competitors are multinational giants like Unilever, Procter and Gamble (P&G) and Henkel. Apart from goods manufactured in India by the multinational outfits, Nirma also faces competition from imported products. Further, there is competition from large and small Indian firms.

It is obvious that in the domestic market, Nirma is competing against the technological, financial, marketing, managerial and prowess of multinationals and domestic firms.

Even tiny local enterprises face severe foreign competition. For example, a wayside shop selling local products like fresh lime soda or *nimbu pani* and fresh juice encounter competition from natural and synthetic beverages marketed by multinationals.

The tiny enterprises, however, often take advantage of the emerging environment by selling competing products, including that of the MNCs, along with his own. In fact, he benefits by dealing in fast moving items in other categories too. Indeed, the tiny entrepreneur does an excellent optimisation of his highly limited shop space, capital and human resource by the prudent choice of the product mix. Many such shops also sell a number of foreign goods. It is often said that distribution is one of the most important factors in international marketing. But one who takes a look at the foreign goods – both durable and non-durable, sold on the footpaths and other unorganised bazaars, would marvel at the channels of distribution of foreign goods.

In short, marketing environment ubiquitously has become global, tempting one to think that marketing invariably is international/global.

Box 1.1

Indicators of Globalisation

There are several indicators that illustrate how goods, capital, and people, have become more globalised. (In this sub-sections, the pre-global economic crisis (which started in 2008) statistics are given)

- The value of trade (goods and services) as a percentage of world GDP increased from 42 in 1980 to about 60 now.
- Foreign direct investment inward stock increased from 10 per cent of world GDP in 1990 to 33 per cent in 2014.
- The stock of international claims (primarily bank loans), as a percentage of world GDP, increased from roughly 10 per cent in 1980 to 48 per cent in 2006.
- The number of minutes spent on cross-border telephone calls, on a per capita basis, increased from 7.3 in 1991 to 28.8 in 2006.
- The number of foreign workers has increased from 78 million people (2.4 per cent of the world population) in 1965 to 191 million people (3.0 per cent of the world population) in 2005 and the rising trend has continued.

The growth in global markets has helped to promote efficiency through competition and the division of labour — the specialisation that allows people and economies to focus on what they do best. Global markets also offer greater opportunity for people to tap into more diversified and larger markets around the world. It means that they can have access to more capital, technology, cheaper imports, and larger export markets. But markets do not necessarily ensure that the benefits of increased efficiency are shared by all. Countries must be prepared to embrace the policies needed, and, in the case of the poorest countries, may need the support of the international community as they do so.

The world's financial markets have experienced a dramatic increase in globalisation in recent years. Global capital flows fluctuated between 2 and 6 per cent of world GDP during the period 1980-95, but since then they have risen to 14.8 per cent of GDP, and in 2006 they totalled $ 7.2 trillion, more than tripling since 1995. The most rapid increase has been experienced by advanced economies, but emerging markets and developing countries have also become more financially integrated. As countries have strengthened their capital markets they have attracted more investment capital, which can enable a broader entrepreneurial class to develop, facilitate a more efficient allocation of capital, encourage international risk sharing, and foster economic growth.

Courtesy: IMF Staff, "Globalisation: A Brief Overview", *IMF Survey*, 08/02 May 2008 (Statistics updated).

EXPANSION OF INTERNATIONAL MARKET

Statistics clearly show that the international market is much more dynamic and is growing much faster than the domestic market. One of the most important facts of this is the difference between the growth rate of the GDP and the global trade. For a long time now international trade has been growing at almost twice the rate of the global GDP. In other words, the proportion of the domestic output sold in the foreign markets has been growing faster than the growth of the domestic income or market. As a result of this, the export-GDP ratio (i.e., the value of exports expressed as a percentage of the GDP) has been increasing in all categories of economies. The growth was faster for the developing economies. In 2013, the export-GDP ratio was 31 per cent for developing economies and 22 per cent for the developed economies. For the world as a whole, it increased from 14 per cent in 1990 to 26 per cent in 2007 and was 25 per cent in 2013.

The increase in the export-GDP ratio has been very fast in respect of a number of emerging economies whose economic growth has been driven by exports, like several South-East Asian economies (particularly the Asian tigers – South Korea, Taiwan, Singapore and Hong Kong) and China. In other words, their growth has been depended to a very large extent on the international market. The export dependence of China's enviable economic growth in the last three decades is particularly noteworthy.

Indeed, China's *international market dependent* economic growth has been spectacular. A new epoch in the economic growth of China started with the economic reforms ushered in 1978, particularly with the second phase of the reform which characterised a major thrust on foreign investment and exports. The results of the transformation *from mark to the market* has been marvelous. China's merchandise export-GDP ratio has risen from 5.6 per cent in 1979 to 17 per cent in 1990, 23 per cent in 2000 and further to 37 per cent in 2007. Including services, in 2013 more than 25 per cent of China's GDP was sold in the foreign market. The value of goods and services imported to China in 2013 was equivalent to about 24 per cent of GDP value. Thus, China's foreign trade (exports and imports) GDP ratio was 50 per cent in 2013. In other words, the economy of communist China is nearly 50 per cent foreign. If one makes an assumption for a moment that foreigners stop buying Chinese goods, it will have the effect Chinese GDP falling by about 25 per cent.

The export (goods and services)-GDP ratio of the world in 2013 was about 30 per cent. This implies that, on an average, every nation sells more than 30 per cent of its domestic production of goods and services in foreign markets and imports goods and services of almost an equal amount.

The average, however, conceals some important factors. For example, the foreign market is highly important for many countries than others. Secondly, a number of countries sell abroad much more than they buy from other countries (examples, China, Germany, Japan) and many countries buy from abroad much more than they sell there (examples, USA, UK, India). Thirdly, many countries which have merchandise trade surplus have services trade deficit (like Germany, Japan and China) and *vice versa* (examples, USA, UK, India).

That the international market is expanding much faster than the domestic market is clear from wide difference between the growth rates of the world GDP and trade that has been observed for a very long period. Estimates of growth rates of world GDP and trade since 1850 (estimates for the war disturbed period of 1914-1950 are not available) show that global trade has grown much rapidly than the GDP. Since 1950, the world trade growth was much faster than the GDP.

That the international market is expanding much faster than the domestic market is clear from wide difference between the growth rates of the world GDP and merchandise exports depicted in Figure 1.1.

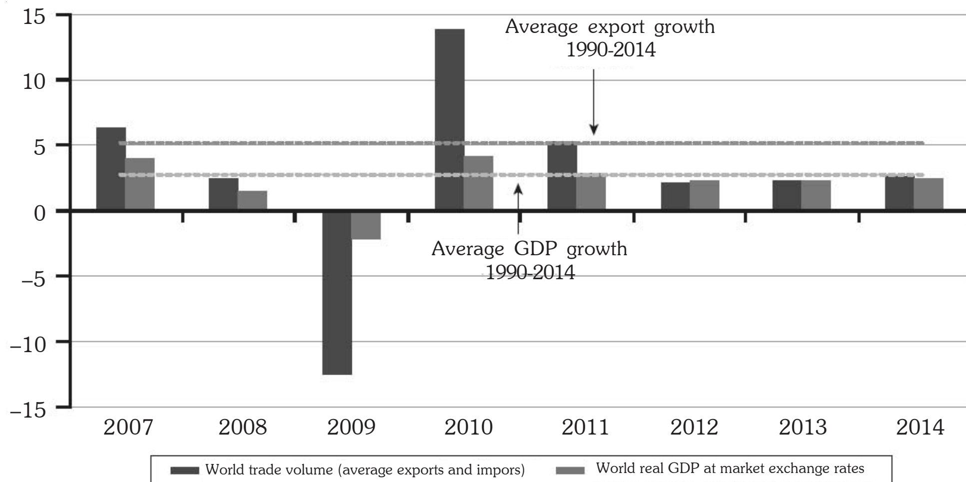

Fig. 1.1: Growth in Volume of World Merchandise Trade and Real GDP, 2007-14 (Annual Percentage Change) and Average Growth Rate, 1990-2014

Source: WTO, World Trade Report, 2015.

For many companies, particularly for large ones headquartered in small countries, international market is the mainstay. For example, the home market (Switzerland) contributes only about two per cent of the total revenue of Nestle, the largest food business MNC of the world. Philips derives only about 8 per cent of its total revenue from the home market (Holland). There have been cases of more than hundred per cent of the profit of the company being made in the foreign markets (in which case domestic operation, obviously, is making losses).

Box 1.2

India's Trade Performance

Because of the strong inward looking policy followed until 1991, the internationalisation of the Indian economy was very limited. As an economy develops the trade-GDP ratio normally increases. But for India, it remained without significant improvement for four decades since the commencement of the development planning in 1951 – the trade-GDP ratio hovering around 15 per cent. However, the liberalisation has brought about a significant turnaround. The merchandise export-GDP ratio increased from about 6 per cent in 1991 to 15 per cent in 2010-11. During this period, the merchandise import-GDP ratio increased from about 9 per cent to 23 per cent, adding up to merchandise trade-GDP ratio of 38 per cent. If the trade in services is included, the trade ratio was nearly 50 per cent of GDP for 2014.

In the recent period, India did much better than the world as a whole in export growth. See table 1.1. During 2002-2008, India's exports grew at almost thrice as fast as the world average exports, and nearly three times higher than the country's GDP growth rate.

Table 1.1 shows that along with the increase in the share of global exports, the ranking of India has also been increasing. The rank in the merchandise exports increased significantly from 31 in 2000 to 19 in 2013. The improvement from 2008 to 2011 is particularly noteworthy. In recent years, export growth rate of India was substantially higher than that of the world exports but declined very recently.

Table 1.1
INDIA'S SHARE AND RANK IN GLOBAL TRADE

Year	*Goods*				*Services*			
	Exports		*Imports*		*Exports*		*Imports*	
	Share (%)	*Rank*	*Share (%)*	*Rank*	*Share (%)*	*Rank*	*Share (%)*	*Rank*
2000	0.7	31	0.8	26	1.2	22	1.4	19
2005	0.9	29	1.3	17	2.3	11	2.2	13
2007	1.0	26	1.5	18	2.7	9	2.5	13
2008	1.1	26	1.8	17	2.8	9	2.6	12
2009	1.2	22	1.9	15	2.6	12	2.4	12
2010	1.4	20	2.1	13	3.0	10	3.3	7
2013	1.7	19	2.5	12	3.2	6	2.8	9
2014	1.7	19	2.4	12	3.2	8	2.6	10

Source: WTO, *World Trade Report* of different years.

Foreign markets are important not only for MNCs or other large companies but also for many small firms. About half of the total US exports is the creation of small firms. The same is true of Germany. More than one-third of the total exports of India is contributed by the small scale sector, including village and cottage industries. Many of India's *hundred per cent export-oriented units* (EOUs) are small firms.

The importance of the international market is further elaborated in the section *Reasons for/ Motives of International Marketing.*

Growth of World Merchandise Exports

For a long time now, global trade, both merchandise and services, has been growing much faster than global output. That trade has been growing faster than world output means that a growing proportion of the national output is traded internationally.

Table 1.2
GROWTH OF WORLD MERCHANDISE EXPORTS

Year	*Value of merchandise exports (Billion dollars)*
1950	55
1960	113
1970	280
1980	1,846
1990	3,311
2000	6,350
2008	16,070
2013	18,816
2014	18,930

Source: Compiled from various sources.

In 2014, the combined value of trade in goods and commercial services amounted to nearly $24 trillion. The ratio of merchandise and services in the global trade remained more or less stable at about 80: 20 since 1990.

Much of the trade takes place between the developed countries, particularly the *triad* (USA, Western Europe and Japan). Bulk of the exports of the developing countries is also absorbed by the developed countries. In 2014, developing countries had more than 40 per cent share in merchandise trade.

As is indicated by Table 1.3, just three countries – China, USA and Germany — account for about 29 per cent of the global trade in goods. More than half of the world exports originate in just 10 countries. 30 countries contribute more than 80 per cent of the global trade in merchandise trade.

For many years, the first rank in terms of the value of exports was occupied by the US, with Germany and Japan in second and third positions respectively. However, in 2003, Germany relegated USA to the second position from the long held top position in export of goods. In 2014, China ranked 1st, USA 2nd, Germany 3rd and Japan 4th.

The United States has been the largest importer followed by Germany. China quickly emerged as one of the top importers, stepping up to third rank in 2003, from 12th in 1997 and 6th in 2002, whereas China's rank in exports improved from10th in 1997 and 5th in 2002 to 4th in 2003, 2nd in 2008 and 1st in 2009.

Table 1.3 also reveals that there are several developing countries in the list of the top exporters. A small number of countries account for the bulk of the total exports of the developing countries.

India's share in the global merchandise exports declined from about 2 per cent in 1950 to about 0.4 per cent in1980. Since around the mid-1980s, there has been a slight improvement and it was about 1.7 per cent in 2014 with a rank of 19. In 2014, India's share in global imports was 2.4 per cent, ranking 12. See Table 1.1.

Table 1.3

LEADING EXPORTERS AND IMPORTERS OF MERCHANDISE, 2014

Rank	Exporters	Value	Share	Rank	Importers	Value	Share
1	China	2,342	12.4	1	United States	2,413	12.7
2	United States	1,621	8.6	2	China	1,959	10.3
3	Germany	1,508	8.0	3	Germany	1,216	6.4
4	Japan	684	3.6	4	Japan	822	4.3
5	Netherlands	672	3.6	5	United Kingdom	684	3.6
6	France	583	3.1	6	France	678	3.6
7	Korea, Republic of	573	3.0	7	Hong Kong, China	601	3.2
					- retained imports	151	0.8
8	Italy	529	2.8	8	Netherlands	588	3.1
9	Hong Kong, China	524	2.8	9	Korea, Republic of	526	2.8
	- domestic exports	16	0.1				
	- re-exports	508	2.7				
10	United Kingdom	506	2.7	10	Canada[a]	475	2.5
11	Russian Federation	498	2.6	11	Italy	472	2.5
12	Canada	475	2.5	12	India	463	2.4

13	Belgium	471	2.5	13	Belgium	452	2.4
14	Singapore	410	2.2	14	Mexico	412	2.2
	- domestic exports	216	1.1				
	- re-exports	194	1.0				
15	Mexico	398	2.1	15	Singapore	366	1.9
					- retained imports[b]	173	0.9
16	United Arab Emirates[c]	360	1.9	16	Spain	358	1.9
17	Saudi Arabia, Kingdom of[c]	354	1.9	17	Russian Federation[a]	308	1.6
18	Spain	325	1.7	18	Chinese Taipei	274	1.4
19	India	322	1.7	19	United Arab Emirates[c]	262	1.4
20	Chinese Taipei	314	1.7	20	Turkey	242	1.3
21	Australia	241	1.3	21	Brazil	239	1.3
22	Switzerland	239	1.3	22	Australia[c]	237	1.2
23	Malaysia	234	1.2	23	Thailand	228	1.2
24	Thailand	228	1.2	24	Poland	220	1.2
25	Brazil	225	1.2	25	Malaysia	209	1.1
26	Poland	217	1.1	26	Switzerland	203	1.1
27	Austria	178	0.9	27	Austria	182	1.0
28	Indonesia	176	0.9	28	Indonesia	178	0.9
29	Czech Republic	174	0.9	29	Saudi Arabia, Kingdom of	163	0.9
30	Sweden	164	0.9	30	Sweden	163	0.9
	Total of above[d]	**15,542**	**82.1**		**Total of above[d]**	**15,592**	**82.0**
	World[d]	**18,930**	**100.0**		**World[d]**	**19,018**	**100.0**

Source: WTO, World Trade Report, 2015.

An important trend has been the growth of the intra-regional trade. In fact, some people view world trade as consisting broadly of intra-regional trade and inter-regional. There is also talk of regionalisation versus globalisation of world trade. Regional integration schemes tend to increase intra-regional trade. The European Union is a highly integrated marketplace, with two-thirds of its trade transactions taking place within the region. In 2007, intra-trade accounted for slightly more than half (51 per cent) of the exports of the North American Free Trade Agreement (NAFTA). In 2000, this share was 56 per cent. However, as trade with countries outside NAFTA's area has been growing at a somewhat faster pace than intra-NAFTA trade, this share has been declining. Other trade blocs, such as MERCOSUR, the Andean Community or ASEAN, show a less pronounced integration. MERCOSUR countries carry out only around 14 per cent of their trade with other countries in the agreement, the Andean Community only 8 per cent, and ASEAN a quarter.

There has been a considerable change in the composition of the global trade. The share manufactures in the total exports increased substantially, while that of the primary commodities declined correspondingly. The change has been more pronounced in respect of the developing countries. The share of primary commodities, excluding fuels, in their exports dropped from 63 per cent in 1960 to 13 per cent by 2001; in 2013 also the share was about 13 per cent.

Agricultural exports accounted for almost 47 per cent of total merchandise exports in 1950, but their share was less than 10 per cent in 2013. Fuels and mining products accounted for nearly 22 per cent of the exports (18 for fuels alone) in 2013.

Manufactures, by contrast, increased their share from 38 per cent in 1950 to over three-fourths by the late 1990s. In 2013, their share was about 65 per cent. The share of manufactured goods in developing-country exports increased very steeply.

GLOBAL SOURCING AND PRODUCTION SHARING

The trend of global sourcing and production sharing has been growing. Encouraged by the success of the Japanese industry, outsourcing became so prominent in the United States, that an increasing dependence on outside suppliers during the decade of 1980s helped reverse a trend toward increased vertical integration that had been occurring for almost a century. In other words, the 1980s witnessed a trend toward deintegration or the emergence of hollow manufacturing companies.

Box 1.3
Spreading Web of Global Production Network

The compositional shifts in trade have created a new pattern in the international exchange of goods, services, and ideas. Trade in components is one part of that new pattern. "Sourcing" such components from abroad is an increasingly common practice, and use of the internet is sure to expand the process, encouraging entry by new producers throughout the developing world. While precise numbers are difficult to come by, in the early 1990s one-third of all manufactures' trade involved parts and components. This type of trade has generated an ever-spreading web of global production networks that connect subsidiaries within transnational firms to unrelated designers, producers, and distributors of components. These networks offer their constituent firms access to new markets and commercial relationships and facilitate technology transfer. Advances in information technology help firms from developing countries into global production networks. General Electric, for instance, posts information on its component requirements on the internet, and firms from all over the world bid to supply them.

Courtesy: World Bank, *World Development Report*, 1999/2000.

Outsourcing has been much more conspicuous with the Japanese industries than others. For instance, typically figures of about 60 to 70 per cent outsourcing for Toyota versus 30 to 40 per cent for General Motors were reported. The successful use of higher percentage of subcontracting by Toyota, Nissan and other Japanese automotive companies has been cited increasing in recent years as a model for US managers who have increased their own outsourcing.[2] As a result of the massive outsourcing programme, GM's share of parts and components produced in-house was predicted to drop from 60 per cent to 45 per cent by the end of 1980s.[3]

Much of the increased sourcing over the past decade or so has been global in nature. Many companies have adopted global sourcing as a major competitive strategy.

Some of the offshore sourcing was in fact accompanied by plant or product line closings in the United States as US manufacturers sought the advantage of cheaper labour abroad, either in their own plants or from others.[4]

According to the *Purchasing* survey, the reasons for offshore purchases are the following: listed in the order of importance:[5] (*i*) Lower price, (*ii*) Better quality, (*iii*) Only source available, (*iv*) More advanced technology, (*v*) More consistent attitude, (*vi*) More cooperative delivery, and (*vii*) Countertrade requirements.

It may be noted that, besides the above, outsourcing has certain other advantages. It reduces the capital and manpower requirements. It may also impart more flexibility to adjust to certain conditions like a recession.

International sourcing accounts for an estimated one-third of the world trade. Many developing countries have taken a lot of advantage of this trend. India, however, has not benefited to any

significant extent. However, with the changes in the business environment, there are positive signs of change. The Indian auto components industry has become, for instance, suppliers to foreign heavy weights like General Motors, Renault, Fiat, etc. The export performance of the Indian auto components is expected to improve very significantly with the further improvement in quality and productivity which the industry is now striving to achieve.

Production sharing is a natural corollary of the growing international sourcing. Production sharing, a term introduced by Drucker, refers to the practice of carrying out different stages of manufacturing of a product in several countries.

Such production sharing has become quite common in many industries including high technology and sophisticated products. The technical development and designing may be done in one country, the various components may be manufactured in different countries, the assembling may be done in some other country/countries and the product may be marketed globally. For example, the parts and components of a motor car finally assembled in US or a European country are obtained from a large number of suppliers in different countries. In short, what is marketed as an American car or German car is not purely American or German, but really transnational. Most of the parts and components of the IBM personal computer sold in the US, under the label 'made in USA' are manufactured abroad. According to the data given in one report in 1985,[6] nearly three-fourths of the total manufacturing costs of the IBM PC was accounted for by parts and components manufactured overseas. The US owned plants overseas supplied more than one-third of these foreign parts and components. Drucker points out that the only thing really made in Japan in respect of an handheld electronic calculator with the label "made in Japan" is the label.

Drucker argues that the practice of production sharing will be "the most important form of economic integration, needed by developed and developing countries alike. In production sharing, the resources of the developing countries — their abundant labour for traditional jobs — are brought together with the resources of the developed countries — their management, their technology, their educated people, their markets and purchasing power."[7]

Drucker further argues that "production sharing is the best hope — perhaps the only hope — for most of the developing countries to survive without catastrophe the explosive expansion of working-age people in search of a job."[8] Developing countries can, of course, benefit immensely by production sharing. But, to argue that it is the only hope is to grossly underestimate the potentials of the developing countries. Further, Drucker does not appear to have paid sufficient attention to the fact that substantial production sharing takes place between advanced economies.

An interesting fallout of the production sharing is that a ban on the import of a product could mean harm to some industrial units in that country which are parties to the production sharing. Thus, "When shoe workers' union in the United States or shoe manufacturers in North Carolina agitate for a ban on importation of 'cheap foreign imports', no cattle grower in the Great Plains realises that they are actually agitating to ban the export of American hides (out of which the shoes are manufactured) on which his livelihood depends."[9]

THE GROWING ATTRACTIVENESS OF DEVELOPING COUNTRY MARKETS

The developing countries (China, India, Brazil and Russia are among the 10 largest economies of the world, in general, have been growing faster than the developed ones. They are inhabited by about 85 per cent of the world population but has a share of only 25 per cent of the global GDP. In purchasing power parity terms, however, they account for more than 40 per cent of the global.

The share of the developing countries in the global trade has also been growing at almost twice the rate for the developed countries.

Their global economic share will further increase and they will play an increasingly important role in international business.

In fact, developing country's firms are making inroads into developed country markets and a number of developing economies have trade surplus with developed countries. Several developing countries are now among the major exporters of the world.

This does not mean that all the developing countries will grow at high rates. The impressive picture of overall performance of the developing countries is the result of the very good performance of a small number of them – like China, India, South-East Asian economies, Russia, and some Latin American countries. Many developing economies present a very poor picture of performance – even very pathetic in a large number of cases.

Encouraged by the liberalisation, foreign investment flow to the developing countries has been surging.

The increasing attractiveness of the developing country's capital markets is reflected in their faster market capitalisation.

While population in several developed countries are either saturating or declining, it is still rising fast in the developing countries. According to the United Nations Population Division, the world population will likely increase by 2.5 billion over the next 43 years, passing from the current 6.7 billion to 9.2 billion in 2050. This increase is equivalent to the total size of the world population in 1950, and it will be absorbed mostly by the less developed regions, whose population is projected to rise from 5.4 billion in 2007 to 7.9 billion in 2050. In contrast, the population of the more developed regions is expected to remain largely unchanged at 1.2 billion, and would have declined, were it not for the projected net migration from developing to developed countries, which is expected to average 2.3 million persons annually.

The share of developing countries in global merchandise exports increased from about 34 per cent in 1980 to 43 in 2013. The share of developing economies in world service exports was 34 per cent in 2013.

The fast rising income and population indicate the growing importance of the developing countries in the globalising world economy. No wonder, they are receiving increasing attention by MNCs and investment inflows to them have been surging.

According to the *BRIC Report* by the global consulting firm *Goldman Sachs*, at the end of the present century, China will be the largest and India the second largest economies in the world. A major part of the additional income and demand in future will come from the BRIC (Brazil, Russia, India and China). There are also several other developing countries with high growth potential. For example, *Goldman Sachs* refers to the *Next Eleven (N-11)* – a very diverse grouping that includes Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam.

INTERNATIONAL MARKETING

International marketing is not the same thing as international trade. Only a part of the international trade flows represents international marketing. Further, there is a category of international marketing which is not captured by the international trade statistics.

Walsh, who states international marketing is perhaps best regarded as a short-hand expression for the special international aspects of marketing, defines international marketing as:

(*a*) "the marketing of goods and services across national frontiers, and

(*b*) the marketing operations of an organisation that sells and/or produces within a given country when:

(*i*) that organisation is part of, or associated with, an enterprise which also operates in other countries; and

(*ii*) there is some degree of influence on or control of the organisation's marketing activities from outside the country in which it sells and/or produces."[10]

"Another view is that international marketing is simply an attitude of mind, the approach of a company with a truly global outlook, seeking its profit impartially around the world, "home" market included, on a planned and systematic basis."[11]

"Another definition of international marketing is that it is the marketing function of multinational companies."[12]

This author would define International Marketing as ***marketing in an internationally competitive environment, no matter whether the market is home or foreign***. For example, although its market is confined almost entirely to India, the competition which *Nirma* encounters is indeed international. Its major competitors include MNCs like Unilever, P&G, Colgate Palmolive, etc. Besides, there is also competition from imported products. Thus, many firms in their own home market face the technological, financial, organisational, marketing and other managerial prowess of the multinationals, as is reflected in Box 1.1.

As stated earlier, international marketing is not the same thing as international trade. The sale abroad of a good produced in India is international trade but from a truly managerial point of view it can be regarded as international marketing if it is sold to the ultimate buyer under the brand name of the exporter. Many of India's exports are repacked or further processed and sold to the ultimate buyer under foreign brand names. For example, the spices imported in bulk from India are packed in consumer pack, after processing or in the same condition as it was imported, and sold under foreign brands. Even products exported in consumer packs from India are repacked abroad, without any further processing, and sold under foreign brand names. In such cases, the Indian exports represent international trade but not international marketing.

It may also be noted that a considerable share of several products sold abroad under the Indian brand names, like pickles and curry powders, are bought by the ethnic population (i.e., the Indian population abroad).

Special Problems in International Marketing

Some people talk of "the differences between domestic marketing and international marketing". But, the fact is that, there is no basic difference between these two; the principles of marketing are universal. What are referred to by some people as differences are not really differences but special problems or features of international marketing.

What makes international marketing strategy different from the domestic one is the differences in the marketing environment. The important special problems in international marketing are given below:

1. Political and Legal Differences: The political and legal environment of foreign markets are different from that of the domestic. The complexity generally increases as the number of countries in which a company does business increases. It should also be noted that the political and legal environment is not the same in all provinces of many home markets. For instance, the political and legal environment is not exactly the same in all the States of India.

2. Cultural Differences: The cultural differences is one of the most difficult problems in international marketing, as explained in the next chapter. Many domestic markets, however, are also not free from cultural diversity.

3. Economic Differences: As described in a following chapter, the economic environment may vary from country to country.

4. Differences in the Currency Unit: The currency unit varies from nation to nation. This may sometimes cause problems of currency convertibility, besides the problems of exchange rate fluctuations. The monetary system and regulations may also vary.

5. Differences in the Language: An international marketer often encounters problems arising out of the differences in the language. Even when the same language is used in different countries, the same words or terms may have different meanings or connotations. The language problem, however, is not something peculiar to the international marketing. The multiplicity of languages in India is an example.

6. Differences in the Marketing Infrastructure: The availability and nature of the marketing facilities available in different countries may vary widely. For example, an advertising medium very effective in one market may not be available or may be underdeveloped in another market.

7. Trade Restrictions: Trade restrictions, particularly import controls, is a very important problem which an international marketer faces.

8. High Costs of Distance: When the markets are far removed by distance, the transport cost becomes high and the time required for effecting the delivery tends to become longer. Distance tends to increase certain other costs also.

9. Differences in Trade Practices: Trade practices and customs may differ between countries.

REASONS FOR/MOTIVES OF INTERNATIONAL MARKETING

There are several answers to the question 'why firms go international?' The factors which motivate or provoke firms to go international may be broadly divided into two groups, viz., the pull factors and the push factors.

The *pull factors*, most of which are *proactive reasons*, are those forces of attraction which pull the business to the foreign markets. In other words, companies are motivated to internationalise because of the attractiveness of the foreign market. Such attractiveness include, broadly, the relative profitability and growth prospects.

The *push factors* refer to the compulsions of the domestic market, like saturation of the market, which prompt companies to internationalise. Most of the push factors are *reactive reasons*.

Important reasons for going international are described below.

Profit Motive

One of the most important objectives of internationalisation of business is the profit advantage. International business could be more profitable than the domestic. As pointed out earlier, there are cases where more than 100 per cent of the total profit of the company is made in the foreign markets (in which case the domestic operation, obviously, is incurring loss).

Even when international business is less profitable than the domestic, it could increase the total profit.

Further, in certain cases, international business can help increase the profitability of the domestic business. This is illustrated with the help of Figure 1.2.

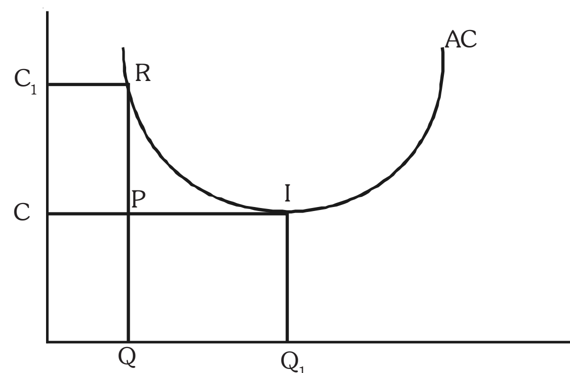

Fig. 1.2: Impact of Exports on Average Unit Cost

One of the important motivations for foreign investment is to reduce the cost of production (by taking advantage of the cheap labour, for example). While in some cases, the whole manufacturing of a product may be carried out in foreign locations, in some cases only certain stages of it are done abroad. A significant share of the merchandise imported into the United States is manufactured by foreign branches of American companies. Several American companies ship parts and components to overseas locations where the labour-intensive assembly operations are carried out and then the product is brought back home. The North American Free Trade Agreement comprising the US, Canada and Mexico is expected to encourage large relocation of production to Mexico where the labour is substantially cheap.

Growth Opportunities

The enormous growth potential of many foreign markets is a very strong attraction for foreign companies. In a number of developing countries, both the population and income are growing fast. It may be noted that several developing countries, the newly industrialising countries (NICs) and the Peoples' Republic of China in particular, have been growing much faster than the developed countries. Growth rate of India has also been good and the liberalisation seems to have accelerated the growth.

Even if the market for several goods in these countries is not very substantial at present, many companies are eager to establish a foothold there, considering their future potential. Similarly, when the East European economies have been opened up, there have been a rush of MNCs to establish a base in these markets.

Domestic Market Constraints

Domestic demand constraints drive many companies to expanding the market beyond the national border.

The market for a number of products tend to saturate or decline in the advanced countries. This often happens when the market potential has been almost fully tapped. In the United States, for example, the stock of several consumer durables like cars, TV sets etc. exceed the total number of households. Estimates are that in the first quarter of the 21st century, while the population in some of the advanced economies would saturate or would grow very negligibly, in some others there would be a decline. Such demographic trends have very adverse effects on certain lines of business. For example, the fall in the birth rate implies contraction of market for several baby products.

Another type of domestic market constraint arises from the scale economies. The technological advances have increased the size of the optimum scale of operation substantially in many industries making it necessary to have foreign market, in addition to the domestic market, to take advantage

of the scale economies. It is the thrust given to exports that enabled certain countries like South Korea to set up economic size plants. In the absence of foreign markets, domestic market constraint comes in the way of benefiting from the economies of scale in some industries.

Domestic recession often provokes companies to explore foreign markets. One of the factors which prompted the Hindustan Machine Tools Ltd. (HMT) to take up exports very seriously was the recession in the home market in the late 1960s. The recession in the automobile industry in the early 1990s, similarly, encouraged several Indian auto component manufacturers to explore or give a thrust to foreign markets.

Competition

Competition may become a driving force behind internationalisation. A protected market does not normally motivate companies to seek business outside the home market. Until the liberalisations which started in July 1991, the Indian economy was a highly protected market. Not only that the domestic producers were protected from foreign competition but also domestic competition was restricted by several policy induced entry barriers, operated by such measures as industrial licensing and the MRTP regulations. Being in a seller's market, the Indian companies, in general, did not take the foreign market seriously. The economic liberalisation, ushered in India since 1991, which has increased competition from foreign firms as well as from those within the country, have, however, significantly changed the scene. Many Indian companies are now systematically planning to go international in a big way.

Many companies also take an offensive international competitive strategy by way of counter-competition.

The strategy of *counter-competition* is to penetrate the home market of the potential foreign competitor so as to diminish its competitive strength and to protect the domestic market share from foreign penetration. "Effective counter-competition has a destabilising impact on the foreign company's cash flows, product related competitiveness and decision making about integration. Direct market penetration can drain vital cash flows from the foreign company's domestic operations. This drain can result in lost opportunities, reduced income, and limited production, impairing the competitor's ability to make overseas thrusts."[13] Thus, IBM moved early to establish a position of strength in the Japanese main frame computer industry before two key competitors, Fujitsu and Hitachi, could gain dominance. Holding almost 25 per cent of the market, IBM denied its Japanese competitors vital cash flow and production experience needed to invade the US market. They lacked sufficient resources to develop the distribution and software capabilities essential to success in America. So the Japanese have finally entered into joint ventures with US companies having distribution and software skills (Fujitsu with TRW, Hitachi with National Semi-conductor). In fact, in Fujitsu's case, it was an ironic reversal of the counter-competitive strategy by expanding abroad to increase its economies of scale for the fight with IBM back home.[14] The Texas Instruments established semi-conductor production facilities in Japan "to prevent Japanese manufacturers from their own markets". Even after much development work, the Japanese producers could muster neither the R&D resources nor the manufacturing capability to compete at home or overseas with acceptable product in sufficiently large quantities.[15]

Government Policies and Regulations

Government policies and regulations may also motivate internationalisation. There are both positive and negative factors which could cause internationalisation.

Many governments give a number of incentives and other positive support to domestic companies to export and to invest in foreign countries. Similarly, several countries give a lot of importance to import development and foreign investment.

Sometimes, as was the case in India, companies may be obliged to earn foreign exchange to finance their imports and to meet certain other foreign exchange requirements like payment of royalty, dividend, etc. Further, in India, permission to enter certain industries by the large companies and foreign companies was subject to specific export obligation.

Some companies also move to foreign countries because of certain regulations, like the environmental laws in advanced countries.

Government policies which limit the scope of business in the home country may also provoke companies to move to other countries. Here is an interesting case: In the early seventies, having failed to make any headway within India, the only alternative left for the Birla Group was to set up industries in other countries and it put up several successful companies in all the ASEAN countries. "This was surely a paradox. The same government which refused us permission to set up manufacturing capacities within the country allowed us to set up industries outside the country for the same products for which it has said 'no' in India. Thus, we set up a viscose staple fiber plant in Thailand, and started exporting fiber back to India."[16] According to one study, "the evidence suggests that one of the most important motivations behind foreign direct investment by Indian firms has been the desire to escape the constraining effects of Government of India's policy. It appears that a number of Indian locally domiciled foreign collaboration industries, those involved in manufacturing at least, go overseas to avoid a policy environment that restricts their domestic growth and undermines their competitiveness. To the extent that foreign direct investment from India takes place for such negative reasons, the phenomenon may be regarded as disguised form of capital flight from India."[17]

With the recent changes in the government of India's economic policy, the situation, however, has changed. Many Indian companies are entering international market or are expanding their international operations because of positive reasons.

Monopoly Power

In some cases, international business is a corollary of the monopoly power which a firm enjoys internationally. Monopoly power may arise from such factors as monopolisation of certain resources, patent rights, technological advantage, product differentiation etc. Such monopoly power need not necessarily be an absolute one but even a dominant position may facilitate internationalisation.

As Czinkota and Ronkainen observe, exclusive market information is another proactive stimulus.[18] This includes knowledge about foreign customers, marketplaces, or market situations not widely shared by other firms. Such special knowledge may result from particular insights by a firm based on international research, special contacts a firm may have or simply being in the right place at the right time (for example, recognising a good business situation during a vacation). Although such monopoly element may give an initial advantage, competitors could be expected to catch up soon.

Spin-off Benefits

International business has certain spin-off benefits too.

International business may help the company to improve its domestic business; international business helps improve the image of the company. International marketing may have pay-offs for the internal market too by giving the domestic market better products.

Further, the foreign exchange earnings may enable a company to import capital goods, technology etc. which may not otherwise be possible in countries like India.

Another attraction of exports is the economic incentives offered by the government.

Strategic Vision

The systematic and growing internationalisation of many companies is essentially a part of their business policy or strategic management. The stimulus for internationalisation comes from the

urge to grow, the need to become more competitive, the need to diversify and to gain strategic advantages of internationalisation. Many companies in India, like several pharmaceutical firms, have realised that a major part of their future growth will be in the foreign markets.

There are a number of corporations which are truly global. Planning of manufacturing facilities, logistical systems, financial flows and marketing policies in such corporations are done considering the entire world as its, and a single, market — a borderless world.

INTERNATIONAL ORIENTATIONS

The degree and nature of involvement in international business or the international orientations of companies vary very widely.

The analysis provided by Wind, Douglas and Perlmutter within the framework of the modified EPRG scheme is helpful in understanding the levels of involvement of firms in international business.[19]

The EPRG framework identifies four types of attitudes or orientations toward internationalisation that are associated with successive stages in the evolution of international operations. These four orientations are:

1. Ethnocentrism (home country orientation);
2. Polycentrism (host country orientation),
3. Regiocentrism (regional orientation); and
4. Geocentrism (world orientation).

These stages are assumed to reflect the goals and philosophies of the company insofar as international operations are concerned and lead to different management strategies and planning procedure for international operations.

Ethnocentric Orientation

In the ethnocentric company, overseas operations are viewed as secondary to domestic operations and primarily as a means of disposing of "surplus" domestic production. The top management views domestic techniques and personnel as superior to foreign and as the most effective in overseas markets. Plans for overseas markets are developed in the home office, utilising policies and procedures identical to those employed in the domestic market. Overseas marketing is most commonly administered by an export department or international division, and the marketing personnel is composed primarily of home country nationals. Overseas operations are conducted from a home country base, and there is likely to be a strong reliance on export agents. There is a tendency to employ the domestic product mix without major modifications for the overseas market. In short, under ethnocentrism the international marketing is normally characterised by the *extension* strategy described in Chapter 9.

The ethnocentric position appears to be appropriate for a small company just entering international operations, or for companies with minimal international commitments because this approach entails a minimal risk and commitment to overseas markets — no international investment is required, and no additional selling costs incurred, with the possible exception of higher distribution costs. This position may be inappropriate for a company which wants to expand its international business significantly.

Polycentric Orientation

As the company begins to recognise the importance of inherent differences in overseas markets, a polycentric attitude emerges. The prevalent philosophy at this stage is that local personnel and techniques are best suited to deal with local market conditions. Subsidiaries are established in overseas markets, and each subsidiary operates independently of the others and establishes its own marketing objectives and plans.

The environment of each market is considered while formulating the marketing strategy. There is market segmentation, at least on a country basis. "Emphasis is put on local laws, custom and culture and great care is taken to understand the local way of doing business. This usually results in the maximum degree of geographic decentralisation as local managers are recognised as being psychologically close to markets, environments and customers."[20] Under polycentrism, marketing is normally characterised by the *adaptation* strategy described in Chapter 9. The important merit of polycentrism is the adaptation of the marketing strategies to the local conditions.

Regiocentric and Geocentric Orientations

A regiocentric company views different regions as different markets. A particular region with certain important common marketing characteristics is regarded as a single market, ignoring national boundaries. "Strategy integration, organisational approach and product policy tend to be implemented at regional level. Objectives are set by negotiation between headquarters and regional HQ on the one hand and between regional HQ and individual subsidiaries on the other."[21]

A geocentric company views the entire world as a single market and develops standardised marketing mix, projecting a uniform image of the company and its products, for the global market. "The business of the geocentric multinational is usually characterised by sufficiently distinctive national markets that the ethnocentric approach is unworkable, and where the importance of learning curve effects in marketing, production technology and management makes the polycentric philosophy substantially sub-optimal."[22]

Wind, Douglas and Perlmutter have pointed out the advantages and problems of these orientations as follows.

Since the regiocentric and geocentric orientations imply the identification of regional or global market segments crossing national boundaries as well as the development of standard policies throughout a given segment, they may provide improved coordination and control. Geocentrism is viewed as entailing high costs in collecting information and administering policies on a worldwide scale. In this respect, the regiocentric appeal is generally viewed as more economical and manageable. In both cases, however, national environmental constraints may restrict multinational operations and make the approach unfeasible. For example, national differences in laws and currencies may severely hinder any practical implementation of this "world market" perspective. The impact of these national environmental differences is considered in most cases to be more critical for marketing activities than for production and finance activities. The geocentric position may, therefore, be more advantageous for production and research and development than for marketing.

In general, the desirability of a particular international orientation — E, P, R, or G — tends to depend on several factors, such as the size of the firm, the experience gained in a given market, the size of the potential market, and the type of the product and its cultural dependency.

INTERNATIONALISATION STAGES

Most companies pass through different stages of internationalisation.

There are, of course, many companies which have international business since their very beginning, including 100 per cent export-oriented companies. Even in the case of many of the hundred per cent export-oriented companies, the development of their international business would pass through different stages of evolution.

A firm which is entirely domestic in its activities normally passes through different stages of internationalisation before it becomes a truly global one.

There are many companies which enthusiastically and systematically go international as part of their corporate plan. However, in the case of many firms the initial attitude towards international

business is passive and they get into the international business in response to some external stimuli. For example, a sample survey[23] of US firms exporting industrial products revealed that most of them first began exporting through the action of an outside party — about 48 per cent responded to unsolicited orders and 44 per cent were approached by foreign distributors. In the earlier surveys, the percentage of the total number of firms which began exporting responding to unsolicited orders was much higher.

A firm may start exports on an experimental basis and if the results are satisfying it would enlarge the international business and in due course it would establish offices, branches or subsidiaries or joint ventures abroad. The expansionary process may also be characterised by increasing the product mix and the number of market segments, markets and countries of operation. In the process, the company could be expected to become multinational and finally global.

In short, in many firms overseas business initially starts with a low degree of commitment or involvement; but they gradually develop a global outlook and embark upon overseas business in a big way.

The important stages in the evolutionary process are the following:

Domestic Company

Most international companies have their origin as domestic companies. The orientation of a domestic company essentially is ethnocentric. A purely domestic company "operates domestically because it never considers the alternative of going international. The growing stage-one company, when it reaches growth limits in its primary market, diversifies into new markets, products and technologies instead of focusing on penetrating international markets."[24] However, if factors like domestic market constraints, foreign market prospects, increasing competition etc. make the company reorient its strategies to tap foreign market potential, it would be moving to the next stage in the evolution.

A domestic company may extend its products to foreign markets by exporting, licensing and franchising. The company, however, is primarily domestic and the orientation essentially is *ethnocentric.* In many instances, at the beginning exporting is indirect (see Chapter 6).

The company may develop a more serious attitude towards foreign business and move to the next stage of development, i.e., international company.

International Company

International company is normally the second stage in the development of a company towards the transnational corporation. The orientation of the company is basically ethnocentric and the marketing strategy is *extension,* i.e, the marketing mix 'developed' for the home market is extended into the foreign markets. International companies normally rely on the international division structure (see Chapter 8) for carrying out the international business.

Multinational Company

When the orientation shifts from ethnocentric to polycentric, the international company becomes multinational. In other words, "When a company decides to respond to market differences, it evolves into a stage three multinational that pursues a *multidomestic* strategy. The focus of the stage-three company is multinational or, in strategic terms, *multidomestic* (That is, the company formulates a unique strategy for each country in which it conducts business)".[25] The marketing strategy of the multinational company is *adaptation* described in Chapter 9.

In multinational companies, "each foreign subsidiary is managed as if it were an independent city state. The subsidiaries are part of an area structure in which each country is part of a regional organisation that reports to world headquarters."[26]

Global/Transnational Company

According to Keegan, global company represents stage four and transnational company stage five in the evolution of companies. However, several people use these terms as synonyms and by global corporation they refer to the final stage in the development of the corporation. According to Keegan, "the global company will have either a global marketing strategy or a global sourcing strategy but not both. It will either focus on global markets and source from the home or a single country to supply these markets, or it will focus on the domestic market and source from the world to supply its domestic channel."[27] However, according to the interpretation of some others, all strategies — product development, production (including sourcing) marketing etc. — will be global in respect of the global corporation.

The "transnational corporation is much more than a company with sales, investments, and operations in many countries. This company, which is increasingly dominating markets and industries around the world, is an integrated world enterprise that links global resources with global markets at a profit."[28]

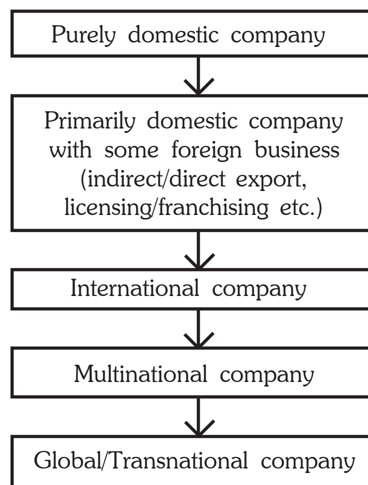

Fig. 1.3: Stages in the Evolution of Companies

Bartlett and Ghoshal point out that in transnational companies, "the activities and resources are neither centralised in the parent company, nor decentralised so that each subsidiary can carry out its own tasks on a local-for-local basis. Instead the resources and activities are dispersed but specialised, so as to achieve efficiency and flexibility at the same time. Furthermore, these dispersed resources are integrated into an interdependent network of worldwide operations."[29] They further elaborate that, "in contrast to the global model, the transnational mentality recognises the importance of flexibility and responsive country-level operations — hence, the return of *national* into the terminology. And compared to multinational approach, it provides for linking and coordinating those operations to retain competitive effectiveness and economic efficiency — as indicated by the prefix *trans.*"[30]

The orientation is geocentric and marketing strategy is, by and large, standardised. As Keegan observes, "it recognises similarities and differences and adopts a world view. This is the company that thinks globally and acts locally. It adopts a global strategy allowing it to minimise adaptation in countries to that which will actually add value to the country customer. This company does not adapt for the sake of adaptation. It only adapts to add value to its offer."[31]

The different stages of development from a purely domestic to a transnational company is summarised in Figure 1.3.

Bartlett and Ghoshal explain the differences between the different types of companies as follows: "The global company tends to concentrate all its resources — often locating them in its home country — so as to exploit the scale economies available in each activity. The multinational company typically disperses its resources among its different national operations so as to be able to respond to local needs. And the international company tends to centralise those resources that are key to developing innovations to be adapted worldwide.

The transnational, however, must develop a more sophisticated and differentiated configuration of assets and capabilities. It first decides which key resources and capabilities are best centralised within the home-country operation, not only to realise scale economies but also to protect certain core competencies and to provide the necessary supervision of corporate management. Certain other resources may be concentrated but not necessarily at home — a configuration that might be termed *excentralisation* rather than *centralisation*. Some other resources may be decentralised on a regional or local basis, either because potential economies of scale are smaller than the benefits to be gained from greater differentiation or market responsiveness, or because of the need to create flexibility and reduce risks by avoiding exclusive dependence on a single facility. The result is a complex configuration of assets, resources and capabilities that centralises some resources at home, excentralises some abroad, and distributes yet others among its many national operations. Furthermore, the company integrates these dispersed yet specialised resources through strong interdependencies."[32]

INTERNATIONAL MARKETING DECISIONS

A firm which plans to go international has to make a series of strategic decisions. They are broadly the following:

(i) International Business Decision: The first decision a company has to make, of course, is whether to take up international business or not. This decision is based on a serious consideration of a number of important factors, such as the present and future overseas opportunities, present and future domestic market opportunities, the resources of the company (particularly skill, experience, production and marketing capabilities and finance), company objectives, etc.

(ii) Market Selection Decision: Once it has been decided to go international, the next important step is the selection of the most appropriate market. For this purpose, a thorough analysis of the potentials of the various overseas markets and their respective marketing environments is essential. Company resources and objectives may not permit a company to do business in all the overseas markets. Further, some markets are not potentially good, and it may be suicidal to waste company resources in such markets. A proper selection of the overseas market(s), therefore, is very important.

(iii) Entry and Operating Decisions: Once the market selection decision has been made, the next important task is to determine the appropriate mode of entering the foreign market. The important modes of entering the foreign market are discussed in a subsequent chapter.

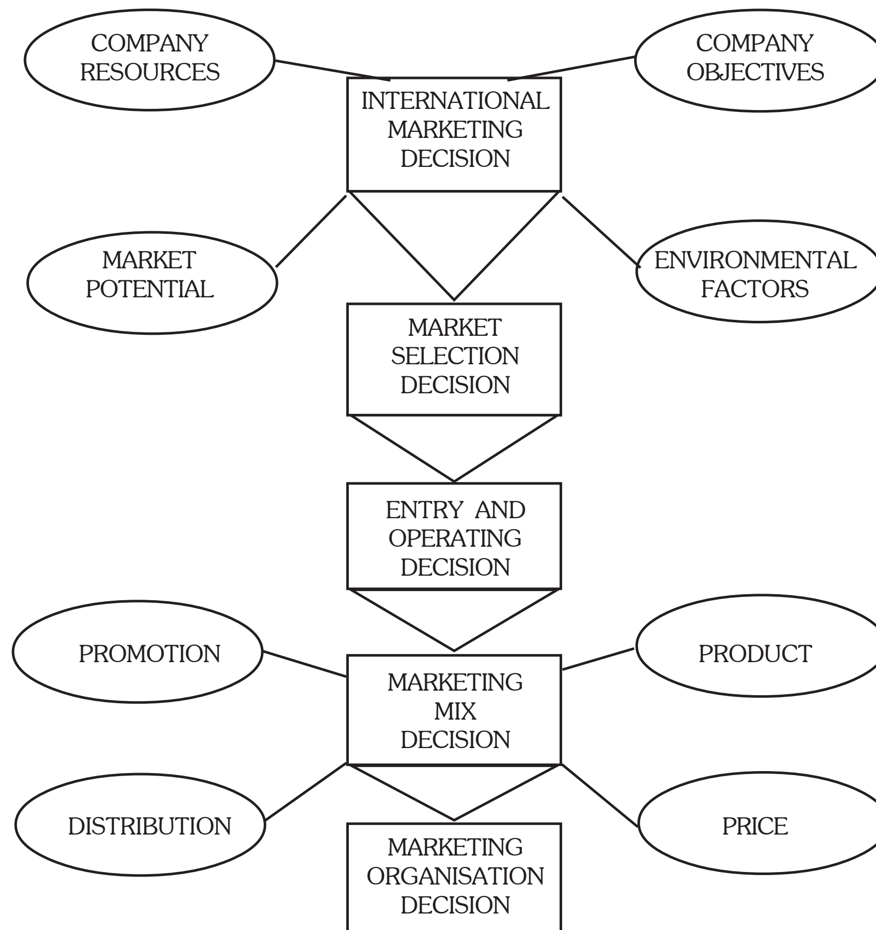

Fig. 1.4: International Marketing Decisions

(iv) Marketing Mix Decision: The foreign market is characterised by a number of uncontrollable variables. The marketing mix consists of internal factors which are controllable. The success of international marketing, therefore, depends to a large extent on the appropriateness of the marketing mix. The elements of the marketing mix — product, promotion, price and physical distribution — should be suitably designed so that they may be adapted to the characteristics of the overseas market. More details are given in some of the following chapters.

(v) International Organisation Decision: A company which wants to do direct exporting has also to decide about its organisational structure, so that the exporting function may be properly performed. This decision should necessarily be based on a careful consideration of such factors as the expected volume of export business, the nature of the overseas market, the nature of the product, the size and resources of the company, and the length of its export experience. The nature of the organisation structure of the company will depend on a number of factors like its international orientation, nature of business, size of business, future plans etc. The common types of organisational set-ups are dealt with is detail in Chapter 8.

SCOPE OF MARKETING INDIAN PRODUCTS ABROAD

The potential for international marketing is enormous for Indian firms. The fast expansion of the international business, as indicated by the statistics provided at the beginning of this chapter, is an indication of this. The scope of international business for developing countries is amply demonstrated by the rapid strides made by several developing countries like South Korea, Taiwan, Hong Kong, Singapore and People's Republic of China. India's performance, in comparison with these countries has been very poor. Table 1.1 clearly shows that India's record has been unimpressive, whether one compares it with China, a much larger economy than India, or the other nations mentioned above, which are very smaller than those of several states of India, albeit, India has performed better than many other developing countries. Developing countries like South Korea with very good economic performance has such well-known multinationals like Hyundai, Daewoo, Samsung, LG, which are making inroads into India, whereas India with its massive size and diverse resource base and which has a longer history of industrialisation can hardly boast anything of that sort.

The rapid strides made by several other developing countries in the international market, and trends of the growing economic power of the developing countries described earlier are indications of the enormous global business opportunities which Indian firms could exploit.

A look at some of the successful Indian example, covering products ranging from bullock cart technology to high-tech would indicate the strategies Indian firms may employ to seize the various opportunities.

Product modification to suit the requirements of the foreign markets will enable international marketing of many products by Indian firms. Examples include TI cycles, Hero cycles, TTK pressure cookers etc. (see the section *Product Adaptation* in Chapter 9).

Another international marketing opportunity which a number of Indian firms may avail of is the one provided by the vocation of certain industrial segments of the market in the developed countries by the large players as they become unattractive for them. For example, several dominant firms have vacated the ply tyre segment in the developed markets as this segment has shrunk due to the popularity of radial tyres. Similarly, developed country firms have given up production of several chemical products due to various reasons.

There are enormous international marketing opportunities for developing products that suit the specific markets. The Balsara, for example, developed an herbal toothpaste, brand named *Auromere* to take advantage of the growing preference for nature based products in the USA Balsara's R&D scored a unique advantage when Auromere was developed as saccharine free toothpaste. The company expanded its market by introducing other variants of mint and menthol. As these were taboo for users of homeopathic medicine, it introduced a toothpaste free of such mints. Other variations include Auromere Fresh Mint for the young and Auromere Cina Mint, containing a combination of cinnamon and peppermint.

Indian firms with products of acceptable quality may explore the foreign markets. The Pricol, supplier of dashboard instruments to Maruti, thus entered the US market in a small way and today it is an international player. The Sundaram Fastners, which was adjudged as one of the 20 best Asian companies, is a highly reputed global supplier of automobile parts like radiator caps to dominant players like General Motors. There is enormous opportunity to take advantage of the growing global sourcing. The growing foreign investment in India and development of quality consciousness in Indian firms will encourage the growth of an ancillary sector of quality products and thus enlarge the Indian base for global sourcing.

Firms which are suppliers to foreign firms or whose products are sold under foreign brand names may explore the possibility of selling their own products under their own brand names.

There are a number of products in which the developing countries have advantage like textiles, leather, jems and jewellery, seafood etc. Although these are among India's important export items, the nation has not been very successful, when compared with several other developing countries, in exploiting these opportunities.

Many products, which become off patent provide international marketing opportunities for firms of developing countries like India because of the low cost advantage. A number of them pose technical challenges. The Technocrat Industries, an Indian firm set up in 1972 by two fresh graduates from IIT, succeeded in mastering the technology of drum closures, precision products used to seal drums in which oil and chemicals are stored, competed with the MNC in the Indian market and entered foreign markets. Several Indian pharmaceutical firms are globalising using generics and bulk drugs as their mainstay.

India is an important exporter of many products like spices and seafood. They are, however, mostly commodity exports. A lot of potential exists for developing their value added exports. There is also considerable scope for quality improvement, product development and value addition in respect of several other categories like leather, textiles etc.

There are a number of Indian companies/conglomerates with strategic strength like Reliance, Arvind Mills, Bajaj, Ranbaxy, Sundaram Fastners, Essel Packaging, Tata, Birla etc., who have the potential to become global players. The new competitive environment is compelling Indian firms to be more cost and quality conscious and market oriented and to pay more attention to R&D, indeed a number of companies have developed a global orientation. Even when a company is selling only in the domestic market it may indeed be facing a global competition. The global competition in the domestic market should provoke Indian companies to meet global competition globally.

DRIVING AND RESTRAINING FORCES

There are a number of forces which induce and propel globalisation and thereby expand the scope and importance of international marketing. On the other hand, there are also forces which restrain globalisation.

DRIVING FORCES

The important forces driving globalisation are the following:

Liberalisation

One of the most important factors, which have given a great impetus to globalisation since the 1980s is the almost universal economic policy liberalisations which are fostering a borderless business world. While a lot of the liberalisations owe it to the GATT/WTO, substantial liberalisations have been occurring outside the GATT/WTO like, for example, the revolutionary economic policy changes in China and other socialist/communist nations. It may be noted that it has become quite common to describe the global trend as LPG (liberalisation, privatisation and globalisation) indicating the mutually interdependent and reinforcing nature of these forces. One of the impacts of liberalisation and privatisation is the surge in cross-border M&As and other FDI resulting in greater global economic integration.

MNCs

Multinational enterprises which link their resources and objectives with world market opportunities, have been a powerful force driving globalisation. Taking advantage of the liberalisation trend, there has been a fast growth of the number of MNCs and their global network of affiliates. The MNCs leverage their strengths to link global resources and opportunities and thereby strengthen the globalisation trend, as explained in the next chapter.

Technology

Technology is a powerful driving force of globalisation. Technological advances have tremendously fostered globalisation. Several technological developments become a compelling reason for internationalisation. Technological break-throughs are substantially increasing the scale economies and the market scale required to break-even. (See Chapter 17)

Transportation and Communication Revolutions

Technological revolution in several spheres, like transport and communication, has given a great impetus to globalisation by their tremendous contribution to the reduction of the disadvantages of natural barriers like distance and cost. The developments in the field of air cargo transportation has fostered globalisation by enabling quick and safe transportation of sensitive goods (like perishables and goods subject to quick changes in fashion/taste). Developments of containerisation and refrigeration have also been of high significance. The steep fall in the cost of transportation and communication have considerably accelerated pace of globalisation. All these have contributed to the drastic transformation of the logistical and global distribution of the value chain system. The world wide web has a stupendous impact on globalisation. Global sourcing was encouraged not only by trade liberalisation but also by technological developments, which reduced transport costs. Advent of containerisation and supertonnage cargo ships drastically reduced transport costs.

The IT revolution has made an enormous contribution to the emergence of the global village. (More information in Chapter 17)

Product Development Costs and Efforts

The cost of new product development is very huge in several industries such as pharmaceuticals. To recoup such high costs a global market is required. A corollary is that the fast technological changes, which hasten product obsolescence, necessitate a short pay back period, which can be realised only with a very large market.

Further, because of the huge investment and diverse skill requirements associated with new product development, cross-border alliances in research and development are becoming more and more popular. Again, in a number of cases different phases of the product development are carried out in different countries either by a company's own affiliates or by outsourcing.

Quality and Cost

The two most important determinants of demand are the quality and price of the offering. These can be better achieved when a firm is global in its operations.

Rising Aspirations and Wants

Because of the increasing levels of education and exposure to the media, particularly the electronic media, the aspirations of people all around the world are rising. They aspire for everything that can make life more comfortable or satisfying. If domestic firms are not able to meet their wants, they would naturally turn to the foreign firms. The customer today is, by and large, global. He wants a world-class product or a product of desired attributes at international price. He may desire a product available anywhere in the world. His aspirations cannot be tied down to the domestic availability.

Competition

Another important force driving the globalisation is increasing competition. Heightened competition compels firms to explore new ways of increasing their efficiency, including by extending their international reach to new markets at an early stage and by shifting certain production activities to reduce costs. It also results in international production taking new forms, with new ownership and contractual arrangements, and new activities being located in new sites abroad.[33]

World Economic Trends

There are some world economic trends, which add momentum to the globalisation trend. One of the important trends is the difference in the growth rates of the economies/markets. The comparatively slow growth of the developed economies or the stagnation of some of their markets and the fast growth of a number of developing countries prompt developed country firms to turn to the expanding markets elsewhere. The differences in the growth characteristics exist even within the categories of developed and developing countries.

Secondly, the domestic economic growth and the opportunities outside reduce the opposition to globalisation. A classic example is China. China has benefited tremendously out of foreign investment; the fast growing Chinese economy provides scope for a large number of players in the expanding market. At the same time, China is enormously exploiting the business opportunities outside the country. Globalisation should be a two-way process, which can be mutually beneficial.

Another driving force of globalisation is the economic liberalisation, as pointed out earlier, characterised by deregulation and privatisation.

Regional Integration

The proliferation of regional integration schemes, like the European Union (EU), North American Free Trade Agreement (NAFTA) etc., by creating a borderless world between the members of such trade blocs, foster the globalisation trend. A major part of the global trade now is intra-regional trade (i.e., trade between the members of the trade blocs). Some of these regional blocs also give a fillip to the cross-border investments and financial flows.

Leverages

A very important factor that supports globalisation is the unique opportunity global company possesses to develop leverage. A global company can leverage its experience to expand its global operations. The more the number of countries it operates in a business sector, the more could be the scope for leverage.

According to Keegan, "leverage is simply some type of advantage that a company enjoys by virtue of the fact that it conducts business in more than one country" and a global company possess the following four important types of leverage."[34]

1. Experience Transfers: A great strength of a global corporation is the experience it can leverage for expanding or strengthening its global operations. "It can draw on management practices, strategies, products, advertising appeals, or sales or promotional ideas that have been tested in actual markets and apply them in other comparable markets."[35]

2. Scale Economics: As pointed out earlier, the cost is one of the important determinants of success. Cost advantage, in many cases, derives out of scale economies. The scale economies have been expanding in a number of industries. To realise scale economies, it is often essential to go after the global market. Technological break-throughs are substantially increasing the scale economies and the market scale required to break-even. Although scale economies are often most conspicuous in manufacturing, a global company may achieve economies on a global scale by centralising other functional activities too.

3. Resource Utilisation: Another strength of a global company is its competence in sourcing the resources globally.

4. Global Strategy: Keegan observes that "the global company's greatest single advantage can be its global strategy. A global strategy is built on an information system that scans the world's business environment to identify opportunities, trends, threats, and resources. When opportunities

are identified, the global company adheres to the three principles identified earlier: It leverages its skills and focuses its resources to create superior perceived value for customers and achieve competitive advantage. The global strategy is a design to create a winning offer on a global scale. This takes great discipline, much creativity, and constant effort. The reward is not just success — it is survival."[36]

RESTRAINING FORCES

There are also several forces, which restrain the globalisation trend. There are two types of factors, which hamper globalisation, viz., external factors and internal factors.

External Factors

External factors include government policies and controls, which restrain cross-border business, social and political opposition against foreign business etc.

Internal Factors

Internal factors refer to factors within the organisation, which discourage globalisation. One such factor is the management myopia or "near-sightedness" which comes in the way of a global orientation. Further, the organisational culture may hamper or pamper globalisation.

A more elaborate version of this section is available in the author's book *International Business* (Prentice-Hall of India).

PARTICIPANTS IN INTERNATIONAL MARKETING

There are different categories of participants in International Marketing. Important categories are the following:

Private Firms

The bulk of the international transactions are carried out by private firms – MNCs; other large firms, and SMEs.

MNCs: MNCs account for a large part of the international marketing. About one-third of the international trade is estimated to be intra-company transfers, i.e., trade between affiliates or divisions of the MNCs located in different countries. Besides, they market large quantities of products to international customers. See the section MNCs and International Trade in Chapter 3 for some details.

Other Large Firms: Besides MNCs, there are a large number of large firms active in international marketing. Although, they do not qualify to be regarded as MNCs, many of them have manufacturing and other operational facilities in foreign countries.

SMEs: Small and medium enterprises also play a very significant role in international business. A very large number of them do considerable business abroad. There are many in this category which are hundred per cent or primarily export oriented. In the case of USA and Germany, the largest exporting nations, more than half of the exports are contributed by small firms. About 35 per cent of India's exports come from village and small industries.

Public Sector Undertakings

In several countries, public sector also play a very important role in foreign trade. State trading was the rule in the communist countries. State trading was prominent in socialist countries. Even in some of the mixed economies like India, state trading had an important place. There was substantial *canalisation* of foreign trade of India (a canalised item can be exported/imported only by a public sector undertaking). The liberalisation has very significantly reduced the role of state trading. The share of canalised items in the total business of state trading agencies like STC and MMTC has substantially come down. They now have to do business mostly on their own, like private trading

corporations. Besides, the state trading agencies, a number of public sector undertakings do significant international trade, like marketing their products and buying their requirements.

Trading Companies

There are, many trading companies, including public sector (like STC and MMTC), which are specialised in foreign trade. They are merchant exporters, (i.e., those which export products manufactured by other firms). Trading companies in countries like Japan do very huge volumes of trade.

Individuals

A large number of individuals also do international marketing. One of the very significant contributions of the world wide web and the internet is the empowerment of individuals and small firms to start business and to expand their business horizon. They are now able to easily access information from throughout the world and get into direct contact with buyers/sellers globally.

(Supplement this section with the sub-sections *Indirect Exporting* and *Types of Foreign Intermediaries* in chapter 11).

FUTURE OF INTERNATIONAL MARKETING

It may be predicted that in future the word *international* will disappear from international business or *international marketing* because there will not be any substantial difference between domestic business/marketing and international business/marketing. so that there is no need for the adjective *international*. As pointed out earlier, international competition in the 'domestic' market is so pervasive that international marketing may be defined as marketing in an internationally competitive environment, whether the market is foreign or domestic.

There are several trends that would make globalisation and international marketing more pronounced in future. Important among them are the following. In fact, most of them were indicated in the section *Driving and Restraining Forces*.

1. *Globalisation of supply chain and operations management.* The growing trend towards globalisation of supply chain and operations management will increase the importance of international marketing. For details, see the chapter *Internationalisation of Operations Management* in the author's *International Business* (Prentice-Hall of India).

2. *International investments.* The continuing high levels of international investments and increasing international production tend to increase the importance of international marketing.

3. *Information surge and consumer choice.* Because of the information surge, consumers are fairly well aware of the galaxy different categories of products available across the world. The consumer affluence make consumers more demanding, generating cross boarder demand.

Keegan, who observes that the world economy has undergone revolutionary changes during the past 50 years, points out that the following six major changes will continue well into this century.[37]

4. *World growth.* World economy would grow fairly fast. The developing countries have been growing much faster than the developed ones and this trend would continue.

5. *Domination of the world economy.* One of the major changes is the emergence of the world economy as the dominant economic unit and the resultant decline of the power of nations like the United States to pressurise policies and behaviours of other nations.

6. *Trade cycle decision rule.* The old trade cycle model (see chapter 9), which implied that as a product matures the location of production must shift to low-wage countries, has been clarified. Keegan points out that the location of production is not dictated exclusively by wage levels. For any product in which labour is less than, say, 15 per cent to 20 per cent of total costs, the location of production of mature products may be anywhere in the world. Factors such as transportation costs,

availability of skilled labour, market responsiveness, and market access and high levels of innovation in product design and manufacturability may all indicate that the best location for production is a high-income, high-wage country.

It may be pointed out that, as against the above observations, that shift of production location happens in case of many products even now. Although Keegan has taken automobile as an example to support his point, it should be noted that the production of low end models has been shifting to developing countries like India. This trend increases the scope of international marketing.

7. *Pervasiveness of free markets*. The fall of communism and socialism and the resultant ubiquitous market economy and globalisation are stupendously expanding the scope of international marketing.

8. *Accelerating growth of global markets.* Global markets would grow at rates that were once thought impossible, driven by the high rate of growth in both the high- and low-income countries.

9. *The rise of the Internet and information technology.* International marketing is boosted by such factors as the advances in information technology and the rise of the internet. See Chapter 17 for details.

There are also some factors which tend to hamper international marketing, like the restraining forces mentioned earlier. Policies of domestic protection could restrain the growth of international marketing. For example, countries like the US, which were champions of free trade, are increasing domestic protection when they see that their interests are adversely affected by free trade.

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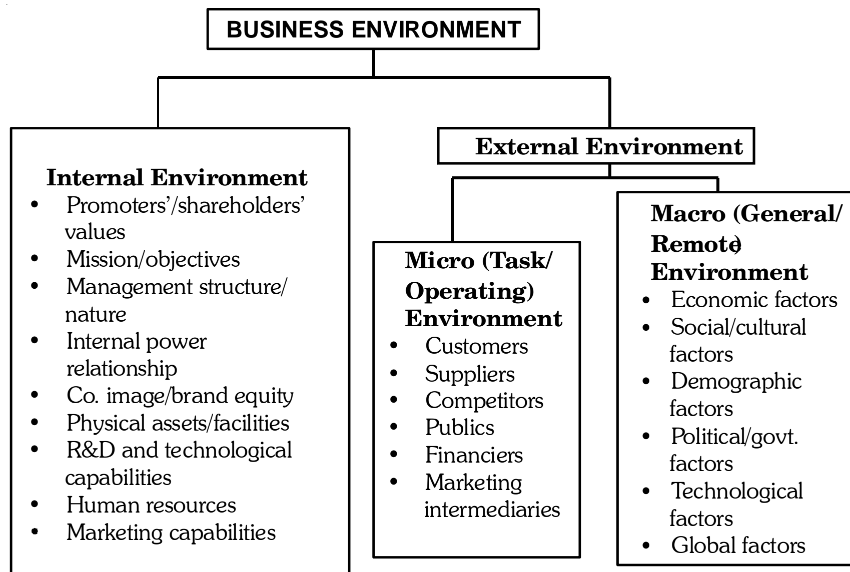
2

INTERNATIONAL MARKETING ENVIRONMENT

Marketing environment refers to all those internal (firm related) and external (market related) forces which are relevant to marketing strategy formulation. Figure 2.1 gives a summary picture of the elements of the business environment. For a detailed account, see the author's *Business Environment* (Himalaya Publishing House).



What make markets different are the differences in the marketing environment. Such strategic decisions as whether a company should enter a given foreign market or not, what market entry strategy should it employ, what strategy should it adopt in respect of product, promotion, pricing and distribution, etc. are based on two sets of factors, viz., the internal environment and external environment.

Therefore, what makes the international marketing strategy different from the domestic strategy is, obviously, the differences in the marketing environment. The strategic question, therefore, is not

whether the market is foreign or domestic but whether the business environment is same or different. If the foreign and domestic business environments are same, there is no need for different strategies. On the other hand, if there are substantial differences in the business environment within the domestic market, these may be needed for different strategies. In short, it is the differences in the marketing environment which may make the international business strategy different from the domestic one.

Box 2.1

The Environmental Challenge

"Substantial challenges face any organisation intent on getting to the future first. The first challenge, how to navigate from here to there arises, as both public and private institutions struggle to plot a course through an increasingly inconsistent environment, where experience is rapidly devalued and familiar landmarks no longer serve as guideposts. Never before has the institutional terrain been changing so quickly or have industry boundaries been so malleable. Never before have competitors, partners, suppliers and buyers been so indistinguishable. How, then, does one get to the future first even when there is no map?"

(Gary Hamel and C.K. Prahalad in the preface to Competing for the Future.*)*

What makes a business strategy which is successful in one market a failure in another market is often the differences in the business environment. In other words, the differences in the business environment may call for changes in the business strategies, i.e., there should be adaptation of the business strategy to suit the environment of the market.

It may be noted that significant differences in the business environment may exist even within a country, particularly if the country is geographically very vast, very populous and multicultural. The differences in the level and nature of industrialisation and economic development between different states and different regions within the states and preferences, beliefs and customs etc. of the different cultures may vary significantly, as is the case with India also. Dissimilar weather and climatic conditions, topographical factors etc. could also be decisive factors.

In short, the basic thing is not whether the market is domestic or foreign but whether the business environment of the different markets is similar or dissimilar.

It is the differences in the marketing environment between markets that calls for modifications to the marketing strategy and not whether the market is domestic or foreign.

However, in many cases the differences in business environment between nations are often more substantial than within a country. A detailed analysis of the business environment of the foreign countries is, therefore, an essential prerequisite for formulating international business strategies.

There are hundreds of cases of market failures emanating from the failure to properly understand the market characteristics and their implications for marketing and the resultant ill conceived marketing efforts. An analysis of the experience of leading American firms in the major markets of the world has identified that "the outstanding marketer is keenly aware of the variations from one market to another. He never thinks solely in terms of 'the Common Market'. He knows that countries, and even sections of countries, differ enormously in almost every factor critical to his market planning."[1]

As Cateora and Keaveney point out, "the key to successful international business is adaptation to the differences in the environment that usually exist from one market to another. Adaptation is not a passive process but a conscious effort on the part of the international marketer to anticipate the influences of both the foreign and domestic uncontrollable environments on a marketing mix and then to adjust the marketing mix to minimise their effects."[2]

Box 2.2

The Problem Self-reference Criterion

A root cause of many wrong decisions in international business is what is described by Lee[3] as the ***self-reference criterion*** **(SRC)** in making decisions. SRC connotes an unconscious reference to one's own cultural values, experiences and knowledge as the basis for decisions. The SRC is one of the most difficult to break. Lee proposes a systematic four-step framework for eliminating this form of myopia.

- Define the problem or goal in terms of home-country cultural traits, habits, and norms.
- Define the problems or goal in terms of the foreign cultural traits, habits, and norms.
- Isolate the SRC influence in the problem and examine it carefully to see how it complicates the problem.
- Redefine the problem without the SRC influence and solve for the foreign market situation.

There are a number of examples of even mighty multinationals tasting bitter failure because of their failure to adapt to the idiosyncrasies of the foreign markets. In many cases it was the SRC which doomed them to failure. For example, Procter & Gamble. (P&G) stormed into the Japanese market with American products, American managers, American sales methods and promotion strategies. The result was disastrous until the company learnt how to adapt products and marketing style to Japanese culture. P&G which entered Japan in 1973 lost money until 1987 but by 1991 Japan became its second largest foreign market. Similarly, the American company Texas Instruments which started making semi-conductors in Japan in 1961 took an American approach to hiring, pay and benefits, dismissing the Japanese system of offering bonuses two times a year as impractical. The workers disagreed, morale crumbled and the company had trouble recruiting employees. Later, when the company adopted the Japanese methods of recruiting and reward including bonuses and a promotion system based on seniority, the situation vastly changed and in 1985 it won the Deming prize for quality control, in Japan. Apple computers and the Colgate-Palmolive products are also among those which failed in Japan as they did not adapt to the Japanese market. likely, a combination of these.

Awareness of the problem of SRC would prompt strategists to thoroughly evaluate the environment of each market and formulate strategies suitable for the market. Many companies, like McDonalds, do so in different foreign markets, including India. A study of 300 major American companies doing business in Japan has revealed that most of the successful companies entered the market with the strength of a resource-driven product, a technological lead, a new to Japan concept, a differentiated marketing strategy or most.

In short, the business environment is a very important determinant of business strategy. When the business environments of different countries are dissimilar, an international firm will have to design different strategies to suit the environments of these markets. In other words, to be successful in a foreign market, a company should establish a strong insider position based on the marketing environment there. In his famous book, *The Borderless World*, Kenichi Ohmae, the renowned management expert and author, observes that *insiderisation* is the key to success in a foreign market. "When global success rests on market-by-market functional strength, you have to play a series of domestic games against well-defined competitors. You have to become a true *insider* in that market. If the market requires a first class sales force, you have to have one. If competition turns on dealer support programs, that's where you have to excel. Some occasions do exist when doing more better is the right and the necessary course, to follow. Still there are usually opportunities to redefine these domestic games to your own advantage."[4]

A brief account of the important environmental factors relevant to international business is given below.

THE ENVIRONMENT OF GLOBAL MARKETING

In global marketing, there are three different sets of relevant external environment. A firm doing global marketing, thus, has to consider the:

- Internal environment
- Domestic environment
- Foreign environment
- Global environment

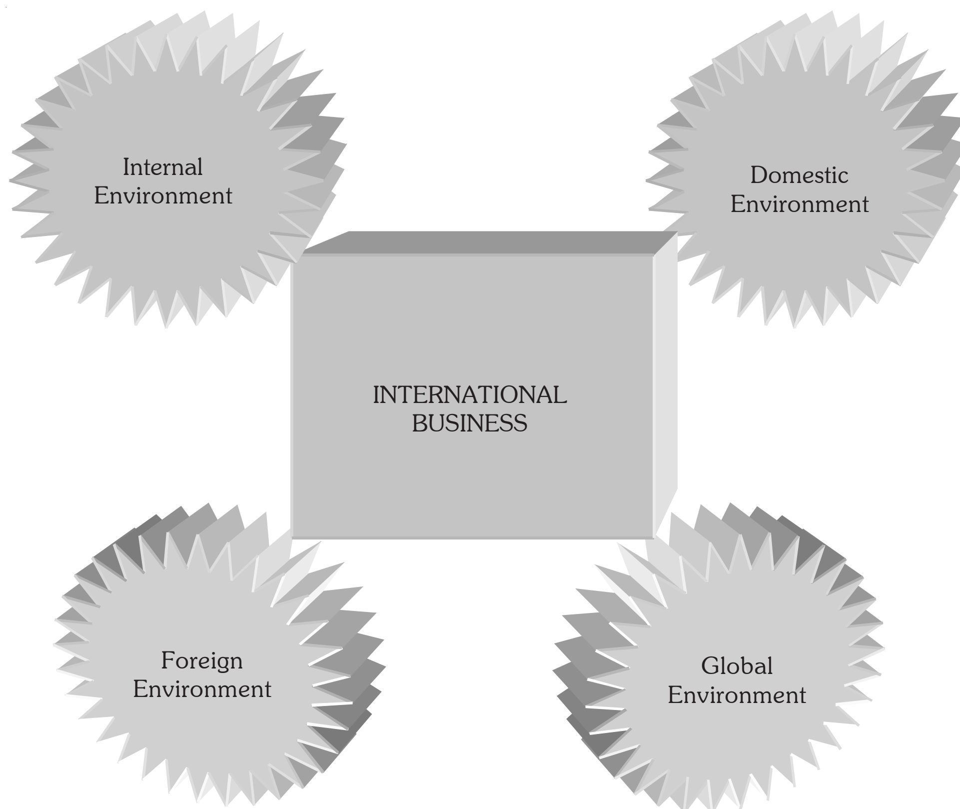


Fig. 2.1: Environment of International Business

Internal environment refers to the firm-related factors. The competence of a firm to do international business depends on a number of internal factors like the mission and vision of the firm, the attitude, capabilities and commitment of the top management and the entire people in the organisation, organisational structure and decision taking and implementing factors, financial and other resources and capabilities. International business demands strict adherence to production and delivery schedules, commitment to quality, quick and effective response to customer requirements, cost competitiveness, innovativeness etc. The internal environment has a lot of bearing on all these.

A company which wants to do or does business abroad has a relevant domestic (home country environment). For example, there may be government policies/regulations governing foreign business of domestic companies, such as those pertaining to foreign trade and investment. In many cases the domestic micro and macro environments have a bearing, but in some cases it is the macro environment that is mostly important. For a company which does not manufacture or source any thing domestically for the foreign business, the domestic micro environment may not be very relevant. (It may also be noted that in several cases the decision to manufacture domestically any thing for the foreign market is based on an assessment of the domestic micro environment too.)

Foreign environment here refers to the environment of the relevant foreign market. The nature of the components of the business environment may differ between different markets. For example the business environment in the US is very different from those in China, Russia, Middle East or other regions or nations. Further, the business environment may vary very widely within a foreign country. Such environmental variations are common in respect of policies and regulations applicable to foreign trade and investment and several other policies and laws governing business. The socio-cultural, demographic, economic and natural factors may vary substantially within as well as between countries. The difference in the external environment may even necessitate, in some cases, modification of the internal environment.

The global environment refers to those global factors which are relevant to business, such as the WTO principles and agreements; other international conventions/treaties/agreements/declarations/ protocols, etc.; economic and business conditions; impacts of major developments like war, substantial fluctuations in oil prices; sentiments in other countries etc. Similarly, there are certain developments which have global impact, like substantial fluctuations in the crude oil price, global economic meltdown (for example, the global economic crisis that erupted in the second half of 2008 resulting in a fall in global trade in 2009, among other things)/boom, war or major political developments, etc.

An Indian company which wants to globalise would have to adopt internationally acceptable standards and practices in several respects, like accounting and reporting, governances etc. particularly if it wants to tap the international capital market or enter in to foreign collaboration. For example, if a company wants to make an ADR/GDR issue, it will have to present its external reporting according to the US GAAP (Generally Accepted Accounting Principles). Adoption of GAAP may present a different picture performance of the company.

A brief account of the important environmental factors is given below:

Economic Environment

The economic environment has much to do with the scope of business, business prospects and business strategy.

The nature and level of development of the economy, economic resources, size of the economy, economic system and economic policies, economic conditions, trends in the GNP growth rate and per capita income, nature of and trends in foreign trade, domestic supply and demand conditions are all factors relevant to business.

The nations of the world are broadly classified as developing countries (or less developed countries — LDCs) and developed countries (or more developed countries — MDCs).

Nearly three-fourths of the total number of nations of the world are developing countries, inhabited by about 85 per cent of the world population. Of the 216 economies listed by the *World Development Report*, 2012, 71 were high income economies and all the remaining were developing countries.

The developing countries fall into two categories, viz., *low income countries* and *middle income countries*. The developed countries are *high income countries*. While most of the high income economies are industrial economies, some of them, like Kuwait and Saudi Arabia, are oil exporters. *Low income economies* are those with a GNI per capita of $ 1,035 or less in 2012. Within the group of the low income economies, the United Nations has identified a special category, namely *least developed countries*, most of whom suffer from one or more of the following constraints: a very low GNI per capita, landlocked, remote insularity, desertification and exposure to natural disasters. There were 32 low income economies in 2013.

Middle income economies are those with a GNI per capita of more than $ 1,035 but less than $ 12,616 in 2012. The middle income economies are divided into two categories,

viz., lower middle income (with GNI per capita between $ 1,035 and $ 4,085) and upper middle income (with GNI per capita between $ 4,086 and $ 12,616).

High income economies are those with a GNP per capita of $ 12,616 or more in 2012.

The developed economies as a group are sometimes referred to as the North as they, with some exceptions like Australia and New Zealand, are in the northern hemisphere and the developing economies are referred to as the South as most of them are in the southern hemisphere.

The differences in the levels of development and income have implications for the business.

In the developing countries, particularly in the low income economies, the demand for many categories of goods and services is limited because of the low levels of income. Even products which are regarded as essential in advanced economies are regarded as luxuries in these countries, like, for example, refrigerator, TV, or even an electric fan. Import or production of such items may not be allowed or encouraged by the governments of these countries. The price and consequently the demand for them may be affected by high taxes on them because of their categorisation as luxuries.

Many developing countries suffer from severe balance of payments problems. Therefore, their import policies, in general, are very restrictive.

A number of developing countries, however, hold out very good prospects for business in future because of three reasons, viz.,

(*i*) A steady increase in population,

(*ii*) Increase in income,

(*iii*) Growing democratisation and individual freedom.

It may be noted that the economic growth rates of several developing countries, like the newly industrialising countries (NICs) like South Korea, Taiwan, Hong Kong and China have been enviable. A number of other developing countries have also been trying to get into the fast track by reforming their economic policies. As pointed out in Chapter 1, under the section *The Growing Economic Power of Developing Countries*, the share of the developing countries in the increase in the world income has been growing and it would continue in future.

The developed economies are characterised by high levels of income and consumption and business competition. Foreign trade is more liberal in comparison with that of most of the developing countries. Import restrictions are confined, by and large, to import competing industries.

The markets for many products in these economies are nearing saturation or have already saturated or are even declining mostly because of the population trends.

While the advanced economies are characterised by high level of competition in the industrial sector and fast technological changes and innovation, most developing countries lag behind in these respects. Obsolete technologies are not uncommon in the LDCs. Companies in the developed economies even viewed the developing countries as a market for obsolete technologies and products.

The differences in the income levels may necessitate product and price modifications. The *Aero* Shoes' *Woodland* range of shoes, the replica of the well-known US brand *Timberland,* has been introduced in India for less than one-third of the US price, although the Indian target is the upper segment of the market.

In countries where the income levels are low, the scope for charging a price as high as in the high income economies would be limited. Cost reduction may become essential for price reduction. In many cases, considerable reduction in cost can be achieved by manufacturing the product in the developing country where the labour cost is low. Cost reduction may also be achieved by reducing packaging costs. Low cost models without the frills may be appropriate for markets with low incomes.

It may also be noted that in some of the very populous low income countries, there exists significant demand for high value items. For example, although India is a low income economy, there is a good market for many high value products. If five per cent of the Indian population is well off, the absolute number (about 50 million) is larger than the total population of many of the developed countries. No wonder, companies have introduced in India refrigerators, television sets etc., with substantially high price tags.

A developing country firm intending to do business in the advanced and competitive markets must bear in mind the fact that the environment in such markets may be different from that in the domestic. Product quality, features, styling and finish, packaging etc., are very important for success in these markets. In case of some products, *agarbathis* for example, the cost of packaging may be higher than the cost of the product without the package. The increased cost of improved quality, features, packaging etc. would be more than compensated by the higher price chargeable from the foreign market.

In many developing countries, the demand for several products is limited by, among other things, the absence or inadequacy of use facility characteristics. For example, the demand for electrical appliances is affected by the extent of electrification and power supply; the demand for TV sets is affected by the extent of telecast coverage. It may be noted that the colour telecast started in India only in the early 1980s, until some years prior to that even the black and white telecast was confined to a few metropolitan cities.

The difference in the level of development may cause a difference in the nature of demand for a product. In the developed countries most of the households possess consumer durables like automobile, refrigerator, radio, TV and a number of other household appliances. As the population has almost saturated, the major part of the demand for these products consists of *replacement demand* and the share of the *new demand* in the total demand is small. Similarly, the demand for most of the consumer non-durables is also from, by and large, the existing consumers. As against this, the major component of the demand for consumer durables in the LDCs is the *new* demand and the *replacement* demand, if at all, is very small. A significant share of the total demand for many consumer non-durables including such products as dental toiletries, cosmetics, newspapers and magazines, packaged food and so on is also new demand in these markets.

This difference in the nature of demand has important implications for marketing. In the developed countries, the consumers are familiar with the product and they are, generally, more capable of evaluating the products and are better equipped to make the choice. They are also capable of identifying the common problems with the product functioning and rectifying the minor problems by themselves without having to call in a serviceman. On the other hand, most of the consumers in the developing countries are new to many products; they need to be educated about the product, assured about after sales service and they may need more after sales assistance than their counterparts in the developed countries. Creation of primary demand is very important in developing countries even for products which have become quite common in the developed countries.

As replacement demand is the major component of the demand for many consumer durables in the developed countries, companies often resort to the strategy of planned obsolescence of products to keep up the demand.

All these show that the economic environment of different countries is not similar indicating that different business strategies may be required for the different markets.

The different regions of a national economy may show great diversity in the economic nature. In such cases, it may not be appropriate to regard it as a single economic unit. Kenichi Ohmae argues that "nation states are no longer meaningful units in which to think about economic activity.

In a borderless world, they combine things at the wrong level of aggregation."[5] Ohmae points out that in a borderless economy, "the units that do make sense are region-states, i.e., geographical units which are natural economic zones. They may or may not fall within the boundaries of a particular nation."[6]

Social Environment

The social or cultural environment encompassing the religious aspects; language; customs, traditions and beliefs; tastes and preferences; social stratification; social institutions; buying and consumption habits etc. are all very important factors for business. What is liked by people of one culture may not be liked by those of some other culture. One of the most important reasons for the failure of a number of companies in foreign markets is their failure to understand the cultural environment of these markets and to suitably formulate their business strategies.

Many companies modify their products and/or promotion strategies to suit the tastes and preferences or other characteristics of the population of the different countries. Significant differences in the tastes and preferences may exist even within the same country, particularly when the country is very vast, populous and multicultural, like India.

For a business to be successful, its strategy should be the one that is appropriate in the socio-cultural environment. The marketing mix will have to be so designed as best to suit the environmental characteristics of the market. In Thailand, Helene Curtis switched to black shampoo because Thai women felt that it made their hair look glossier. Nestle, today brews a large number of varieties of instant coffee to satisfy different national tastes.

Even when people of different cultures use the same basic product, the mode of consumption, conditions of use, purpose of use or the perceptions of the product attributes may vary widely so that the product attributes, method of presentation, positioning, or method of promoting the product may have to be varied to suit the characteristics of different markets.

The differences in language sometimes pose a serious problem, even necessitating a change in the brand name. Chevrolet's brand name Nova in Spanish means "it doesn't go". In Japanese, General Motors' "Body by Fisher" translates as "corpse by Fisher". In Japanese, again, 3M's slogan "sticks like crazy" translates as "sticks foolishly". In some languages, Pepsi Cola's slogan "come alive" translates as "come out of the grave". *Cue seems* to be a good brand name for toothpaste, but in French-speaking countries cue is a crude slang expression for derrieres.

The values and beliefs associated with colour vary significantly between different cultures. Blue, considered feminine and warm in Holland, is regarded as masculine and cold in Sweden. Green is a favourite colour in the Muslim world; but in Malaysia, it is associated with illness. White indicates death and mourning in China and Korea; but in some countries, it expresses happiness and is the colour of the bridal dress. Red is a popular colour in the communist countries, but many African countries have a national distaste for red colour.

Social inertia and associated factors come in the way of the promotion of certain products, services or ideas. We come across such social stigmas in the marketing of family planning ideas, use of biogas for cooking etc. In such circumstances, the success of marketing depends, to a very large extent, on the success in changing social attitudes or value systems.

There are also a number of demographic factors, such as the age and sex composition of population, family size, habitat, religion, etc. which influence the business.

While dealing with the social environment, we must also consider the social environment of the business which encompasses its social responsibility and the alertness or vigilance of the consumers and of society at large.

The societal environment has assumed great importance in recent years. As Barker observes, business "traditionally has been held responsible for quantities — for the supply of goods and jobs, for costs, prices, wages, hours of works, and for standards of living. Today, however, business is being asked to take on responsibility for the quality of life in our society. The expectation is that business — in addition to its traditional accountability for economic performance and results — will concern itself with the health of the society, that it will come up with the cure for the ills that currently beset us and, indeed, will find ways of anticipating and presenting future problems in these areas."[7]

As Stern succinctly points out, the "more educated the society becomes, the more interdependent it becomes, and the more discretionary the use of its resources, the more marketing will become enmeshed in social issues. Marketing personnel are at interface between company and society. In this position, they have the responsibility not merely for designing a competitive marketing strategy, but for sensitising business to the social, as well as the product, demand of society."[8]

In a number of countries, consumerism — "a social movement seeking to augment the rights and powers of the buyers in relation to sellers" — has emerged as a force to be reckoned with.

The number and proportion of the women in the workforce have been rising in most of the countries. However, the percentage of women working outside the household vary significantly between nations. This ratio is generally high in the advanced countries in comparison with the developing countries. Birth control has been a contributory factor in raising the proportion of women employees.

That the wife as well as the husband are working means less time and energy available for cooking at home. It is estimated that, in the US of the three meals a day, one and a half are eaten away from the home and of the remainder, half are ready prepared. It also means that the family operates differently. It is estimated that $ 40 billion in family funds is now spent by teenagers, mostly for groceries and other household items.[9] This has lot of implications for the marketers. In the developing countries, particularly, the situation would be different from that in the US

The rise in the number of double income households increases the demand for a number of products like household appliances, electronic gadgets, packaged food products, etc.

There are also several other demographic trends which have implications for business strategy formulation. While some of these trends are confined to certain countries only, the strength of other trends vary greatly between nations. For example, the number of unmarried couples living together has risen in the two decades ended 1990 from about half a million to 2.5 million in the US[10] Such a thing is quite unheard of in several countries like India.

Similarly, the high divorce rate has created over a million single parent families in the US. Most of the divorced remarry, leading to the emergence of a large number of blended families. This is not the situation in several countries where people attach more sanctity to marriage so that the marriage lasts lifelong. In countries where the culture is that a marriage relationship is to last lifelong, a company may advertise that its durable product will be a lifelong companion like one's life partner, but to use such a promotional theme in a culture where divorce rate is high and even unmarried partnerships which normally last for only short periods is common, will be a blunder.

One in four US homes now consists of a person living alone compared to about one in thirty years ago. The Census Bureau estimates that this group will continue to expand growing to 33.7 million households by 2000. Experts say these loners are more prone to impulse buying because there is no other household member to disagree with or question the purchase.[11]

In short, the social environment of different markets differ vastly. Even within a nation, cultural diversity may be very significant. It is essential to understand these differences to formulate successful business strategies.

Demographic Environment

Demographic factors such as size of the population, population growth rates, age composition, family size, nature of the family, income levels etc. have very significant implications for business.

The size of the population is an important determinant of demand for many products. There are countries with only a few lakh of people on the one hand and those with hundreds of millions on the other hand. According to the *World Development Report 1996*, there were 58 countries with a population of less than one million. India has several multimillion cities.

Poor countries with small population are generally not attractive for business. However, even such countries may hold out opportunities for some companies. As these markets may not be of interest for large companies, small firms may find promising *niches* in these markets.

Advanced countries, particularly with large population, are generally attractive markets. The major part of the international trade and foreign investments naturally take place between these nations. Because of the large potential of these markets, competition is generally strong in them.

Several high income nations, however, pose a problem for many businesses. Because of the decline in the birth rates and the consequent fall in the size of the baby population, the market for baby products has shrunk. This has prompted some companies to reposition their products (originally introduced as baby products) and to pay more importance to international business.

The declining birth rate has, however, been a boon to certain industries. For example, industries such as hotels, airlines and restaurants have benefited from the fact that young childless couples have more time and income for travel and dining out. Small families have also similar advantages when compared with large families.

Although birth rates have fallen in many developing countries, the population growth rates are still very high. This coupled with a steady increase in income drives fast the growth of the markets of a number of developing economies.

When the population is very large, even if the country is generally poor, there could be a sizeable market even for those goods and services which are regarded luxuries in these countries. For example, as pointed out in an earlier section, if just five per cent of the Indian population is well to do, the absolute number is larger than the total population of many of the high income economies.

High population growth rate also implies an enormous increase in the labour supply. When the Western countries experienced industrial revolution, the population growth was comparatively slow. Labour shortage and rising wages encouraged the growth of labour intensive methods of production. Capital intensive technologies, automation, and even rationalisation, are opposed by labour, and many sociologists, politicians and economists in developing countries. Cheap labour and a growing market have encouraged many multinationals to invest in developing countries. Many companies in the developed countries have relocated their production facilities, wholly or partially, in the developing countries to reduce the labour costs.

The problems of developing countries due to the population explosion also indicate the enormous scope for several industries. A very significant share of the Indian population is below the poverty line. Although these people, who do not have sufficient income even to meet the bare minimum basic necessities of life, do not come within the market for a large variety of goods and services, the existence of such a large size of poor population has a lot of other implications. To solve the basic problems, the additional number of children to be educated, the additional number of people to be provided with medical care, water supply etc. during one Five Year Plan in India are more than what most nations have done over centuries. While it is a formidable national challenge, it also indicates enormous business opportunities.

The occupational and spatial mobilities of population too have implications for business. If labour is very mobile between regions and occupations, labour problems are likely to be less than would otherwise be the case.

If the labour is highly heterogeneous in respect of language, religion and caste, ethnicity etc., personnel management is likely to became a more complex task. A highly heterogeneous population with its varied tastes, preferences, beliefs temperaments etc. give rise to differing demand patterns and calls for differing marketing strategies.

Some nations have been experiencing a change in the ethnic composition of the population. In some countries like the US, the immigrant population has grown quite substantially. It may be noted that a number of Indian companies have been targeting their exports at the ethnic population.

There are, thus, a number of demographic trends with implications for business.

Political and Government Environment

The political environment including the characteristics and policies of the political parties, the nature of the constitution and government system and the government environment encompassing the economic and business policies and regulations are among the factors of utmost importance in the market selection and business strategy formulation. These factors may vary very considerably between different nations.

While there are not radical differences in the philosophies of major political parties in some countries, the situation is quite different in some others. The government system in a number of countries, including several countries which are making rapid economic progress and having liberal policies towards foreign capital and technology, is not very democratic. That does not mean that they are not good to make business with. As a matter of fact, in several such countries the procedures are simpler and decisions are quicker than in some of the democratic countries.

Until the political and economic changes ushered in the late 1980s and in the early 1990s in the Eastern Europe, and erstwhile USSR, these countries were a separate block by themselves with several common characteristics. Private enterprises were very limited and State trading, particularly counter trade, was the rule. There were a lot of restrictions on imports and foreign business. This did not, of course, mean that the communist system was insurmountable for multinationals or other foreign firms. Under such a system, in several instances, winning over the top brass of the party or government was a strategy to obtain business. It may be noted that although companies like PepsiCo were kept out of India they were doing better with countries like USSR.

In the past, public sector was assigned a very important role in many non-communist, particularly the developing countries too. In India, for example, before the policy changes of 1991, 17 of the most important industries were exclusively reserved for the public sector. In addition, the public sector was to play a leading role in another 12 important industries. Thus, the industrial policy of India which wanted the public sector to gain *control over the commanding heights* of the economy limited the scope of the private enterprise, both domestic and foreign. Even in areas where foreign capital was allowed, there was ceiling on the foreign equity participation. Even after the policy liberalisation in India, the foreign equity participation is normally restricted to 51 per cent as against 40 per cent in the past.

Further, in the past, foreign firms in many developing countries were under the fear of nationalisation.

The clock, however, has turned a full circle in most of the communist and many other countries. Privatisation has progressed at an amazing speed. More than 8,500 state owned enterprises (SOEs) in over 80 countries were privatised in the 12 years ending in 1991 and the trend continues. The erstwhile communist countries and the Peoples' Republic of China, where the communist party is still in power, are on the rapid road from mark to the market.

As against the past suspicion of and antagonism against foreign capital and technology, a large number of the developing countries, including the former communist ones, are in a competition to woo foreign capital and technology. As a result, there has been an influx of foreign investment to these countries.

Although the trend of the direction of government policies across the world appears to be broadly one of convergence, there are lots of differences in the restrictions and regulations of business, scope of foreign business, trade policies, procedures, incentive systems and so on.

Hostilities between some countries affect business of firms even in third countries. Arab nations, for example, did not do business with firms having dealings with Israel. These countries even insisted that third country firms who wanted to do business with them must produce an Israel boycott certificate. Because of the political ties with Israel, the US government had adopted countervailing laws to prevent the US firms from complying with this boycott.

Some countries also demand a *certificate of origin* of the imports to the country.

There are also wide variations in the policies and regulations regarding the conduct of the business. For example, certain trade practices or promotional methods/strategies allowed in some countries may be regarded as unfair by the laws of some other countries. In many countries, there is a lot of restriction on the use of the media. Radio and television, in particular, are under State monopoly or under strict state control in a number of countries. The advent of cable TV, however, is creating problems for regulation.

Many governments specify standards for products to be marketed in the country. Marketing of certain products are even banned in some countries. Policy or regulations regarding quality control and inspection vary considerably between nations. Such is the case with packaging and labelling.

Promotional activities are subject to government controls in almost every country. However, the nature, extent and severity of the controls vary widely.

In most of the countries, product promotion is subject to various types of controls. For example, in India, *Doordarshan* does not entertain advertisements of certain products like alcoholic drinks; cigarettes, cigars, beedies and pan masala; baby food etc. Alcoholic drinks are not allowed to be advertised in other media too. In many countries, including India, the package and advertisements of cigarettes shall carry the statutory warning that cigarette smoking is injurious to health. Baby food marketers are not allowed to promote the product as a substitute for breast feeding.

In some countries, product comparison advertisements and use of superlatives like *best, better* etc. are not allowed. Use of children to endorse products is banned in some countries. In the United States, the Federal Trade Commission (FTC) may require the company to provide sufficient evidence to substantiate the company's claims regarding quality, performance etc. In India, several unfair trade practices like false advertisements, misleading presentation of the product etc. are controlled under the Competition Act.

Regulation of the quality, prices, packaging, labelling etc. is also very common.

Technological Environment

The type of technology in use, the level of technological developments, the speed with which new technologies are adopted and diffused, the type of technologies that are appropriate, the technology policy etc. are important to business.

The international product life cycle described in Chapter 10 shows how the production locations and trade flows shift at different stages of the product life cycle.

Advances in technology may also cause relocation of production. For example, several companies in the advanced countries had shifted the TV production to developing countries to take advantage

of the cheap labour. However, when further technological developments reduced the labour content of the TV, some firms relocated their production back to the developed countries.

Some labour abundant countries have a preference for labour intensive technology. Mechanisation and automation may be opposed in such countries. Such a situation may adversely affect the business.

Particularly in the past, several countries, like India, did not have a favourable attitude towards foreign technology. The overemphasis on the development of technology indigenously had led to high costs and distorted developments. Again, the policy bias in favour of small business has resulted in production units of uneconomic size in a number of industries. Further, the reservation of certain products exclusively for the small scale sector promoted several companies, including multinationals, to resort to such strategies as franchising and contract manufacturing in some of these industries in India. The reservation of products for the small scale sector sometimes comes in the way of adoption of modern technology if it involves capital investment higher than the specified limit.

In many developing countries, including India, the TV arrived very late. Although the colour TV had become quite common in the advanced and even in some developing countries when the telecast started in India, in the early period there was only black and white telecast. The cable TV came to India only by about the beginning of the 1990s. The late introduction and the slow expansion of the telecast affected not only the TV business but also the advertising industry and product promotion.

The time lags in the introduction of technologies may even result in some products not being able to reap the market. The electronic typewriter became popular in India before the electric typewriter could penetrate the market. The electronic typewriter could not achieve growth because of the advent of the computer.

Many companies in advanced countries have considered the developing countries as a market for their obsolete technology. Several developing countries even import second hand plant and machinery.

There is often a time lag between countries in the adoption and diffusion of technologies. The developing countries generally lag behind the developed ones. Even among the developed countries, the technology absorption is not simultaneous and similar. The lag has, however, been diminishing in several cases. Ohmae points out that black and white television sets extensively penetrated households in the United States nearly a dozen years before they reached comparable number of viewers in Europe and Japan. With colour television, the time lag fell to about five or six years for Japan and a few more for Europe. With video cassette recorders, the difference was only three or four years — but this time Europe and Japan led the way, the United States, with its focus on cable TV, followed. With the compact disc, household penetration rates evened up after only one year. Now with MTV available by satellite across Europe there is no lag at all.[12]

Technological environment of the use facilities etc. also have very important implications for business. For example, advances in the technologies of food processing, packaging and preservation, transportation etc. have facilitated product improvements and introduction and have considerably improved the marketability of products. The advent of microwave ovens has given a new dimension to food marketing. It is expected that in the US by the end of 20th century nearly 90 per cent of the households will be using microwave ovens. Experts predict that by the turn of the century, in-home preparation of the main evening meal will take only fifteen minutes.[13] In the early days, anything microwaveable was O.K. Now consumers are looking for more quality and even more convenience. Herb Baum, President of Campbell, USA, points out that any time you offer a product with a cooking time greater than five minutes, you are getting into a border line of inconvenience. In terms of packaging, there will be a tremendous move to microwave containers which will offer the consumers the option of using the package as both the cooking and serving vessel.[14]

Thanks to writers like Schumacher, the concept of appropriate technology became popular in the developing world. Intermediate technology, which often means a technology which combines elements of traditional technology with elements of modern technology, gained importance in the developing countries. Thus, the sophisticated capital intensive technologies in use in the developed countries are not acceptable in some sectors in several of the developing countries. An Indian company, Mekins Agro Products Ltd., with designs from International Crop Research Institute for Semi Arid Tropics (ICRISAT), Hyderabad, introduced easy to maintain bullock-drawn agricultural equipment in India. It has been exporting them to other developing countries with comparable agrarian environments.

Differences in the technological environment may call for product modifications.

INTERNATIONAL TRADING ENVIRONMENT

International trade accounts for the major part of the international business. Certain other forms of international business, like international investment, may also be affected by international trade. The international trading environment is, therefore, a very important factor affecting international business. The trading environment affects not only the exports and imports but also other factors such as international investment and financial flows.

The international trading environment includes important factors such as trade barriers, trade agreements, trading blocs, cartels and multinational trade negotiations.

TRADE BARRIERS

One of the most important features of the international trading environment is the proliferation of the trade barriers.

The main objectives of imposing trade barriers are to protect domestic industries from foreign competition, to promote indigenous research and development, to conserve the foreign exchange resources of the country, to make the balance of payments position favourable, to curb conspicuous consumption, to mobilise revenue for the government and to discriminate against certain countries.

After the Second World War, there was a progressive liberalisation of trade by the developed countries. Successive rounds of negotiations in the GATT have cut tariffs on trade in manufactures from an average level of 40 per cent in 1947 to about 3 per cent in the 1990s in the industrial countries.

Even though the process of elimination of the tariff barriers has continued, since around the mid-1970s the liberalisation trend in the developed countries has been replaced by a growing protectionism. A number of problems like the currency crisis, oil crisis, debt crisis, recession, high unemployment and trade deficits produced an atmosphere in which demands for protection increased dramatically. Added to these has been the growing competition from Japan and the newly industrialising countries. As a response to this, the developed countries have increased the non-tariff barriers (NTBs). In addition to the *hard-core* NTBs such as quotas, voluntary export restraints, multifibre arrangements (MFA) etc., these include measures such as price restraints and health and safety regulations. The exports of developing countries have been hit much more than those of the developed ones by such protectionism. The NTBs grew substantially and by 1987, they affected almost one-third of the OECD imports from developing countries. There has been a further growth of the restrictions in recent years. According to World Bank estimates, the restrictions cost developing countries at least $ 40 billion a year in forgone exports of goods and services and they reduced the developing countries' GNP by 3 per cent — an annual loss of $ 75 million.[15]

There are, broadly, two types of trade barriers, viz., tariff barriers and non-tariff barriers.

Tariffs

Tariffs in international trade refer to the duties or taxes imposed on internationally traded goods when they cross the national borders.

As noted above, after the Second World War, there has been a reduction in the average level of tariffs in the advanced countries. However, the tariff rates are generally high in the developing countries. With the recent economic liberalisation across the world, many developing countries have reduced the tariff rates and NTBs as part of their trade liberalisation.

India has had one of the highest tariff walls in the world. The government, following the recommendation of the Tax Reforms Committee (Chellaiah Committee) steadily reduced the peak level of tariffs from over 300 per cent in 1991 to 50 per cent in 1995. Further, import duties on capital goods, project imports, basic feed stocks for petrochemicals, etc. were brought down. The government proposes to further reduce the average and maximum tariffs and simplify and rationalise the tariff structure in order to bring the country's tariff structure in line with those of other developing countries.

Non-tariff Barriers

Non-tariff barriers (NTBs), some of which are described as new protectionism measures (as against tariffs which are regarded as traditional barriers), have grown considerably, particularly since around the beginning of the 1980s. The export growth of many developing countries has been seriously affected by the NTBs.

Types of NTBs

The NTBs are of two categories. The first category includes those which are generally used by developing countries to prevent foreign exchange outflows or result from their chosen strategy of economic development. These are mostly traditional NTBs such as import licensing, import quotas, foreign exchange regulations and canalisation of imports.

The second category of NTBs are those which are mostly used by developed economies to protect domestic industries which have lost international competitiveness and/or which are politically sensitive for governments of these countries. One of the most important new protectionism measures under this category is the voluntary export restraint (VER).

There are different forms of NTBs. The NTBs which have significant restrictive effects are described as hard-core NTBs. These include import prohibitions, quantitative restrictions, voluntary export restraints (VERs), variable levies, multifibre arrangement (MFA) restrictions, and non-automatic licensing. Examples of NTBs excluded from this group include technical barriers (including health and safety restrictions and standards), minimum pricing regulations, and, the use of price investigations (for example, for countervailing and anti-dumping purposes) and price surveillance.[16]

A brief account of the important NTBs are given below:

Quotas

Quantitative restrictions which take the form of quotas is a very important traditional means of restricting imports and exports. The impact of quota is drastic in comparison with tariffs. Economists, therefore, normally prefer tariffs to quota.

There are import quotas and export quotas.

A quota on the export of a product from a country may be imposed if the government feels that exports in excess of that will affect interests of the domestic consumers. Sometimes, an export quota is the result of an international commodity agreement (described in a following section of this chapter).

The aim of import quota, obviously, is to restrict the quantity of imports. The quantitative restriction may be to protect the interests of the domestic producers or to conserve foreign exchange resources. Important types of import quotas are described below.

(i) Tariff Quota: A tariff quota combines the features of the tariff as well as of the quota. Under a tariff quota, the imports of a commodity up to a specified volume are allowed duty free or at a special low rate; but any imports in excess of this limit are subject to duty or a higher rate of duty.

(ii) Unilateral Quota: In a unilateral quota, a country unilaterally fixes a ceiling on the quantity of the import of a particular commodity.

(iii) Bilateral Quota: A bilateral quota results from negotiations between the importing country and a particular supplier country, or between the importing country and export groups within the supplier country.

(iv) Mixing Quota: Under the mixing quota, the producers are obliged to utilise domestic raw materials up to a certain proportion in the production of a finished product.

Licensing

Quota regulations are generally administered by means of licensing.

Under the import licensing system, the prospective importers are obliged to obtain a licence from the licensing authorities: the possession of an import licence is necessary to obtain the foreign exchange to pay for the imports. In a large number of countries, import licensing has become a very powerful device for controlling the quantity of imports — either of particular commodities or aggregate imports. Exports of certain products may also be regulated by licensing.

Voluntary Export Restraints

Voluntary export restraints (VERs) are bilateral arrangements instituted to restrain the rapid growth of exports of specific manufactured goods. The United States and the European Community have, thus, regulated the imports of several products.

Under the VERs, the exporting country voluntarily restrains the export of the specified product in order to either help the other country to reduce its trade deficit or to protect domestic industry (of the importing country). VERs are adopted under pressure from the importing country.

The recent advances in VERs and other new protectionism measures dates from the establishment of the Multifibre Arrangement (MFA) in the mid-1970s. Other bilateral arrangements have involved mainly restraining the growth of specific exports from Japan and the newly industrialising countries (NICs).

One of the significant achievements of the Uruguay Round is the agreement to end the MFA; the MFA is to be phased out over a period of ten years since 1995. This is expected to boost the trade in textiles by about 25 per cent. The main beneficiaries of this are the textile exporting developing countries including India.

Administered Protection

Administered protection encompasses a wide range of bureaucratic government actions, which have grown in absolute as well as relative importance over the last decade or more. More recent VERs are in fact regarded as the outgrowth of administered protection actions. Mention has already been made of one of the administrative measures, viz., licensing. Other important administrative protection measures include the following.

Safeguards: Safeguard actions which under WTO Article XIX enables countries to undertake temporary restrictions against surges threatening the viability of domestic industries, have become a

common form of administered protection. Although, such measures are initially resorted to provide some breathing space and flexibility for structural adjustment, they often lead to some or other form of permanent barrier.

The Uruguay Round has sought to limit the misuse of safeguard action. The Uruguay Round Agreement which seeks to rationalise the safeguard also stipulates that a member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or similar measures on export or import trade. The Agreement however, provides for special consideration for the developing countries.

Health Standards: Several health and product standards imposed by developed countries hinder the exports of developing countries because of the added costs of technical requirements. The need for maintaining health and product standards is unquestionable. The objection should be to their use with the deliberate intention of trade restriction or discrimination.

The Agreement on Technical Barriers to Trade (also known as the Standards Code) evolved by the Tokyo Round of the GATT lays down that when governments or other bodies adopt technical regulation or standard for reasons of safety, health, consumer or environmental protection, or for other purposes, these should not create unnecessary obstacles to trade. Exporters from developing countries complain, however, that this code is not respected by developed countries in several cases.

Customs Procedures: Certain customs procedures of many countries become trade barriers. For example, studies point out that frequent changes of Japan's customs regulations are themselves a significant barrier to exporters, especially those not affiliated with Japanese overseas joint ventures.

The Tokyo Round formulated a Customs Valuation Code intended to provide a uniform and neutral system for the valuation of goods for customs purposes which will confirm to the commercial realities and to prevent the use of arbitrary or fictitious values.

Consular Formalities: A number of countries insist on certain consular formalities like certification of export documents by the respective consulate, of the importing country, in the exporting country. This becomes a trade barrier when the fees charged for this is very high or the procedure is very cumbersome.

Government Procurement: Government procurements often tend to hinder free trade. The Tokyo Round has, therefore, formulated an agreement on government procurement with a view to securing greater international competition in government procurements.

State Trading: State trading also hinders free trade many a time because of the countertrade practices, canalisation etc. State trading was an important feature of the foreign trade of the centrally planned economies and many developing countries. With the economic liberalisations in most of these countries, the role of state trading has declined.

Monetary Controls: In addition to foreign exchange regulations, other monetary controls are some times employed to regulate trade, particularly imports. For instance, to tide over the foreign exchange crisis in 1990-91 and 1991-92, the Reserve Bank of India took several measures which included a 25 per cent interest rate surcharge on bank credit for imports subject to a commercial rate of interest of a minimum 17 per cent, the requirement of substantially high cash margin requirement on most imports other than capital goods, and restrictions on the opening of letters of credit for imports.

Environmental Protection Laws: The growing concern for environmental protection has led to the extension of environmental protection regulation to the imports. For example, the US has imposed restrictions on the import of shrimp harvested with commercial fishing technology which does not use turtle exclusion device.

Foreign Exchange Regulations: Foreign exchange regulations are an important way of regulating imports in a number of countries. This is done by the State monopolising the foreign exchange resources and not releasing foreign exchange for import of items which the government do not approve of for various reasons. Restrictions on currency convertibility can also affect imports.

Miscellaneous: Exports from developing countries face problems in developed countries on such issues as use of child and sweat labour (as in carpet and clothing industries), environmental problems, etc.

Impact of NTBs

The NTBs are less transparent, difficult to identify and their impact on exporting countries is almost impossible to quantify. "It contravenes widely accepted principles of non-discrimination and transparency in measures to restrict trade principles which remain sound. NTBs usually discriminate against the lowest-cost sources of imports. Over the years, the NTBs have been becoming more and more extensive and intensive. Today, they are not confined to the labour intensive products where the developing countries have an advantage but also cover sophisticated products. Japan and the newly industrialising countries (NICs) like South Korea are among the most affected countries by NTBs. Developing country exports are also significantly affected by them. However, the NTBs have come to affect the intra-OECD (i.e., trade between developed economies) also. The NTBs tend to offset favourable effects of the GATT/WTO negotiations on trade liberalisations like the reductions in the average levels of tariffs.

As a matter of fact, several advanced countries like the USA who were high priests of free trade increasingly resort to several NTBs, particularly against the developing countries and certain countries like Japan.

NTBs seriously affect many exporting countries. As pointed out earlier, developing country exports to developed countries face considerable NTBs. In several cases, the impact is very severe. For example, the VER covering the tapioca exports of Thailand to the European Community, established in 1982, caused its tapioca exports to decline by 40 per cent and its export earnings to fall by about $ 300 million (representing somewhat over 10 per cent of Thailand's total export earnings from the EC).[17] However, such draconic VERs which not simply reduce the growth rate but the level of exports have not been widely applied to non-apparel exports of developing Asian countries other than Korea.[18]

As the Asian Development Bank study points out, "with the reduction of the average tariff levels in the industrial countries, non-tariff barriers to imports of manufactures have increased in relative importance in these countries, including in categories of labour intensive and other products for which less developed countries have a strong comparative advantage. Moreover, through the exercise of various forms of administrative protection, non-tariff barriers have increased in importance in absolute terms and have been applied with increasing discrimination, causing bilateral trade arrangements in many cases to reign over more globally efficient multilateral trade arrangements and threatening the gains, especially to less developed countries, of negotiated tariff reductions.[19]

Apparel exports is the most affected of the developing countries because of such barriers. This has been done mostly by the Multifibre Arrangement (MFA) which "constitutes a restrictive system, imposing economic costs on the economies of developing as well as industrial countries. Several of the country studies cite instances of lost apparel exports, production and employment due to reporting, certification and other problems involved in administering bilateral MFA agreements, whereby the system of administrative controls creates such uncertainties, especially for new exporters or financially weak firms, that export production must be curtailed or abandoned by many firms.[20] Another important cost of the MFA is rent seeking, i.e., established exporters tend to enjoy greater than perfectly competitive returns from their export sales since quota rights enable them to sell in protected markets.

NTBs also cause diversion of production and exports. For example, some Indian textile and apparel firms decided to set up manufacturing facilities in Nepal in order to circumvent MFA quota controls on their exports from India and to avoid the local costs of purchasing added quota rights. Similarly, exporters have attempted to diversify their exports to non-quota countries.

NTBs and India's Exports

The problem of NTBs for Indian exports has been growing.

The ADB study of the effects of NTBs on India's exports to developed countries has come to the following conclusion.[21]

Conventional NTBs generally do not exist in developing country markets at least for Indian exports. Their impact on exports of marine products and leather and leather manufactures to developed economies is somewhat marginal. Their potential adverse effects on India's emerging exports of temperate zone agro-products can be critical. Exports of metal manufactures and ready-made garments from India have suffered on account of the NTBs in developed economies. Extension and intensification of NTBs is bound to severely restrict India's export expansion in these two relatively important export sectors of the economy. Apart from the actual imposition of these NTBs, the "noise" created is often adequate to drive out exporters and induce a fall in exports. NTBs and their administration bring about undesirable changes in the structure of domestic industry and in the distribution of rewards between rent, profit and wage incomes. The uncertainty they create clearly has an adverse effect on capacity creation and investment in the industry. As a factor responsible for an investment shortage, NTBs prevent the industry from making full use of technological potential and economies of scale. These facts were unambiguously brought out in the findings of survey of garment firms in India.

The above-mentioned study has also pointed out that in the case of NTBs, Indian exporters had not taken full advantage of the scope which existed. Thus, improvements in domestic capability will surely yield export expansion at least in the short run.

The problem for NTBs for Indian exports has increased recently. The threat under the *Super 301* and *Special 301* is an indication of this. The indications are that India may have to face more problems in future. NTBs are often employed when a country's exports to a country increases considerably causing problems to the industries in importing country or when the exporting country does not toe the economic or political lines of the powerful importing country.

COMMODITY AGREEMENTS

International Commodity Agreements are inter-governmental arrangements concerning the production of, and trade in, certain primary products with a view to stabilising their prices.

Commodity agreements have been tried in different cases for quite some time now. "The worsening for primary product exporters of their terms of trade in the second half of the fifties, their lagging export earnings, inadequate reserves, mounting external indebtedness, and the consequential frustration of plans for rapid economic developments caused these countries to cast around for ways of escaping from their predicament. Out of this search came the idea that commodity agreements could be used as a way of raising (or halting a fall in) the world prices of commodities, and in this way of transferring income from consuming to producing countries."[22]

In its Final Act, the UNCTAD-I made a comprehensive statement on the functions of international commodity agreements. The commodity agreements should have, it said, "a basic objective of stimulating a dynamic and steady growth and ensuring reasonable predictability in the real export earnings of the developing countries so as to provide them with expanding resources for their economic and social development, while taking into account the interests of consumers in importing countries, through

remunerative, equitable and stable prices for primary commodities, having due regard to their import purchasing power, assured satisfactory access and increased imports and consumption as well as coordination of production and marketing policies."[23]

Commodity Agreements may take any of the four forms, namely, quota, buffer stock, bilateral contract, or multilateral contract.

Quota Agreements

International quota agreements seek to prevent a fall in commodity prices by regulating their supply.

Under the quota agreement, export quotas are determined and allocated to participating countries according to some mutually agreed formula, and they undertake to restrict the export or production by a certain percentage of the basic quota decided by the central committee or council. For instance, Coffee Agreement among the major producers of Latin America and Africa limited the amount that could be exported by each country.

Quota agreements have already been tried in case of coffee and sugar, and commodities like tea and bananas have been suggested as prospective candidates for new agreements.

It has been pointed out that quotas "are bad theoretically because they imply misallocation of resources. They protect inefficient producers, freeze markets, and probably keep supplies below the optimum level."

Quotas have the advantage, however, of being manageable. "They avoid accumulation of stocks, require no financing and do not call for continuous operating decisions. Some past base year, however arbitrary, can usually be made to serve as a standard to facilitate delicate decisions. In practice, quotas would probably have to be combined with buffer pools in order to provide the necessary short-run flexibility of supply."[24]

Buffer Stock Agreements

International buffer stock agreements seek to stabilise commodity prices by maintaining the demand-supply balance.

Buffer stock agreements stabilise the price by increasing the market supply by the sale of the commodity when the price tends to rise and by absorbing the excess supply to prevent a fall in the price. The buffer stock plan, thus, requires an international agency to set a range of prices and to buy the commodity at the minimum and sell at the maximum.

The buffer pool method has already been tried in case of tin, cocoa, and sugar, and commodities like rubber, tea and copper have been suggested as prospective candidates for new agreements.

The buffer stock arrangements, however, suffer from certain limitations. It can be effected only for those products which can be stored at a relatively low cost without the danger of deterioration. Further, large financial resources and stocks of the commodity are required to launch the programme successfully. It has, moreover, been pointed out that "in the absence of production and export quotas to protect the buffer pool, there is always the prospect that some countries might use it to create easy foreign exchange for themselves. Export subsidies and special exchange rates might provide the means to that end. Finally, the present division of the world into different currency areas would hamper the functioning of buffer pools."[25]

Bilateral/Multilateral Contracts

Bilateral contract to purchase and sell certain quantities of a commodity at agreed prices may be entered into between a major importer and exporter of the commodity. In such an agreement,

an upper price and a lower price are specified. If the market price, throughout the period of the agreement, remains within these specified limits, the agreement becomes inoperative. But if the market price rises above the upper limit specified, the exporting country is obliged to sell to the importing country a certain specified quantity of the commodity at the upper price fixed by the agreement. On the other hand, if the market price falls below the lower limit specified, the importer is obliged to purchase the contracted quantity at the specified lower price.

Such international sale and purchase contracts may also be entered into by two or more exporters and importers. Bilateral/multilateral agreements are usually concluded between the major supplier(s) and the major importer(s) of the commodities.

The best known example of this type of commodity agreement is the *International Wheat Agreement*, which fixed the maximum price at which the exporting countries guaranteed to supply stipulated amounts of wheat to the importing countries, and the minimum price at which the importing countries agreed to purchase fixed amounts of wheat from the exporters.

As Wallich points out,[26] this type of agreement has the advantage of preserving the free market as an allocator of resources and an indicator of trends, provided that not all the supplies are covered by it. The technical problems of the contract are quite manageable, although difficulties grow as the agreement is drawn tighter to make it more effective. The contract has the grave disadvantage, however, of creating a two price system. It requires domestic controls of some sort and a buffer stock to implement it, and it is quite apt to put the participating governments into the commodities' business. In an extreme case, it may become nothing but a payment by the government of one country to that of another without ever touching the producer or consumer.

The experiences of the post-war market stabilisation schemes indicate that a combination of different control techniques is likely to be more effective than reliance on a single technique alone.

CARTELS

Existence of international cartels hamper free trade in the concerned products. International cartels are agreements between producers located in different countries or between governments of different countries to restrict competition.

Although the main aim of a cartel, normally, is to control prices, this is often accompanied by output and investment quotas for making the price control effective.

Cartels are common in the market structure known as oligopoly which is characterised by a relatively small number of firms. As Wilson observes, "it is characteristic of this type of market that firms tacitly collude to keep out potential competitors and to reduce the degree of competition between themselves. Although these firms do not formally agree on these policies, they carry them out implicitly because it is in their mutual interest to do so."[27]

While domestic cartels are often prohibited or controlled by the respective governments, international cartels are often sponsored or sanctioned by the governments of the countries concerned. Examples include the Organisation of Petroleum Exporting Countries (OPEC) and International Air Transport Association (IATA), a cartel of major airlines established to set up air fares and restrict competition.

Cartels should be distinguished from International Commodity Agreements. The cartel is basically a unilateral decision by producers to cooperate while a commodity agreement, in principle, includes consumers in the negotiations, although in practice consumers (as opposed to consuming governments) have little direct say in their operation.

It may also be noted that although the major objective of a cartel is to raise price and restrict competition, it may have other goals as well. For example, to develop the industry in a broader sense or, as in the case of the OPEC, to act as a distributor of international aid.

Although cartels were not new, it was with the quadrupling of the price of oil in the early 1970s and the arrival of OPEC as an effective cartel in the oil market that cartels began to receive considerable attention. "Developed countries were anxious to establish whether OPEC would be able to survive, and less developed countries were interested in the possibilities for replicating its example in other commodities exported in the main by poor countries."[28] After remaining as a powerful force for many years the OPEC began to weaken due to several reasons including conflict of interest and finally its disintegration appeared to have started with the decision of Ecuador to pull out of the 13-member OPEC.

STATE TRADING

In the words of the Report of the Committee on State Trading, Government of India, state trading means import and export transactions of a state owned or state controlled agency involving purchase of goods for commercial resale. In a broader sense, state trading also includes purchases from abroad for governmental use and disposal of surplus stocks originally purchased by government.

In the centrally planned economies, state trading was, naturally, the rule. In many non-communist developing countries like India, state trading was assigned an important role for the development of foreign trade and to protect certain other national interests. Indeed, in the past the communist countries tried to use the foreign trade policy to encourage state trading by developing countries. In fact, one of the objectives of establishing the State Trading Corporation of India (STC) was to expand the foreign trade with the centrally planned economies.

It may be noted that the recent economic reforms in the centrally planned economies and other developing countries have significantly reduced the role of state trading.

State Trading in India

The Government's role in foreign trade is not confined to import and export controls, export promotion and import substitution measures. It directly participates in the import and export business through its agencies like the State Trading Corporation of India (STC), the Minerals and Metals Trading Corporation of India (MMTC), and the Mica Trading Corporation of India (MITCO) which have been set up by the Government of India to engage in import and export business in specified areas. In course of time, they came to account for more than one-fifth of India's foreign trade.

The State Trading Corporation of India Ltd. was established in 1956, primarily to deal with bilateral trading partners in East European countries. The objectives of the STC, as envisaged by the Government, were:

1. To help reduce the difficulties experienced in expanding trade with centrally planned countries;
2. To help maintain quantitative regulations of imports and some equilibrium in the prices of commodities and indigenous products;
3. To provide developmental finance for organised production and boost exports of small scale sector;
4. To check unhealthy competition and undercutting of prices in international markets;
5. To organise integrated developments of production, transport and port facilities in respect of bulk commodities;
6. To promote the production of non-traditional items and open up new fields for the export of traditional items;
7. To undertake internal trade as and when the situation warrants it;
8. To ensure adequate and regular supplies at reasonable and stable prices of essential commodities to meet local demand;

9. To effect exports and imports at more favourable prices through increased bargaining power;
10. To stimulate the production of essential agricultural and industrial commodities by means of price and other incentives;
11. To facilitate the import of goods under foreign aid programmes.
12. To facilitate the implementation of trade agreements and barter deals; and
13. To act as a vehicle for the implementation of government policies.

Later, the STC was asked to pay due attention to the development of non-canalised exports and for the development of new products and markets for exports.

The STC has some subsidiaries (Projects and Equipments Corporation; Cashew Corporation of India; Handicrafts and Handlooms Exports Corporation of India and Central Cottage Industries Corporation).

The Minerals and Metals Trading Corporation of India Ltd. (MMTC) established in 1963 as a subsidiary of the STC, was later made independent of the STC and further quite sometime later it was made a general trading house (instead of confining to minerals and metals trading).

Reorientation of the Role

Canalised trade was the mainstay of the public sector trading houses. As pointed out earlier, with the new trade policy, the scope of canalisation has been substantially reduced. In this context, the government has clarified that the objectives of public sector trading organisations would be reoriented towards their emerging as international trading houses capable of operating in a competitive global environment, of serving as effective instruments of public policy and of providing adequate support to the small scale/cottage industries.

Canalisation

State trading is often associated with *canalisation*. Canalisation means establishment of state monopoly in foreign trade. In other words, an item that is canalised can be imported or exported, as the case may be, only by the designated state trading agencies. The emphasis is on the control of foreign trade flows rather than on the ownership of the organisation or agency conducting it.

State trading agencies may also trade in products which are not canalised, in addition to the canalised items. Thus, while canalisation essentially means state trading, there may also be state trading without canalisation.

Most of the objectives of the state trading mentioned earlier are also the objectives of canalisation. Canalisation also has, obviously, the disadvantages of state trading mentioned earlier.

It is pointed out, "for a majority of developing countries, the basic rationale behind establishing canalising agencies was more socio-economic and geo-political than economic. Several of them adopted an ideological approach towards establishing them. In their post-independence zeal, many developing countries decided that the critical means of production should be in the hands of the public. Espousing import canalisation was a part of this thought process. There were various objectives for setting up canalising agencies, which at times, were overlapping, irreconcilable and even confusing. One can find canalising agencies which were based totally on economic considerations, and varying combinations of the two objectives."[29]

Canalisation had grown considerably in India. The Committee on Import-Export Policies and Procedures (Alexander Committee 1978) pointed out that there were at that time 24 canalising agencies, which together handled as many as 200 products. Beginning in the early 1970s, there was a steady increase in the incidence of canalisation and during the period from mid-1970s to the early 1980s, canalised imports constituted as much as three-fifths to two-thirds of the total imports.

As the Alexander Committee[30] points out, the need for bulk purchasing, deriving optimum price for imports and exports, safeguarding the interest of the small producers, mopping up premium elements involved in trading operation in the situation of excess demand condition, provision of infrastructural facilities of generating imports and export trade at lower costs, etc. were some of the arguments for the introduction of canalisation. At one time in the history of canalisation, the nationalisation of import and export trade had also figured as an objective.

The trade and industry and a number of studies, including the reports of the Alexander Committee and the Abid Hussain Committee, have expressed clear dissatisfaction about the canalisation system. This encouraged the government to decanalise a number of items. A trend towards decanalisation was set in with the Exim policy for 1985-88 which decanalised 53 times of import which did not meet the criteria for canalisation. The Export-Import Policy (1992-97) has significantly pruned the list of canalised items.

TRADING BLOCS AND GROWING INTRA-REGIONAL TRADE

An important trend in international trade has been the growth of intra-regional trade. Intra-regional trade has been fostered by the economic integration schemes or trading blocs.

Some people view world trade as consisting broadly of intra-regional trade and inter-regional trade. There is also talk of regionalisation vs. globalisation of world trade.

The share of intra-regional trade in the total world trade increased in the 1980s in Western Europe, North America and Asia. In other words, trade within the region grew substantially faster than world trade. In 1990, intra-regional trade in goods accounted for 61 per cent of total trade in goods of the European Community, 41 per cent for Asia and 35 per cent for North America. Over 60 per cent of the trade of the Pacific Rim nations stays within the area.

Regional integration schemes tend to increase intra-regional trade. For example, trade between the 12 members of the EC increased from about 40 per cent in 1960 to 60 per cent in 1990. Intra-regional trade increased in the EFTA and ASEAN.

There is a worldwide trend towards forming new regional arrangements and to strengthen the existing ones. Inspired by the EEC, several regional integration schemes have been formed by the developing countries, particularly in the Latin America and Africa. However, none of them could become a commendable success. By the late 1970s, outward oriented policies had begun to capture the imagination of policymakers. In the years that followed, unilateral, non-discriminatory trade liberalisation became the order of the day and regionalism was pushed to the background. The situation, however, changed by the end of the 1980s and today regionalism is “back with a vengeance”. In its current incarnation, regionalism has engulfed all major players in the world economy. Latin American countries are eager to join with North America in free trade agreement. The possibility of the division of the world into three major trading blocs — America, Europe and East Asia — is seriously debated.

A brief account of the different forms of economic integration and the important integration schemes across the world are given below.

Forms of Economic Integration

Economic integration is a general term, which covers several kinds of arrangements by which two or more countries agree to draw their economies closer together. All of the arrangements have one common feature — the use of tariffs to discriminate against goods produced by countries, which are not parties to the agreement. All tariffs discriminate against foreign products. The key feature of the various agreements for integration is that tariffs are used to discriminate among different countries. This kind of discrimination is achieved by according preferential treatment to the goods produced by the other member countries.

There are several degrees or levels of economic integration. The important forms of economic integration are outlined below:

Free Trade Area

A free trade area is a grouping of countries to bring about free trade between them. The free trade area abolishes all restrictions on trade among the members; but each member is left free to determine its own commercial policy with non-members.

Customs Union

The customs union is a more advanced level of economic integration than the free trade area. It not only eliminates all restrictions on trade among members but also adopts a uniform commercial policy against non-members.

Common Market

The common market is a step ahead of the customs union. A common market allows free movement of labour and capital within the common market, besides having the two characteristics of the customs union, namely, free trade among members and a uniform tariff policy towards outsiders.

Economic Union

A still more advanced level of integration is the economic union. Apart from satisfying the conditions of the common market mentioned above, the economic union achieves some degree of harmonisation of economic policies such as monetary policy, fiscal policy, etc. This is what the European Union (EU) is striving to achieve.

Economic Integration

The ultimate form is full economic integration characterised by the completion of the removal of all barriers to intra-bloc movement of goods and factors, unification of social as well as economic policies and all the members bound by decisions of a supernational authority consisting of executive, judicial and legislative branches.

EUROPEAN UNION

The European Economic Community (EEC), also known as European Common Market (ECM), European Community (EC), and European Union (EU), is by far the most successful of the regional economic integration schemes.

The EEC which originally comprised six nations, namely, Belgium, France, Federal Republic of Germany, Italy, Luxembourg and Netherlands was brought into being on 1st January 1958, by the Treaty of Rome, 1957.

The Treaty of Rome required every member country to:

1. eliminate tariffs, quotas and other barriers on intra-community trade;
2. devise a common internal tariff on imports from the rest of the world;
3. allow the free movement of factors of production within the community;
4. harmonise their taxation and monetary policies and social security policies; and
5. adopt a common policy on agriculture, transport, and competition in industry.

The EEC was expanded in 1973 with the inclusion of the United Kingdom, Denmark and Ireland. Greece joined the Community in 1981. Spain and Portugal became members on January 1, 1986, raising the number of members to twelve. With Austria, Finland and Sweden joining the union in the early 1990s, the number rose to 15. In March 2012, the EU had 27 members.

Several more countries are eager to join the EC. To qualify for membership in the EC, a country must be European and democratic.

EC-1992

By July, 1968, a Customs Union had been established among the original six members of the EEC as they abolished tariffs on trade among themselves and imposed a common tariff schedule on imports from other countries. The community members had also taken some noteworthy steps towards approximating their economic policies including adoption of Common Agricultural Policy (CAP) in 1962 and establishment of the European Monetary System in 1979. A detailed programme for attaining a single integrated market was set forth by the EC Commission (the EC's executive body) in June 1985 in a White Paper entitled "Completing the Internal Market". The EC Council (the EC's supreme decision-making body) promptly committed the EC to carry out White Paper's programme by 1992. This programme which envisaged the unification of the economies of the member nations into a single market by removing all border barriers to trade and factor mobility and by unifying the economic policies and regulations came to be described as Europe 1992/EC-1992.

The White Paper listed 300 specific areas (subsequently reduced to 279) for action by 1992. These actions were intended to eliminate the physical, technical and fiscal obstacles to an integrated market to achieve a genuine European Community without internal economic frontiers with freedom of movement for goods, services, persons and capital.

The barriers targeted for removal pertained to the following eight categories:

1. Border control,
2. Limitations on the movement of people and their right of establishment,
3. Differing internal taxation regimes,
4. Lack of common legal framework for business,
5. Controls on movement of capital,
6. Heavy and differing regulation of services,
7. Divergent product regulations and standards,
8. Protectionist public procurement policies.

With a population much larger than that of USA and a GDP near to that of the US and much higher than that of Japan, the EC is the largest market in the world. It may be noted that a single member of the Community (Germany) emerged as the second largest exporter and importer of the world. The EC accounts for roughly a quarter of the world trade.

There was significant increase in the share of intra-regional trade of the EU members in their total trade of the EU members in their total trade. However, recently there has not been significant change in this ratio.

The unification of the EC is expected to produce great benefits to the member nations. It would lead to the restructuring of the economy of the EC and would result in efficiency improvement in production, trade creation and increase in consumption. It was estimated that over five to six years, the Community's GDP would be raised by 4.5 per cent, consumer prices reduced by about 6 per cent and employment increased by 2 million.

The transitional period, however, is likely to create some problems. For example, the structural adjustment may throw many people unemployed.

Some observers refer to the EC 1992 as the European Fortress/Fortress-92 implying that henceforth exports from non-member countries to the EC will have to encounter a mounting barrier. EC officials, however, say that the Fortress Europe story is senseless and groundless and that they will not be

tempted by protectionism. They argue that the single European market will boost world trade and growth.

It is, however, true that the real purpose of the single market is to boost the competitiveness of European industry against its rivals, particularly the USA, Japan and South-East Asian nations. This being the fact, the benefits of liberalisation will not be extended to non-EC countries in a unilateral and automatic way. Non-members who want to sell their goods and services in Europe will have to provide EC with reciprocal access to their national markets.

Euro

Euro, the common currency of European Union, was launched by 11 of the 15 members of EU on January 1, 1999. Euro currency and coins did not come into circulation until 2002, although banking and trading transactions in Euro commenced on January 1, 1999. The national currencies of the euroland nations continued in circulation until July 1, 2002, the deadline for the withdrawal of national currencies and coins.

The Treaty on European Union (Maastricht Treaty) of 1991, which set the stage for the monetary union, has set out its objectives and laid down certain eligibility criteria known as the 'convergence criteria' (or 'Maastricht criteria') for member countries to join the EMU such as maintaining budget deficit, public debt, inflation, long-term interest rate and exchange rate within defined limits.

Greece could not join the euro launch as she could not satisfy these criteria (but adopted euro as the national currency in 2001). United Kingdom and Denmark opted out, although they satisfied the eligibility criteria, due to domestic political reasons. Box 2.3 shows the period when different countries have adopted the euro. Now, euro is the national currency of only 19 of the 28 member countries of the EU. These 19 countries with a combined population of 338 million have handed over monetary sovereignty to an entity at arm's length from national politics: the European Central Bank (ECB). The other members of the EU are yet to meet the conditions for adopting the single currency and once they do so, they will be eligible to replace their national currency with the euro.

Box 2.3

Milestones in the Evolution of Euro

March 1979: The setting up of the European Monetary System based on a currency unit called ECU, designed to stabilise exchange rate and counter inflation, which marked a major step towards a single currency.

February 1986: Single European Act signed, which included provisions on a monetary union.

February 1992: The Maastricht Treaty put single European currency as a top agenda item.

December 1995: EU named the currency *euro* and started campaign to gather support.

January 1999: The euro was launched as an electronic currency. Eleven countries came on board for using the currency for non-cash purposes.

January 1, 2002: Euro notes and coins came in to circulation.

July 1, 2002: Withdrawal of national currencies and coins and their complete replacement by euro notes and coins.

The group of countries which have adopted euro as their currency is officially referred as the euro area. It is also known as euro land/euro zone. Today, the euro area represents about one-sixth of world GDP and one-fifth of world trade.

The euro is also widely used beyond the euro zone, either formally as legal tender or for practical purposes, by a whole array of countries such as close neighbours and former colonies.

Box 2.4
Adoption of Euro by EU Members – A Chronology

Year	Countries	Total Number of Countries
1999	Belgium, Germany, Ireland, Spain, France, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland	11
2001	Greece	12
2007	Slovenia	13
2008	Cyprus, Malta	15
2009	Slovakia	16
2011	Estonia	17
2014	Latvia	18
2015	Lithuania	19

Monetary and Fiscal Policies of Euro Area

The monetary policy decisions for the Euro area are made by the European Central Bank (ECB), which along with the National Central Banks (NCB) of all EU members comprise the European System of Central Banks (ESCB). The ECB is controlled by a Governing Council consisting of an Executive Board (with six members appointed by the heads of State or Governments of countries in the Euro area) and the governors of the NCBs of the euro land. In designing the EMU, the architects laid great emphasis both on the independence of the ECB and on the simplicity and severity of its anti-inflation objective. The Maastricht Treaty directs the ECB to support the general economic policies of the Community, but, crucially, without prejudice to the objective of price stability.

Some sovereignty is voluntarily pooled when a country adopts the euro, as governments must coordinate their economic policies and control their spending. It is, however, argued that in today's globalised world, national sovereignty is often more illusion than reality, particularly in the monetary sphere, where only a few dominant currencies really matter. By coordinating their policies, governments can actually gain influence and power in the economic sphere. Economically, the euro area is greater than the sum of its parts.

The fiscal policy, however, remains in the hands of individual national governments — though they undertake to adhere to commonly agreed rules on public finances known as the Stability and Growth Pact. They also retain full responsibility for their own structural policies (labour, pension and capital markets), but agree to coordinate them in order to achieve the common goals of stability, growth and employment.

Benefits of Euro

It is rightly observed that the euro is one of the strongest tangible symbols of the common identity and shared values of Europe, European nations and Europeans themselves. The purpose of Economic and Monetary Union and the euro was to facilitate the better functioning of the EU economy, bringing more jobs and greater prosperity for Europeans. It has been estimated that more than 10 million new jobs were created in the euro area within the seven years since the euro was introduced compared with only 1.5 million in the previous seven years.[30] The benefits of euro are not confined to the euro area. Euro benefits the global economy in several ways.

The European Commission adumbrates the benefits of euro as follows: Apart from making travel easier, a single currency makes very good economic and political sense. The framework under which the euro is managed makes it a stable currency with low inflation and low interest rates, and

encourages sound public finances. A single currency is also a logical complement to the single market which makes it more efficient. Using a single currency increases price transparency, eliminates currency exchange costs, oils the wheels of the European economy, facilitates international trade and gives the EU a more powerful voice in the world. The size and strength of the euro area also better protect it from external economic shocks, such as unexpected oil price rises or turbulence in the currency markets. Last but not least, the euro gives the EU's citizens a tangible symbol of their European identity, of which they can be increasingly proud as the euro area expands and multiplies these benefits for its existing and future members.

The euro as the common of many important economies is expected to significantly benefit the economies of the member countries, the business and individuals (both within and outside the euro area).

The single currency brings in a single interest rate, eliminates currency risk and gives equity and bond markets the necessary scope and liquidity to attract big investors. Europe has been expected rank alongside the US as the deepest and most liquid market in the world.

The common currency benefits consumers in several ways. It imparts price transparency throughout the euro land — when there were many currencies, price comparisons were not so easy. Prices now will tend to be equal throughout the Euro area.

The single currency saves a lot on the cost of hedging against exchange rate risks, estimated at $ 25 billion. Companies in the euro land benefit from the ease of outsourcing, relocation of production bases, mergers and take-overs, transportation, procedures, marketing etc., besides the savings on hedging costs. These would also help improve their global competitiveness.

The European Commission points out that the benefits of the euro are diverse and are felt on different scales, from individuals and businesses to whole economies. These benefits, many of which are interconnected, include:

- A stable currency
- More choice, and stable and transparent prices for consumers and citizens
- Greater security and more opportunities for businesses and markets
- Improved economic stability and growth
- More integrated financial markets
- Greater ease of international trade
- Low inflation and low interest rates
- Elimination of currency exchange costs
- A stronger presence for the EU in the global economy
- A tangible sign of a European identity

The European Commission further observes that scale of the single currency and the euro area also brings new opportunities in the global economy. A single currency makes the euro area an attractive region for third countries to do business, thus promoting trade and investment. Prudent economic management makes the euro an attractive reserve currency for third countries, and gives the euro area a more powerful voice in the global economy. Scale and careful management also bring economic stability to the euro area, making it more resilient to so-called external economic 'shocks', i.e., sudden economic changes that may arise outside the euro area and disrupt national economies, such as worldwide oil price rises or turbulence on global currency markets. The size and strength of the euro area make it better able to absorb such external shocks without job losses and lower growth.

The single currency brings new strengths and opportunities arising from the integration and scale of the euro area economy, making the single market more efficient.

Before the euro, the need to exchange currencies meant extra costs, risks and a lack of transparency in cross-border transactions. With the single currency, doing business in the euro area is more cost-effective and less risky.

Meanwhile, being able to compare prices easily encourages cross-border trade and investment of all types, from individual consumers searching for the lowest cost product, through businesses purchasing the best value service, to large institutional investors who can invest more efficiently throughout the euro area without the risks of fluctuating exchange rates. Within the euro area, there is now one large integrated market using the same currency.

The euro does not bring economic stability and growth on its own. This is achieved first through the sound management of the euro-area economy under the rules of the Treaty and the Stability and Growth Pact (SGP), a central element of Economic and Monetary Union (EMU). Second, as the key mechanism for enhancing the benefits of the single market, trade policy and political cooperation, the euro is an integral part of the economic, social and political structures of today's European Union.

Euro vs. Dollar

It has been generally felt that an important impact of the Euro will be the decline in the dominance of the US dollar in the global economy because the Euro will increasingly replace the dollar in several spheres. In 1991, the year in which the euro was launched, more than 70 per cent of the foreign exchange reserves holding by central banks and governments was in US dollars. The corresponding share of the euro was less than 18 per cent. The share of the Euro rose above 25 per cent by 2006 and of the dollar fell to about 65 per cent. The EMU and euroland would expand in size with more countries joining both. The euro is also accepted as a currency of peg by several nations. The dominance of dollar was expected to decline in the securities market also with the increasing presence of the euro. It may be noted that the stock exchanges of London and Frankfurt entered into a dynamic agreement for cooperation which has been widely perceived as a vanguard effort to integrate the European stock markets into a single European stock exchange. The integrated Frankfurt-London exchange would be the world's second largest stock exchange. There would be a substantial increase in the investments in the European securities markets (which will have both European and foreign securities) by both Europeans and foreigners. In short, the dominance of dollar is on decline and a bi-polar global monetary order is expected to emerge. A stable and growing European economy is, however, beneficial to the US (as also to other nations) because of mutual interdependencies in the integrated global economy.

Euro has quickly established itself as a global currency without becoming a true rival to the greenback's status. It is now the most important world currency after the US dollar, and in some respects, for example in bond markets, has even overtaken the dollar. In December 2006, the value of euro bank notes and coins in circulation overtook the value of US dollar cash in circulation. The euro accounts not only for a substantial and increasing part in the denomination of the international debt market, but also for a large part of international bank liabilities and foreign exchange transactions. This gives the European Union a stronger voice in the world.

In its early years the euro fell against the dollar, but it has later significantly gained in value. Table 2.1 shows that until 2002 dollar appreciated against the euro. Although, on the whole, there was an appreciation of the euro after that, in the beginning of 2009 the euro was quoting much lower than at the time of its launch. However, it was significantly higher than in the early years of this decade. Between early 2002 and July 2009, euro appreciated about 58 per cent against dollar.

Although the euro-dollar exchange rate fluctuated both ways, between the launch of euro in 1999 and early 2012, there was a very slight appreciation of the euro against the US dollar.

Euro and India

The euro has important implications for India. The euro area accounts for large share of India's foreign trade. Further, the EU is an important source of aid and foreign investment. Indian companies have significant investment interests in Europe and they also tap the European capital market.

Indian firms benefit, like their counterparts in other countries, from the advantages of a single currency instead of many. According to a study conducted by B. Bhattacharya and Vinayak Ghatate of the Indian Institute of Foreign Trade,[10] the Euro will benefit Indian exports by making it cheaper in the euro land. According to this study, 15 product groups in the country's export basket have a price elasticity which will help them to capture a significant portion of the European markets with lower prices. The product groups that will benefit include foodstuffs, fats and oils, plastics, wood articles, textiles, articles of stone, chemicals, base metals, vehicles, vegetable products, wood pulp and pearls.

According to the study, the Euro would reduce the transaction costs and help in greater integration of capital markets, while resulting in a higher level of growth in the euro area.

The greater price transparency brought in by euro throughout the euro land was expected to give a push towards a uniform pricing strategy for different markets. However, the euro will not result in a uniform retail pricing structure throughout euro land because of the divergent cost structure in businesses.

The study has observed that as the pressure to introduce uniform prices will come from the higher end of distribution channel, and Indian exporters would have to redesign their export pricing strategies accordingly.

If the Euro becomes a strong currency, it will make India's imports from euro land costlier. However, if due to greater integration the European firms become more efficient, the exchange-rate-induced price-rise may get neutralised by higher efficiency and productivity levels.

As the study has opined, the advent of the Euro is both a challenge and an opportunity for Indian exporters and it will now depend on their skills to use it to their advantage.

Table 2.1

EXCHANGE RATES OF RUPEE WITH EURO AND DOLLAR

Period	€1 = ₹	$1 = ₹
Beginning of January 1999	50.32	42.6
Beginning of January 2000	44.90	43.55
Beginning of January 2001	44.20	46.78
Beginning of January 2002	43.21	48.3
Beginning of January 2003	50.04	48.03
Beginning of January 2004	57.52	45.68
Beginning of January 2005	57.79	43.47
Beginning of January 2006	54.08	44.73
Beginning of January 2007	57.82	44.16
Beginning of January 2008	57.89	39.15
Beginning of January 2009	67.12	48.41
Beginning of January 2010	66.62	46.30
Beginning of January 2011	59.63	44.67
Beginning of January 2012	68.95	53.31
Beginning of January 2013	72.36	54.80
Beginning of January 2014	85.04	61.88
Beginning of January 2015	76.42	63.16
Beginning of January 2016	71.92	66.24

Source: http://www.x-rates.com/cgi-bin/lookup.cgi

Table 2.1 shows that the rupee appreciated, like the dollar, against euro until 2002. Figure 2.1 reveals that there has not been any consistency in the directional trend in the exchange rates of rupee with dollar and euro. For example, when the rupee appreciated gains dollar at times, it depreciated against euro. Between the time of launch of euro (January 1999) and July 2009, the rupee depreciated about 34 per cent against euro and 12 per cent against dollar. Between 2002 — when the euro started its upward movement after the initial fall — and 2009, rupee depreciated about 56 per cent against euro, while the Indian currency kept, by and large, its head above the greenback.

Recent period witnessed a depreciation of the rupee as Table 2.1 shows.

During 2013 and 2014, while the Rupee depreciated against dollar, it appreciated against Euro.

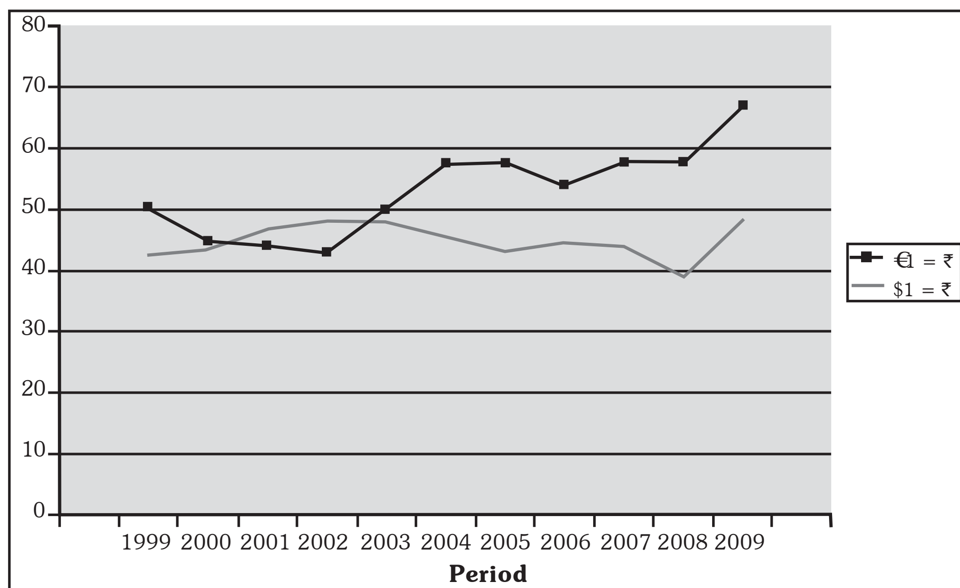


Fig. 2.2: Exchange Rates of Rupee with Euro and Dollar (Exchange Rates at the Beginning of the Year)

Conclusion

A decade of euro's performance leaves a mixed picture. According to the *Economist*, so far the experiment has worked fairly well. The ECB has fulfilled its remit to maintain the purchasing power of the euro. Since the currency's creation the average inflation rate in the euro area has been just over 2 per cent. Fears that the euro would be a "soft" currency have proved unfounded. However, much against the hype about the avowed benefits, it is felt that so far the euro has brought neither greater prosperity nor political union. Job creation improved but productivity increases have slowed, leaving the region's trend growth rate much the same as before EMU.

That 9 EU countries are still outside the euro area exposes the inability of many of them to fulfill the norms and the internal resistance of others to adopt the euro. Margaret Thatcher, former British Prime Minister, was strongly opposed to UK adopting euro. There has not been any change in the Britain's reluctance to give up its independent monetary policy. Her policy brass tend to see a flexible exchange rate as a useful safety valve. Since a referendum in 2003 came out against the country joining the euro club, has shown no interest in getting closer to it. Sweden which enjoys, like the UK, a credible monetary regime with an efficient central bank does not seem to have much to gain from hitching itself to the ECB. Denmark, whose currency is pegged to the euro, presents a different case. After failing twice to secure a popular vote in favour of joining the euro area, it is mulling a third referendum after 2009. Denmark, in fact, It has the worst of all worlds. The currency peg is open to speculative attack, so its exchange rate stability is precarious; yet to preserve it, the country has had to sacrifice an independent monetary policy.

The other eight non-euro area members are former planned economies in central and eastern Europe (CEE) that joined the EU on or after May 2004. All are keen to adopt the euro as it will significantly benefit them. Most are small and very open economies whose exports account for a large share of GDP and whose trade ties to the euro area are strong. As emerging economies, they are prone to sudden shifts in foreign investor sentiment, which makes for volatile currencies, so exchange rate stability holds considerable appeal for them. None of them has a long record of stable money, so loss of monetary independence would not be greatly mourned. For four of the eight, the euro is already their monetary anchor.

The global financial turmoil is posing the biggest test the euro zone has so far faced. It is observed that some euro area member states are adjusting too slowly to economic shocks, which creates the risk that the gap between fast and slow growth countries could become entrenched over time unless the pace of structural reform is stepped up. This is one of the conclusions of the first Annual Statement on the Euro Area. Another is that despite the powerful "one market, one money" argument of the 1980s the European Union's single market is still largely unfinished business. Tackling these weaknesses will allow euro area members to realise the full benefits of the single market and raise their growth potential and job creation. Finally, although it accounts for a fifth of world trade and 25 per cent of world reserves, the euro area lacks a coherent voice on the world stage. Projecting itself more strongly would allow the euro area to show economic leadership and to promote stability in the world economy and financial markets. The challenges for the euro area members are to speed up the pace of economic reform, promote prudent macroeconomic policies, complete the single market and show leadership on the world stage.

INDO-EU TRADE

The European Union, taken as a single unit, is India's largest trading partner. India's trade with EC grew substantially over the years.

In 2013-14, the EU accounted for nearly 16 per cent of India's exports (little more than the share of USA). While the EU supplied more than 10 per cent of the imports, the share of USA was only about 6 per cent.

Within the important trade partners of India include Germany, United Kingdom, Belgium, France and Italy.

India's main exports to EC include textiles, jute, leather and leather manufactures, polished diamonds, engineering goods, chemicals, marine products etc. Imports include edible oils, fertilisers, dairy products, steel, capital goods, optical instruments, aluminium and copper products, synthetic rubber and photo and cinematographic goods.

India also receives technology, investment and development aid from EC countries.

India's export performance has been regarded as poor. Several factors such as lack of price competitiveness, poor quality, poor quality image, bad reputation in respect of delivery schedules, poor export marketing skills, protectionist policy pursued by the EEC countries etc., have contributed to this. These problems indicate the areas of corrective measures to improve Indian exports to the EEC. The EC is a highly competitive market courted by a large number of trading nations and unless Indian competitiveness measures up to the international level, things will become more difficult.

The EC is a very potential market and India should pay sufficient attention to taking advantage of this enlarging market. Many countries, including Japan and South-East Asian countries, have been taking measures to overcome the Fortress by setting up manufacturing/assembling units in the Community. India's achievements in this direction has, however, been not very significant.

One great advantage for the Indian exporters, like exporters from any other country, from the Europe 1992 is that henceforth they will have to deal with only one set of rules and regulations instead of the past situation of having to deal with the rules and regulations of each member country of the EEC to which they want to export.

OTHER REGIONAL GROUPINGS

Although several Free Trade Areas have been in existence for quite some time now, this idea seems to have gained a lot of appreciation in recent years.

The *European Free Trade Association* (EFTA), brought into being by the Stockholm Convention, 1960, is one of the oldest free trade areas.

Some of the members like Finland, Denmark, UK, Portugal, Austria, and, Sweden later left the Association to join the EC.

The *Latin American Free Trade Area* (LAFTA) was established in 1961 by the Treaty of Montevideo by Argentina, Brazil, Mexico, Chile, Peru, Uruguay and Paraguay. Colombia and Ecuador joined the Area later. The treaty of Montevideo aims at the elimination of all customs duties and other restrictions on trade between the member countries.

A free trade agreement between Australia and New Zealand went into effect in December 1988. The *Australia New Zealand Closer Economic Relations Trade Agreement* (ANZCERTA) is currently the only Pacific Rim free trade arrangement. The *North American Free Trade Agreement* (NAFTA) between the USA and Canada to drop all trade barriers (1988) was later extended to Mexico, making North America a giant free trade area.

A number of countries in several other parts of the world have formed free trade or other forms of economic cooperation arrangements. These include the *Central American Common Market* (CACM), the *Andean Pact,* the *Caribbean Common Market* (CARICOM) in Latin America, the *Economic Community of West African States* (ECOWAS), the *Preferential Trade Area* (PTA), the *Economic Community of Central African States* (CEEAC), and the *Southern African Development Coordination Conference* (SADCC) in Sub-Saharan Africa; and the *Gulf Cooperation Council* (GCC) in the Middle East.

There have been proposals for several new regional groupings. According to Naisbitt and Aburdene, who argue that there is a big, powerful, overarching megatrend towards worldwide free trade, as we turn to the 21st century, we will witness the link up of North America, Europe, and Japan to form a golden triangle of free trade. The EC, EFTA and North America together account for nearly two-thirds of the world imports and about half of the developing country exports.

In the post-World War II period, the Soviet Union and East European countries sought to foster economic ties via the Council for Mutual Economic Assistance (CMEA) or (COMECON). With the

collapse of communism, the CEMA also collapsed. The East European nations may seek integration with the EC.

The Association of South-East Asian Nations (ASEAN) was formed by the Bangkok Declaration, 1967, by five countries, viz., Indonesia, Malaysia, Philippines, Singapore and Thailand with a view to accelerating economic progress. Brunei joined the Association in 1984. The economic growth rate of the ASEAN which is richly endowed with natural resources has been very high. This region accounts for the lion's share of the world's natural rubber, palm oil and tin. It is also an important producer of sugar, coffee, timber, petroleum, nickel, bauxite, tungsten and coal.

SAARC

The proposal for cooperation among the countries of South Asia began to receive considerable support from the dawn of the 1980s and after much deliberations, the South Asian Association for Regional Cooperation (SAARC) involving seven countries, namely, India, Bangladesh, Pakistan, Nepal, Bhutan, Sri Lanka and Maldives, was formally launched in December 1985. Mr. Rajiv Gandhi, the then Prime Minister of India, described the opening day of the SAARC summit in December 1985 as an important day in the history of resurgent Asia, when seven neighbours had come together in an act of faith. He called upon the developing countries to make a conscious effort to remain outside the vortex of tensions and conflicts which pose a serious threat to their progress and prosperity. The participants of the summit affirmed that the birth of SAARC was a logical response to the problems facing the region. The fundamental goal of SAARC is to accelerate economic and social development through optimum utilisation of their human and material resources.

According to Article I of the Charter of the SAARC, the objectives of the Association are:

1. to promote the welfare of the people of South Asia and to improve their quality of life;
2. to accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realise their full potentials;
3. to promote and strengthen collective self-reliance among the countries of South Asia;
4. to contribute to mutual trust, understanding and appreciation of each other's problems;
5. to promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields;
6. to strengthen cooperation with other developing countries;
7. to strengthen cooperation among themselves in international forums on matters of common interests; and
8. to cooperate with international and regional organisations with similar aims and purposes.

Article II of the Charter lays down the following principles:

1. Cooperation within the framework of the Association shall be based on respect for the principles of sovereign equality, territorial integrity, political independence, non-interference in the internal affairs of other States and mutual benefit.
2. Such cooperation shall not be a substitute for bilateral cooperation but shall complement them.
3. Such cooperation shall not be inconsistent with bilateral and multilateral obligations.

With about 1200 million inhabitants, the SAARC accounts for over one-fifth of the world population. The density of population in the SAARC countries, which have only about 3.3 per cent of the world's land area, is very high, nearly double when compared to the average density of the low income economies as a whole. According to the projections of the World Bank, the average annual growth

rate of population during 1980-2000 will be well above 2 per cent in these countries, except in India (1.8 per cent); the data for Maldives is not available.

A major share of the world's poor live in these countries. All these are low income economies.

India holds about two-thirds of the total population of the Association. On the other extreme is the tiny country of Maldives with a land area of 298 sq. kms, inhabited by about 2 lakh people. Bhutan is a comparatively small country, with a total population much less than that of Bangalore, where the second SAARC summit was held.

While Sri Lanka is an island and Maldives an archipelago, Nepal and Bhutan are landlocked countries for whom the easiest entry to the sea routes is through the ports of India and Bangladesh. Despite the growing importance of the services and industrial sectors in these countries, the majority of the population still derives its livelihood from agriculture.

It is rightly pointed out that increased intra-regional trade is a major means of promoting regional economic cooperation. In South Asia, however, such trade, at present, is at a low level. Intra-regional exports and imports of these countries have generally formed less than 10 per cent of world trade of each country, except for Nepal's trade which is especially high because of its trade with India, and for India, trade with the region, which because of its size, remains a small percentage (two or three per cent) of the total.

In general, there has also been a decline in the intra-regional trade of each country during the last decade or so, reflecting a more rapid expansion of trade with extra-regional countries — developed and developing.

Some of the member countries are major exporters of certain commodities and, therefore, major competitors in the international market. For example, jute exports by India and Bangladesh and tea exports by Sri Lanka and India. Let us hope that the SAARC will become a forum to help avoid unhealthy competition in such areas and to help formulate joint strategies to get a better deal, particularly for the primary commodities in the international market. Cooperation may also provide better scope of offshore or third country trading, utilising the expertise of organisations like the STC and MMTC. The scope of beneficial counter trade among the member countries also needs to be fully explored.

The member countries of SAARC have many common features and problems which are characteristic of the developing countries. There are a number of areas which offer scope for development through mutual help and cooperation. Some such areas have already been identified and some follow up has been made by making organisational arrangements to forge greater cooperation and interdependence among the people of the region in meteorology, health, civil aviation, shipping, agriculture, communication and renewable sources of energy.

It is pointed out that there is a great scope for cooperation for water resource development. Nepal can sell to India enormous and, for Nepal, highly lucrative opportunities for the generation of hydel power. The position of Bangladesh in terms of hydrographic leverage with India is very similar. In return, so is India's leverage with these two countries because India is the only feasible and substantial buyer of the cooperation they can offer for the optimum utilisation of the water flowing through them. Similarly, India and Pakistan still have, despite the Indus Valley treaty, valuable cooperation to offer or withhold from each other.

The second summit of the SAARC held in Bangalore in November 1986 decided to set up its Secretariat at Kathmandu, Nepal. The Summit decided to expand and strengthen the cooperative programmes of the Association and wanted the following actions to be taken:

1. South Asian broadcasting programme covering both radio and television.
2. Concrete steps to develop tourism in the region, including facilities for limited convertibility of national currencies for tourists from SAARC countries.
3. Cooperation in educational, scientific, technical and research and development fields.

There are, however, a number of important problems which affect the relationships among these countries. India has both the advantages and disadvantages of all other members being her neighbours. The size of India, large as it is, geographically separates some of the members. The dominant position of India, by virtue of her resource endowments and impressive developments in a number of fields, *albeit* should be considered as assets, is not always well taken by some of the members. Border disputes, ethnic issues and differences in political outlooks and affiliations, cause mutual mistrust among the members and there are no signs of substantial improvement of the situation in the near future. The members are very well aware of the implications of these problems. The 1983 Delhi Declaration of the SAARC foreign ministers was categorical about keeping all bilateral and contentious issues and political matters out of the SAARC summit, at least during its formative stage. Addressing the SAARC Summit in December 1985, Mr. Rajiv Gandhi declared that the participating countries have not sought to melt their bilateral relationships into a common regional identify but rather to fit South Asian cooperation into their respective foreign policies as an additional dimension and have evolved modalities which do not allow bilateral stresses and strains to impinge on regional cooperation.

SAPTA

The Sixth SAARC Summit held in Colombo in 1991 strongly mooted the idea of a SAARC Preferential Trading Arrangement (SAPTA) and the Foreign Ministers of all the member states (India, Pakistan, Bangladesh, Nepal, Sri Lanka, Bhutan and Maldives) signed the Agreement on April 11, 1993 during the Seventh SAARC Summit in Dhaka. SAPTA became effective from December 7, 1995.

The basic principles of SAPTA are as follows:

1. Overall reciprocity and mutuality of advantages.
2. Step-by-step negotiations and extension of preferential trade arrangement in stages.
3. Inclusion of all types of products — raw, semi-processed and processed.
4. Special and favourable treatment to Least Development Countries (LDCs).

The special treatment of LDCs includes allowance of favourable percentage points, application of relaxed rules of origin, favourable terms for technical assistance, duty-free access, deeper tariff preferences, removal of non-tariff and para-tariff barriers, negotiation of long-term contracts to support sustainable exports and provision of special facilities with regard to shipping and documentation, preparation and establishment of industrial and agricultural projects, training facilities and support to export marketing, etc. possibly linked to cooperative financing and buyback arrangements.

The share of intra-regional trade in the total trade of SAARC countries is very insignificant. This has not increased even after the formation of the SAARC. There was, in fact, some fall in the intra-regional trade after the coming into effect of the Association. During the decade commencing in 1985, it declined from 4.5 per cent to 3.5 per cent. The share of individual countries' trade within the region varies. While the share of the region in the total exports of Maldives, Nepal (17-18 per cent in 1994) and Bangladesh (12.8 per cent) is fairly high, that of India (0.5 per cent) and Pakistan (1.6 per cent) is very low.

The share of the region in the members' imports also shows a skewed pattern. While only about 0.5 per cent of India's imports originate from SAARC countries, it is fairly high in respect of

Nepal (18.3 per cent in 1994). While India and Pakistan have been enjoying trade surplus in the intra-regional trade, all others have been confronting deficit. High levels of tariff and non-tariff barriers have been affecting the trading between SAARC countries.

All the SAARC countries have implemented substantial reduction in tariffs and also modified their tariff structures as part of the ongoing economic policy reforms. These changes have been carried out with a view to improving the efficiency of domestic industries. This process in itself should help the expansion of intra-regional trade. But the presence of non-tariff barriers in different forms are acting as constraints to realise the potential for trade expansion.

The SAARC Preferential Trading Arrangement (SAPTA) is expected to play an important role in boosting the intra-regional trade. According to the country perspective exports on SAPTA, this preferential arrangement would benefit SAARC countries due to the following reasons:

1. The countries can substantially reduce the transport and transit cost because of geographical continuity among the members.
2. Capital goods produced within the region may be more compatible to the factor endowment of member states than those imported from developed countries.
3. The increasing competition among the member states would result in technical efficiency in existing industry as marginal firms might be forced to reduce their cost. Resources will be reallocated away from less efficient firms and monopolies protected by the tariff wall will no longer be in a sheltered position.
4. As economic ties get stronger and countries become committed to common economic goals, political problems will gradually recede. When economic benefits gain significance, amicable environment may evolve for dissolving political problems.
5. Regional cooperation may also pave the way for regional banks or corporation which might be influential in promoting regional investment in larger projects.

It is intended to develop SAPTA into a South Asian Free Trade Area (SAFTA), The SAARC Council of Ministers which met in December 1995 reached an agreement to realise the objectives of SAFTA, preferably by the year 2000 but not later than 2005.

Today, SAARC countries' share in total world trade is not even I per cent, and their trade among themselves lingers below 3 per cent of their total foreign trade. This compares poorly with more than 60 per cent for intra-European Union trade of their global trade and nearly 40 per cent for North America and East Asia.

According to a study by the International Food Policy Research Institute (IFPRI), the intra-regional trade would expand by more than $ 800 million following SAPTA, which was more than double the then existing trade. Indian exports to the region was expected to double, increasing by almost $ 270 million. According to the IFPRI study, the target gains accrue when liberalisation is across the board for all trade partners. Economic welfare in that case is expected to improve by nearly $ 5,600 million per year. Much of the improvement will occur from the intra-SAARC trade in food products and primary commodities. The chief gainers of this would be Bangladesh and Pakistan who would lead the increase in inter-regional food imports.

Although some liberalisation measures have been taken following the establishment of SAPTA, some of them are regarded as flawed or inadequate. It is even suspected that the concession exercise is just so much playing to the gallery. Consider, for example, the fact that the majority of the products offered concessions by members are not being imported by them at all. It is, therefore, not surprising that preferential imports cover only a very small percentage of the total intra-regional trade.

It is also argued that the approach of SAFTA to introduce trade concessions, initially, on a product-by-product basis is a drag on trade liberalisation. There are, however, provisions in the Agreement for across-the-board tariff reduction as well as for adopting a sectoral approach to reduction in tariffs. The product-by-product approach may be justified on the ground that the developing counties need to exercise more caution in the matter of trade liberalisation. Further, members will not benefit from tariff concession on many products as they already have equal, or better, levels of tariff preferences and market access under other arrangements.

It is also pointed out that many items with large intra-trade potential are not extended the trade preferences.

There is a view that what is needed is a customs union and not a free trade area because a free trade area has an important problem that goods from a non-member country may enter a member country and from there freely flow throughout the free trade area causing damage to the domestic industry/agriculture of some of the members. The 'rule of origin' designed to check this does not work. In practice, effectively.

INDO-LANKA FREE TRADE AGREEMENT

According to the Bilateral Free Trade Area Agreement signed by India and Sri Lanka on 28th December 1998, a large number of items will be eligible for duty free trade. India has offered to permit as much as 1000 items on zero duty from Sri Lanka and Sri Lanka will allow duty free imports of 900 items from India.

The main objectives of this Free Trade Agreement, according to its preamble, are the following.

1. To promote through the expansion of trade the harmonious development of the economic relations between India and Sri Lanka.
2. To provide fair conditions of competition for trade between India and Sri Lanka.
3. In the implementation of this agreement both the countries would pay due regard to the principle of reciprocity.
4. To contribute, in this way, by the removal of barriers to trade to the harmonious development and expansion of world trade.

The agreement also provides for safeguard measures under which if any product, which is the subject of preferential treatment, is imported into the territory of a contracting party in such a manner or in such quantities as to cause or threaten to cause serious injury in the importing country to the agreement, the importing country with prior consultations except in critical circumstances suspend provisionally without discrimination the preferential treatment accorded under the agreement.

The contracting parties are also free to apply their domestic legislation to restrict imports in cases where prices are influenced by unfair trade practices like subsidies or dumping. This agreement would have long-term consequences as other members might try to "multilateralise" it within the SAARC region by demanding similar preferential treatment within the trading arrangement bloc.

It is feared that the India-Sri Lanka Free Trade Agreement would very adversely affect the farmers of India as several cash crops would enter India duty free from Sri Lanka depressing their domestic prices.

As India is a very large market, the Free Trade Agreement is likely to benefit Sri Lanka a lot and the benefits to India may not be much as Sri Lanka is a small market.

WORLD TRADE ORGANISATION

The World Trade Organisation (WTO) — the successor of the General Agreement on Tariffs and Trade (GATT) established in 1948 — came in to being in 1948.

A very short account of the GATT is given below to provide a background of the WTO.

GATT

The General Agreement on Tariffs and Trade (GATT), the predecessor of WTO was born in 1948 as result of the international desire to liberalise trade.

The establishment of an International Trade Organisation (ITO) had also been recommended by the Bretton Woods Conference of 1944 which had recommended the IMF and World Bank. Although the IMF and World Bank were established in 1946, because of objections that its enforcement provisions would interfere with the autonomy of domestic policy making, the ITO charter was never ratified. Instead the GATT, which had been drawn up only ass an interim agreement to fill the gap until the ITO charter was ratified, became the framework for international trading system since into being in 1948. The international trading system since 1948 was, at least in principle, guided by the rules and procedures agreed to by the signatories to the GATT which was an agreement signed by the contracting nations which were admitted on the basis of their willingness to accept the GATT disciplines.

The GATT was transformed into a World Trade Organisation (WTO) with effect from January, 1995. Thus, after about five decades, the original proposal of an International Trade Organisation has taken shape as the WTO, The WTO which is a more powerful body than the GATT has an enlarged role than the GATT.

India is one of the founder members of the IMF, World Bank, GATT and the WTO.

Objectives of GATT

The primary objective of GATT was to expand international trade by liberalising trade so as to bring about all-round economic prosperity. The Preamble to the GATT mentioned the following as its important objectives.

1. Raising standard of living
2. Ensuring full employment and a large and steadily growing volume of real income and effective demand.
3. Developing full use of the resources of the world.
4. Expansion of production and international trade.

GATT embodied certain conventions and general principles governing international trade among countries that adhere to the agreement. The rules or conventions of GATT required that:

1. Any proposed change in the tariff, or other type of commercial policy of a member country should not be undertaken without consultation of other parties to the agreement.
2. The countries that adhere to GATT should work towards the reduction of tariffs and other barriers to international trade, which should be negotiated within the framework of GATT.

For the realisation of its objectives, GATT adopted the following principles:

1. *Non-discrimination*: The principle of non-discrimination requires that no member country shall discriminate between the members of GATT in the conduct of international trade. To ensure non-discrimination the members of GATT agree to apply the principle of most favoured nation (MFN) to all import and export duties. This means that "each nation shall be treated as well as the most favoured nation." As far as quantitative restrictions are permitted, they too, are to be administered without favour.

   However, certain exceptions to this principle are allowed. For instance, GATT does not prohibit economic integration such as free trade areas or customs union, provided the purpose of such integration is "to facilitate trade between the constituent territories and not to raise

barriers to the trade of other parties." The GATT also permits the members to adopt measures to counter dumping and export subsidies. However, the application of such measures shall be limited to the offending countries.

2. *Prohibition of Quantitative Restriction*: GATT rules seek to prohibit quantitative restrictions as far as possible and limit restrictions on trade to the less rigid tariffs. However, certain exceptions to this prohibition are granted to countries confronted with balance of payments difficulties and to developing countries. Further, import restrictions were allowed to apply to agricultural and fishery products if domestic production of these articles was subject to equally restrictive production or marketing controls.
3. *Consultation*: By providing a forum for continuing consultation, it sought to resolve disagreements through consultation. So far eight Rounds of trade negotiations were held under the auspices of the GATT. Each Round took several years. The Uruguay Round, the latest one, took more than seven years to conclude, as against the originally contemplated more than four years. This shows the complexity of the issues involved in the trade negotiations.

An Evaluation of GATT

The growing acceptance of GATT, despite its shortcomings, is evinced by the increase in the number of the signatories. When the GATT was signed in 1947, only 23 nations were party to it. It increased to 99 by the time of the Seventh Round and 117 countries participated in the next, i.e., the Uruguay Round. WTO now (end of May 2016) has 162 members and many countries were seeking membership. The signatory countries account for about 90 per cent of the international trade indicating the potential of the WTO in bringing about an orderly development of the international trade.

One of the principal achievements of GATT was the establishment of a forum for continuing consultations. "Disputes that might otherwise have caused continuing hard feeling, reprisals, and even diplomatic rupture have been brought to the conference table and compromised".

GATT could achieve considerable trade liberalisation. There were, of course, several exceptions.

Agricultural trade was clearly an exception to the liberalisation. Far from becoming freer, trade in agriculture became progressively more distorted by the support given to farmers (which took the form of severe barriers to imports, and subsidies to exports) in the industrial nations.

Similarly, another exception was textiles. Trade in textiles was restricted by the Multifibre Arrangement (MFA). Under the MFA, imports of textile items to a number of developed countries were restricted by quotas.

Besides agriculture and textiles, two exceptions to the general trend of trade liberalisation have been trade of developing countries and economic integration. Developing countries with balance of payments problems have been generally exempted form the liberalisation. Even the Uruguay Round has granted such exemptions to developing countries.

Although the picture of trade liberalisation has to be qualified with such exceptions, the GATT achieved very commendable trade liberalisation. The average level of tariffs on manufactured products in industrial countries was brought down from about 40 per cent in 1947 to nearly three per cent after the Uruguay Round.

Indeed the period of 1950-1973 is conspicuous by the splendid results of progressive trade liberalisation. In the 275 years since 1720, this period witnessed the highest average annual growth rates in output and international trade. These rates were substantially higher than for any other period. Indeed, the 1950s and 1960s are described as the golden decades of capitalism. The output levels of companies using newer and newer technologies in many cases were much larger than the

domestic markets could absorb. Expansion of markets to other countries enabled even companies in other industries to increase their output. There was also a surge in international investments.

The progressive liberalisation of trade, however, suffered a setback since 1974, Although the elimination of Tariff Barriers continued, even the developed countries have substantially increased Non-tariff Barriers since then.

The collapse of the Bretton Woods system in the early 1970s and the oil crisis made matters very difficult for many countries, both developing and developed, and as a result of these demands for protection increased dramatically. The developing country exports have been hit very hard by the NTBs, as pointed out earlier in this chapter.

Further, the exports of developing countries gained significantly less from the GATT Rounds than did exports of the industrial nations. The trade liberalisation has been confined mostly to goods of interest to the developed countries. In case of agricultural commodities not only was that there was no liberalisation, but also there was an increase in protection. Manufactured products of interest to developing countries like textiles and clothing, footwear etc. have been subject to increasing non-tariff barriers. While the developed countries enjoy a more liberalised trading environment, the growing NTBs have been severely affecting the exports of developing countries. Ironically, the developed countries are increasing the protectionism when the developing countries are liberalising. This is indeed a sad commentary on the GATT and other multilateral organisations.

GATT and WTO

Following the UR Agreement, GATT was converted from a provisional agreement into a formal international organisation called World Trade Organisation (WTO) with effect from January 1, 1995. WTO now serves as a single institutional framework encompassing GATT and all the results of the Uruguay Round. It is directed by a Ministerial Conference that will meet at least once every two years and its regular business is overseen by a General Council.

The old GATT system allowed, under what was known as the 'grandfather clause', existing domestic legislation to continue even if it violated a GATT agreement that a member country had accepted by being a signatory to GATT. The WTO, specially rules this out.

The situation, after the coming into effect of WTO may be described as *the GATT is dead, long live the GATT*.

Table 2.2
DIFFERENCE BETWEEN GATT AND WTO

GATT	*WTO*
GATT was *ad hoc* and provisional	WTO and its agreements are permanent
GATT had contracting parties	WTO has members
GATT system allowed existing domestic legislation to continue even if it violated a GATT agreement	WTO does not permit this
GATT was less powerful, dispute settlement system was slow and less efficient, its ruling could be easily blocked	WTO is more powerful than GATT, dispute settlement mechanism is faster and more efficient, very difficult to block the rulings

Under the old system, there were two GATTs: (i) GATT the Agreement—i.e., the agreement between contracting parties (governments) setting out the rules for conducting international trade; (ii) GATT the Organisation — an international organisation created to facilitate discussions and

administration related to the Agreement (adhoc, though, continued to exist until the establishment of the WTO). GATT the organisation, ceased to exist with the establishment of WTO; GATT the agreement, which always dealt with (and still does) trade in goods, continues lo exist, in amended form, as part of the WTO alongside two new agreements, viz., General Agreement on Trade in Services (GATS) and General Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs). The old text is now called 'GATT 1947' and the updated version is called 'GATT 1994'. *In short, the WTO is GATT plus a lot more.*

Role and Functions of WTO

WTO is the only international organisation dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business fairly.

The business environment is very significantly influenced by the World Trade Organisation (WTO) principles and agreements. They also affect the domestic environment. For example, India has had to substantially liberalise imports, including almost complete removal of quantitative import restrictions.

The liberalisation of imports implies that domestic firms have to face an increasing competition from foreign goods. Liberalisation of foreign investment can result in growing competition from MNCs.

These liberalisations, on the other hand, also provides new opportunities for Indian firms as the foreign markets become more open for exports and investments.

The liberalisation also enables Indian firms to seek foreign equity participation and foreign technology. This could help them to expand their business or improve competitiveness.

Further, the liberalisation facilitates global sourcing by Indian firms so that they can improve their competitiveness. Indian suppliers can benefit from global sourcing by foreign firms.

Firms will have to be efficient and dynamic to survive the global competition. Inefficient firms may go out of business.

Consumers stand to benefit significantly from the liberalisation.

The WTO has the following five specific functions.

1. The WTO shall facilitate the implementation, administration and operation and further the objectives of the Multilateral Trade Agreements and shall also provide the framework for the implementation, administration and operation of Plurilateral Trade Agreements.
2. The WTO shall provide the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the Agreements.
3. The WTO shall administer the 'Understanding on Rules and Procedures Governing the Settlement of Disputes'.
4. The WTO shall administer the 'Trade Review Mechanism'.
5. With a view to achieving greater coherence in global economic policy making, the WTO shall cooperate, as appropriate, with the IMF and IBRD and its affiliated agencies.

The General Council will serve four main functions:

1. To supervise on a regular basis the operations of the revised agreements and ministerial declarations relating to (a) goods, (b) services and (c) TRIPs;
2. to act as a Dispute Settlement Body;
3. to serve as a Trade Review Mechanism; and
4. to establish Goods Council, Services Council and TRIPs Council, as subsidiary bodies.

The WTO is a more powerful body with enlarged functions than the GATT and is envisaged to play a major role in the world economic affairs. To become a member of the WTO, a country must completely accept the results of the Uruguay Round.

Organisational Structure

Decisions in the WTO are made by the entire membership. This is typically by consensus. A majority vote is also possible but it has never been used in the WTO, and was extremely rare under the WTO's predecessor, GATT. The WTO's agreements have been ratified in all members' parliaments.

The WTO's top level decision-making body is the *Ministerial Conference* which meets at least once every two years.

Below this is the *General Council* (normally ambassadors and heads of delegation in Geneva, but sometimes officials sent from members' capitals) which meets several times a year in the Geneva headquarters. The General Council also meets as the Trade Policy Review Body and the Dispute Settlement Body.

At the next level, the *Goods Council, Services Council and Intellectual Property (TRIPs) Council* report to the General Council.

Numerous *specialised committees, working groups* and *working parties* deal with the individual agreements and other areas such as the environment, development, membership applications and regional trade agreements.

All WTO members may participate in all councils, committees, etc, except Appellate Body, Dispute Settlement Panels, Textiles Monitoring Body, and Plurilateral Committees.

WTO Agreements – A Bird's Eye View

Uruguay Round (UR) is the name by which the Eighth Round of the multilateral trade negotiations (MTNs) held under the auspices of the GATT is popularly known because it was launched in Punta del Este in Uruguay, a developing country, in September 1986.

The first six Rounds of MTNs concentrated almost exclusively on reducing tariffs, while the Seventh Round (Tokyo Round 1973-79) moved on to tackle non-tariff barriers (NTBs). The UR sought to broaden the scope of MTNs far wider by including new areas such as:

- Trade in services
- Trade related aspects of intellectual property rights (TRIPs)
- Trade related investment measures (TRIMs).

Because of the inclusion of these new aspects in the GATT negotiations, the developing countries had serious apprehensions, about outcome of the Uruguay Round.

The Uruguay Round took up three basic subjects for discussion:

1. Reducing specific trade barriers and improving market access.
2. Strengthening GATT disciplines.
3. Problems of liberalisation of trade in services, trade related aspects of intellectual property rights (TRIPs) and trade related investment measures (TRIMs).

The most outstanding feature of the UR was the inclusion of the subjects in the 3rd item referred to above in the MTNs of GATT. The traditional concerns of the GATT were limited to international trade in goods. The UR went much beyond goods to services, technology, investment and information.

Some of the important features of the Uruguay Round Agreements are given below.

The WTO endeavours to ensure that trade is as fair as possible and as free as practicable by negotiating rules and abiding by them. The WTO's rules — the agreements — are the result of negotiations between the members. The current set were the outcome of the 1986-94 Uruguay Round negotiations which included a major revision of the original General Agreement on Tariffs and Trade (GATT).

GATT is now the WTO's principal rule-book for trade in goods. The Uruguay Round also created new rules for dealing with trade in services, relevant aspects of intellectual property, dispute settlement, and trade policy reviews. The WTO agreements, are intendd to ensure that the members operate a non-discriminatory trading system that spells out their rights and their obligations. Each country receives guarantees that its exports will be treated fairly and consistently in other countries' markets. Each promises to do the same for imports into its own market. The system also gives developing countries some flexibility in implementing their commitments.

Goods Trade in goods was the concentration of GATT until the Uruguay Round negotiations. From 1947 to 1994, GATT was the forum for negotiating lower customs duty rates and other trade barriers; the text of the General Agreement spelt out important rules, particularly non-discrimination.

Since 1995, the updated GATT has become the WTO's umbrella agreement for trade in goods. It has annexes dealing with specific sectors such as agriculture and textiles, and with specific issues such as state trading, product standards, subsidies and actions taken against dumping.

Services Banks, insurance firms, telecommunications companies, tour operators, hotel chains and transport companies looking to do business abroad can now enjoy the same principles of freer and fairer trade that originally only applied to trade in goods.

These principles appear in the new General Agreement on Trade in Services (GATS). WTO members have also made individual commitments under GATS stating which of their services sectors they are willing to open to foreign competition, and how open those markets are.

Intellectual Property The WTO's intellectual property agreement amounts to rules for trade and investment in ideas and creativity. The rules state how copyrights, patents, trade marks, geographical names used to identify products, industrial designs, integrated circuit, layout designs and undisclosed information such as trade secrets — "intellectual property" — should be protected when trade is involved.

Dispute Settlement The WTO's procedure for resolving trade quarrels under the Dispute Settlement Understanding is vital for enforcing the rules and therefore for ensuring that trade flows smoothly. Countries bring disputes to the WTO if they think their rights under the agreements are being infringed. Judgements by specially-appointed independent experts are based on interpretations of the agreements and individual countries' commitments.

The system encourages countries to settle their differences through consultation. Failing that, they can follow a carefully mapped out, stage-by-stage procedure that includes the possibility of a ruling by a panel of experts, and the chance to appeal the ruling on legal grounds. Confidence in the system is borne out by the number of cases brought to the WTO — almost 250 cases in seven years compared to some 300 disputes dealt with during the entire life of GATT (1947-94).

Policy Review The Trade Policy Review Mechanism's purpose is to improve transparency, to create a greater understanding of the policies that countries are adopting, and to assess their impact. Many members also see the reviews as constructive feedback on their policies.

All WTO members must undergo periodic scrutiny, each review containing reports by the country concerned and the WTO Secretariat.

Development and Trade

Over three quarters of WTO members are developing or least developed countries. All WTO agreements contain special provision for them, including longer time periods to implement agreements and commitments, measures to increase their trading opportunities and support to help them build the infrastructure for WTO work, handle disputes, and implement technical standards.

The 2001 Ministerial Conference in Doha set out tasks, including negotiations, for a wide range of issues concerning developing countries. Some people call the new negotiations the Doha Development Round.

Before that, in 1997, a high-level meeting on trade initiatives and technical assistance for least developed countries resulted in an "integrated framework" involving six intergovernmental agencies, to help least developed countries increase their ability to trade, and some additional preferential market access agreements.

A WTO committee on trade and development, assisted by a sub-committee on least developed countries, looks at developing countries' special needs. Its responsibility includes implementation of the agreements, technical cooperation, and the increased participation of developing countries in the global trading system.

Technical Assistance and Training

The WTO organises around 100 technical cooperation missions to developing countries annually. It holds on average three trade policy courses each year in Geneva for government officials. Regional seminars are held regularly in all regions of the world with a special emphasis on African countries. Training courses are also organised in Geneva for officials from countries in transition from central planning to market economies.

The WTO set up reference centres in over 100 trade ministries and regional organisations in capitals of developing and least-developed countries, providing computers and internet access to enable ministry officials to keep abreast of events in the WTO in Geneva through online access to the WTO's immense database of official documents and other material. Efforts are also being made to help countries that do not have permanent representatives in Geneva.

GATS

The General Agreement on Trade in Services (GATS) which extends multilateral rules and disciplines to services is regarded as a landmark achievement of the UR, although it achieved only little in terms of immediate liberalisation.

Because of the special characteristics and the socio-economic and political implications of certain services, they have been generally subject to various types of national restrictions. Protective measures include visa requirements, investment regulations, restrictions on repatriation, marketing regulations, restrictions on employment of foreigners, compulsions to use local facilities etc. Heavily protected services in different countries include banking and insurance; transportation; television, radio, film and other forms of communication; and so on.

The GATS defines services as the supply of a service from the territory of one member (country) into the territory of any other member; in the territory of one member to the service consumer of any other member; by a service supplier of one member, through commercial presence in the territory of any other member; or by a service supplier of one member, through presence of natural persons of a member in the territory of any other member.

In short, the GATS covers four modes of international delivery of services.

1. Cross-border supply (transborder data flows, transportation services)
2. Commercial presence (provision of services abroad through FDI or representative offices).
3. Consumption abroad (tourism)
4. Movement of personnel (entry and temporary stay of foreign consultants)

The framework of GATS includes basic obligation of all member countries on international trade in services, including financial services, telecommunications, transport, audio visual, tourism, and professional services, as well as movement of workers.

Among the obligations is a most favoured nation (MFN) obligation that essentially prevents countries from discriminating among foreign suppliers of services.

Another obligation is the transparency requirements according to which each member country shall promptly publish all its relevant laws and regulations pertaining to services including international agreements pertaining to trade in services to which the member is a signatory. Further, each member shall also respond promptly to all requests for specific information, by any other member, pertaining to any aspect of the service covered by the GATS. Each member shall also establish one or more enquiry points to provide specific information to other members. However, no member needs to provide any confidential information, the disclosure of which would impede law enforcement, or otherwise be contrary to public interest, or which would prejudice legitimate commercial interests of particular enterprise, public or private.

The GATS lays down that increasing participation of developing countries in world trade shall be facilitated through negotiated commitments on access to technology, improvements in access to distribution channels and information networks and the liberalisation of market access in sectors and modes of supply of export interest to them.

With reference to domestic regulation, the Agreement lays down that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner. There would be a requirement that parties establish ways and means for prompt reviews of administrative decisions relating to the supply of services.

It is recognised that particular pressures on the balance of payments of a member in the process of economic development or economic transition may necessitate the use of restrictions to ensure, *inter alia*, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development or economic transition.

A member country may, therefore, apply restrictions on international transfers and payments for current transactions under certain circumstances envisaged under the GATS. In the event of serious balance of payments and external financial difficulties or threat thereof, a member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments including on payments or transfers for transactions related to such commitments.

The commitments of member countries under the GATS also include national treatment(that is, to treat foreign suppliers of services like domestic suppliers) and provision of market access.

The Agreement on Trade in Services also establishes the basis for progressive liberalisation of trade in services through successive rounds of negotiations, which also applies to other agreements under the Final Act.

As stated earlier, the fear of the developing countries is that the liberalisation of trade in services will lead to the domination of the services sector of the developing countries by the multinationals of the industrialised countries. As a matter of fact, the trade in services is already dominated by the developed countries. The developing countries are net importers of services and their deficit has been growing. The apprehension is that a liberalisation of trade in services will accentuate the problem.

Although many services are labour intensive and, therefore, the developing countries should be expected to have an advantage here, there have been several constraints in benefiting from this advantage. These include, technical, organisational, financial and legal. Moreover, immigration laws of developed countries restrict the manpower flow from the developing to developed countries. This severely limits the scope of developing countries in benefiting from their comparative advantage. It may be noted that the industrial countries did not like to bring this issue in the Uruguay Round.

TRIMs

Trade Related Investment Measures (TRIMs) refers to certain conditions or restrictions imposed by a government in respect of foreign investment in the country. TRIMs were widely employed by developing countries.

The Agreement on TRIMs provides that no contracting party shall apply any TRIM which is inconsistent with the WTO Articles. An illustrative list identifies the following TRIMS as inconsistent.

1. Local content requirement (i.e., a certain amount of local inputs be used in products)
2. Trade balancing requirement (i.e., imports shall not exceed a certain proportion of exports)
3. Trade and foreign exchange balancing requirements
4. Domestic sales requirements (i.e., a company shall sell a certain proportion of its output locally)

The Agreement requires the notification of all WTO-inconsistent TRIMs and their phasing out within two, five and seven years by industrial, developing and least developed countries respectively. Transition period can be extended for developing and least developed countries if they face difficulties in eliminating TRIMs.

A number of TRIMs were employed in India prior to the liberalisation ushered in 1991 and many of them have been phased out since then.

TRIPs

One of the most controversial outcomes of the UR is the Agreement on Trade Related Aspects of Intellectual Property Rights including Trade in Counterfeit Goods (TRIPS). TRIPs along with TRIMs and services were called the “new issues” negotiated in he Uruguay Round.

Protection of intellectual property rights has become an issue of wide and serious discussion with the formation of the General Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) under the Uruguay Round (UR) Agreement of the GATT (now the WTO) in 1994.

Intellectual property rights may be defined as “information with commercial value”. IPRs have been characterised as a composite of “ideas, inventions and creative expression” plus the “public willingness to bestow the status of property” on them and give their owners the right to exclude others from access to or use of protected subject matter”.

According to the WTO, *intellectual property rights are the rights given to persons over the creations of their minds. They usually give the creator an exclusive right over the use of his/her creation for a certain period of time*.

Intellectual property rights (IPRs) include patents, trade marks, copyrights, geographic indications, undisclosed information (such as trade secrets), industrial designs, and layout designs of integrated circuits, and plant variety protection. Special *(sui generis)* forms of protection have also emerged to address specific needs of knowledge-producers as in the case of plant breeder’s rights and the protection of layout designs of integrated circuits. A number of countries also have trade secret laws to protect undisclosed information that gives a competitive advantage to its owner.

Objectives of Protection of Intellectual Property

Encourage and reward creative work The main social purpose of protection of copyright and relating rights is to encourage and reward creative work. This is also relevant to protection in other areas (e.g., industrial designs and patents).

Technological innovation Intellectual property rights are designed to provide protection for the results of investment in the development of new technology, thus giving the incentive and means to finance research and development activities.

Fair competition The protection of distinctive signs and other IPRs aims to stimulate and ensure fair competition among producers.

Consumer protection The protection of distinctive signs should also protect consumers, by enabling them to make informed choices between various goods and services.

Transfer of technology A functioning intellectual property regime should also facilitate the transfer of technology in the form of foreign direct investment, joint ventures and licensing.

Balance of rights and obligations While the basic social objectives of intellectual property protection are as outlined above, it should also be noted that the exclusive rights given are generally subject to a number of limitations and exceptions, aimed at fine-tuning the balance that has to be found between the legitimate interests of right holders and of users.

IPRs and Developing Countries

There is a strong view that although the IPRs are intended to encourage R&D, they often provide an opportunity for the developed country firms an opportunity to exploit the developing countries.

Disadvantages/Limitations

The major disadvantages/limitations of a strong the regime of IPRs, as regards developing countries are the following.

The developing countries, particularly the very poor among them, are ill equipped for significant R&D. In a world order where the industrial countries are the major producers of technology and developing countries heavily depend on imports of technology, IPRs turn out to be, generally, more beneficial to industrial countries than to developing countries. Developed countries enormously benefit from the benefits of higher prices resulting from the market power provided by IPRs, at the expense of developing countries; while industrial countries gain huge amounts of net transfers from TRIPs while developing countries, including India, are expected to experience net outward transfers on account of TRIPs.

A strong IPRs regime without adequate safeguards to protect interests of weaker sections can create very serious problems in developing countries. Exorbitant prices will make patented essential patented drugs beyond the reach of common man.

Developing countries, generally, don't have adequate institutional mechanism and resources to properly administer IPRs regime. For example, a proper competition law and its efficient enforcement are required to combat the potential anticompetitive abuse of IPRs. While in many industrial countries such abuses are dealt with by general competition law, IPR statutory provisions, or other regulations and guidelines, the developing countries are generally handicapped by the weakness of their regulatory system. A World Bank publication, therefore, cautions that "unless developing countries rapidly establish adequate competition frameworks and regulatory institutions that also address monopoly abuse of IPRs, it is possible that increasing IPR protection could result in welfare losses from monopoly behaviour."

Benefits

Protection of IPRs is not without gains to developing countries.

Stronger IPR protection may encourage investment, both foreign and domestic.

Stronger IPR protection could be expected to give a boost to R&D in countries like India whose potential intellectual capital may be expected to grow in great width and in depth.

IPR systems provides a great opportunity to developing countries to benefit from protection of indigenous property rights and traditional knowledge. Developing countries hold approximately 90 per cent of world biological resources, which are particularly important in the development of new pharmaceuticals. Mechanisms for sharing the proceeds from commercialising genetic resources can be written into the IPR law, or alternatively, institutions can be built to protect the collective intellectual property rights for traditional knowledge held by cultural groups.

Developing countries are also adversely affected by bilateral agreements on IPRs. Since bilateral agreements usually provide for stronger IPRs than TRIPs —which mandates only minimum standards — these agreements may impede the ability of developing countries to implement the flexibility permitted in TRIPs. For example, in 1998 the United States had signed bilateral agreements on IPRs with 21 countries and had included many IPR provisions in science and technology agreements and bilateral investment treaties. In general, the validity of international agreements and standards loses force if bilateral agreements proliferate, superseding the international agreement. The political and economic balance of power does not usually tip in favour of poorer developing countries in negotiating cross-border agreements, and this imbalance is probably accentuated when they enter bilateral agreements.

Experiences and Practices

The empirical evidence on the potential benefits of IPRs is weaker than might be expected. Research in industrial countries does not provide strong evidence that IPRs are necessary to stimulate R&D or innovation in most sectors. Some studies show that a realistically designed IPRs system becomes beneficial after a country has attained a certain level of technological development and R&D capability. Further an IPRs system becomes beneficial when it incorporates the required safeguards having regard to the conditions and needs of the country. It is observed that although ensuring a core level of IPR protection may increase developing country access to foreign technologies by safeguarding returns for foreign technology producers, excessively strong IPRs can inhibit the diffusion of knowledge. In developing countries, knowledge is built more through access, imitation, and diffusion of foreign technologies rather than only local research. Legitimate ways to transfer technology under some IPR systems such as reverse engineering or inventing around patents are restricted under strong IPRs. The importance of adopting appropriate policies that allow access to technologies can be seen for some East Asian countries in their early stages of development. This principle is generally followed worldwide, with countries adopting more flexible IPRs at lower levels of per capita income. In Malaysia and Korea, growth in industrial sectors took place under weak IPR regimes, and in later periods governments emphasised incentives for innovation in IPRs as sophisticated local technology sectors developed. Japan introduced patents in the early 20th century after reviewing IPR systems in Europe and the United States. The Japanese system adapted other patent regimes to suit local needs. Emphasis was placed on securing access to foreign technologies, incremental technology development, and diffusion of innovation, through features such as strong antitrust guidelines for technology licensing and a central licensing office as a countervailing influence on foreign bargaining power pressuring for change in its IPR system.

Maximising Developing Country Benefits from TRIPs

Having committed to implement TRIPs, to maximise their net gains developing countries need to take advantage of the flexibility built into TRIPs. There are several areas of flexibility within TRIPs that provide the potential for developing countries to maximise benefits by promoting access to technology and preventing anticompetitive abuses while maintaining incentives to innovate, tackle piracy, and still meet TRIPs minimum standards. The *World Development Report 2002* makes the following suggestions in this regard.

Scope and Exclusion. Developing countries can narrow the scope of what falls under IPRs in the following areas in conformity with TRIPs. First, developing countries can adopt a narrow interpretation of what constitutes an invention and hence what needs to be patented. For example, Argentina, Brazil, and China have elected not to extend patent protection to software. Second, developing countries can take advantage of the TRIPs article that allows limitations and exceptions to copyright. For example, some countries permit unauthorised use for social purposes such as education and scientific research. Third, developing countries can avoid patenting life forms and can apply special provisions under TRIPs to exempt public goods from IPR protection. Finally, developing countries can expand IPR scope to protect genetic resources, traditional knowledge and folklore, as is promoted by the World Intellectual Property Organisation.

Compulsory Licensing. Countries can use compulsory licensing, allowed by TRIPs under some circumstances, to control anticompetitive behaviour that results from IPRs or in national emergencies, such as public health crises. The license, issued by national authorities, authorises the use of IPR-protected subject matter without the consent of the rights holder, with compensation to the latter to be determined by the government.

Parallel Imports. Parallel imports refers to IPR-protected products imported into a country after being released legitimately in another country. Free trade in IPR-protected goods ensures competition in product markets, reduces prices, and enhances consumer access to new technologies. But trade in IPR-protected products may restrict access to new technologies for developing countries. TRIPs neither endorses nor prohibits parallel imports.

Price Regulation. Some countries regulate price levels and price increases—as is allowed under TRIPs—to ensure that IPRs do not restrict consumer access through excessively high prices, particularly in pharmaceutical products. But price regulations are often fraught with problems.

Competition Law. Anticompetitive abuse of IPRs can be controlled by an effective competition law.

Complementary Actions. The impact of IPRs depends on the broader institutional and policy environment. More liberal trading rules also reduce the risk of monopoly abuse of IPRs by domestic firms. Human capital development is also important; IPRs are more likely to increase technology transfer and encourage domestic innovation in countries with higher levels of human capital.

Another factor is the promotion of national innovation systems. Integration of IPR rules with complementary policies to foster innovation such as public sector research involvement where appropriate can stimulate growth by increasing the commercialisation of inventions.

Although, under TRIPs Article 67, industrial country members are obligated to provide technical and financial support for implementing the agreement, only limited assistance has been provided to fulfill this commitment: mostly training and technical assistance in drafting IPR laws. More technical support that is geared toward helping developing countries take advantage of the flexibility allowed in the TRIPs agreement is needed. Concrete financial assistance targets and grants of patents to developing countries (especially for emergency human development needs such as HIV/AIDS treatment) are some of the proposals made for better implementation of Article 67. Others include increased

technology transfer assistance and fiscal incentives, such as guaranteed purchase of new drugs for developing countries.

On copyrights and related rights, the Agreement requires compliance with the provisions of *Bern Convention to* which India is a signatory and the new Copyright Act of India already meets the requirements of the TRIPs Agreement. Trade and Merchandise Marks Act of 1958 was replaced by a new Act, namely, The Trade Marks Act, 1999, so as to provide for the protection of service marks also.

PATENTS

A patent is a legal protection granted for an invention that is new, non-obvious and useful. The patent grants the patent holder the exclusive right to make use or sell the patented products or process. The main purpose of the patent system is to benefit the society. Patents, by providing an opportunity to recoup the cost of invention (which is quite substantial in many cases) and to make profit out of the invention, encourage research and development and thereby contribute to the well-being of the society.

An invention, to be patentable, must satisfy the following three conditions.

- It is new.
- It is useful to the society.
- It is non-obvious to a person possessed of average skill in the art.

Exclusion of an invention from patentability for commercial exploitation is permitted if it is necessary to protect public order or morality, including to protect human, animal or plant life or health or to avoid serious prejudice to the environment. A nation may also exclude from patentability (a) diagnostic, therapeutic and surgical methods for the treatment of humans or animals; (b) plants and animals other than microorganisms and essentially biological process for the production of plants or animals other than non-biological and microbiological process. However, members shall provide for the protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof.

Indian Patent Law

Patent protection in India has a long history. Patent protection was introduced in India in the 18th century. Formal patent protection was ushered in by the Patents Act, 1911. The Patents Act, 1970 amended and consolidated the law related to patents.

Some very significant amendments to India's patent law was, however, necessitated by the Agreement on Intellectual Property Rights that emerged from the Uruguay Round of multilateral trade negotiations that brought into being the WTO. Being a member of the WTO, India was obliged to align its patent law with the stipulations under the WTO with effect from January 1, 2005. Accordingly, the Indian Patents Act, 1970 and the Patent Rules 1972 were amended.

The Indian Patents Act, 1970, as amended and effective from January 1, 2005, lays down:

- The eligibility, procedures and conditions for grant of patents
- Inventions and other subjects not patentable
- Rights and obligations of patentee
- Grounds for revocation of patents
- Matters related to working of the patent and compulsory licensing
- Rights of government regarding patented products

Grant and Revocation of Patents

The Patents Act lays down the eligibility, procedures and conditions for grant of patents and grounds for revocation of patent.

Under the Act, a patent may be granted to an invention, subject to the provisions of the Act. According to the Act, an "invention" means a new product or process involving an inventive step and capable of industrial application. An "inventive step" means a feature of an invention that involves technical advance as compared to the existing knowledge or having economic significance or both and that makes the invention not obvious to a person skilled in the art.

There is also provision for the grant of patents of addition to the patentee (i.e., granting of patent in respect of any improvement in or modification of an invention which is patented. The grant of patent of addition shall be for a term equivalent to that of the patent for the main invention.

The Act also provides for revocation of patents on certain grounds such as any claim made for the grant of patent has been found invalid, or the Central Government feels that a patent or the mode in which it is exercised is mischievous to the state or generally prejudicial to the public interest.

Items not Patentable

A list of inventions and other subjects not patentable is provided in the Patents Act. Some examples of those which are not patentable: Inventions which are frivolous or contrary to public interest; method of agriculture or horticulture; any process of treatment of human beings or animals; plants and animals (other than microorganisms but including seeds, varieties and species and essentially biological processes for production or propagation of plants and animals); a mathematical or business method or a computer program *per se* or algorithms; the mere discovery of a scientific principles or the formulation of an abstract theory or discovery of any living thing or non-living substance occurring in nature; a mere scheme or rule or method of performing mental act or method of playing game; a presentation of information; topography of integrated circuits; an invention which, in effect, is traditional knowledge or which is an aggregation or duplication of known properties of traditionally known component or components.

Product Patent

The amended Act provides for grant of product patent. Previously, for food, pharmaceutical and chemical products only process patent was granted. This meant that any body was free to manufacture the same or similar product by a process different from the patented one. This is no more allowed because of the adoption of the product patent.

Patent Period

For food, pharmaceutical and chemical products, previously the patent period was 14 years. Now patents are granted for all products for a period of 20 years from the date of application.

Rights and Obligations of Patentee

The Act lays down the rights and obligations of patentee. A Patent granted under this Act confers on the patentee the exclusive right to use, make, sell or import the patented process/product. The Act normally prevents third parties from using, making, selling or importing the patented process/product without the consent of the patentee.

The Patents Act makes it clear that patents are not granted merely to enable patentees to enjoy a monopoly but to encourage inventions and to secure that the inventions are worked in India on a commercial scale and to the fullest extent that is reasonably practicable without undue delay; and to make the benefit of the patented invention available at reasonably affordable prices to the public.

Working of the Patent

As pointed out above, a patent is granted subject to certain considerations which ensure that it is properly worked in the country to serve the interests of the society. Working of patent means that the patented product is produced in India and made available sufficiently at reasonable prices within reasonable time.

The Act makes it clear that a patent is granted to encourage inventions and to secure that the inventions are worked in India on a commercial scale and to the fullest extent that is reasonably practicable without undue delay; the patent shall not be deemed a monopoly right to import the patented article in to the country. It is also expected that a patent contributes to the promotion of technological innovation and to the transfer and dissemination of technology to the mutual advantage of the producers and users of the technological knowledge.

Compulsory Licensing

The Act provides for compulsory licensing of the patent and revocation of the patent if it is not worked in the country.

A serious concern in India and elsewhere has been that product patents will result in exorbitant prices for drugs, seriously impairing the health and nutritional requirements of the large majority of the population. The considerations regarding the working of patents, laid down in the Act seek to safeguard the public interest in this respect. To protect the interests of the public, Indian Patents Act provides for grant of compulsory licence on ground such as failure to work the patent in the country. Compulsory licensing means grant of licence to third party to work the Patent in the country.

The compulsory licensing sections of the Act are intended to check the abuse of patent rights. They can be invoked if the reasonable requirements of the public with respect to patented inventions have not been satisfied and the patented invention is not available for public at a reasonably affordable price, and if the patented invention is not worked in the territory of India. Section 92 of this law provides for action in case of national emergency, extreme urgency and public non-commercial use, and can be invoked without the grace period of 3 years from grant of patent.

The Act also has a provision for enabling grant of compulsory licence for export of medicines to countries, which have insufficient, or no manufacturing capacity, to meet emergent public health situations (in accordance with the Doha Declaration on TRIPs and Public Health).

Parallel Import

The Act also provides for parallel import so that patented product can become available at the lowest international price.

Exceptions

The Patents Act also lays down certain exceptions to the rights of the patentee.

Any patented product or process may by made, imported or used by or on behalf of the government for its own use or purpose. The Central Government may also acquire a patent for public purpose, if necessary.

Any patented medicine or drug may be imported by the Government for the purpose merely of its own use or for distribution in any dispensary, hospital or other medical institution maintained by or on behalf of the Government or any other dispensary, hospital or other medical institution specified by the government in public interest.

Any patented process or product may be used or made by any person, for the purpose merely of experiment or research including the imparting of instructions to pupils.

Evaluation

The amendments to the Patents Act has come in for scathing criticism in India. The 1970 Act was regarded as a skillfully drafted piece of legislation which sought to protect the infant drugs and pharmaceuticals and chemicals industries from foreign monopolies in these fields. The critics fear that the adoption of product patent will enable the multinational drug firms to exploit the Indian consumers. While it is true that patent confers monopoly power on the patentee, in the absence of product patent the patentee does not get sufficient protection.

According to Government sources, the apprehensions that the Patent Amendment will drive up drug prices by ruling out access and availability of medicines at low cost are unfounded. "In the first place, the fact remains that 97 per cent of all drugs manufactured in India are off-patents and so will remain unaffected. These cover most of the life-saving drugs, as well as medicines for common ailments. In patented drugs also, in most of the cases there are always alternatives available. Further, the country has 13 Sections under Chapter XVI pertaining to Compulsory Licensing in place; and the Act has strong provisions under Chapter XVII of the Act for outright acquisition of patents to meet national requirements. Besides, there is also the Drug Price Control Order administered by the National Pharmaceuticals Price Authority. With such a framework in place, the concerns and fears relating to rise in drug prices are misplaced. Besides, there are adequate safeguards to protect the interests of domestic industry and the common man from any increase in the prices of drugs."

However, the fact that patented drugs, by and large, are vital ones makes the situation very serious. If the government does not make effective use of the safeguards in the Act to protect the interests of the consumers, their plight could become miserable.

It is also pointed out that, apart from manufacture of drugs, the product patent regime will help the pharmaceutical industry to tap outsourcing of clinical research. By participating in the international system of IPR protection, India, with its vast pool of scientific and technical personnel, and well-established expertise in medical treatment and health care, has unlocked vast opportunities in both exports and outsourcing and has the potential to become a global hub in the area of R&D based clinical research. The Patent Ordinance also provides adequate safeguards to protect the interest of the domestic industry, and the citizen from any increase in prices of drugs.

The Patent Act needs further fine-tuning.

DISPUTE SETTLEMENT

A proper mechanism for settling disputes is essential for effective and smooth functioning of a rules-based system. The WTO's procedure underscores the rule of law, and it makes the trading system more secure and predictable. The system is based on clearly defined rules, with timetables for completing a case.

WTO members have agreed that if they believe fellow-members are violating trade rules, they will use the multilateral system of settling disputes instead of taking action unilaterally. That means abiding by the agreed procedures, and respecting judgements.

Typically, a dispute arises when one country adopts a trade policy measure or takes some action that one or more fellow-WTO members considers to be breaking the WTO agreements, or to be a failure to live up to obligations. A third group of countries can declare that they have an interest in the case and enjoy some rights.

A procedure for settling disputes existed under the old GATT, but it had no fixed timetables, rulings were easier to block, and many cases dragged on for a long time inconclusively. The Uruguay Round agreement introduced a more structured process with more clearly defined stages in the procedure. It introduced greater discipline for the length of time a case should take to be settled, with flexible

deadlines set in various stages of the procedure. The agreement emphasises that prompt settlement is essential if the WTO is to function effectively. It sets out in considerable detail the procedures and the timetable to be followed in resolving disputes. If a case runs its full course to a first ruling, it should not normally take more than about one year — 15 months if the case is appealed. The agreed time limits are flexible, and if the case is considered urgent (e.g., if perishable goods are involved), then the case should take three months less.

The Uruguay Round agreement also made it impossible for the country losing a case to block the adoption of the ruling. Under the previous GATT procedure, rulings could only be adopted by consensus, meaning that a single objection could block the ruling. Now, rulings are automatically adopted unless there is a consensus to reject a ruling — any country wanting to block a ruling has to persuade all other WTO members (including its adversary in the case) to share its view.

Although much of the procedure does resemble a court or tribunal, the preferred solution is for the countries concerned to discuss their problems and settle the dispute by themselves. The first stage is therefore consultations between the governments concerned, and even when the case has progressed to other stages, consultation and mediation are still always possible.

ANTI-DUMPING MEASURES

The UR Agreement provides greater clarity and more detailed rules concerning the method of determining dumping and injury, the procedure to be followed in anti-dumping investigations, and the duration of anti-dumping measures. It also clarifies the role of dispute settlement panels in conflicts relating to anti-dumping actions taken by national authorities.

A product is regarded as dumped when its export price is less than the normal price in the exporting country or its cost of production plus a reasonable amount for administrative, selling and any other costs and for profits.

Anti-dumping measures can be employed only if dumped imports are shown to cause serious damage to the domestic industry in the importing country. Further, anti-dumping measures are not allowed if the 'margin of dumping' (i.e., the price differences) is *de minimis* (defined as 2 per cent of the export price of the product) or the volume of dumped imports is negligible (less than 3 per cent of imports of the product in question).

Dumping occurs when the price at which the goods are exported to India is lower than their normal value. The difference between this export price and the normal value is known as the margin of dumping. It is generally expressed as a percentage of the export price. In the ordinary course of trade, the normal value is the comparable price at which goods under complaint are sold in the domestic market of the exporting country or territory. If the normal value cannot be determined this way, the following two alternative methods are provided for: (i) Comparable representative export price to an appropriate third country, (ii) Cost of production in the country of origin with reasonable addition for administrative, selling and general costs and for profits.

In India, anti-dumping actions are taken by the Directorate of Anti-dumping and Allied Duties, Ministry of Commerce, as per the Customs Tariff Act, 1975, as amended in 1995, based on Article VI of GATT 1994. For the government to initiate anti-dumping action, the Indian industry must be able to show that dumped imports are causing or threatening to cause material injury to the Indian domestic industry. Obviously, the ability of India to do so depends on proper environmental monitoring, database and procedural familiarity.

Material retardation to the establishment of an industry, is also regarded as injury. For anti-dumping actions, a causal link between the material injury being suffered by the Indian industry and the dumped imports must be established.

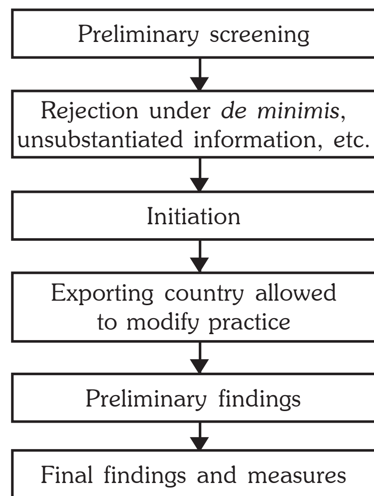


Fig. 2.3: Anti-dumping Investigation Process

The economic and financial impact of the dumped imports on the concerned Indian industry can be demonstrated, *inter alia,* by decline in output, loss of sales, loss of market share, reduced profits, decline in productivity, decline in capacity utilisation, reduced return on investments, price effects, and adverse effects on cash flow, inventories, employment, wages, growth, investments, ability to raise capital, etc. Anti-dumping action is not applicable if the margin of dumping is insignificantly small (less than two per cent of the export price) or the volume of imports is negligible (i.e., the volume from one country is less than three per cent of the total imports of that product), provided the aggregate imports from such countries do not account for more than seven per cent of total imports.

Anti-dumping duty shall not exceed the margin of dumping. It is suggested that it would be desirable if the appropriate authorities impose a lesser duty which is adequate to remove the injury caused to the domestic industry. The Government of India has accepted this principle.

Anti-dumping actions may be suspended or terminated if the exporter concerned furnishes an undertaking to revise the price to remove the dumping or the injurious effect of dumping. The rules also provide for retrospective measures in certain cases.

The anti-dumping investigation process is diagrammatically presented in figure 2.3.

SAFEGUARD ACTIONS

Members may take safeguard actions, i.e., import restrictions to protect a domestic industry from the negative effects of an unforeseen import surge, if a domestic industry is threatened with serious injury. The UR Agreement, however, prohibits the use of such actions where they constitute grey area measures, including voluntary export restraints, orderly marketing arrangements or other similar measures applied on either exports or imports. The existing grey area measures are to be phased out by 1999. Further, the Agreement provides for discipline on the use of all safeguard measures, including time limits, requirements for safeguard investigation, and non-discrimination (generally) among sources of supply.

Safeguard measures would not be applicable to developing countries where their share in the member country's imports of the product concerned is relatively small.

EVALUATION OF THE URUGUAY ROUND

The Uruguay Round was by far the most complex and controversial one. The fact that it took more than seven years to complete the negotiations as against the originally contemplated more than four years indicates the complexities involved. It is the inclusion of new areas like TRIPs, TRIMs, services and the attempts to liberalise agricultural trade and the elimination of NTBs like MFA that increased the complexity of the negotiations.

The success of the UR Agreement will depend upon the spirit with which it will be translated into practice. The tariffication of trade barriers was claimed to be a significant success of the UR. However, because of the way the NTBs were converted into tariffs, the so-called dirty tariffication, many of the tariff bindings exceeded the protection rate applying during the base period (which itself was one of generally high level of protection), some by as much as 200 per cent.

Several estimates of the gains from the UR Agreement are available. They vary widely. According to some estimates, the real world income (in constant 1992 US dollar) will increase by between $ 212 billion and $ 274 billion in 2005. Further, such annual increases will follow. This amounts to around one per cent of World GDP. According to a GATT study, the gain will be as high as $ 510 billion.[31]

Most of the gains will accrue to the developed countries. Some developing countries in the category of least developed countries and net food importers are expected to lose because of the Uruguay Round package.

According to some estimates the increase in real income will be roughly 1.6 per cent of GDP for the European Union, 0.2 per cent for the US and 0.9 for Japan. As a single country, the largest gain in absolute terms will accrue to the US (between $ 28 and $ 67 billion). It will be between $ 27 and $ 42 billion for Japan, between $61 and $ 98 billion for the EU and between $ 36 and $ 78 billion for the developing countries. The gains would amount to about 2.5 per cent of the GDP for China, 0.5 per cent for India, 0.6 per cent for South Africa and 0.3 per cent for Brazil.

The GATT had estimated that world trade would increase by 12 per cent (on top of the normal growth rate), if the UR package is completely implemented. In constant 1992 US dollars, this represents an increase of $ 745 billion. The value of world exports (including services) will increase by around 10 per cent. Exports of North America will increase by 8 per cent and European Union by 10.3 per cent. Some of the largest projected increases in world trade are in areas that are of interest to developing countries. For instance, world trade in textiles is projected to grow by 34 per cent, that in clothing by 60 per cent and that in agricultural, forestry and fishery products by 20 per cent.

According to the estimates made by the World Bank, OECD and the GATT Secretariat, the income effects of the implementation of UR package will add between $ 213 to $ 274 billion annually to world income. The GATT Secretariat's estimate of the overall trade impact is that the level of merchandise trade in goods will be higher by $ 745 billion in the year 2005, than it would otherwise have been. The largest increase will be in the areas of clothing (60 per cent), agriculture, forestry and fishery products (20 per cent) and processed food and beverages (19 per cent). Since India's existing potential export competitiveness lies to a significant extent in these product groups, India could be expected to obtain gains in these sectors.

It was estimated, cuts in protection on total merchandise trade will increase real incomes in developing countries by $ 55 to $ 90 billion (or 1.2 to 2 per cent of their GDP in 1992) while the gains to the world as a whole will be in the order of $ 200 billion.

EVALUATION OF WTO

WTO has come to play a very important role in the global, and thereby, national economies. National economic policies are significantly influenced by the principle, policies and agreements of WTO. Because of this, there are severe criticisms against WTO, particularly in the developing countries. In fact, WTO has both positive and negative impacts. The growing acceptance of GATT/WTO, despite their shortcomings, is evinced by the increase in the number of member countries. When the GATT was signed, in 1947, only 23 nations were party to it. The membership of the WTO increased from 128 in July 1995 to 161 countries at the end of April 2015 and a number of nations more have been negotiating membership. It is interesting to note that the People's Republic of China, which was one of the original signatories of the GATT quit it in the late 1940s following the assumption of power by the communist party, but got admitted to the WTO, after prolonged negations, with effect from January 1, 2002. The WTO members now account for over 95 per cent of the international trade indicating the potential of the WTO in bringing about an orderly development of the international trade.

Benefits of WTO

1. GATT/WTO has made significant achievements in reducing the tariff and non-tariff barriers to trade. Developing countries too have been benefiting significantly out it.
2. The liberalisation of investments has been fostering economic growth of a number of countries.
3. The liberalisation of trade and investment has been resulting in increase in competition, efficiency of resource utilisation, improvement in quality and productivity and fall in prices and acceleration of economic development.
4. WTO provides a forum for multilateral discussion of economic relations between nations.
5. It has a system in place to settle trade disputes between nations.
6. WTO has a mechanism to deal with violation of trade agreements.
7. WTO does considerable research related to global trade and disseminates a wealth of information.

Drawbacks/Criticisms

As mentioned above, the WTO has been subjected to a number of criticisms. Important drawbacks/ criticisms include the following.

1. Negotiations and decision-making in the WTO are dominated by the developed countries.
2. Many developing countries do not have the financial and knowledge resources to effectively participate in the WTO discussions and negations.
3. Because of the dependence of developing countries on the developed ones, the developed countries are able to resort to arms-twisting tactics.
4. Many of the policy liberalisations are done without considering the vulnerability of the developing countries and the possible adverse effect on them.
5. The WTO has not been successful in imposing the organisation's disciplines on the developed countries.
6. The developing countries have, in general, been getting a raw deal from the WTO.

It may also be noted that it has become a trend to blame WTO even for matters for which it is not responsible.

It is necessary that the developing countries do their homework properly before they go to the negotiating table, stand united to protect their common interests and formulate and implement strategies to combat the threats and to take advantage of the opportunities of the emerging world order.

The tragedy, however, is that not only that the developed countries are not earnestly implementing the provisions of the UR Agreement which will benefit the developing countries, but also they tend to become more protectionist in several respects. The irony is that while the developing countries have been increasingly opening up their markets, the developed countries have been increasing the barriers to the developing countries in several respects.

Joseph E. Stiglitz, a Nobel laureate and former chief economist and senior vice president of World Bank (had also been on the Council of Economic Advisors under President Clinton) observes that "the level of pain in developing countries created in the process of globalisation and development as it has been guided by the IMF and the international economic organisations has been far greater than necessary. The backlash against globalisation draws its force not only from the perceived damage done to developing countries by policies driven by ideology but also from the inequities in the global trading system. Today, few—apart from those with vested interests who benefit from keeping out the goods produced by the poor countries—defend the hypocrisy of pretending to help developing countries by forcing them to open up their markets to the goods of the advanced industrial countries while keeping their own markets protected, policies that make the rich richer and the poor more impoverished—and increasingly angry."

THE DOHA DEVELOPMENT AGENDA

The Doha Round (DR), which was officially launched at the WTO's Fourth Ministerial Conference in Doha, Qatar, in November 2001, is the latest round of trade negotiations among the WTO members.

The aim of DR is to achieve major reform of the international trading system through the introduction of lower trade barriers and revised trade rules. The Round is also known semi-officially as the Doha Development Agenda as a fundamental objective is to improve the trading prospects of developing countries. The Ministerial Declaration made at the launch of Doha Round placed development at its centre. "We seek to place developing countries' needs and interests at the heart of the Work Programme adopted in this Declaration," they said: "… We shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules, and well targeted, sustainably financed technical assistance and capacity-building programmes have important roles to play." The Ministerial Declaration provided the mandate for the negotiations in 10 important areas, viz., agriculture; non-agricultural market access (NMA); services; rules; intellectual property; geographical indications and biodiversity; trade and environment; trade facilitation; special and differential treatment; dispute settlement; and, e-commerce.

Agriculture

The agriculture negotiations began in 2000, under a commitment of members made in the 1986-94 Uruguay Round to continue reform in the trade. They were brought into the Doha Round when it was launched in 2001. Broadly, the objective is to reduce distortions in agricultural trade caused by high tariffs and other barriers, export subsidies, and some kinds of domestic support. The negotiations also take into account social and political sensitivities in the sector and the needs of developing countries.

Non-agricultural Market Access (NAMA)

Non-agricultural products include industrial goods, manufactured goods, textiles, fuels and mining products, footwear, jewellery, forestry products, fish and fisheries, and chemicals. Collectively, they represent almost 90% of world merchandise exports. Three crucial elements in the negotiation are: (1) *To cut tariffs* according to general formula based on a coefficient. Overall around 40 countries,

which include the world's largest traders, will apply the formula. All the others have different specific provisions. (2) *Flexibilities* for developing countries (that would allow these countries to make smaller or no cuts in tariffs for limited percentages of their most sensitive sectors). (3) *Special treatment* for small, vulnerable economies (31); least-developed countries (LDCs) (32); recently acceded members (RAMs) (16); members with low binding coverage (12); and others.

Services

Services such as telecommunications, banking, insurance, construction, distribution and transport help to enhance overall economic performance.

Over the last 20 years or so, the government's role in the supply of many services has changed fundamentally from producer, distributor and financier to regulatory control and enforcement. To reflect these new market realities, the international trading system was adjusted with the entry into force of the WTO's General Agreement on Trade in Services (GATS) in January 1995. The four modes of delivering or trading a service as defined in the Uruguay Round were mentioned under the caption GATS in this chapter.

Under the Doha Round of Negotiations: (1) Governments aim to open, improve and clarify the rules on regulations, the poorest countries and flexibilities. (2) A la carte system: Each government has the right to decide which sectors it wants to open to foreign companies and to what extent, including any restrictions on foreign ownership.

The main concern is whether the GATS force governments to privatise and deregulate all services, including public services, to allow foreign competition from transnational corporations? There is no legal obligation on a government to privatise any service, nor does the GATS outlaw government or private monopolies. Even if a government decides to open its domestic public services to foreign suppliers, it retains the right to set limits on foreign involvement, to set qualification requirements, to set standards for consumer health and safety and to introduce new regulations to pursue any other policy objective.

Some key issues in the Doha negotiations are:

- Many developed countries are looking for new export opportunities in sectors such as financial services, telecoms, energy services, express delivery and distribution services.
- Several developing countries are seeking similar opportunities in sectors such as tourism, medical services and professional services, as well as opportunities for their individual service providers under mode 4.
- In addition, many countries, both developed and developing, are working on clearer disciplines on domestic regulations such as qualification standards for professionals such as accountants, lawyers and healthcare workers.

Rules

The Negotiating Group on Rules covers anti-dumping; subsidies and countervailing measures, including fisheries subsidies; and regional trade agreements. The main aims are:

- The negotiations are aimed at "clarifying and improving disciplines" under the Agreements on Anti-dumping, and on Subsidies and Countervailing Measures.
- Participants also aim to "clarify and improve WTO disciplines on fisheries subsidies, taking into account the importance of this sector to developing countries".
- The negotiations are also aimed at "clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements".

Anti-dumping

An informal group of 15 participants (Brazil; Chile; Colombia; Costa Rica; Hong Kong, China; Israel; Japan; Korea; Mexico; Norway; Singapore; Switzerland; Chinese Taipei; Thailand; and Turkey), calling themselves "Friends of Anti-dumping Negotiations" (FANs), believe that the existing Anti-dumping Agreement should be improved to counter what they consider to be an abuse of the way anti-dumping measures can be applied. They have tabled many proposals for tightening disciplines on the conduct of anti-dumping investigations.

The US and other major users of anti-dumping have emphasised the importance of ensuring that anti-dumping measures remain effective in addressing unfair trade. They have also proposed a number of amendments to the anti-dumping and countervailing rules.

Subsidies and Countervailing Measures

The negotiations in subsidies and countervailing measures relate to two related subjects: the multilateral disciplines governing the provision of subsidies by members, and the disciplines on the use of countervailing measures against subsidised imports. With respect to multilateral subsidies disciplines, there have been an increasing number of WTO disputes in recent years, relating for example to commercial vessels, regional aircraft, large civil aircraft, and cotton. With respect to countervailing measures, some 202 countervailing-duty investigations have been initiated since 1995. The number of initiations has gone down from a peak of 41 in 1999 to 14 in 2008.

Although there have been fewer proposals on subsidies than on anti-dumping, a wide range of proposals have nevertheless been submitted regarding prohibited subsidies, actionable subsidies and export credits. Many proposals made in the anti-dumping negotiations, such as with respect to injury determinations and investigation procedures, may also be relevant in the context of countervailing measures.

Trade and Environment

At Doha, members agreed to negotiate on greater market opening in environmental goods and services; on the relationship between WTO rules and trade obligations set out in multilateral environmental agreements (MEAs) and on the exchange of information between those institutions.

Trade Facilitation

The endeavour is to cut red tape at the border. The aim is to ease trade flows and customs procedures and to facilitate the movement, release and clearance of goods. More specifically, members will clarify and improve three articles of GATT relating to transit, fees and formalities (paperwork and documentation) connected with trade, and transparency of regulations. This is an important addition to the overall negotiation since it would cut bureaucracy and corruption in customs procedures and would speed up trade and make it cheaper by saving millions of dollars.

Special and Differential Treatment

The WTO agreements contain special provisions which give developing countries special rights and allow other members to treat them more favourably. These are "special and differential treatment provisions" (abbreviated as S&D or SDT). The special provisions include:

- Longer time periods for implementing agreements and commitments
- Measures to increase trading opportunities for these countries
- Provisions requiring all WTO members to safeguard the trade interests of developing countries
- Support to help developing countries build the infrastructure to undertake WTO work, handle disputes, and implement technical standard
- Provisions related to least-developed country (LDC) members

In the Doha Declaration, ministers agreed that all special and differential treatment provisions should be reviewed, in order to strengthen them and make them more precise, effective and operational.

Dispute Settlement

At the Doha Ministerial Conference in November 2001, members agreed to negotiate to improve and clarify the dispute settlement system. The negotiations are not formally part of the single undertaking, which means they are not legally tied to the success or failure of the other negotiations mandated by the declaration.

E-commerce

Since 1998, WTO members have agreed not to impose customs duties on electronic transmissions. A work programme was set up at the same time to clarify the concepts and impacts of this new area in trade. One of the decisions ministers are expected to take at their 2009 conference in Geneva is to extend this "moratorium" on charging duties, as they have previously done from one ministerial conference to the next.

Broadly speaking, electronic commerce is the advertising, sale and distribution of products or services electronically.

The WTO work programme was launched in 1998 and reinforced at the Doha Ministerial Conference in 2001. The General Council has decided that the task should cover reviewing all issues related to trade arising from global electronic commerce, including the economic, financial and development needs of developing countries.

Related issues have been examined by the Services, Goods and Intellectual Property (TRIPS) Councils and the Trade and Development Committee. However, activity slowed in recent years. From the 2005 Hong Kong Ministerial Conference, when ministers last raised the issue, until the run-up to the Geneva Ministerial Conference in 2009, no substantive discussions took place.

A Review of DR

Even after a decade of its launching, the Doha Round has not come to a consensus and conclusion on many issues. As *The Economist* has remarked, ten years of trade talks have sharpened divisions, not smoothed them (April 28th, 2011). The wish for a deal by the end of 2011 has not materialised. In a blunt assessment of the state of affairs, Pascal Lamy, the head of the WTO, pointed to "a clear political gap" which "is not bridgeable."

The most significant differences are between developed nations led by the European Union (EU), the United States (USA), and Japan and the major developing countries led and represented mainly by Brazil, China, India, South Korea, and South Africa. There is also considerable contention against and between the EU and the USA over their maintenance of agricultural subsidies — seen to operate effectively as trade barriers. One of the most serious bones of contention is the aim of proposed cuts in tariffs on manufactured goods. America sees the Doha talks as its final opportunity to get fast-growing emerging economies like China and India to slash their duties on imports of such goods, which have been reduced in previous rounds but remain much higher than those in the rich world. It wants something approaching parity, at least in some sectors, because it reckons its own low tariffs leave it with few concessions to offer in future talks. But emerging markets insist that the Doha round was never intended to result in such harmonisation. These positions are fundamentally at odds.

A major problem confronting the development countries pertain to implementation issues. Developing countries pointed out that they have had problems with the implementation of the agreements reached in the UR because of limited capacity or lack of technical assistance. Further, they also claim that

they have not realised certain benefits that they expected from the Round, such as increased access for their textiles and apparel in developed-country markets. They seek a clarification of language relating to their interests in existing agreements.

A small number of these implementation issues were resolved before the Doha Ministerial. At the Doha meeting, the Ministerial Declaration directed a two-path approach for the large number of remaining issues: (a) where a specific negotiating mandate is provided, the relevant implementation issues will be addressed under that mandate; and (b) the other outstanding implementation issues will be addressed as a matter of priority by the relevant WTO bodies. Outstanding implementation issues are found in the area of market access, investment measures, safeguards, rules of origin, and subsidies and countervailing measures, among others.

India's Stand on Key Negotiating Issues

Agriculture

- Substantial and effective reductions in overall trade-distorting domestic support (OTDS) of the US and EU.
- Self-designation of an appropriate number of special products (SPs).
- An operational and effective Special Safeguard Mechanism (SSM).
- Simplification and capping of developed country tariffs.

Non-Agricultural Market Access (NAMA)

- Adequate and appropriate flexibilities for protecting economically vulnerable industries.
- Participation in sectoral initiatives only on a non-mandatory and good faith basis without prejudgement of the final outcome, with substantial special and differential treatment provisions for developing countries.
- Serious consideration of non-tariff barrier (NTB) textual proposals with wide support such as the horizontal mechanism.

Services

- Need for qualitative improvement in the revised offers especially on Modes 1 (cross-border supply) and 4 (movement of natural persons).
- Appropriate disciplining of domestic regulations by developed countries.

Rules

- Tightening of disciplines on anti-dumping (deletion of zeroing clause and reiteration of the lesser duty rule).
- Effective special and differential treatment for developing countries on fisheries subsidies.

Trade-related Aspects of Intellectual Property Rights (TRIPs)

- Establishing a clear linkage between the TRIPs Agreement and the Convention on Bio-diversity (CBD) by incorporating specific disclosure norms for patent applications.
- Enhanced protection for geographical indications (GIs) other than wines and spirits.

(This sub-section is adopted from Government of India, *Economic Survey* 2011-12.)

WTO AND DEVELOPING COUNTRIES

As in the case of the previous Rounds, the developing countries, in general, are dissatisfied with the outcome of the Uruguay Round.

Do Developing Countries Lose Out in the WTO System?

The Wall Street Journal has reported that while the US and the EC are getting the best pieces of the world trade pie, the developing countries are getting the crumbs.

It is true that the Uruguay Round mostly benefits the developed countries. That does not mean that developing countries like India are losing – their gain is limited as compared to that of the developed countries. Certain indiscriminate liberalisations indeed harm the interests of the developing countries, particularly the most disadvantaged among them like the LDCs and further liberalisation by developed countries is needed for the developing countries to take advantage of globalisation.

Special Consideration

Some of the areas like TRIPs, TRIMs and services have been very sensitive as far as the developing countries are concerned as the Uruguay Round Agreements in them mean that the developing countries will have to lower the protection against competition from the unequal developed economies. However, as in the previous Rounds, the UR also gives special considerations to developing countries, particularly to the least developed countries and to those with balance of payments problems. The Agreement, however, lays down that member countries imposing trade restrictions for balance of payment purposes should do so in a way that causes minimum disruption to international trade and quantitative restrictions should be avoided as far as possible.

The Hong Kong Ministerial Meet held in December 2005 also has recognised the need for special consideration to some of the problems of the developing countries.

The problems of developing countries, however, need a more serious consideration by the WTO.

Agricultural Trade Liberalisation

Indeed, it would be the developed countries who would suffer most by liberalisation of the agricultural sector. But to argue that the developed countries should completely liberalise agriculture without any reciprocity on part of the developing countries is clearly illogical. As a matter of fact, the UR proposals in respect of agriculture, as in several other cases, give special consideration to the developing countries. Developed countries will, however, be hit hard. For example, agricultural subsidies in the European countries have been of the order of 30 to 50 per cent.

While the liberalisation of agricultural trade and the increase in agricultural prices due to cut in producer subsidies in the developed countries would benefit agricultural exporters, the increase in food prices due to cut in subsidies may adversely affect the food importers. More than 100 of the developing nations are reported to be net food importers. However, the increase in food prices should be expected to make food production in these countries more competitive leading to an increase in production. It may be noted here that it has been alleged that the subsidisation of production and export of farm production in the developed countries would have the effect of discouraging their production in the developing countries where farmers have not been able to compete with the imported stuff bearing artificially low price because of the subsidies. It is estimated that since subsidised agricultural exports cannot be dumped on the world market, international agricultural prices could go up by as much as 10 per cent.

Textiles Trade Liberalisation

International trade in textiles was estimated to be worth $ 240 billion a year. Estimates are that after the phasing out of MFA, world exports of textiles may go up by $ 25 billion a year. With a 2.2 per cent share in the world textile trade, India's share in the additional exports could be $ 0.55 billion. But the real gain will depend on the country's ability to compete with countries like China, Hong Kong, Taiwan, South Korea, etc. which are considered leaders in the textile trade.

Services Trade Liberalisation

Developing countries were very apprehensive about the proposal to liberalise trade in services. However, fortunately for them, the differences of opinion between the US and EC on this issue left the service sector largely unaffected.

Dissimilar Effects

The effect of the UR is not the same on all countries. For example, a measure which favourably affects one developed country may unfavourably affect another developed country. Further, the extent of the favourable or unfavourable impact may also vary. It is, therefore, quite natural that conflicts of interest have occurred both among developed and developing countries. Latin American countries were perhaps not very interested in liberalising the trade in textiles because they calculated that if they could gain a direct entry to the NAFTA through some regional arrangement, it would provide them an edge over competitors like India and Pakistan.

Some studies also show that Sub-Saharan Africa, Indonesia and some Caribbean islands will be poorer as a result of the UR Agreement. However, if liberalisation leads to higher productivity, they would also gain.

No country is, therefore, entirely pleased with the UR proposals. "The surest proof of the success of the Uruguay Round is that no country is entirely happy at the outcome." Although India is quite dissatisfied that the textile trade is not adequately liberalised, some people in the US are angry over the liberalisation move, alleging that two million jobs in the US would now hang in balance.

As the foreign minister of Uruguay remarked, all nations which signed the Uruguay Round Trade Agreement have "a sense of shared dissatisfaction." As the GATT Director General Peter Southerland stated, the signing of the Uruguay Round trade pact does not mean the end of disputes. Southerland remarked that it marked the start of disputes. There will be disputes between developed and developing countries, between developing countries and between developed countries. "There are more than 5 billion people competing for their share of the pie, and that makes conflicts all the more inevitable."

Unequal Participation

Although it was expected that significant benefits would accrue to the developing countries from the UR Agreement, they have been encountering many roadblocks.

The developing countries are disadvantaged in the WTO system because of their inability to effectively participate in the negotiation process. They suffer from lack of intellectual and financial capability to meaningfully participate in the discussions and negotiations. They are not able to understand the implications and possible impacts of different proposals and agreements because of their analytical deficiencies. According to Dubey, "most of the agreements and understandings reached during the Uruguay Round trade negotiations are unequal and unbalanced from the point of view of developing countries. This was mainly because of the weak bargaining position of these countries, their general state of unpreparedness for the negotiations, their dearth of skilled manpower and financial resources to participate effectively, and the lack of transparency in the negotiating process. Some of the agreements are inherently unequal and unbalanced."[32]

Besides, lack of earnestness on the part of the governments is also responsible for the suffering of the developing countries. For example, the delay in taking protective measures in respect of geographical indications by Government of India is responsible for the *basmati* rice issue and the like.

Box 2.5

The Participation Gap

Just as inclusive democracy is needed to ensure minority participation at the national level, inclusive global democracy is needed in which all countries—small and weak as well as large and powerful—have a voice in decisions. Participation is needed as a matter of right, and to create a global economy with fair and just rules. Global economic policy-making occurs in a world of grossly unequal economic and political power. The playing field is not level when the "teams" have vastly different resources, expertise and negotiating power. Poor and small countries can ill afford the high costs of participating in the WTO, for example. Fourteen of them have either a one-person delegation in Geneva or none at all. They lack access to well-researched legal and economic policy advice. And they cannot afford top legal representation in dispute settlements. The community of states has an obligation to put in place procedures for greater participation and transparency in global decision-making. The WTO, for example, has been heavily criticised for its non-transparent and non-participatory decision-making, depending more on informal consensus than formal procedures. A major review of decision-making in international bodies should focus on two issues. One is the participation of small and weak countries in the processes of negotiation and dispute settlement. The second is the participation of civil society—including corporations, trade unions and global networks of NGOs—in a forum for open debate rather than in behind-the-scenes lobbying and on-the-street demonstrations.

Courtsey: UNDP, *Human Development Report 2000.*

An IMF publication observes that while small and poor countries have acquired a very significant say in decision-making in the WTO, their ability to participate in the "reciprocity game" at the heart of the WTO remains limited. These countries also pose a challenge for the WTO because their interest in the broader trade liberalisation agenda is more limited as a result of their existing preferential access to rich country markets.[33]

One of the underlying reasons for the developing countries not benefiting much out of WTO is "that it is a mercantilist institution in the sense that countries trade off one another's protection—you give me better access to your market, and I'll give you better access to my market. The currency for these negotiations is market size. However, the small and poor countries don't have much to offer either individually or collectively to the rest of the world in terms of market access."

So their influence derives not from this traditional coinage of the WTO but from the fact that the WTO is a very democratic institution. Each country has one vote and to make a major.

Implementation Issues

The developing countries are virtually deceived in several cases as the UR Agreements have not been implemented in letter and spirit by the developed countries. They have resorted to covert measures to deny the developing countries the legitimate benefits of the proposed trade liberalisations.

Dubey points out that, subsidies normally maintained by developed countries have been made non-actionable, while several of those given by developing countries in pursuit of an export-led development strategy have either been prohibited or put in the actionable category. Subsidies to farmers maintained by major developed countries have, instead of coming down, gone up primarily because these countries were able to switch over to subsidies permissible under the Agreement on Agriculture, before the commencement of its implementation.[34] Liberalisation of textiles trade has hailed as a boon for the developing countries. However, here also the developing countries have been deceived because developed importing countries have sought to comply with the targets of liberalisation set out in the Agreement on Textiles and Clothing (ATC) by taking credit for the items already outside restriction.[35]

As an UNCTAD Report points out, rich countries, despite their commitment in the TRIPs agreement, have taken no real steps to share their technology in the interests of reducing poverty. The TRIPs agreement includes provisions for technology transfers, but with few details and no discussion on

implementation. The TRIPs agreement does not provide intellectual property protection for indigenous knowledge such as those used in traditional medicine. The TRIPs agreement introduces a global minimum standard for promoting invention. Intellectual property regimes are intended to balance the two social goals of promoting inventions and promoting the use of inventions, Thus, the TRIPs agreement incorporates provisions in the interests of users, such as compulsory licensing or parallel imports that give governments flexibility to allow local manufacturing or imports of goods under patents. But the wording of these provisions is so vague that they are difficult to apply—so clarifying them would be a first step.

Another way rich countries tilt the playing field for trade seems, on its face, to have little to do with trade. Rich countries, to varying degrees, pay large subsidies totheir domestic food producers. These subsidies are so large—totalling $ 311 billion a year—that they affect world market prices of agricultural goods, causing direct harm to poor countries. EU-subsidised exports have contributed to the decline of the dairy industries in Brazil and Jamaica and the sugar industry in South Africa. West African cotton producers have increased the efficiency of their cotton sector, achieving competitive production costs. But they cannot compete against subsidised farmers in rich countries. Annual agricultural subsidies in rich countries considerably exceed the national income of all of Sub-Saharan Africa.

Developing countries have identified various instances of inequalities and imbalances in the Uruguay Round Agreements and submitted a large number of formal proposals for rectifying them. These proposals have been known as the implementation issues. It is argued that the implementation issues should be urgently resolved and any new round of MTN shall be taken up only after that. However, the developed countries want the new round of MTN soon.

"The implementation issues are not a spanner thrown by a group of developing countries to ape a new round of trade negotiations. Their attempt to resolve them is designed to safeguard their most vital trading interests and to restore a modicum of balance in WTO agreements after an unfortunately belated realisation that developing countries were short-changed in the Uruguay Round negotiations. What is at stake is the very credibility of the international trading system in the eyes of the developing countries. Resolution of the implementation issues is the only way to restore credibility."[36]

Conclusion

One of the achievements of the UR is the making of the rules and regulations more transparent, thus making trade harassment and unilateral actions more difficult. The results of the UR will be implemented by the newly set up World Trading Organisation (WTO) making dispute settlement and arbitration easier.

Because of the unequal participation and lack of bargaining power, the developing coutries have not been getting a fair deal from the WTO and other international organisations. To make matters worse, as observed earlier, while the developing countries have been increasingly opening up their markets, the developed countries have been increasing protection and denying justice to the developing countries in several respects. As Stiglitz candidly observes, "the international institutions must undertake the perhaps painful changes that will enable them to play the role they *should* be playing to make globalisation work, and work not just for the well off and the industrial countries, but for the poor and the developing nations. The developed world needs to do its part to reform the international institutions that govern globalisation. We set up these institutions and we need to work to fix them. If we are to address the legitimate concerns of those who have expressed a discontent with globalisation, if we are to make globalisation work for the billions of people for whom it has not, if we are to make globalisation with a human face succeed, then our voices must be raised. We cannot, we should not, stand idly by."[37]

WTO AND INDIA

The Uruguay Round Agreements and WTO have come in for scathing criticisms in India. Many politicians and others have argued that India should withdraw from the WTO. Most of the criticisms are either baseless or due to lack of knowledge of the international trading environment, and misinformation, or are just meant to oppose the government by the opposition parties.

Should India Quit WTO?

Accepting the demand of some of the critics, that India should withdraw from the WTO will be a great blunder that the nation can commit. By being a part of WTO, India enjoys the most favoured nation (MFN) status with all the other members of the WTO. Opting out of the system would mean an infinitely laborious task of entering into bilateral negotiations with each and every one of the trading partners which would amount to "having one's arms twisted bilaterally by the US, the EC and Japan, turn by turn, on everything from intellectual property rights to NPT, human rights and environmentally clean technologies for packaging." It may be noted at this juncture that China got readmitted to the system after a long wait and lobbying.

One major controversy pertains to the agricultural subsidies. Much hue and cry have been raised in India about this factor. However, it needs to be mentioned that the Agreement would not adversely affect India's agricultural subsidies and its agriculture exports. Developing countries were expected to largely benefit because of the lowering of the agricultural protection by the developed countries, in spite of the fact that the wish of the developing countries that the major Western nations would totally drop subsidies for their producers, substantially lower tariffs, and open markets did not materialise. However, the developed nations, in general, have not brought about the expected liberalisation.

India's Trade Gain

Assuming that India's market share in world exports improves to one per cent, and that she is able to take advantage of the opportunities that are created, the trade gains may consequently be placed at $ 2.7 billion exports per year. More generous estimates range from $ 3.5 to $ 7 billion worth of extra exports.

However, India's gain will be much less than those of several other developing countries like China and the newly industrialised economies because: (i) India's share in the world trade is very low and (ii) The foreign trade-DGP ratio of India is low. The gain will also depend on the rate of growth of India's exports.

Compliance Measures

India has taken several measures to comply with the TRIPs Agreement. On copyrights and related rights, the Agreement requires compliance with the provisions of *Bern Convention to* which India is a signatory and the new Copyright Act of India already meets the requirements of the TRIPs Agreement. Trade and Merchandise Marks Act of 1958 was replaced by a new Act, namely, The Trade Marks Act, 1999, so as to provide for the protection of service marks also.

For the protection of Geographical Indications of Goods, a *sui generis* legislation, viz., the Geographical Indications of Goods (Registration and Protection) Act, 1999 has been enacted in order to comply with the requirements under the TRIPs Agreement and to protect products of Indian origin as well. The Act primarily intends to protect the valuable geographical indications of our country. The protection under the Act is available only to the geographical indication registered under the Act and to the authorised users. The Act permits any association of persons or producers or any organisation or authority established by law representing the interest of the producers of goods to register a geographical indication. It may be possible to argue that the holders of the traditional

knowledge in goods produced and sold using geographical indication can register and protect their traditional knowledge under this law.

The Indian Parliament has passed the Protection of Plant Varieties and Farmers' Rights Act, 2001 with the objective of giving a significant thrust to agricultural growth by providing an effective system for the protection of plant varieties and farmers' rights. This is expected to stimulate investments for research and development both in the public and the private sectors for the development of new plant varieties by ensuring appropriate returns on such investment. The Indian legislation acknowledges that the conservation, exploration, collection, characterisation, evaluation of plant genetic resources for food and agriculture are essential to meet the goals of national food and nutritional security as also for sustainable development of agriculture for the present and future generations. It also acknowledges that the plant genetic resources for food and agriculture are the raw material indispensable for crop genetic improvement. The concept of effective benefit sharing arrangement between the provider and the recipient of the plant genetic resources forms an integral part of our Act.

India provides for the protection and enforcement of different fields of intellectual property through both specific national legislation as well as the Code of Civil Procedure and the Code of Criminal Procedure by way of civil remedies and criminal penalties. These provide effective deterrent to the infringement of IPRs. The criminal cases and civil suits for the infringement of IPRs lie in the judicial system for other cases.

The amended patent law contains provisions for mandatory disclosure of source and geographical origin of the biological material used in the invention while applying for patents in India. Provisions have also been incorporated to include non-disclosure or wrongful disclosure of the same as grounds for opposition and for revocation of the patents, if granted. To protect traditional knowledge from being patented, provisions have also been incorporated in the law to include anticipation of invention by available local knowledge, including oral knowledge, as one of the grounds for opposition as also for revocation of patent. In order to further strengthen these provisions, a new provision has been added to exclude innovations which are basically traditional knowledge or aggregation or duplication of known properties of traditionally known component or components from being patented.

India is a party to the Connection on Biological Diversity (CBD), which came into force in December 1993. The CBD offers opportunities to India to realise the benefit of these resources. We have already introduced a Bill in the Parliament which is likely to be passed in the coming Winter Session of the Parliament in December 2002. The proposed legislation addresses the basic concerns of access to, collection and utilisation of biological and knowledge by foreigners and sharing of benefits arising out of such success.

Various suggestions have been advanced in India to extend protection to knowledge, innovations and practices. These include: (i) documentation of TK; (ii) registration and innovation patent system; and (iii) development of a *sui generis* system. It is sometimes believed that proper documentation of associated TK could help in checking bio-piracy. Documentation could be a double-edged sword. It is assumed that if the material/knowledge is documented, it can be made available to patent examiners the world over so that prior art in the case of inventions based on such materials/knowledge are/is readily available to them.

SUMMARY

The salient features of the Uruguay Round Agreement are given below:

1. The Uruguay Round substantially expanded the scope of multilateral trade negotiation by including services, intellectual property rights (TRIPs) and trade related aspects of investment measures (TRIMs), as against only goods in the past.

2. With effect from January 1, 1995, GATT (which was temporary and ad hoc) was replaced by a permanent organisation, the WTO.

3. WTO is GATT plus a lot more. Under the GATT there was only one major agreement — GATT. Under the WTO, there are agreements related to three major areas — GATT, GATS and TRIPs.

4. WTO is a more powerful and effective organisation than GATT. It has a more effective dispute settlement mechanism.

5. The Uruguay Round Agreement seeks to liberalise trade in manufactures by enlarging tariff bindings, reducing tariffs and removing tariffs.

6. A significant achievement of the UR is the measures to liberalise trade in agriculture, which was a highly protected sector, particularly in the developed countries. These measures are tariffication, tariff bindings, tariff cuts and reduction in subsidies and domestic support.

7. All member countries are required to adopt product patent (as also process patent). India had only process patent for drugs, food and chemical substances for which the patent period was 7 years and 14 years for other products. Under the WTO regime, the patent period for all products is 20 years.

8. As under GATT, under WTO also developing countries, particularly least developed countries, are accorded a number of concessions and favours. Their liberalisation requirements are lower and they are allowed longer period to fulfil the liberalisation commitments. The WTO also calls upon the developed nations to grant special preferences to imports from developing countries. There are also some committees under the WTO to look after the interests and special needs of the developing countries.

9. There is a general complaint that the fruits of the liberalisation accrue mostly to the developed countries. It is pointed out that the industrialised countries, which make up only 20 per cent of the membership, will appropriate about 70 per cent of the additional income generated by the implementation of the UR agreements. The losers, mostly in Africa and Caribbean, are some of the poorest countries in the world. The developed countries gain substantially because of their higher level of participation in trade and because of the fact that significant part of liberalisations has been in respect of goods of interest to them. Liberalisation of trade in textiles, by phasing out MFA, however, will substantially benefit the developing countries.

10. Even after all UR concessions are fully implemented by the industrialised countries, significant trade barriers in the form of high tariff peaks (exceeding 12 per cent but in some cases reaching or exceeding 300 per cent) will continue to affect many exports from developing countries. The removal of such barriers needs to be given high priority. There are several other areas of critical importance to the developing countries.

11. Developing countries are terribly disadvantaged due to the *participation gap* and the improper implementation.

12. Estimates of India's possible gain from the trade liberalisation vary very widely — between $ 2 billion and $ 7 billion a year. Although the liberalisation of trade in textiles will benefit the developing countries, India's gain will depend a lot on her competitive strength *vis-a-vis* other textile exporters.

India's gain from the trade liberalisation will be much less than that of many other developing countries, such as the South-East Asian economies and China, because India's share in the world trade is very low (less than one per cent) and her foreign trade-GDP ratio is very low.

The principles and Agreements of WTO have very significant impact on the business environment. Figure 2.4 provides a bird's eye view of the important impacts.

Note: The material on 'The Doha Declaration' given in this chapter is adopted from Government of India, *Economic Survey,* 2001-02.

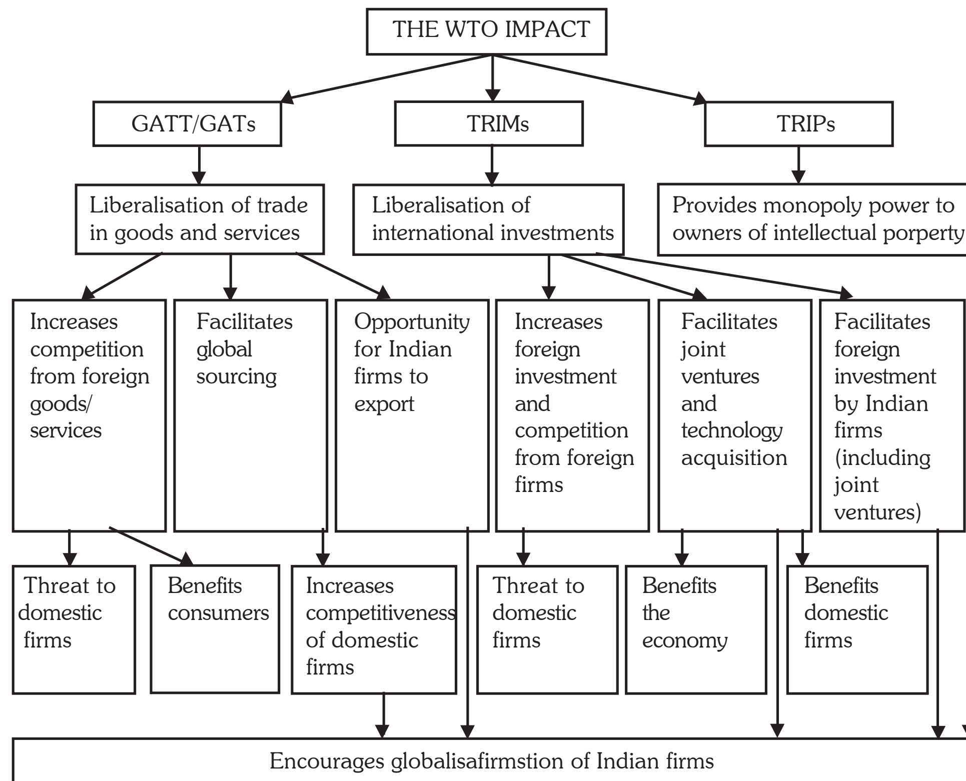


Fig. 2.4: The WTO Impact

THE BALI PACKAGE

The 9th Ministerial Conference of the WTO was held in Bali (Indonesia) in December 2013. In this Ministerial, all the 159 members of the WTO agreed on a package of measures which represents a positive step towards concluding the Doha Round of trade negotiations, which began in 2001.

The "Bali Package", which is the first set of agreements struck since the WTO was created in 1995, embodies a series of decisions aimed at streamlining trade, allowing developing countries more options for providing food security, boosting least-developed countries' trade and helping development more generally.

The "Bali Package", consists of a selection of issues from the broader Doha Round negotiations. It comprises 10 ministerial decisions/declarations covering, the following three broad areas, which are described as the three pillars of the Bali Package:

Trade facilitation

Agricultural issues

Development issues

Trade Facilitation Trade Facilitation Agreement aims to streamline trade by cutting "red tape" and simplifying customs procedures. The Agreement aims at simplifying not only the documentation required to clear goods, but also the procedures employed by border agencies. Focusing on the biggest risks allows border agencies to speed up the flow of goods across the border, and increases the collection of duties. It has been described as a classic 'win-win' subject for developing and developed

countries, since there should be no losers. It contains special provisions for developing countries to help them implement the Agreement. Benefits to the world economy are estimated to be between US$ 400 billion and US$ 1 trillion.

Agricultural Issues On agriculture, it was decided to give temporary protection to food stockholding programmes used for food security purposes and agreed to "exercise utmost restraint" in using all forms of export subsidy and other measures with similar effects. It was agreed to improve how tariff rate quotas are managed and to add some rural livelihood and land-use programmes of special interest to developing countries to the list of those that can be freely subsidized. They also committed to making progress in addressing cotton within the agriculture negotiations. On development, it was decided to establish a monitoring mechanism to analyse and review all aspects of the implementation of "special and differential treatment" provisions for developing countries contained in multilateral WTO agreements. They also took a number of decisions relating to least-developed countries (LDCs). These included improving the transparency of preferential rules of origin so that LDCs can better use the preferences accorded to them, and improving the implementation of duty-free and quota-free market access for imports from LDCs. Ministers also addressed the putting into operation of the waiver allowing WTO members to grant preferential market access to LDC services and service suppliers.

Development Issues On development, it was decided to establish a monitoring mechanism to analyse and review all aspects of the implementation of "special and differential treatment" provisions for developing countries contained in multilateral WTO agreements. They also took a number of decisions relating to least-developed countries (LDCs). These included improving the transparency of preferential rules of origin so that LDCs can better use the preferences accorded to them, and improving the implementation of duty-free and quota-free market access for imports from LDCs. Ministers also addressed the putting into operation of the waiver allowing WTO members to grant preferential market access to LDC services and service suppliers.

UNCTAD

The widening trade gap between the developed and developing countries, the general dissatisfaction of the developing countries with the GATT and the need for a new organisation for international economic cooperation in the field of trade and aid, designed to reduce the trade gap of developing countries, encouraged the establishment of the United Nations Conference on Trade and Development (UNCTAD) in 1964 as a permanent organ of the UN General Assembly. The UNCTAD was designed to serve as a forum in which trade-related development issues could be discussed and analysed to lead to the negotiations of international understanding on issues that were in dispute.

The Conference, which is a plenary body of a large number of countries, meets normally at intervals of 4 years.

Functions

The principal functions of UNCTAD are:

1. To promote international trade with a view to accelerating economic development;
2. To formulate principles of and policies on international trade and related problems of economic development
3. To negotiate multinational trade agreements; and
4. To make proposals for putting its principles and policies into effect.

The major activities of UNCTAD include research and support of negotiations for commodity agreements, technical elaboration of new trade activities designed to assist developing countries in the areas of trade and capital.

Basic Principles

UNCTAD's action programme and priorities have been laid down in the various recommendations adopted by the first conference in 1964. These recommendations are based on the following basic principles:

1. Every country has the sovereign right freely to dispose of its natural resources in the interest of the economic development and well-being of its own people and freely to trade with other countries;

2. Economic relations between countries, including trade relations, shall be based on respect for the principles of sovereign equality of states, self-determination of people, and non-interference in the internal affairs of other countries; and

3. There shall be no discrimination on the basis of differences in socio-economic systems and the adoption of various trading methods and trading policies shall be consistent with this principle.

A Review of the Functioning of UNCTAD

Given the important role of primary commodities and natural resources in the external sectors of developing countries, the initial focus of UNCTAD was on commodity policy and effort to stabilise and expand the export earnings of these countries. In the process, UNCTAD adopted a group approach to negotiations with OECD countries (i.e., the industrial economies) lining up together (Group B), the centrally planned economies of Central and Eastern Europe and the Soviet Union plus a few other similar economies forming their own grouping (Group D), and developing countries coming together under the aegis of the Group 77 to coordinate their positions. China formed a separate group.

Despite the debates and disagreements over the years, UNCTAD played a key role in the emergence of:

1. the Generalised System of Preferences (GSP);
2. a maritime shipping code;
3. special international programmes to help the least developed countries; and
4. international aid targets.

During the 1970s, in line with the major changes in the international economic environment — the breakdown of the Bretton Woods System, oil price shocks, inflation and accumulation of debt by many developing countries — UNCTAD became a central forum for debates between the North and the South. Its negotiations became politically charted and most of its sessions during the 1970s and 1980s reflected sharp divisions between participants, even as global consensus seemed to be emerging in the 1980s.

Thirteenth session UNCTAD was held at Doha (Qatar) from 21st to 26th April 2012. The theme of UNCTAD XIII was "Development-centred Globalisation: Towards Inclusive and Sustainable Growth and Development." It had four sub-themes, viz., (1) Enhancing the enabling economic environment at all levels in support of inclusive and sustainable development. (2) Strengthening all forms of cooperation and partnerships for trade and development, including North-South, South-South and triangular cooperation. (3) Addressing persistent and emerging development challenges as related to their implications for trade and development and interrelated issues in the areas of finance, technology, investment and sustainable development. (4) Promoting investment, trade, entrepreneurship and related development policies to foster sustained economic growth for sustainable and inclusive development.

UNIDO

The United Nations Industrial Development Organisation (UNIDO), which was set up in January 1967, is an organ of the UN General Assembly. The primary function of UNIDO is to promote industrialisation in developing countries by encouraging the mobilisation of national and international resources. Particular attention is given to manufacturing industries. Unlike UNCTAD, UNIDO works directly with business firms, generally on an industry basis. The major activities of UNIDO fall into the following three categories:

Operational Activities: These include direct technical assistance to industries (at the request of the governments of the developing country) and in-plant training programmes whereby groups of technicians and engineers from developing countries facing a common industrial problem are brought together to consider, how industry in the more advanced countries avoids or solves similar problems.

Research: In this area, UNIDO conducts feasibility studies on the requirements and potential industry in developing countries. Export-oriented industries are given special attention.

Coordination: The coordinating activities of UNIDO include mostly the organisation and sponsoring of inter-regional and international meetings, seminars and symposia.

INTERNATIONAL TRADE CENTRE

The International Trade Centre (ITC) is the focal point in the United Nations System for technical cooperation with developing countries in trade promotion. ITC was created by the General Agreements on Tariffs and Trade (GATT) in 1964 and since 1968 has been operated jointly by GATT (now WTO) and the UN, the latter acting through the United Nations Conference on Trade and Development (UNCTAD). As an executing agency of the United Nations Development Programme (UNDP), ITC is directly responsible for implementing UNDP financed projects in developing countries related to trade promotion.

ITC can advise developing countries on their overall approach to marketing communications, as well as on individual information and publicity activities. This entails establishing a strategy with broad communications objectives that are in line with the firm's international marketing goals and defining specific actions to achieve those objectives. Trade fairs are one such specific activity. For instance, ITC can provide guidelines on choosing the most appropriate fairs for the firms and products concerned, preparing the exhibition budget, designing the stand, producing publicity material, briefing the participants, manning the stand, following up on business inquires and evaluating exhibition performance. Similar ITC services are available for planning and executing trade missions, solo exhibitions and store promotions, which all call for skills in conducting marketing research, selecting participants and products, preparing promotional material, making detailed arrangements and following through with business contacts.

For trade promotion publications, ITC can give advice on developing a publications plan and determining specific types of publications to be part of it, such as product and company brochures, export directories, and trade promotion bulletins, newsletters and magazines. Suggestions on contents, graphics, production and distribution are part of this service. Briefly, the ITC assists the developing countries by working with them in:

Developing a national trade promotion strategy, including analysing export potential, choosing priority markets and setting export targets.

Establishing appropriate government institutions and services, such as a central trade promotion organisation and services for exporters in trade information, export financing, export quality control, export costing and pricing, export packaging trade fairs and commercial publicity, the legal aspects of foreign trade, international physical distribution of goods, trade promotion services for small and medium-size enterprises, and commercial representation abroad.

Finding market opportunities for current export products, both non-traditional items and elected primary commodities, and using effective marketing techniques to promote them abroad; adapting other products to foreign market requirements and developing new items for export; and promoting exports of technical consulting services.

Training government trade officials, businessmen and instructors in export marketing and trade promotion, and establishing a national framework for developing export training over the long term.

Improving import operations and techniques to optimise scarce foreign exchange resources.

INTERNATIONAL LEGAL ENVIRONMENT

As indicated earlier in this chapter, business policies and regulations have much to do with the political system and the characteristics of the political parties and politicians.

There are wide variations between countries in the policies and regulations regarding the conduct of the business. For example, certain trade practices or promotional methods/strategies allowed in some countries may be regarded as unfair by the laws of some other countries. In many countries, there is a lot of restriction on the use of the media. Radio and Television, in particular, are under State monopoly or under Strict state control in a number of countries. The advent of cable TV, however, is creating problems for regulation.

In most countries, apart from those laws that control investment and related matters, there are a number of laws that regulate the conduct of the business. These laws cover such matters as standards of product, packaging, promotion, ethics, ecological factors etc.

In many countries, with a view to protecting consumer interests, regulations have become stronger. Regulations to protect the purity of the environment and preserve the ecological balance have assumed great importance in many countries.

Some governments specify certain standards for the products (including packaging) to be marketed in the country: some even prohibit the marketing of certain products. In most nations, promotional activities are subject to various types of controls. Several European countries restrain the use of children in commercial advertisements. In a number of countries, including India, the advertisement of alcoholic liquor is prohibited. Advertisements, including packaging, of cigarettes must carry the statutory warning that "cigarette smoking is injurious to health". Similarly, baby foods must not be promoted as a substitute for breast feeding. In countries like Germany, product comparison advertisements and the use of superlatives like *best* or *excellent* in advertisements is not allowed. In the United States, the Federal Trade Commission is empowered to require a company to provide sufficient evidence to substantiate the claim concerning the quality, performance or comparative prices of its products.

There are a host of statutory controls on business in India. Although the controls have been substantially brought down as a result of the liberalisation, a number of controls still prevail.

Many countries today have laws to regulate competition in the public interest. Elimination of unfair competition and dilution of monopoly power are the important objectives of these regulations.

Certain changes in government policies such as the industrial policy, fiscal policy, tariff policy etc. may have profound impact on business. Some policy developments create opportunities as well as threats. In other words, a development which brightens the prospects of some enterprises may pose a threat to some others. For example, the industrial policy liberalisations in India have opened up new opportunities and threats. They have provided a lot of opportunities to a large number of enterprises to diversify and to make their product mix better. But they have also given rise to serious threat to many existing products by way of increased competition; many seller's markets have given way to buyer's markets. Even products which were seldom advertised have come to be promoted very heavily. This battle for the market has provided a splendid opportunity for the advertising industry.

Kinds of Legal Systems

The legal systems that exist in different countries across the world may be classified into three categories, viz., common law, civil law or code law, and theocratic law.

The basis for **common law** is tradition, past practices, and legal precedents set by the courts through interpretations of statutes, legal legislation, and past rulings. Common law seeks "interpretation through the past decisions of higher courts which interpret the same statutes or apply established and customary principles of law to a similar set of facts."[37] **Code law**, on the other hand, is based on an all-inclusive system of written rules (codes) of law. Under code law, the legal system is generally divided into three separate codes: commercial, civil, and criminal. The civil law system, also called a codified legal system, is based on a detailed set of laws that make up a code. Rules for conducting business transactions are a part of the code.[38]

The common law, derived from English law, is found in England, the United States, Canada, and many other countries which were once under English influence The civil or code law, derived from Roman law, is found in Germany, Japan, France, and in many other countries.

The two legal systems 'differ primarily in that common law is based on the courts' interpretations of events, while civil law is based on how the law is applied to the facts. An example of an area in which the two systems differ in practice is contracts. In a common law country, contracts tend to be detailed, with all contingencies spelled out. In a civil law country, contracts tend to be shorter and less specific because many of the issues that a common law contract would cover already are included in the civil code. So, when entering into contracts abroad, it is important for the manager to understand which type of legal system will establish the contract. Also civil law tends to be less adversarial than common law because judges rely on detailed legal codes rather than on precedent.[39]

The **theocratic law** system is based on religious precepts. The best example of this system is Islamic law, which is found in Muslim countries. Islamic law, or Shariat, is based on the following sources: The Koran, the sacred text; the Sunnah, or decisions and sayings of the Prophet Muhammad; the writings of Islamic scholars, who derive rules by analogy from the principles established in the Koran and the Sunnah; and, the consensus of Muslim countries' legal communities. The Islamic is found in Muslim countries.[40] Also see the reference to the Islamic banking system in the sub-section *Religion* in this chapter.

Categories of Laws

There are broadly, three sets of laws and regulations relevant to international business, viz.,

- International laws, treaties, conventions, etc.
- Laws of foreign countries.
- Laws of home country, (i.e., India), related to foreign trade.

INTERNATIONAL REGULATIONS

International business is governed or influenced by several laws, treaties, agreements, conventions, etc.

Several attempts have been made to unify some of the commercial laws. For example, the international Institute for the Unification of Private Law drafted two Uniform Laws on International Sales, and these were adopted by a conference at The Hague in 1964. These are *The Uniform Law on International Sale Goods* (Uniform Law on the Sales) and the Uniform Law on the formation of Contract for the International Sale of Goods (Uniform Law on Formation). The former aims at the unification of the substantive law of international sales, in particular the obligations of the buyer and seller and the passing of the risk. The latter is complementary to the former: it attempts to reconcile the differences of common and civil law on offer and acceptance lending to the conclusion of an international contract. However, these laws are yet to be given effect to by a number of countries.

There are, however, several international regulations of the trade between countries.

As pointed out in Chapter 6, the WTO principles and regulations have a very important bearing on the international business.

Incoterms

Incoterms brought out by the International Chamber of Commerce are common sale or trade terms used in international trade to express the sale price and the corresponding rights and responsibilities of the seller and the buyer. The purpose of the Incoterms is to provide a set of international rules for interpretation of the most commonly used trade terms in foreign trade.

Settlement of Disputes

Disputes are not uncommon in international trade. Disputes of certain nature are settled by the WTO or in accordance WTO principles.

In other cases there are broadly two avenues for the settlement of the disputes, viz.:

- Judicial dispute settlement.
- Extra-judicial dispute settlement.

In the first case, the dispute is settled by litigation, i.e., by judicial court. Litigation often takes very long time, is very expensive and strains relationship between the parties involved. Therefore, extra-judicial dispute settlement may be preferred.

If the firm favours extra-judicial dispute settlement, a *conciliation* clause or an *arbitration* clause be incorporated in the sales contract. The difference between conciliation, also called mediation, and arbitration lies in the different aims of these procedures. It has been stated: "If parties agree on conciliation, they want an amicable settlement of their dispute with the active assistance of a third person, the conciliator, or they hope at least that an amicable settlement can be achieved. But if they agree on arbitration, they intend to

adopt an adversary stance and will demand the resolution of their dispute by a decision, though a decision of private judge of their choice and not judges appointed by the state. Arbitration is thus closer to court proceedings than conciliation."[41]

For an international businessman, arbitration offers distinct advantages over litigation, because it is quicker, cheaper and private. Further, the arbitration award, at least in principle, is final but a court case may go to appeal to higher courts.

It is desirable to entrust arbitration to established institutions, so as to avoid ad hoc judgements, like International Chamber of Commerce (ICC), International Council for Commercial Arbitration (ICCA) and the International Centre for Settlement of Investment Disputes.

The Indian Council of Arbitration promotes arbitration as a means of settling commercial disputes and popularises arbitration.

Laws of Foreign Countries

A firm doing business abroad has to consider the relevant laws and regulations of the concerned foreign countries.

The national laws governing business may be different in different countries. Laws related to product packaging and labelling, price, promotion, trade practices etc., are among the important regulations which the exporter should consider.

Regulations Related to Products

Product Standards: Many countries have established standards for many of the products. Such standards pertain to quality, safety, health consideration, etc. For example, ISO 9000 accredition is necessary for certain products for selling in markets like the European Union. Each country may have its own product standards or specifications. If the motor vehicle is taken as an example, in some countries the steering wheel should be on the left-side while in others it should be on the right side. There may be specifications about things such as the distance between the head lights, the height of the head lights, etc. In some countries, the product quality will have to be accredited by an approved organisation.

Disclosures: In case of several products, in many countries it is mandatory to make certain disclosures about the products like the ingredients, potency, shelf-life, possible adverse effects (if any), etc.

Environmental Laws: Regulations related to environmental protection are growing in a number of countries. Products the production or harvesting of which cause serious ecological problem may not be permitted to be marketed in some countries. Similarly, biologically non-degradable packaging may not be allowed or penalties or fees may have to be paid for the social costs of using such materials.

Product Liability: In several countries, if a person suffers any damage because of a product, the injured person has to prove that the producer was at fault in respect of the defect in the product (fusing the damage, to get compensation for it. But the product liabilities laws of countries like the USA and several European countries place the consumer in a very comfortable position: the consumer does not have to prove that the producer was at fault.

Where the liability of the producer is based simply on the fact that the damage has been caused by a defect although no fault on his part is involved, then the loss or damage suffered by the consumer is passed on to the producer.

Packing and Labelling Regulations

Many countries have their own regulations regarding packaging and labelling. There may be regulations regarding the packaging materials, method of packaging, packaging standards, etc. Similarly, there may be regulations regarding the different aspects of packaging. There may be certain mandatory disclosures to be made. Labelling in local language is compulsory in some countries. For example, in Canada, use of both French and English is compulsory.

Regulation of Price

Many countries have laws regulating price. This is true of even the market economies.

Regulation of Promotion

Promotional activities are, generally, subject to various types of controls. The nature of the controls vary widely between countries. In some countries like Libya media advertising is not possible. In some countries, certain products like alcoholic drinks, tobacco products etc., are not allowed to be advertised in any or some of the media. A number of countries have regulations controlling false claims. In the USA, the Federal Trade Commission (FTC) may require a company to provide sufficient evidence to substantiate the company's claims concerning the quality, performance, or comparative prices of its products. Product comparison advertisements are not permitted in some countries. The use of superlatives like best, better or excellent is prohibited for product comparisons in some countries. Some countries have restrictions on illustrations and use of photographs of women in advertisements.

In most of the countries, product promotion is subject to various types of controls. For example, in India, *Doordarshan* does not entertain advertisements of certain products like alcoholic drinks; cigarettes, cigars, beedies and pan masala; baby food etc. Alcoholic drinks are not allowed to be advertised in other media too. In many countries, including India, the package and advertisements of cigarettes shall carry the statutory warning that cigarette smoking is injurious to health. Baby food marketers are not allowed to promote the product as a substitute for breast feeding.

Regulation of Trade Practices

Many countries have laws regulating trade practices like restrictive trade practices. Similarly, there are also laws designed for consumer protection.

Indian Laws

There are some important legislations in India pertaining to exports.

The Foreign Trade (Development and Regulation) Act: The most important law regulating the foreign trade of India is the Foreign Trade (Development and Regulation) Act, 1992, which has replaced the *Imports and Exports (Control) Act, 1947*.

The objective of the Foreign Trade (Development and Regulation) Act, 1992, is *to provide for the development and regulation of foreign trade by facilitating imports into, and augmenting imports from India and matters connected therewith or incidental thereto.*

The Act empowers the Central Government to:

(*i*) Make provisions for the development and regulation of foreign trade by facilitating imports and increasing exports; and

(*ii*) Make provisions for prohibiting, restricting or otherwise regulating the import and export of goods.

Under the Act, the Central Government has appointed a Director General of Foreign Trade (DGFT) for carrying out the Government orders issued under this Act. Government has also appointed officers subordinate to the Director General, "known as Joint Director Generals."

According to this Act, no person shall make any import or export except under an Import-Export Code number granted by the DGFT or the officer authorised by him.

The Act empowers the Government to control the import or export of any commodity by licensing. It also empowers the Government to prohibit the import or export of any goods.

Besides the Foreign Trade (Development and Regulation) Act and Foreign Exchange Management Act (FEMA), there are some laws which control the trade in certain items. For example, the export of antiquities is regulated under the Antiquities and Art Treasures Act, 1972; export of coffee is regulated by the Coffee Board under the Indian Coffee Act, 1942; and export of tea is regulated under the Tea Act, 1953.

No export of any goods can be made without obtaining customs clearance under the *Customs Act,* 1962. According to this Act, no carrier can accept any export cargo for shipment to foreign destination without ensuring that the formal permission has been granted by the Customs authorities. The Customs authorities at the ports exercise full control over entry inward, unloading, entry outward and loading of the export cargo in terms of the statutory provisions.

Another important legislation for export regulation is the Export (Quality Control and Inspection) Act, 1963. This Act, which is intended to provide for the sound development of the export trade of India through quality control and inspection and for matters connected therewith, empowers the Central Government to: (i) Notify commodities which shall be subject to quality control or inspection or both prior to export; (ii) Specify the type of quality control or inspection which will be applied to a notified commodity; (iii) Establish, adopt or recognise one or more standard specifications for a notified commodity; (iv) Prohibit the export of the notified commodity, unless it is accompanied by a certificate to the effect that the commodity satisfies the conditions relating to quality control or inspection.

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APPENDIX 2.1

MULTIFIBRE ARRANGEMENT (MFA)

International trade in textiles was restricted for a long time by MFA type arrangements between importing developed economies and exporting developing economies which restricted textile imports to developed economies. The origin of the MFA type arrangement can be traced back to 1935, when the US textile industry was already protected with a tariff of 40 to 60 per cent. Over the years, the scope of the arrangement widened and EC countries also adopted this restriction. In 1961, a Short-term Cotton Textile Arrangement was negotiated under the auspices of the GATT at the request of the US and in 1962 it was replaced by the Long-term Arrangement Regarding International Trade in Cotton Textiles (LTA). Although the LTA was a multilateral document, it essentially functioned as a set of bilateral agreements which allowed importing countries to negotiate not on a country by country basis and in some cases to impose unilateral quotas without penalty. In view of the growing importance of the synthetic fibres in textiles, in 1974 the LTA was replaced by MFA which remained in force until 1977. The MFA II which remained in force between 1978 and 1981, which allowed more restrictive quotas than did MFA I, reflected the strong protectionist sentiment of the EC. MFA III 1982-86, maintained the restrictions of earlier arrangements and added some additional constraints on large exporters and "surge" mechanism which limited growth of medium-size exporters. The MFA IV, 1986-1991, by adding silk, linen, ramil and jute to the existing list of fibres in the Arrangement continued the historic tradition of including all conceivable fibres in the MFA and plugging all the "leaks" which allowed the imports of clothing and textiles to grow under the previous arrangements.

The main objective of the industrial economies in restricting the textile imports was to protect the domestic industry. The increase in the productivity in the textile industry reduced employment in this industry. Added to this was the threat of the surging imports from the low-cost producers and consequent deindustrialisation in the absence of protection.

The MFA certainly was against the most fundamental principle of multilateral trading system — the principle of non-discrimination. Because of the restrictions, consumers in the MFA importing countries had to pay a heavy price. Trade was distorted. The exports and economic growth of developing countries suffered.

The UR Agreement seeks to phase out the MFA by 2005.

3

MNCs AND INTERNATIONAL BUSINESS

A number of industries are dominated, globally, by large corporations known by such names as international corporation, multinational corporation, transnational corporation and global corporation (or firm, company or enterprise). A significant share of the world's industrial investment, production, employment and trade are accounted for by these more than one lakh MNCs with over 9 lakh affiliates.

According to the *World Investment Report 2011*, of the nearly 9 lakh foreign affiliates of MNCs, only about 3.7 lakh were in developed countries. China alone accounted for about 2.86 lakh (compared to about 2,200 in India).

The value added by all foreign affiliates of MNCs as a percentage of world GDP doubled from about 5 per cent in the beginning of the 1980s to nearly 10 per cent in 2008 and remains so today.

Box 3.1

International Production and Marketing

The growth of international production is an important part of the process of globalisation. *International production* refers to that part of the production of goods and services of countries that is controlled and managed by firms headquartered in other countries. Firms can exercise control of production in countries (*host countries*) other than their own (*home country*) either through the ownership of a minimum share of equity — that is, a minimum share in the capital stock or assets — of the enterprises in which the production takes place, or through contractual (non-equity) arrangements that confer control upon them. Exercising control and having a voice in the management of an enterprise located abroad (foreign affilitate) — whether through capital investment or through contractual arrangement — leads to international production.

Firms that engage in international production — transnational corporations (TNCs) — establish, under the common governance of their headquarters, international production systems in which factors of production move, to a greater or lesser extent, among units located in different countries. These systems increasingly cover a variety of activities, ranging from research and development (R&D) to manufacturing to service functions such as accounting, advertising, marketing and training, dispersed over host country locations and integrated to produce final goods or services. They are also increasingly being established, especially in developed countries, through mergers between existing firms from different countries or the acquisition of existing enterprises in countries by firms from others. Once internationally dispersed production units under common governance are established, mobile and location bound factors of production to which a TNC has access in home and host countries (and sometimes even third countries) are combined in each

unit in ways and for production that contribute the most to the firm's economic and strategic objectives. From the perspective of factor use - as distinct from that of location as host or home country for enterprises engaged in international production — *all* of the production that takes place in these TNC production systems (in parent firms or home-country units as well as foreign affiliates or host-country units) constitutes international production.

Courtesy: UNCTAD, *World Investment Report, 1999.*

Table 3.1
TRENDS IN FDI FLOWS

Region/Country	Inflow ($ billion)					Outflow ($ billion)				
	2007	2008	2009	2010	2013	2007	2008	2009	2010	2013
World	1975	1791	1198	1309	1452	2198	1969	1175	1451	1411
Developed countries	1390	1020	606	619	566	1830	1581	858	990	857
Developing countries	574	650	519	617	778	317	328	268	400	454
S-E Europe and CIS	91	121	72	74	108	52	60	49	62	99
India	**26**	**43**	**36**	**24**	**28**	**19**	**20**	**16**	**13**	**12**

Source: UNCTAD, *World Investment Reports* of different years.

Foreign investment has been growing substantially faster than world output and export. Production of foreign affiliates of MNCs has been growing faster than world GDP and exports. International production is substituting exports (i.e., foreign markets are served by producing there rather than exporting to them).

Although the multinational corporation took birth in the early 1860s, it was after the Second World War that multinationals have grown rapidly. In the early days, the United States was the home of most of the MNCs. Now there are a large number of Japanese and European multinationals. However, the number of multinationals from developing countries has been growing fast. South Korea has, for example, well-known MNCs like Samsung, Hyundai, LG, and Daewoo.

MNCs of the US are more focused, i.e., they confine their business to one industry or product category. In fact, several American MNCs which attempted diversification, mostly by the acquisitions route, reverted to focus, after bitter experiences with the diversification. Compared with the US MNCs, most European companies have a much broader product line. Japanese companies, generally, have product lines that are much too broad. Of the top ten corporation in the US, only one (General Electric) is a classic conglomerate, while in Japan eight are conglomerates and only two are not (Toyota Motor and Nippon Telegraph and Telephone). Similarly, the Korean corporations are far too diversified. Recent trends indicate that the diversified corporations have many odds against them and the focus strategy is more successful.

Definitions

There is, however, no universally accepted definition of the term multinational corporation. As an ILO report observes, "the essential nature of the multinational enterprises lies in the fact that its managerial headquarters are located in one country (referred to for convenience as the "home country") while the enterprise carries out operations in a number of other countries as well ("host countries").[1] 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 licensing technology are not multinational enterprises."[2]

Jacques Maisonrouge, president of IBM World Trade Corporation, defines an MNC as a company that meets five criteria:[3]

(i) It operates in many countries at different levels of economic development.

(ii) Its local subsidiaries are managed by nationals.

(iii) It maintains complete industrial organisations, including R&D and manufacturing facilities, in several countries.

(iv) It has a multinational central management.

(v) It has multinational stock ownership.

James C. Baker defines the multinational corporation as a company:[4]

(a) which has a direct investment base in several countries; and

(b) which generally derives from 20 per cent to 50 per cent or more of its net profits from foreign operations;

(c) whose management makes policy decisions based on the alternatives available anywhere in the world.

Terms such as international corporation, multinational corporation, transnational corporation and global corporation are often used as synonyms. However, several multinationals have evolved into certain advanced stage of transnational organisation and operations that it becomes necessary to draw some distinction between these terms.

A company with manufacturing investment (or service operation) in at least one foreign country may be regarded as an *international corporation*. However, multinational implies international operations of more significance than this, as indicated in the definition of the MNC given above, such as direct investment in several countries and a considerable share of the total business being in foreign countries. A multinational corporation is, obviously, an international corporation. Only those international corporations which satisfy certain criteria, as described above, may be regarded as multinationals.

It would be useful to draw a distinction between the multinational corporation and transnational corporation.

"Multinational companies are usually organised around a national headquarters, from which international control is exercised — they still have a national identity, even though their subsidiaries may not always care to allow that identity to obtrude in the markets they serve."[5] *A transnational company* is a multinational "in which both ownership and control are so dispersed internationally. There is no principal domicile and no one central source of power."[6] Examples include Royal Dutch-Shell and Unilever.

The term *global corporation* is also often used to mean more or less the same thing as the transnational corporation. However, as pointed out in Chapter 1, some people make some distinction between transnational and global corporations.

It may also be pointed out here that some marketing and management experts add some essential dimension to the term global corporation, although it is not agreed upon by many others. According to them, a global corporation is one which views the entire world as a single homogeneous market which should be catered to by globally standardised products. Theodore Levitt, the world renowned professor of marketing who has championed this line of thinking, observes that while "the multinational corporation operates in a number of countries and adjusts its products and practices in each — at a high relative cost", "the global corporation operates with resolute constancy — at a low relative cost — as if the entire world (or major region of it) were a single entity; it sells the same thing the same way everywhere."[7] According to Levitt, "the world is becoming a common marketplace in which people — no matter where they live — desire the same products and lifestyles. Global

companies must forget the idiosyncratic differences between countries and cultures and instead concentrate on satisfying universal drives."[8] Levitt who says that "the world's needs and desires have been irrevocably homogenised" argues that this "makes the multinational corporation obsolete and the global corporation absolute".[9] Levitt's theory has been strongly criticised by several experts. For details, see the chapter on *Product Strategies*.

Organisational Transformation

As pointed out above, many of the multinationals have transformed themselves to transnational/ global corporations. Whatever may be the differences in the nomenclature or the views regarding the strategies of the multinational, it has reached a new watershed in its evolution. Dunning observes: "From behaving largely as a confederation of loosely knit foreign affiliates, designed primarily to serve the parent company with natural resources or local markets with manufactured products and services, to its maturation over the years as a controller of a group of integrated value adding activities in several countries, the MNC is now increasingly assuming the role of an orchestrator of production and transactions within a cluster, or network, of cross border internal-external relationships, which may or may not involve equity investment, but which are intended to serve its global interests."[10]

He further adds: "From being mainly a provider of capital, management and technology to its outlying affiliates, each operating more or less independently of each other, and then a coordinator of the way in which resources are used within a closely knit family of affiliates; the decision-making nexus of the MNE in the late 1980s has come to resemble the central nervous system of a much larger group, independent but less formally governed activities, whose function is primarily to advance the global competitive strategy and position of the core organisation. This it does, not only by, or even mainly by, organising internal production and transactions in the most efficient way; or by its technology, product and marketing strategies; but by the nature and form of alliances it concludes with other firms."[11]

Globalisation of Business

These corporations which have become transnational/global, "stop thinking of themselves as national marketers who venture abroad and start thinking of themselves as global marketers. The top management and staff are involved in the planning of worldwide manufacturing facilities, marketing policies, financial flows and logistical systems. The global operating units report directly to the chief executive or executive committee, not to the head of an international division. Executives are trained in worldwide operations, not just domestic or international. Management is recruited from many countries; components and supplies are purchased where they can be obtained at the least cost; and investments are made where the anticipated returns are the greatest."[12]

Globalisation is indeed a strategy to gain competitive strength.

Globalisation, in its true sense, is a way of corporate life necessitated, facilitated and nourished by the transnationalisation of the world economy and developed by corporate strategies. Globalisation is an attitude of mind — it is a mindset which views the entire world as a single market so that the corporate strategy is based on the dynamics of the global business environment. International marketing or international investment does not amount to globalisation unless it is the result of such a global orientation.

Box 3.2
Dimensions of Globalisation

1. Doing, or planning to expand, business globally.
2. Giving up the distinction between the domestic and foreign market and developing a global outlook of the business.
3. Locating the production and other physical facilities on a consideration of the global business dynamics, irrespective of national considerations.
4. Basing product development and production planning on the global market considerations.
5. Global sourcing of factors of production, i.e., raw materials, components, machinery/technology, finance etc. are obtained from the best source anywhere in the world.
6. Global orientation of organisational structure and management culture.

Several Indian companies have also adopted a global strategy of their business. The strategy conceived by the Arvind Mills for globalisation, given in Box 3.3 makes it clear.

Box 3.3
Arvind Mills
Renovision on the Art of Global Dominance

- Source raw materials wherever they are cheapest.
- Manufacture wherever in the world is most cost-effective.
- Sell in those global markets where prices are highest.
- Raise finances globally.
- Forge international strategic alliances.
- To manage all these, take on the best talent from all over the world.

And you will have achieved the stature of a true multinational.

Multinationals develop integrated international production logistics and marketing system. The *production sharing* between various units in different countries. For example, take Toyota, Japan's largest and world's second largest automobile company. About two-thirds of Toyota's total business is outside Japan. More than half of its vehicles sold overseas is manufactured overseas and the remaining exported from Japan. Toyota has established integrated manufacturing systems in all three of its main markets — North America, Europe and Asia. Plants in China, Indonesia, Malaysia, Philippines, Taiwan and Thailand turned out nearly a third of the company's overseas production. These manufacturing units are interlinked by flows of components/parts, production planning etc. To cite a different example, Mazda's sports car, MX-5 Miata, was designed in California, had its prototype created in England, was assembled in Michigan and Mexico, using advanced electronic components invented in New Jersey and fabricated in Japan, financed from Tokyo and New York, and marketed globally. The *global sourcing*, described in Chapter 1, throws light on some other aspect of global integration.

Dominance of MNCs in Global Economy

The global liberalisation has paved the way for fast expansion and growth of the MNCs. According to UNCTAD's *World Investment Report* (WIR) 1997, there were about 45,000 MNCs with about 282,000 foreign affiliates (FAs), but according to the WIR 2011, the number of MNCs were more than one lakh and of FAs nearly 9 lakh. Developing countries now account for nearly 30 per cent of the TNCs worldwide, compared to less than 10 per cent in 1992. Majority of the FAs of TNCs are in the developing countries. Interestingly, nearly half of the FAs in the world and about 85 per cent of the total number of located in the developing countries are in communist China.

The value added of all foreign affiliates of MNCs as a percentage of world GDP increased significantly over the last few decades.

The following paragraphs based on the *World Investment Reports* provide some indications of the economic dominance of the multinationals.

The TNCs are present in virtually all countries and economic activities, rendering it a formidable force in today's world economy.

Table 3.2
TOP 10 GLOBAL FORTUNE 500 COMPANIES, 2014

Rank	Company	Country	Industry	Revenue in USD
1	Walmart	United States	Retail	$476.3 billion
2	Royal Dutch Shell	Netherlands United Kingdom†	Petroleum	$459.6 billion
3	Sinopec	China	Petroleum	$457.2 billion
4	China National Petroleum Corporation	China	Petroleum	$432.0 billion
5	ExxonMobil companies'	United States	Petroleum	$407.7 billion
6	BP	United Kingdom	Petroleum	$396.2 billion
7	State Grid Corporation of China	China	Power	$333.4 billion
8	Volkswagen	Germany	Automobiles	$261.5 billion
9	Toyota	Japan	Automobiles	$256.5 billion
10	Glencore	Switzerland	Commodities	$232.7 billion

† Fortune had previously listed Shell as a Dutch company, but as of the 2013 listing, it is listed as British/Dutch.

The size of large TNCs is sometimes compared to that of countries' economies, as an indicator of the influence that the former have in the world economy.

According to one comparison of the sales volume of firms with the GDP of countries, the annual sales of the large MNCs is larger than the GDP of a large number of countries, including several developed economies.

The universe of TNCs is quite diverse, and includes a growing number of small and medium-sized enterprises, TNCs from countries in Central and Eastern Europe that have only recently begun to engage in international production, and large TNCs based in the developing world. Although less transnational overall than the world's top 100 TNCs, some of the developing-country TNCs are quite sizeable — witness, for example, the size of the foreign assets ($ 8 billion) of Petroleos de Venezuela, the largest TNC from the developing world and the only developing-country firm to appear in the top 100 list.

There has been a fast increase in the number of MNCs from developing countries. Now China ranks 2nd in the number of companies in the Global Fortune 500 list, relegating Japan to the third position. In the 2014 list, China had 95 companies compared to 128 of USA, 57 of Japan and 8 of India.

With the proliferation of MNCs and rapid rise in FDI, the share of multinationals in global production has been on the increase. According to the estimates of UNCTAD, value added by TNCs worldwide, in their operations both at home and abroad, accounted for more than a quarter of global GDP in 2013. In 2013, foreign affiliates accounted for more than one-tenth of global GDP and one-third of world exports. In 2013, foreign affiliates of TNCs employed about 71 million people, compared to about 21 million in 1990.

Table 3.3
FORTUNE 500 INDIAN COMPANIES, 2014

Fortune 500 Rank in terms of Turnover				Company	Country Rank 2014	Industry Type
2014	2013	2013	2011			
96	88	83	98	Indian Oil	1	Petroleum
114	107	99	134	RIL	2	Petroleum
242	229	225	271	BPCL	3	Petroleum
284	260	267	335	HPCL	4	Petroleum
287	316	314	358	Tata Motors*	5	Automobile
303	298	285	291	SBI	6	Banking
424	369	357	360	ONGC	7	Petroleum
486	471	401	369	Tata Steel	8	Iron & Steel

State-owned TNCs

An interesting development is the growth of State-owned TNCs [defined as enterprises comprising parent enterprises and their foreign affiliates in which the government has a controlling interest (full, majority, or significant minority), whether or not listed on a stock exchange]. In 2010, there were at least 650 State-owned TNCs, with more than 8,500 foreign affiliates, operating around the globe. While this makes them a minority in the universe of all TNCs, they nevertheless constituted a significant number of the world's 100 largest TNCs (19 companies in 2010). SOEs from developing and transition economies have a larger share in their top 100 TNCs (28 in 2009). While relatively small in number (less than 1 per cent of all TNCs), their FDI is substantial, reaching roughly 11 per cent of global FDI flows in 2010.

State-owned TNCs constitute a varied group. Developing and transition economies are home to more than half of these firms (56 per cent), though developed countries continue to maintain a significant number of State-owned TNCs. In contrast to the general view of State-owned TNCs as largely concentrated in the primary sector, they are diversified and have a strong presence in the services sector.

State-owned TNCs tend to be most active in financial services and industries that are capital-intensive, require monopolistic positions to gain the necessary economies of scale, or are deemed to be of strong strategic interest to the country. In 2010, roughly 70 per cent of State-owned TNCs operate in the services sector, led by financial services.

As Table 3.3 shows, five of the eight Indian Global 500 companies are public sector enterprises.

MNCs and International Trade

Peter Drucker remarks that multinationalism and expanding world trade are two sides of the same coin.[13] He points out that the period of most rapid growth of multinationals — the fifties and sixties — was the period of most rapid growth of multinational trade. Indeed, during this period the world trading economy grew faster — at an annual rate of 15 per cent or so in most years — than even the fastest growing domestic economy, that of Japan.[14]

It is estimated that between one-fourth and one-third of manufactured goods now moving in world trade are being shipped from one branch to another of the MNCs; that is, they are intra-company shipments. The sale of foreign subsidiaries in the host countries in which they are located are three to four times as large as total world exports.[15]

There was a very significant increase in the export intensity (i.e., the percentage of exports to total sales) of the foreign affiliates of many MNCs. The export intensity of foreign affiliates of US MNCs, for example, increased from less than 20 per cent in the mid-sixties to over 40 per cent in the early 1990s for all economies; it doubled from about 20 to 40 per cent in the case of developed economies; jumped from about six to 22 per cent in the case of the Latin American affiliates and from 23 to 64 per cent for developing Asia. The average export intensity of all the affiliates has, however, remained between 21-24 per cent for a long time. In the case of India, however, it was very low. More than 40 per cent of the total exports of China is done by MNC affiliates. The export contribution of foreign affiliates in China is far larger than the total exports of India.

Apart from trade in commodities, other transactions also take place extensively between the different parts of these enterprises — for example the granting of loans, the licensing of technology and the provision of services. In all such transactions, transfer prices may be settled which are different from the price which would have been the case between independent parties operating at arm's length. Such differences may reflect the legitimate concerns of the companies but are also capable of being used in order to shift profits from high to low tax countries or to get around exchange or price controls or customs duties. As the Brandt Commission observes, the ability of multinationals to manipulate financial flows by the use of artificial transfer prices is bound to be a matter of concern to governments. The monitoring and control of transfer prices involves inter-governmental cooperation and measures to secure due disclosure of relevant information by companies. This is necessary to make effective tax laws covering transfer prices which exist in many countries. Intra-firm trade also opens up the possibility for corporations to impose restrictive business practices within their own organisation; they can limit the exports of their affiliates; allocate their markets between nations or restrict the use of their technology or that developed by their affiliates. Such practices, although best pursued in the best business interests of the companies, may conflict with the developmental objectives and national interests of host countries.[16]

Merits of MNCs

As the preface to the ILO report on *Multinational Enterprises and Social Policy* observes, "for some, the multinational companies are an invaluable dynamic force and instrument for wider distribution of capital, technology and employment; for others, they are monsters which our present institutions, national or international, cannot adequately control, a law to themselves with no reasonable concept, the public interest or social policy can accept."[17]

The important arguments in favour of and against the MNCs are mentioned below. MNCs, it is claimed, help the host countries in the following ways:

1. MNCs help increase the investment level and thereby the income and employment in the host country.
2. The transnational corporations have become vehicles for the transfer of technology, especially to the developing countries.
3. They also kindle a managerial revolution in the host countries through professional management and the employment of highly sophisticated management techniques.
4. The MNCs enable the host countries to increase their exports and decrease their import requirements.
5. They work to equalise the cost of factors of production around the world.
6. MNCs provide an efficient means of integrating national economies.
7. The enormous resources of the multinational enterprises enable them to have very efficient research and development systems. Thus, they make a commendable contribution to inventions and innovations.

8. MNCs also stimulate domestic enterprise because to support their own operations, the MNCs may encourage and assist domestic suppliers.
9. MNCs help increase competition and break domestic monopolies.

Demerits

MNCs have, however, been subject to a number of criticisms, like those mentioned below:

1. As Leonard Gomes points out, the MNC's technology is designed for world- wide profit maximisation, not the development needs of poor countries, in particular employment needs and relative factor scarcities in these countries. In general, it is asserted, the imported technologies are not adapted to (a) the consumption needs, (b) the size of domestic markets, (c) resource availabilities and (d) stage of development of many of the LDCs.[18]
2. Through their power and flexibility, MNCs can evade or undermine national economic autonomy and control, and their activities may be inimical to the national interests of particular countries.
3. MNCs may destroy competition and acquire monopoly powers.
4. The tremendous power of the global corporations poses the risk that they may threaten the sovereignty of the nations in which they do business.
5. MNCs retard growth of employment in the home country.
6. The transnational corporations cause fast depletion of some of the non-renewable natural resources in the host country.
7. The *transfer pricing* enables MNCs to avoid taxes by manipulating prices on intra-company transactions.

Perspective

Future holds out an enormous scope for the growth of MNCs. The changes in the economic environment in a large number of countries indicate this. For instance, the number of bilateral treaties that promote and/or protect FDI has increased markedly in recent times.

The *World Investment Report 1992* described several developments that points to a rapidly changing context for economic growth, along with a growing role for transnational corporations in that process. These include:

1. Increasing emphasis on market forces and a growing role for the private sector in nearly all developing countries;
2. Rapidly changing technologies that are transforming the nature of organisation and location of international production;
3. The globalisation of firms and industries;
4. The rise of services to constitute the largest single sector in the world economy; and
5. Regional economic integration, which involve both the world's largest economies as well as selected developing countries.

Code of Conduct

As the Brandt Commission observes, there is now much interest in trying to formulate international codes of conduct for the transfer of technology, for restrictive business practices and transnational corporations. Definite progress has been made in some of these negotiations. Any code, of course, will only work if it can influence the actual behaviour of home and host governments and of investors. The major elements of any effective code should be capable of being eventually translated into agreements between governments. Such an overall regime will have to have elements of both persuasion and effective implementation, with flexible approaches and attitudes on all sides. The participating governments will have to consult with labour and business to find the means to reconcile interests and to monitor

and implement the arguments. The ILO has created a committee for consultation and monitoring the code of conduct relating to multinational enterprises. This offers one model.

According to the Brandt Commission, the principal elements of an international regime for investment should include:

1. A framework to allow developing countries as well as transnational corporations to benefit from direct investments on terms contractually agreed upon. Home countries should not restrict investment or the transfer of technology abroad, and should desist from other restrictive practices such as export controls or market, not restrict current transfers such as profits, royalties and dividends, or the repatriation of capital, so long as they are on terms which were agreed when the investment was originally approved or subsequently negotiated.

2. Legislation promoted and coordinated in home and host countries, to regulate the activities of transnational corporations in such matters as ethical behaviour, disclosure of information, restrictive business practices, cartels, anti-competitive practices and labour standards. International codes and guidelines are a useful step in that direction.

3. Cooperation by governments in their tax policies to monitor transfer pricing and to eliminate the resort to tax havens.

4. Fiscal and other incentives and policies towards foreign investment to be harmonised among host developing countries, particularly at regional and sub-regional levels, to avoid the undermining of the tax base and competitive positions of host countries.

5. An international procedure for discussions and consultations on measures affecting direct investment and the activities of transnational corporations.

MULTINATIONALS IN INDIA

Comparatively very little foreign investment has taken place in India due to several reasons, as stated in the previous chapter (like the dominant role assigned to the public sector in the industrial policy and the restrictive government policy towards foreign investment). Some multinationals, Coca Cola and IBM, even left India in the late 1970s as the government conditions were unacceptable to them.

A common criticism against the MNCs is that they tend to invest in the low priority and high profit sectors in the developing countries, ignoring the national priorities. However, in India, the government policy confined the foreign investment to the priority areas like high technology and heavy investment sectors of national importance and export sectors. Firms which had been established in non-priority areas prior to the implementation of this policy have, however, been allowed to continue in those sectors.

The controversial Foreign Exchange Regulation Act (FERA), 1973, required the foreign companies in India to dilute the foreign equity holding to 40 per cent (exceptions were allowed in certain cases like high technology and export-oriented sectors).

An often heard criticism is that multinationals drain the foreign exchange resources of the developing countries. However, Aiyar's study indicates that, contrary to the popular belief, foreign companies are less of a drain on foreign exchange reserves than Indian ones. He also points out that the public sector has a higher propensity to use foreign exchange on a net basis than multinationals. In fact, the foreign exchange outgo of the public sector alone is greater than the entire trade deficit of the country.[19]

It is not a right approach to estimate the net impact of multinationals on the foreign exchange reserves by taking the net foreign exchange outflow or inflow. If a multinational is operating in an import substitution industry, the net effect on the foreign exchange reserves could be favourable even if there is a net foreign exchange outflow by the company.

Multinationals in several developing countries make substantial contribution to export earnings. The performance in the case of India has, however, been very dismal. This is attributed mostly to the government policy. "We have consistently followed policies in India that discriminate against export production and in favour of production for the local market. In this milieu, it has not made sense for the Indian private sector or public sector to focus on exports. Naturally, it has not made sense for foreign companies either. In 1947, foreign companies did not have an anti-export image. Indeed, the most prominent ones were engaged in the export of tea and jute manufactures. Only after Jawaharlal Nehru decided to emphasise import-substitution at the expense of exports, did foreign (and Indian) companies shun exports.[20]

Although export promotion has been pursued since the Third Plan, the highly protected domestic market and the unrealistic exchange rate made the domestic market much more attractive than exports. However, since the mid-1980s with the economic liberalisation that increased domestic competition and the steady depreciation of the rupee, exports began to become attractive and several foreign companies and companies with foreign participation, as well as Indian companies, have become serious about exports. This was reflected in the acceleration of the export growth.

The new policy is expected to give a considerable impetus for MNCs' investment in India. However, foreign companies find the policy and procedural environment in India still so perplexing and disgusting that a multinational, Motorola, even shifted some of the projects, originally earmarked for India, to China where the government environment is much more conducive.

Several Indian outfits of MNCs are in the low technology consumer goods sector. There are many MNCs which are in high technology area. There are several MNCs in the pharmaceutical industry, like Glaxo, Bayer, Sandoz and Hoechst. Some MNCs like Marubeni and Nissho Iwai confine to foreign trade.

Since the economic liberalisation ushered in 1991, many multinationals in different lines of business have entered the Indian market. A number of multinationals which were in India prior to this have expanded their business. As indicated by *Box 1.1* (Chapter 1), the Indian market is invaded by MNCs.

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4

INTERNATIONAL MARKETING INTELLIGENCE

Sufficient and reliable information is a prerequisite for proper decision making, be it domestic business or international marketing.

Viewed in a broad sense, "the general subject of international marketing intelligence includes the collection, processing, analysis and interpretation of all types of information, from all available sources, to aid business management in making international marketing decision."[1]

Box 4.1
The Key to Success

Those companies that have done the best in the global arena are those that have released themselves from the emotional attachment to the schemes that have made them a success domestically in order to see each new marketplace as a distinct entity. This is not to say that some aspects of domestic plans can't be used internationally; many times the new market will demand elements of the old mixed with the new. The key to success is a reliance on proper research and analysis. Whereas some functions of management (sales, human resources and even some manufacturing processes) may be described as "art," marketing (whether domestic or international) is a science. The stakes are far too high and the pace much too quick to rely on guess work, intuition, or gut feelings. Entering a new market far from home without a detailed plan is akin to building a skyscraper without a blueprint — possible, but highly improbable.

Jeffrey Edmund Curry, *International Marketing*
(California: World Trade Press, 1999)

Proper business intelligence is essential to make all the series of strategic decisions in international marketing described in Chapter 1, viz., international marketing decision, market selection decision, entry and operating decision, marketing mix decision and organisation decision.

INFORMATION REQUIREMENTS

The broad areas of information requirement for international marketing are the following:

International Marketing Decision Related Information

Different types of information are needed to take the critical decision as to whether to go international or not. These include information about the prospects of the foreign markets, competition, other characteristics of the foreign market, domestic market prospects etc.

Market Selection Related Information

Information on a large number of factors is needed for evaluation and selection of the markets. There are many general factors like political and economic stability, currency stability, government policy and regulations, etc. about which information is required. Market selection also requires specific information about the product or industry concerned like the demand trends, government policy and regulations, competitive situation etc. The following chapter provides more details.

Product Related Information

This includes consumer tastes and preference about the product like unit size/quantity, shape, colour, product form, packaging etc; mode, time, frequencies and rates of consumption; purpose of use/uses etc.; regulatory aspects and so on.

Price Related Information

Price related information needed include prevailing price ranges, price trends, margins, pricing practices, government polices and regulations, price elasticity of demand, role of price as a strategic marketing variable etc.

Promotion Related Information

For formulating the promotion strategy data on many aspects like media availability and effectiveness, Government regulations, customs/practices of promotion in the market concerned, competitive behaviour etc. are required.

Distribution Related Information

This includes information on factors like channel alternatives and characteristics, relative effectiveness of different channels, customs and practices of the trade, power and influence of channel members etc.

Competition Related Information

A company will also need information about the competitive environment including the extent of competition, major competitors, relative strengths and weaknesses of competitors, strategies and behaviour of competitors etc.

SOURCES OF INFORMATION

There are broadly two sources of information, viz., internal sources and external sources. Internal sources include sales and cost records, accumulated knowledge of the company personnel and any other data available with the company.

Experienced companies may have a great deal of available information internally, but companies new to international business may have to rely much on external sources.

External sources include sources of both primary and secondary data. A company will have to collect primary data when secondary data are not available, not adequate, or reliable.

Organisations within India

There are a number of export promotion organisations in India which are important sources of information pertaining to foreign markets. While some of these are general others are product specific. Most of them have periodic publications which disseminate useful information. Several of them have also brought out publications intended to provide general guidance and education to exporters. They also carry out market potential studies and other relevant studies.

These organisations include India Trade Promotion Organisation (ITPO), State Trading Corporations, Chambers of Commerce, Confederation of Indian Industry (CII), FIEO, and Export Promotion Councils/

Commodity Boards/Export Development Authorities. Organisations like the Indian Institute of Packaging, Export Inspection Council are also important sources for certain types of information. The Exim Bank has carried out a number of market studies. Although the Exim Bank is primarily a financial institution, it is also an important source of guidance for exporters.

The offices of the consulates/embassies of foreign governments in India provide a lot of information about the respective countries.

Educational and research organisations like the Indian Institute of Foreign Trade, Management Schools/Departments of Universities etc., could also be useful to exporters.

Valuable information can sometimes be obtained from other exporters, export houses and trading houses, banks, ECGC etc.

Organisations Outside India

The International Trade Centre, Geneva, is a very important source of information and assistance to exporters, particularly from developing countries (For details, see the Chapter on Promotion).

Offices of the Indian embassies abroad and concerned departments/organisations of the foreign governments may be approached for certain types of information.

Several governments, like that of Japan, give a lot of importance to import development and they are very much interested in providing the information relevant to importing to these countries. The Japan External Trade Organisation (JETRO), for example, has brought out publications entitled *Access to Japan's Import Market* pertaining to every important import item of Japan. These publications give a lot of information related to the import trade of different products.

There are also certain international organisations related to specific products (like the Infofish, Kaula Lumpur, for Seafood, for example).

Organisations like the World Bank also make studies and reports regarding certain products. The World Trade Organisation (WTO) is an important source for different types of information.

Publications

In many case, a lot of information can be obtained from publications like journals and research publications — national, foreign and international.

As mentioned earlier, the various export promotion organisations have periodical and other publications. Besides these, there are a number of general and specialised publications carrying useful information for the exporters.

Similarly, there are a number of foreign and international publications, general and product specific.

INTERNATIONAL MARKETING INFORMATION SYSTEM AND MARKETING RESEARCH

As Terpstra suggests, "international marketing intelligence involves the creation of an information system, which should, of course, be a part of the company's overall information system for international business. Viewed from this perspective, international marketing intelligence includes several different tasks, one of which is marketing research on individual foreign markets."[2]

The Committee on Definitions of the American Marketing Association defines marketing research as "the systematic gathering, recording, and analysing of data about problems relating to the marketing of goods and services."

A modified definition is that marketing research is "the systematic planning, gathering, recording, analysing and interpreting of data for application to specific marketing decisions."[3] This modified

definition adds two more stages, namely, planning and interpreting and states that marketing research is meant to help decision-making.

Marketing Information System is defined as "an interacting, continuing, future-oriented structure of people, equipment and procedures. It is designed to generate and process an information flow to aid decision-making in a company's marketing programme."[4]

The marketing information system is, thus, much broader than marketing research. Marketing research, in fact, forms a part of the marketing information system. It may, however, be noted that many companies which do not have such a well-established marketing information system as defined above also conduct marketing research.

The marketing information system handles both external and internal data; in marketing research, the emphasis is on handling external information. While the marketing information system is a 'system' which operates continuously, marketing research often operates in a fragmented, intermittent fashion.

Marketing research may be conducted by the company concerned (in-house research) or it may be entrusted to an external agency like marketing research or consultancy organisation, advertising agency, management institute etc.

Utility/Importance/Objectives of Marketing Research

Marketing research is very essential to keep pace with the changing environment characterised by such factors as: (*a*) Increasing competition; (*b*) fast technological developments; (*c*) changing consumer attitudes; (*d*) changing tastes and requirements.

The basic utility of marketing research is that it helps the company to identify the problem areas and environmental opportunities and helps to monitor the environment. One may list several benefits of marketing research, but all these converge to what has been stated above. We may say that marketing research helps to:

1. Identify the deficiencies, if any, of the,
   (*a*) Products;
   (*b*) Pricing;
   (*c*) Distribution; and
   (*d*) Promotion.
2. Identify existing and emerging marketing opportunities.
3. Identify the relative weaknesses and strengths of the company.
4. Monitor the environmental changes.

All these will obviously help the company to take appropriate measures to improve and consolidate its position. Needless to say, marketing research provides certain vital inputs needed for forward planning.

Limitations of Marketing Research

1. Research findings are not always entirely dependable. The performance of many products have been in contradiction to the research indications.
2. It involves costs.
3. In underdeveloped countries, marketing research has its own limitations arising from non-availability of adequate and reliable data, problems in collecting data (including the problems caused by social attitudes, deficiencies of research agencies and in-house research facilities) and so on.
4. It is a time-consuming process.

Scope of Marketing Research

The scope of marketing research is indeed very wide. The broad areas of research are given below. Under each of these areas, there are a number of specific areas of research.

1. Product research
2. Pricing research
3. Distribution research
4. Promotion research
5. Consumer research
6. Marketing environment research
7. Market trend research
8. Marketing efficiency research.

TYPES OF RESEARCH

Broadly, there are two types of research, viz.,

(*i*) Exploratory research.

(*ii*) Conclusive research.

Exploratory Research

"Exploratory research seeks to discover new relationships, while conclusive research is designed to help executives choose from among the possible courses of action, that is, to make decisions."[5]

Exploratory research, as the term indicates, is investigative in nature. For example, the problem may be to find out why the sales of a product is poor or why a particular group of consumers likes or dislikes the product.

Sometimes,[6] exploratory research may lead to conclusive research. "Exploratory research may define a problem which is then 'solved' by conclusive research, but the conclusive research may have by-products which are in effect new exploratory studies leading to new hypothesis."

An exploratory research may be conducted by:

(*i*) Study of secondary data.

(*ii*) Survey of knowledgeable persons.

(*iii*) Analysis of selected cases, i.e., intensive study of a relatively small number of situations.

Conclusive Research

There are two types of conclusive research, namely,

(*i*) Descriptive research.

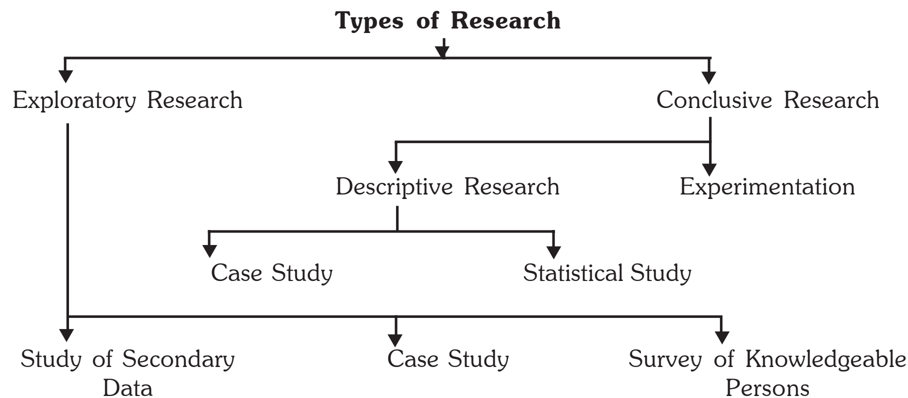
(*ii*) Experimental research.

Descriptive studies are designed to describe certain things. (For example, the characteristics of users of a given product; the degree to which product use varies with demographic variables such as age, sex, income etc.).

Descriptive research may be conducted by:

(*i*) Case study.

(*ii*) Statistical study.



As Boyd *et. al.* points out, the statistical method differs from the case method in the research number of cases studied and in the comprehensiveness of the study of each case. While the case method involves a complete study of a few cases, statistical method involves the study of a few factors in a large number of cases."[7] Statistical studies, thus, bring out averages, percentages, measures of dispersion, etc.

Experimentation may be done in a laboratory situation or in the field. For example, consumer reaction to a new product may be tested in a simulated market situation or in the real market.

PHASES OF A RESEARCH PROJECT

The important steps involved in carrying out research are as follows:

1. Definition of the problem.
2. Conducting of a situational analysis.
3. Conducting of an informal study.
4. Formulation of the research design.
5. Collection of information.
6. Analysis and interpretation of data.
7. Presentation of research findings.

(i) Definition of the Problem: The first step in the marketing research project is the definition of the research problem. This means that the objective or purpose of the research study should be clearly laid down. This is necessary to give a clear direction to research and avoid confusion. This is necessary to help collect the required information, avoid gathering irrelevant information, analyse and interpret data in the proper perspective and to make the best use of the time and other resources.

(ii) Situational Analysis: The situational analysis is particularly important when marketing research is conducted by an outside agency, because the situational analysis is meant to familiarise the researcher with the company and its environment and thereby make the problem more clear to the researcher. The researcher analyses the situation by obtaining the relevant information about the company, its competitors and other relevant environmental factors.

Situational analysis may help to define the research problem more clearly. It may also enable the formulation of the research hypothesis. A hypothesis is a tentative supposition or conclusion which will be tested by research. For example, the situational analysis may give an indication that the reason for the failure of a new product is the ineffectiveness of promotion (the target consumers might not have got the full message of the product). A hypothesis may then be formulated that the

reason for the product failure is the poor promotion and this hypothesis may be tested by research. The research findings may prove or disprove the hypothesis.

(iii) Informal Investigation: This step is indeed an extension of the previous step. While the situational analysis was largely confined to information from company sources (and also library where needed), in this stage, the researcher gathers more information from external sources such as competitors, middlemen, advertising agencies, customers etc.

In the case of some research problems, the needed information will be obtained by this step so that it will not be necessary to continue the research. If the informal investigation reveals the need for a further investigation, the next step will have to be taken, i.e., formulating a research design.

(iv) Research Design: "A research design is the specification of methods and procedures for acquiring the information needed. It is the overall operational pattern of framework of the project that stipulates what information is to be collected from which sources and by what procedures. If it is a good research design, it will ensure that the information obtained is relevant to the questions and that it was collected by objective and economical procedures."[8]

A research design, thus, specifies:

(*i*) The type of information required.

(*ii*) The sources of the information.

(*iii*) The methods or techniques of data collection.

Broadly, there are two sources of information, viz.,

(*i*) Secondary sources.

(*ii*) Primary sources.

Secondary and Primary Data: Secondary data are data which have already been gathered by somebody else and are available to others for use. Such data may be available in published or unpublished form. Books, journals, periodicals, newspapers, reports, theses, dissertations, term papers, papers presented in the seminars and symposia, etc., are sources of secondary data.

A researcher should first try to find out whether reliable and sufficient secondary data are available. If reliable and sufficient secondary data are available, there is no need to collect primary data. Secondary data are normally quick and cheap, whereas primary data are time-consuming and costly to collect.

Primary data, as the term indicates, are first-hand data collected by the researcher (or his assistants). It may be noted that even some of the primary data may be unreliable.

(v) Collection of Data: As stated above, the research design specifies the data requirements, sources of data, methods of data collection, the sampling technique and the sample size. After these things have been specified, it may be necessary to prepare data collection forms like questionnaires/ schedules. It may also be necessary to pre-test the questionnaire before the data collection starts in real earnest to ensure that the questions are clear and do not cause embarrassment to the respondents. Methods of data collection and sampling are described later in this section.

(vi) Processing, Analysis and Interpretation of Data: The raw data have to be processed and presented in an appropriate form like tables to make them easily amenable to analysis. Analysis should be followed by interpretation which includes expressing the findings in more meaningful terms like percentages and drawing useful inferences from them. However perfect the data collection may be, they will not be of any significant use unless they are properly analysed and interpreted.

(vii) Presentation of Findings: The research findings should be presented in an appropriate form (like a report, for example). The type of presentation to be made depends on a number of

factors like the nature of research, its purpose and use, the persons who use them, etc. The findings should be presented in a form and language that will be easily understood by the people who use them. If the research report is very lengthy, a summary of the report should also be included in the report.

METHODS OF DATA COLLECTION

For collecting primary data, there are broadly two methods, viz.,

(i) Observation.

(ii) Survey.

Observational Research

This is the method of collecting data by observing the behaviour of people in a given situation. The observation may be done in a natural situation. For example, the response of consumers to a particular display may be observed in an actual store. An alternative is to observe the consumer behaviour in a simulated situation. For example, a mock store may be established to observe the consumer behaviour.

The observation may be made openly, or through hidden cameras, one-way mirrors or by disguised observers.

The observational method is helpful to collect information that people are unwilling or unable to provide.

Merits

The merits of the observational method are:

(*i*) It provides information about the actual behaviour of consumers.

(*ii*) Chances of bias are limited.

(*iii*) It helps to obtain information which consumers are unwilling or unable to provide.

Limitations

The limitations of the observational method are:

(*i*) It is helpful in getting information only about certain aspects of consumer behaviour.

(*ii*) It provides information only about how consumers behave; it does not provide any information as to why consumers behave so.

(*iii*) In most cases, it is useful only as a supplement to other methods.

Survey Research

This method enables collection of information directly from the consumers. The important contact methods used to collect information by the survey method are:

(*i*) Personal interviewing.

(*ii*) Telephone interviewing.

(*iii*) Mail questionnaires.

Personal Interviewing

There are two forms of personal interviewing, viz.,

(*a*) Individual interviewing.

(*b*) Group interviewing.

Individual interviewing is more suited than group interviewing for collecting information that is too personal.

Group interviewing is less costly than personal interviewing. Certain information which may not be readily forthcoming from individual interviewing may be forthcoming from group interviewing. In group interviewing, the respondents are likely to be more controlled than in individual interviewing. This has both positive and negative effects.

Merits

The merits of personal interviewing are as under:

(*i*) It is the most direct way of eliciting information from the respondents.

(*ii*) It enables the researcher to take the respondent into confidence so as to get his full cooperation.

(*iii*) It enables clarification of points.

(*iv*) It enables the cross-checking of the information provided.

(*v*) It also provides for certain flexibility needed for data collection.

(*vi*) It enables the investigator to observe the environment of the respondent.

Limitations

The important limitations of personal interviewing

(*i*) It is time-consuming and costly, particularly if the respondents are large in number and widely scattered.

(*ii*) Some respondents may be hesitant to reveal certain information in a face-to-face interview.

(*iii*) This method needs trained people who are tactful in collecting information.

Telephone Interviewing

An easy method of collecting information is telephone interviewing. It is very common in advanced countries where most people are available on phone. In countries like India, this method can be employed only in certain cases because of the limitations of telephone ownership. However, this can be employed when the sample consists of people of certain specific strata.

Merits

Important merits of telephone interviewing are:

(*i*) Easy and quick method.

(*ii*) Like personal interviewing, this method also enables taking the respondent into confidence, clarification of points, cross-checking of information to some extent, etc.

(*iii*) As it avoids a face-to-face situation, it is a better method than personal interviewing to get certain types of information, like those which are very personal or sensitive.

(*iv*) It saves time and cost compared to personal interviewing.

Limitations

Following are the important limitations of telephone interviewing:

(*i*) Its scope is limited in countries like India where most people are not available on the phone and where the telephone system is inefficient.

(*ii*) One limitation of this method in comparison with personal interviewing is that there is no scope for personally observing the respondent and his environment.

Mail Questionnaire

One common method is to send the questionnaire to the respondent by post and get it back, after filling up, by post.

Merits

Important merits of this method are:

(*i*) When the respondents are large in number and scattered over distant places, this is a preferable method.

(*ii*) It is also a very economical method.

(*iii*) Respondents can fill in the questionnaire at their leisure and hence they may be in a position to do justice to the requirements.

(*iv*) It avoids embarrassment of talking in person about certain sensitive matters.

Limitations

Limitations of the questionnaire method include:

(*i*) It cannot be used to collect information from the illiterate.

(*ii*) It does not provide scope for clarification.

(*iii*) It does not provide as much scope for cross-checking as in the case of personal or telephone interviewing.

(*iv*) There are chances of the respondents leaving some parts of the questionnaire blank.

(*v*) Many respondents may have to be reminded over and again to send back the questionnaire.

(*vi*) The response rate (i.e., the percentage of people who fill in properly and return the questionnaire) is normally very low.

SAMPLING

When the size of the population, i.e., the number of relevant units to be studied, is very large, sampling becomes necessary for conducting the market research. For example, certain consumer products like toilet soap or toothpaste have several crores of consumers and no market research can afford to make a survey of the entire population of consumers to study the consumer characteristics. A survey of a few hundred consumers selected in such a way as to possess the representative character of the relevant population will serve the purpose of marketing research.

In many market researches, information is collected from a representative sample and not from the entire population. When the relevant population is very small, it will be possible and may be necessary to adopt the census method or complete enumeration method, i.e., of studying all the units. In other cases, sampling may be resorted to.

Reasons for Sampling

1. When the population size is very large, it is not possible to collect information about all the units within a limited time.
2. When the population is very large, collection of information from all the units would be prohibitively expensive.
3. Besides the two problems mentioned above, there could be other practical difficulties like getting sufficient number of qualified investigators, locating all the units, etc.
4. In most cases, a representative sample would provide reasonably adequate and accurate information and the accuracy of information is not going to be justifiably enhanced by studying the entire population.

5. In certain situations, sampling is the only justifiable method. For example, if the material gets destroyed in the process of testing (example: testing of photographic film), there will not be any useful material left after testing if the entire output is subjected to testing.

Sample Characteristics

A sample, to be justifiable, should possess the following qualities:

1. It should be representative of the population so that the information collected from the sample will be dependable.
2. The sample should be of adequate size to ensure reasonable accuracy of information.
3. Sampling is justifiable in terms of time and other resources.

Limitations of Sampling

There may arise sampling error, i.e., the error in selecting the sample. If there is a sampling error, the sample will not be the true representative of the population.

The reliability of the sample depends on the appropriateness of the sampling method used.

Methods of Sampling

There are two broad categories of sampling, viz., non-probability sampling and probability sampling.

Non-probability Sampling

The following are the important non-probability methods of sampling:

(i) Convenience Sampling: Units included in the sample are selected according to the convenience of the investigator. For example, for a sample survey of bus passengers, passengers waiting at bus stops may be included in the sample.

(ii) Quota Control Sampling: Under the quota control sampling, the field workers are required to include in the sample only those units which conform to certain specified parameters and each field worker is assigned quotas of number of units to include according to one or more characteristics. For example, the interviewer may be asked to include in the sample of bus passengers — 20 male students, 15 female students, 30 male employees, 10 female employees and 25 other regular passengers.

(iii) Judgmental Sampling: Under this method, units are included in the sample on the basis of the judgment that the units possess the required characteristics to qualify as representatives of the population. The judgment may be qualitative (an expert opinion) or quantitative (based on certain quantifiable characteristics).

Probability Sampling

There are a number of methods of probability sampling. Some important ones are given below:

1. *Simple Random Sampling:* Units are selected at random so that every unit has an equal chance to getting included in the sample.

2. *Stratified Random Sampling:* When the relevant population consists of different strata like low income households, lower middle income households, upper middle income household, high income households, etc., the population is divided into different strata and certain specified number of units are selected from each stratum at random. It also involves decision about the weightage to be given to each stratum in the sample size.

3. *Systematic Sampling*: Under this method, every *n*th unit is selected from the target population list after the first unit is selected at random.

4. *Cluster Sampling:* Under cluster sampling, a cluster of the relevant population is studied instead of individual units from a very wide area. For example, for a certain study, all the households in a particular neighbourhood (residential) of a city may be included in the sample rather than selecting one or a few household from every neighbourhood of the entire city.

RESEARCH AGENCIES

A firm may have several constraints to conduct a marketing research in foreign countries. It may not have the required knowledge of the foreign marketing environment for conducting the research. It may not have suitable personnel or other expertise and resources.

Because of such reasons, using marketing research firms for conducting the research in foreign markets is quite common. Research agencies so used should be those with professional expertise, credibility and intimate knowledge of the marketing environment.

Advantages of Research Agency

A good research firm has the following advantages:

1. *Expertise:* The client can benefit from the professional expertise and experience of the agency in undertaking marketing research.

2. *Objectivity:* The agency may not have any bias in favour of or against any project whereas certain people in the company may have such biases, or emotional involvements that effect the objectivity.

3. *Knowledge and Familiarity*: The research firm would be familiar with the business and social environment of the market and would have a good knowledge about the characteristics of the industry and the market concerned. Such knowledge and familiarity are essential for properly designing the research project and in successfully carrying it out. It is also essential, in many cases, that the people who do the field work should be conversant with the local languages.

4. *Cost-effectiveness*: Use of an external agency would cause considerable cost. However, a good agency would be more cost-effective than the research being done by the company itself because a research agency has an established infrastructure for research, including the human resource.

Selection of Agency

Selection of the right agency is not always simple or easy; it may involve a careful process.

Collection of information about the research agencies is normally the first step in the process. Sources of such information include export promotion organisations, trade associations, advertising agencies, consultants, management educational/training institutes and research organisations, companies having experience in the field, commercial sections of foreign embassies, international organisations such as the ITC, importers, wholesalers and distributors in the foreign market, trade publications etc.

From the list of the research agencies so collected, a small number should be selected by a preliminary screening. These firms may be invited to indicate their interest in the research project and to supply general background information about themselves, their services and any special expertise they can offer. They may also be requested to give a list of references who may be contacted for an evaluation of their work.

On the basis of the above information, the list should be pruned down to two or three with whom a detailed discussion about the research proposal is held. These agencies may then be asked to submit a written research proposal including a description of the research methodology, time required to complete the work, the total cost involved etc. This should enable the client to negotiate a contract with the best suited agency.

The terms and conditions between the agency and the client should be clearly laid down in a contact or letter of agreement to avoid any conflict or confusion in future. The contract should cover the terms of reference and methodology, the budget and payment terms, time schedule, nature of the report needed etc.

PROBLEMS IN INTERNATIONAL RESEARCH

There may be different problems in international business research. Some of the common problems are the following:

1. The cultural differences make foreign market research a difficult task.
2. It is often very expensive.
3. The research methodology suitable for one market may not be suitable for another market.

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5

MARKET SELECTION

One of the most important decisions in international marketing is market selection.

The global market, made up of well over 200 independent nations with their own distinctive characteristics, is too vast indeed.

It would be very difficult for a company to operate in all these markets. There are barriers which make entry to a number of markets impossible or very difficult. There may be markets which are not profitable or are not worth the trouble. Further, there may be markets which are very risky due to political or other reasons.

Moreover, the company resources may not permit the operation in a large number of countries. There are, of course, companies which operate in majority of the countries of the world. These companies have not achieved such a massive expansion overnight. It has been a gradual expansion achieved over a long period. Further, all types of business do not lend themselves for such substantial international expansion.

A company which wants to enter many market should do it systematically. Too fast an expansion without the resource and organisational strength for such an expansion could be suicidal. The Bulova Watch Company expanded into over one hundred countries. It spread itself too thin, made profits in only two countries and lost around $ 40 million.[1]

All these factors highlight the need for market selection. Even a company with ambitious plans and good prospects for global expansion has got to rank the markets for prioritisation of the expansion plans.

Market selection is based on a thorough evaluation of different markets with reference to certain well-defined criteria, given the company resources and objectives. Marketing research, therefore, becomes necessary to obtain the data required for evaluating the markets. Important source of information are given in the chapter *International Marketing Intelligence.*

It is also necessary to prepare a profile of the selected markets to help the company to formulate the marketing strategy. It may be noted that many of the items of information contained in the market profile are collected for the purpose of evaluation of the markets for market selection.

MARKET SELECTION PROCESS

The important steps involved in the market selection process are depicted in Figure 5.1.

International Marketing Objectives

The first step in any management decision making process is to determine/ascertain the objectives.

The market selected to serve a particular international marketing objective need not necessarily be the best suited to achieve some other international marketing objective. Different international marketing objectives have been described in Chapter 1. Various markets may have different degrees of attractiveness from the point of view of different objectives. More about this is stated under the subtitle *Firm Related Factors* little later in this chapter.

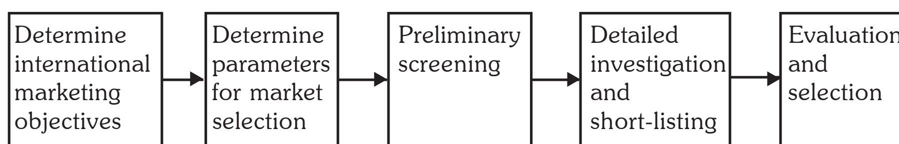

Fig. 5.1: Market Selection Process

Parameters for Selection

For proper evaluation and selection of the markets, it is essential to clearly lay down the parameters and criteria for evaluation. Important parameters often used for market selection are shown in the evaluation matrix described elsewhere in this chapter.

Preliminary Screening

After determining the criteria for market selection, the next important step in market selection process is to conduct a preliminary screening of the markets. The objective of the preliminary screening process is to eliminate the markets which are obviously not potential enough as revealed by a cursory look.

The parameters used for the preliminary screening may vary from product to product. However, parameters like the size of population, per capita income, structure of the economy, infrastructural factors, political conditions etc. are commonly used. Information about some of the factors would enable a company to eliminate certain markets from its consideration. For example, in a country where there is no telecasting, there is obviously no market for TV sets. Similarly if the rural areas are not electrified, there may be no demand for electrical agricultural pump sets. If the household income of the majority of a country with a small population is very low, the demand for costly consumer durables will be limited. Further, there may be countries which should be omitted due to political reasons, including government policies.

A lot of information required for the preliminary screening is available from such publications as the Statistical Year Book of the United Nations and the World Bank's World Development Report.

Short-listing of Markets

Preliminary screening enables to eliminate markets which obviously do not merit consideration at the very outset. There would be a large number of markets left even after the preliminary screening. They are further screened with the help of more information than was used at the preliminary screening stage. The objective is to distill out a small number of markets which are likely to satisfy the company's criteria for market selection for a detailed analysis for ranking them and final selection.

Evaluation and Selection

A thorough evaluation of the short-listed markets is done with reference to the specific parameters and criteria and the markets are ranked on the basis of their overall attractiveness. One or more market(s) is/are selected from the rank list. For further details, see the section *evaluation matrix.*

DETERMINANTS OF MARKET SELECTION

The market selection is normally based on two sets of factors, viz., the firm related factors and the market related factors.

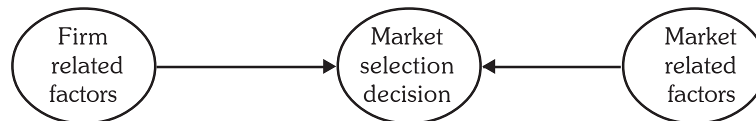

Fig. 5.2: Determinants of Market Selection

Firm related factors refer to such factors as the objectives, resources, product mix, international orientation etc. of the firm.

Firm Related Factors

A firm whose export objective is only to sell out a marginal surplus will select a foreign market suited to serve this purpose. Another firm with the same product, which wants to export a very large quantity, forming a very significant share of its total output, may have different considerations than the first firm in market selection. In the case of the second firm, as the total quantity involved is large and as it forms a significant share of its total output, market diversification would be important to minimise the risk. If we think of a third firm which also wants to export the same product as the first two firms, but which wants to export several other products also, the market(s) which it selects may perhaps be different from what the first two firms have chosen; it would give more importance to the total exports of all its products than that of any single product. Further, the market selection may be influenced by other objectives like growth. When business growth is an important objective, growth potential of the market will be an important criterion for selection.

The planned business strategy may also influence the market selection. For example, a market considered the most important from the point of view of exporting need not necessarily be the one that would be selected for locating production base or a sales office. A company that has plans for large expansion of foreign business may choose a market, to start with, which can serve as a hub of international business.

The market selection is also influenced by the international orientation (refer Chapter 1 for details) of the company.

Another very important determinant is the company resources comprising financial, human, technological and managerial factors.

The dynamism and philosophy of the top management and the internal power relations may also influence the market selection decision.

Market Related Factors

There are a number of market related factors which need to be carefully evaluated for market selection. The market related factors may be broadly grouped into general factors and specific factors. General factors are factors general to the market as a whole whereas the specific factors are factors which are specific to the industry concerned.

General Factors

(i) Economic Factors: Include factors like economic stability, GDP growth trends, income distribution, per capita income, sectoral distribution of GDP and trends, nature of and trends in foreign trade and BoP, indebtedness, etc.

(ii) Economic Policy: Includes industrial policy, foreign investment policy, commercial policy, monetary policy, fiscal policy and other economic policies.

(iii) Business Regulations: Regulations of business like industrial licensing; restrictions on growth, takeovers, mergers etc; restrictions on foreign remittances, repatriations etc; tax laws; import restrictions and local content stipulations; export obligations and so on.

(iv) Currency Stability: Stability of the national currency is another very important consideration in the market selection.

(v) Political Factors: Character of the political system including the nature and behaviour of the ruling party/parties and opposition party/parties, the government system etc. and political stability are among the most important determinants of market selection.

(vi) Ethnic Factors: Ethnic factors like ethnic characteristics, including ethnic differences, and their implications for the business, ethnic harmony etc. should also be analysed.

(vii) Infrastructure: Infrastructural facilities seriously affect business. For example, power shortage could cause considerable production losses. Shipping and other communication bottlenecks could cause lot of delays and loss of business, in addition to high costs.

(viii) Bureaucracy and Procedures: The nature and behaviour of the bureaucracy and the procedural system or styles are also important factors to be considered.

(ix) Market Hub: The ability of a market to act as a hub, a base from where the company can operate in a contiguous region or countries, is a very important factor in the market selection of a company with plans for expansion of international business. South Africa, for example, could be such a hub for the entire Sub-Saharan Africa.

A large number of Indian companies have opened offices in Singapore to use it as a hub to trade with the booming markets of South-East Asia and the Pacific. Singapore is attractive for Indian companies because of its infrastructure, tax incentives and the large Indian population. A company which sets up an operational headquarters (OHQ) in Singapore has to pay only 10 per cent corporate tax against the normal 30 per cent.

Indian industrialists feel that Sweden could be used as a base for exporting to third countries, especially the Baltic states. They also feel that the Swedish industrialists could use India as a sourcing ground to manufacture goods for export to the Asia-Pacific.

Specific Factors

Besides the general factors, there are a number of factors specific to the industry which need to be analysed for evaluating the market. Important specific factors are:

(*i*) Trends in domestic production and consumption and estimates for the future of the product(s) concerned.

(*ii*) Trends in imports and exports and estimates for the future.

(*iii*) Nature of competition.

(*iv*) Government policy and regulations pertaining to the industry.

(*v*) Infrastructure relevant to the industry.

(*vi*) Supply conditions of raw materials and other inputs.

(*vii*) Trade practices and customs.

(*viii*) Cultural factors and consumer characteristics.

Market characteristics including the number and nature of market segments, price trends etc.

Box 5.1

The Chinese Lure

China has been attracting huge FDI. China which is second only to the US in the FDI inflow gets about 30 per cent of the total investment flow to the developing world. The annual FDI inflow to China is more than ten times that to India. In 1997, there were about 145,000 foreign affiliates of MNCs in China. What lures firms to China?

Besides the attractiveness of the huge and fast growing market, China has a generally favourable business environment. According to the *World Competitiveness Report* of the World Economic Forum, China has 32nd rank in competitiveness compared to India's rank of 52 in the list of a total of 59 countries ranked. On the point of openness, China was 7 ranks ahead of India.

Evaluation Matrix

An evaluation matrix is often used for ranking the markets with reference to their attractiveness for the company.

The evaluation matrix will include the relevant general and specific factors. These factors will be expressed in such specific terms so that they lend themselves for clear measurement and evaluation.

The countries to be evaluated may be listed on the horizontal axis and the factors on the vertical axis. Each factor is assigned a raw score and a weightage. The weighted score is obtained by multiplying the raw score with the respective weightage. Markets are ranked by comparing the total weighted scores.

Table 5.1
EVALUATION MATRIX

Attributes	**Weighting Factor**	**Country A**		**Country B**		**Country C**	
		RS	**WS**	**RS**	**WS**	**RS**	**WS**
General							
Political stability	10	10	100	7	70	10	100
Economic stability	8	10	80	7	56	8	64
Currency strength and stability	8	9	72	7	56	8	64
Government policy	8	8	64	8	64	8	64
Infrastructural facilities	8	9	72	6	48	7	56
Ability to serve as marketing hub	10	8	80	5	50	6	60
Tax incentives	5	7	35	6	30	7	35
Ethnic factors	4	7	28	4	16	7	28
Bureaucracy and procedure	7	8	56	6	42	6	42
Sum of weighted scores			587		432		513
Specific							
Competition	8	4	32	7	56	8	64
Demand	10	10	100	6	60	8	80

Labour costs	7	7	49	8	56	7	49
Labour productivity	7	6	42	6	42	8	56
Infrastructure	8	8	64	6	48	8	64
Govt. policy and regulation	8	9	72	7	56	8	64
Incentives	5	6	30	5	25	6	30
Sum of weighed scores			389		343		407
Grand Total			976		775		920
Ranking countries			1		3		2

RS = Raw Score WS = Weighted Score (weighting factors × RS)

MARKET PROFILE

Profiles of selected markets are prepared to help formulate appropriate marketing strategies.

The term market profile is used in two contexts. It may refer to the overall profile of a market, i.e., the general characteristics of a nation like the demographic characteristics, economic characteristics, political characteristics, economic policies and business regulations in general, nature and pattern of foreign trade etc.

In other case, the market profile is a description of relevant characteristics of the market for a specific product in a country. Even the market profile for specific product usually includes, in the beginning, a brief general profile of the country.

The market profile of product is a fairly detailed account of relevant market characteristics. It provides those information which are needed for the formulation of the marketing strategy. A market profile will, for example, help in the formulation of appropriate product strategy, pricing strategy, distribution strategy and promotion strategy.

The market profile for a product should contain the following:

1. Trends in the domestic production, demand, imports and exports and the forecasts of the same for the future.
2. Competitive characteristics — the competitors, their competitive strategies and strengths and weaknesses of the competitors.
3. Market segment characteristics — the number of segments and their size, the success factors in each segment, determinants of demand in each segment, competitive characteristics of each segment, growth potentials of the segments etc.
4. Customer characteristics including tastes and preferences, attitudes, buying habits, usage characteristics, etc.
5. Channel characteristics including trade practices.
6. Promotion characteristics.
7. Factors relevant to pricing, laws related to product, price, promotion, distribution, imports etc.

MARKET SEGMENT SELECTION

A firm has also to make a strategic decision about the segment/segments of the foreign market that it should enter.

The segment/segments that a firm may enter depends on a number of factors like the firm related factors (the size and resources of the firm, its product mix, marketing characteristics of the firm etc.), product related factors (for e.g., whether it is an innovative product or a 'me too' product), competitive factors (the strengths and weaknesses of the competitors, the extent of competition in

the different segments etc.) and other market related factors like the size and characteristics of different segments, growth prospects of different segments etc.

A firm with an innovative product and marketing strength may choose the most lucrative segment/ segments of the market first and may then spread to other segments. However, a small firm with a 'me too' product may not be in a position to compete directly with large established firms.

Small and new firms, therefore, often look for niches for an entry into the market. A market niche is a segment of the market which is ignored by the major players and where there is a need gap to fill. The advantage of niche marketing is that there would not be direct confrontation with the major players. There may not also be any other powerful marketer. As there exists a gap to be filled, there would be reasonable chances of success.

After having established a position of strength in the niches, the firm may move to other segments. This has been a strategy employed by several now well-known Japanese companies in the foreign markets like the US.

Potential market niches often exist for many products in many markets. Willard and Savara observe, on the basis of a study of the success of the foreign firms in the US market, that "in free markets, conditions frequently arise which invite additional competition to enter. Sometimes, these conditions result from the failure of incumbent manufacturers to adequately serve all segments of the market. The dangers of defining one's market too narrowly have been recognised since Levitt's classic article on 'marketing myopia' but the practice persists."[2] Their study reveals that first, US manufacturers created a "window of opportunity" which allowed — perhaps even invited — non-domestic manufacturers into the US market. Secondly, US manufacturers were either slow to recognise or were unable or unwilling to respond quickly and effectively to the competitive challenge of imports. Then, having established an initial presence, non-domestic manufacturers moved quickly to consolidate their position with the US consumers. Only after the entry position had been secured did they move upmarket.[3] In several industries, this strategy has worked sufficiently well that non-domestic competitors have established major — and in some cases dominant — positions in the US market.[4]

Several Indian companies have also been employing similar entry strategies.

REFERENCES

1. Philip Kotler, *op. cit.*, p. 409.
2. Gray E. Willard and Arun M. Savara, "Patterns of Entry: Pathways to New Markets", *California Managment Review*, Winter 1988, p. 59.
3. *Ibid.*
4. *Ibid.*

6

MARKET ENTRY STRATEGIES

One of the most important strategic decisions in international business is the mode of entering the foreign market. On the one extreme, a company may do the complete manufacturing of the product domestically and export it to the foreign market. On the other extreme, a company may do, by itself, the complete manufacturing of the product to be marketed in the foreign market there itself. There are several alternatives in between these two extremes. The choice of the most suitable alternative is based on the relevant factors related to the company and the foreign market.

In some cases, the alternatives available may also be limited. For example, the policy of some governments may not be very positive towards foreign investments. Several governments have a definite preference for joint ventures over complete foreign ownership. In some cases, the government may prefer foreign investment leading to import substitution to perpetual import of a product. Thus, in some cases, government policies may rule out the best alternative if the environment were free.

Important foreign market entry strategies are the following:

(*i*) Licensing/franchising
(*ii*) Exporting
(*iii*) Contract manufacturing
(*iv*) Management contract
(*v*) Assembly operations
(*vi*) Fully owned manufacturing facilities
(*vii*) Joint venturing
(*viii*) Countertrade
(*ix*) Mergers and acquisitions
(*x*) Strategic alliance
(*xi*) Third country location

LICENSING AND FRANCHISING

Licensing and Franchising, which involve minimal commitment of resources and effort on the part of the international marketer, are easy ways of entering the foreign markets.

Under international licensing, a firm in one country (the licensor) permits a firm in another country (the licensee) to use its intellectual property (such as patents, trade marks, copyrights, technology, technical know-how, marketing skill or some other specific skill). The monetary benefit to the licensor is the royalty or fees which licensee pays. In many countries, such fees or royalties are regulated by the government; it does not exceed five per cent of the sales in many developing countries.

A licensing agreement may also be one of cross licensing, wherein there is a mutual exchange of knowledge and/or patents. In cross licensing, a cash payment may or may not be involved.

Franchising is a form of licensing in which a parent company (the franchisor) grants another independent entity (the franchisee) the right to do business in a prescribed manner. This right can take the form of selling the franchiser's products, 'using its name, production and marketing techniques, or general business approach."[1] One of the common forms of franchising involves the franchisor supplying an important ingredient (part, material etc.) for the finished product, like the Coca Cola supplying the syrup to the bottlers.

Usually, franchising involves a combination of many of the elements mentioned above. The major forms of franchising are *manufacturer-retailer* systems (such as automobile dealership), *manufacturer-wholesaler systems* (such as soft drink companies), and *service firm-retailer systems* (such as lodging services and fast food outlets).[2]

There are also cases of cross or reverse franchise agreements. For example, the ITC Hotels and ITT Sheraton Corporation had such an agreement under which ITC Hotel's Welcom group franchised two of its hotels in Bangkok and Hong Kong to ITT Sheraton, holding, in exchange, the franchise for Sheraton in India. Later the partners decided to set up a joint venture — ITC-Sheraton — with Sheraton having a majority stake, to manage all new ITC hotel projects in India.

One of the growing trends recently has been trade mark licensing. Czinkota and Ronkainen point out that trade mark licensing has become a substantial source of worldwide revenue. The total volume of trade mark licensing was expected to reach $ 75 billion by 1990. The names or logos of designers, literary characters, sports teams, and movie stars appear on clothing, games, foods and beverages, gifts and novelties, toys and home furnishings.[3]

A number of foreign companies have entered the Indian market, both industrial and consumer goods, by licensing. The IFB washing machine, for example, was manufactured in India under license from Bosch of Germany. The US multinational General Electric (GE) has licensed its patented technology to a small scale unit in India, established for the manufacture of high intensity discharge (HID) fittings. As electrical fittings were reserved for the small scale sector, GE, had, perhaps no alternative to enter the market.

After four years of scouting around, Nike International Ltd., the world's largest sports shoe and apparel company, finally decided in 1995 to enter the Indian market by licensing. Sierra Industrial Enterprises Ltd., the licensee, will invest in setting up the complete quality control, marketing and distribution operations and will pay Nike 5 per cent royalty on ex-factory price of both footwear and apparel for the use of the brand name.

International licensing/franchising have grown very substantially. Czinkota and Ronkainen succinctly describe their attractiveness or reasons for popularity:

"As an entry strategy, it requires neither capital investment nor knowledge and marketing strength in foreign markets. By earning royalty income, it provides an opportunity to exploit research and

development already committed to. Licensing reduces risk of exposure to government intervention in that the licensee is typically a local company that can provide leverage against government action. Licensing will help to avoid host country regulations that are more prevalent in equity ventures. Licensing may also serve as a stage in the internationalisation of the firm by providing a means by which foreign markets can be tested without major involvement or capital or management time."[4]

Another advantage of licensing is that it may be employed as a preemptive strategy against competitors by combing the foreign markets before the competitors could enter. Thus, as pointed out under the section Competition in Chapter 1, the General Electric of USA by licensing its advanced gas turbine technology to foreign producers who were potential competitors could eliminate possible competition from them.

Licensing has been used by many companies also to harvest their obsolete products. This strategy has been employed, in particular, in developing countries.

When the market is closed by the host country regulations either to imports or to foreign investment, licensing may provide a viable opportunity to enter such a market.

From the point of view of the licensee, licensing provides the great advantage of entering the market with a proven product/technology or marketing intangible without having to run the risk of R&D failures. It also reduces the investment requirements.

In the past, when many US companies, with the prevalent attitude that "we have enough business right here in the States", were not seriously looking to expand globally, licensing appeared to be a very attractive proposition. For example, between 1960-67, about 200 licensing agreements were concluded between the US and Japanese firms for transfer of TV technology to Japan. Firms in several other industries also licensed their technology etc. to foreign firms. But several of them were shocked to learn that they had grossly underestimated the vast potential of the foreign markets. For example, one US firm that licensed an English firm to manufacture and sell its products in the United Kingdom, but agreed to give the English firm an exclusive right to sub-licence the US expertise in other countries, for it then had no marketing commitment to exports. Within a few years, global markets developed for the company's products, and was stuck with another party getting the benefits. Another US firm, a drug manufacturer, gave an Asian company a manufacturing license. The Asian market, which up to then had been nothing at all, boomed, leaving the US firm as almost an outsider.[5]

One of the important risks of licensing is that the licensor would be developing a potential competitor; the licensee would become a competitor after the expiry of the licensing agreement. The licensee may even develop capabilities to introduce better products. The skill of the Japanese in product improvement is well known. In several electronic products, including TV, the Japanese have become world leaders or strong competitors in due course. Licensees in the developing countries might gain an edge over the licensor, after the term of the license, because of their low cost of labour which would enable them to compete with the erstwhile licensor in his own home market as well as in the foreign markets. Some companies are, therefore, hesitant to enter into licensing agreements.

EXPORTING

Exporting, the most traditional mode of entering the foreign market, is quite a common one even now. As pointed out in Chapter 1, international trade has been growing much faster than the world output resulting in greater world economic integration.

Exporting is the appropriate strategy when one or more of the following conditions prevail:

1. The volume of foreign business is not large enough to justify production in the foreign market.
2. Cost of production in the foreign market is high.

3. The foreign market is characterised by production bottlenecks like infrastructural problems, problems with materials supplies etc.
4. There are political or other risks of investment in the foreign country.
5. The company has no permanent interest in the foreign market concerned or that there is no guarantee of the market available for a long period.
6. Foreign investment is not favoured by the foreign country concerned.
7. Licensing or contract manufacturing is not a better alternative.

Exporting is attractive than other modes particularly when underutilised capacity exists. Even when there is no excess capacity, expansion of the existing facility may some times be easier and less costly than setting up production facilities abroad. Further, many governments, as in India, provide incentives for establishing facilities for export production.

The alternatives to making in foreign countries by the international marketer for marketing the goods in the foreign countries are licensing and contract manufacturing. Although these have certain advantages, there are also certain risks. Hence, if a company does not want to go in for licensing or contract manufacturing, the only avenue open is exporting.

Although exporting may turn out to be the best alternative under a given set of conditions or environmental factors, there are several sets of conditions which make exporting less attractive than one or more of other alternatives. Policies of some foreign governments discriminate against imports; in some cases import is even banned. It may be noted that hostility against imports have been encouraging substitution of exports by production in the foreign markets. A number of foreign companies have set up production facilities in the European Community to overcome the import barriers. Japanese transplants in North America have also been caused to a considerable extent by the hostility towards imports.

Besides, in a number of a cases, cost considerations make foreign production or assembly preferable to other entry strategies. Further, as noted in the introductory chapter, exporting marks the first stage in the evolution of international business of many companies. As the international business grows or as the environment changes or to expand the business, it may become necessary to change the strategies.

There are, broadly, two ways of exporting, viz., indirect exporting and direct exporting. They are described in the chapter on *International Distribution*.

CONTRACT MANUFACTURING

Under contract manufacturing, a company doing international marketing contracts with firms in foreign countries to manufacture or assemble the products while retaining the responsibility of marketing the product. This is a common practice in international business. There are a number of multinationals and affiliates of multinationals which employ this strategy in India in respect of some of the products they market, like Park Davis, Hindustan Lever, etc.

Contract manufacturing has the following advantages:

1. The company does not have to commit resource for setting up production facilities.

2. It frees the company from the risks of investing in foreign countries.

3. If idle production capacity is readily available in the foreign country, it enables the marketer to get started immediately.

4. In many cases, the cost of the product obtained by contract manufacturing islower than if it were manufactured by the international firm. For example, the product cost in the small scale sector is much lower than in the large scale sector for many products because of the lower wages,

lower overheads, and tax concessions. Moreover, if excess capacities are available with existing units, it may even be possible to get the product supplied on the marginal cost basis.

5. Contract manufacturing also has the advantage that it is a less risky way to start with. If the business does not pick up sufficiently, dropping it is easy; but if the company had established its own production facilities, the exit would be difficult. It may be interesting to note that the availability of excess capacity with some soap manufactures enabled several foreign companies to experiment with new brands of toilet soap in the Indian market. For example, Godrej soaps manufactured Dettol for Reckitt and Coleman; Clearton for Nicholas Laboratories; Johnson's Baby Soap for Johnson and Johnson; and Ponds Dreamflower, Cold Cream and Sandalwood for Ponds. It may be noted that some of these brands have not succeeded in the market. The cost to the company of the product failure is relatively low when it did not invest in production facilities.

6. Moreover, contract manufacturing may enable the international firm to enlist national support.

Contract manufacturing, however, has the following disadvantages:

1. In some cases, there will be the loss of potential profits from manufacturing.
2. Less control over the manufacturing process.
3. Contract manufacturing also has the risk of developing potential competitors.
4. It would not be suitable in cases of high-tech products and cases which involve technical secrets etc.

MANAGEMENT CONTRACTING

Under the management contract, the firm providing the management know-how many not have any equity stake in the enterprise being managed. In short, "in a management contract, the supplier brings together a package of skills that will provide an integrated service to the client without incurring the risk and benefit of ownership."[6] Thus, as Kotler observes, management contracting is a low-risk method of getting into a foreign market and it starts yielding income right from the beginning. The arrangement is especially attractive if the contracting firm is given an option to purchase some shares in the managed company within a stated period."[7]

Management contract could, some times, bring in additional benefits for the managing company. It may obtain the business of exporting or selling otherwise of the products of the managed company or supplying the inputs required by the managed company.

Management contract enables a firm to commercialise existing know-how that has been built up with significant investments and frequently the impact of fluctuations in business volumes can be reduced by making use of experienced personnel who otherwise would have to be laid off.[8]

Management contracts, obviously, have clear benefits for the clients. "They can provide organisational skills not available locally, expertise that is immediately available rather than built up, and management assistance in the form of support services that would be difficult and costly to replicate locally."[9]

Management contracts have disadvantages under certain conditions. As Kotler observes, the arrangement is not sensible if the company can put its scarce management talent to better use, or if there are greater profits to be made by undertaking the whole venture. Management contract may prevent a company from setting up its own operations for a particular period.

One possible risk from the point of view of the client is overdependence and loss of control. The client should enable itself to steadily develop its own capabilities.

Some Indian companies — Tata Tea, Harrisons Malayalam and AVT — have contracts to manage a number of plantations in Sri Lanka. Tata Tea also has a joint venture in Sri Lanka namely Estate Management Services Pvt. Ltd.

TURNKEY CONTRACTS

Turnkey contracts are common in international business in the supply, erection and commissioning of plants, as in the case of oil refineries, steel mills, cement and fertiliser plants etc.; construction projects and franchising agreements.

"A turnkey operation is an agreement by the seller to supply a buyer with a facility fully equipped and ready to be operated by the buyer's personnel, who will be trained by the seller. The term is sometimes used in fast food franchising when a franchisor agrees to select a store site, build the store, equip it, train the franchisee and employees and sometimes arrange for the financing."[10]

Many turnkey contracts involve government/public sector as buyer (or seller in some cases).

A turnkey contractor may subcontract different phases/parts of the project.

FULLY OWNED MANUFACTURING FACILITIES

Companies with long-term and substantial interest in the foreign market normally establish fully owned manufacturing facilities there. As Drucker points out, "it is simply not possible to maintain substantial market standing in an important area unless one has a physical presence as a producer."[11]

A number of factors like trade barriers, differences in the production and other costs, government policies etc. encourage the establishment of production facilities in the foreign markets. More information about this is provided in the chapter on *International Investment.*

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 in the case of licensing and contract manufacturing.

Wholly owned manufacturing facility has several disadvantages too. In some cases, the cost of production is high in the foreign market. There may also be problems such as restrictions regarding the types of technology, non-availability of skilled labour, production bottlenecks due to infrastructural problems etc. If the market size is small, a separate production unit for the market may be uneconomical. Foreign investment also entails political risks.

Fully owned enterprises may not be allowed or favoured in some countries, particularly in low priority areas.

Moreover, this method demands sufficient financial and managerial resources on the part of the company.

ASSEMBLY OPERATIONS

As Miracle and Albaum point out, a manufacturer who wants many of the advantage that are associated with overseas manufacturing facilities and yet does not want to go that far may find it desirable to establish overseas assembly facilities in selected markets. In a sense, the establishment of an assembly operation represents a cross between exporting and overseas manufacturing.[12]

Having assembly facilities in foreign markets is very ideal when there are economies of scale in the manufacture of parts and components and when assembly operations are labour intensive and labour is cheap in the foreign country. It may be noted that a number of US manufacturers ship the parts and components to the developing countries, get the product assembled there and bring it back home. The US tariff law also encourages this. Thus, even products meant to be marketed domestically are assembled abroad.

Assembling the product meant for the foreign market in the foreign market itself has certain other advantages, besides the cost advantage. The import duty is normally low on parts and components than on the finished product. Assembly operations would satisfy the 'local content' demand, at least to some extent. Because of the employment generation, the foreign government's attitude will be more favourable than towards the import of the finished product.

Another advantage is that the investment to be made in the foreign country is very small in comparison with that required for establishing complete manufacturing facilities. The political risks of foreign investment is, thus, not much.

JOINT VENTURES

Joint venture is a very common strategy of entering the foreign market. In the widest sense, any form of association which implies collaboration for more than a transitory period is a joint venture (pure trading operations are not included in this concept). Such a broad definition encompasses many diverse types of joint overseas operations, viz.,

1. Sharing of ownership and management in an enterprise.
2. Licensing/franchising agreements.
3. Contract manufacturing.
4. Management contracts.

Three of the above have already been discussed in the preceding sections. The following paragraphs are confined to the first category referred to above, i.e., joint ownership ventures. What is often meant by the term joint venture is joint ownership venture.

The essential feature of a joint ownership venture is that the ownership and management are shared between a foreign firm and a local firm. In some cases, there are more than two parties involved. For example, Pepsi's Indian joint venture involved Voltas and Punjab Agro Industries Corporation.

A joint ownership venture may be brought about by a foreign investor buying an interest in a local company, a local firm acquiring an interest in an existing foreign firm or by both the foreign and local entrepreneurs jointly forming a new enterprise.

It is also a common practice to split the local interest between a partner and various public participation (including public sector firms or industrial development organisations). Such a strategy may enable the international firm to retain much control despite a minority holding as the power of the remaining shares is spread out. Further, equity holding by the public would help the enterprise get some public support. Partnership with government organisation may help to obtain favourable treatment from the government.

In countries were fully foreign owned firms are not allowed or favoured, joint venture is the alternative if the international marketer is interested in establishing an enterprise in the foreign market. Many foreign companies entered the communist, socialist and other developing countries by joint venturing.

One important advantage of joint venturing is that it permits a firm with limited resources to enter more foreign markets than might be possible under a policy of forming wholly owned subsidiaries.

In some cases, it is also possible to swap know-how (such as patent rights for equity) in forming joint venture as a means of securing ownership in foreign operations.

Partnership with local firms has certain specific advantages. The local partner would be in a better position to deal with the government and the public. Further, there would not be much public hostility when there is a local partner; it would be much less when there is equity holding by the government sector and the public.

A right local partner for a joint venture can have a major impact on a firm's competitiveness because such a partner can serve as a cultural bridge between the manufacturer and the market. For example, several successful foreign affiliated companies have demonstrated how the right partnership can strongly enhance a firm's competitive edge and its ability to adapt to and cope with the idiosyncrasies of the Japanese market.[13]

As pointed out in the Chapter on *Globalisation of Indian Business,* many Indian firms have used the joint venture route to enter foreign markets.

The economic liberalisation has caused a spurt in joint ventures in India. In the five years since the liberalisation of 1991, more than four thousand joint ventures were entered into between Indian companies and transnationals.

Joint ventures present a mixed picture of success and failure. While some joint ventures are very successful, some face problems from the very beginning and in case of some others problems develop after a period of mutual benefit and success.

A McKinsey worldwide study of more than 200 alliances (principally joint ventures) has shown that their median life span only seven years and in more than 80 per cent of the cases, it ends in one partner selling out to the other.[14]

In fact, joint ventures are not necessarily meant to be permanent. They are meant to serve specific objectives within a period of time and once the objectives are achieved the continuation depends on the reassessment of the situation by the partners.

A number of joint ventures fail to achieve the objectives by either or both the partners and this could naturally result in the breakdown of the alliance.

A joint venture may go through "several points of crisis, caused by the realisation on the part of either — sometimes both — of the partners that its expectations are not being fulfilled and, perhaps, even being negated".[15] Chances of such flash points are more with the flattening out of the gains curve on any of the parameters that govern either partner's decision to be involved in the joint venture. For, at this point, the gains of one of the partners become disproportionate to those of the other, leading the former to re-examine the rationality of retaining the relationship".[16] Such flash points, however, need not necessarily result in the termination of the joint venture, they may be managed so that there will be more equitable gains from the joint venture.

One of the important reasons for the failure of joint ventures in India is the unequal resource and bargaining powers of the partners. The new business environment that resulted from the liberalisation has increased the cases of failures on account of this factor. Many transnationals wanted to hike their share in the equity of the joint venture. This was the reason for the end of the 28 year old partnership between Royal Dutch Shell and NOCIL. Now that foreign firms are able to set up fully owned subsidiaries, a number of foreign firms have turned to such ventures, discarding or neglecting their existing joint ventures in the country. There are also several cases of the Indian partner's stake, fully or partially, sold to the foreign partner because of financial problems. Similarly, when the Indian partner is unable to match up with the resourceful foreign firm in bringing in additional funds for expansion, the Indian partner's share of the equity holding falls.

A joint venture can succeed only if both the partners have something definite to offer to the advantage of the other, and reap definite advantages, and have mutual trust and respect.

THIRD COUNTRY LOCATION

Third country location is sometimes used as an entry strategy. When there is no commercial transactions between two nations because of political reasons or when direct transactions between two nations are difficult due to political reasons or the like, a firm in one of these nations which wants to enter the other market will have to operate from a third country base. For example, Taiwanese entrepreneurs found it easy to enter People's Republic of China through bases in Hong Kong.

Third country location may also be helpful to take advantage of the friendly trade relations between the third country and the foreign market concerned. Thus, for example, Rank Xerox found it convenient to enter the USSR through its Indian joint venture Modi Xerox.

There are several cases of countries not having direct commercial transactions. For example, it was true of Israel and Arab Countries. In the past, government of India did not permit trade with South Africa and Mauritius.

Sometimes, commercial reasons encourage third country location. For example, several Japanese companies established production facilities in developing countries to circumvent the non-tariff barriers (like quotas, voluntary export restraints and orderly marketing arrangement) to imports to countries like the United States and also to avail of the preferential treatment accorded by the developed countries to the imports from the developing countries.

Further, third country location may be resorted to reduce cost of production and thereby to increase price competitiveness to facilitate market entry or for improving/maintaining the market position. The incentives offered by governments, particularly of the developing countries, for investment and exports encourage such third country location. The export processing zones are particularly attractive in this respect.

MERGERS AND ACQUISITIONS

Mergers and acquisitions (M&A) have been a very important market entry strategy as well as expansion strategy. A number of Indian companies have also used this entry strategy as noted towards the end of this chapter.

Mergers and acquisitions have certain specific advantages.

It provides instant access to markets and distribution network. As one of the most difficult areas in international marketing is the distribution, this is often a very important consideration for M&A. The General Electric (GE), USA, took over Hungary's light bulb maker Tungsram. Instead of starting a 'greenfield' operation in Hungary by building a new factory and hiring the people needed, why did the multinational giant take over Tungsram, a typical Hungarian enterprise bogged down with so many problems calling for a painful restructuring? The answer is that Tungsram gave GE entry to the East European light bulb market, from which it had been virtually excluded by Philips and Osram. Tungsram's share of the market in the 1980s was a respectable 9 to 10 per cent.

Another important objective of M&A is to obtain access to new technology or a patent right.

M&A also has the advantage of reducing the competition.

Mergers and acquisitions may also give rise to some problems which arise mostly because of the deficiencies of the evaluation of the case for acquisition. Sometimes, the cost of acquisition may be unrealistically high. Further, when an enterprise is taken over, all its problems are also acquired with it. The success of the enterprise will naturally depend on the success in solving the problems.

It has also been observed that the takeover spree lands several companies in trouble. For example, in the early 1990s, a number of Japanese companies began to sell some of the foreign businesses which they had acquired a few years ago. The main reason for this was the financial crunch.

STRATEGIC ALLIANCE

Strategic alliance has been becoming more and more popular in international business. Also known by such names as entente and coalition, this strategy seeks to enhance the long-term competitive advantage of the firm by forming alliance with its competitors, existing or potential in critical areas, instead of competing with each other. "The goals are to leverage critical capabilities, increase the flow of innovation and increase flexibility in responding to market and technological changes."[17]

Strategic alliance is also sometimes used as a market entry strategy. For example, a firm may enter a foreign market by forming an alliance with a firm in the foreign market for marketing or distributing the former's products. A US pharmaceutical firm may use the sales promotion and distribution

infrastructure of a Japanese pharmaceutical firm to sell its products in Japan. In return, the Japanese firm can use the same strategy for the sale of its products in the US market.

Strategic alliance, more than an entry strategy, is a competitive strategy. Strategic alliances which enable companies to increase resource productivity and profitability by avoiding unnecessary fragmentation of resources and duplication of investment and effort are growing in popularity and are very conspicuous in such industries as pharmaceuticals, computer, nuclear, telematics etc. which are characterised by high fixed costs in R&D and manufacturing and/or high and fast changing technology.

Examples of cross-border alliances in the telematics sector which essentially bring together two separate streams of technology — that related to information gathering and processing and that related to information transmission — include IBM's agreements with STET, Italy's state owned telecommunications company and Nippon Telegraph and Telephone (Japan) to develop computer communications services, and a joint research venture with Ericson (Sweden) to explore the linking of data management technology with digital switching technology.

The automobile industry has been witnessing several alliances for overseas operations. The Isuzu Motors Ltd. and Fuji Heavy Industries Ltd. of Japan have set up a joint plant in the US which can build cars for Fuji and trucks for Isuzu in the same line. Some Japanese automakers have joined forces with foreign big names like General Motors and Chrysler. The European car manufacturers are also teaming up to enhance their competitiveness, often in one-off projects to produce, say, an engine of transmission. Peugeot, Renault and Volvo already share V6 engine.

According to an alliance between Tatas and TFR, a leading French leather finisher and European marketer, Tatas will integrate its production with the exact colour, texture and other requirements of large European buyers, while TFR will provide the existing marketing network, links to key buyers, its name and reputation and knowledge of the latest fashion trends.

Tata Tea has entered into an alliance with Tetley so that the marketing expertise of Tetley is available to market tea abroad.

Explaining international production, Dunning observes that within the service sector strategic alliances are less common, but those between hotels, airlines and tour operators and between accountants and management consultants are increasing; while international consortia of investment banking and construction firms have long been a feature of the world commercial scenario.[18]

COUNTERTRADE

Although the major reason for the substantial growth of countertrade is its use as a strategy to increase exports, particularly by the developing countries, countertrade has been successfully used by a number of companies as an entry strategy. For example, PepsiCo gained entry to the USSR by employing this strategy.

Countertrade is a form of international trade in which certain export and import transactions are directly linked with each other and in which import of goods are paid for by export of goods, instead of money payments.

In the modern economies, most transactions involve monetary payments and receipts, either immediate or deferred. As against this, countertrade refers to a variety of unconventional international trade practices which link exchange of goods — directly or indirectly — in an attempt to dispense with currency transactions."[19]

Forms of Countertrade

Countertrade takes several forms. The following are the most common among them:

Barter

Barter refers to direct exchange of goods of equal value, with no money and no third party involved in it. For example, a countertrade deal between the Minerals and Metals Trading Corporation of India (MMTC) and a Yugoslavian company involved import of 50,000 tonnes of rails of the value of about $ 38 million by the MMTC and the purchase by the Yugoslavian company of iron ore concentrates and pellets of the same value.

Buyback

Under the buyback agreement, the supplier of plant, equipment or technology agrees to purchase goods manufactured with that equipment, or technology. Under the buyback scheme, the full payment may be made in kind or a part may be made in kind and the balance in cash. Thus, a ₹ 20 crore buy back agreement with the Soviet Union provided for the import of 200 sophisticated looms by the National Textiles Corporation. The buyback ratio was 75 per cent.

Compensation Deal

Under this arrangement, the seller receives a part of the payment in cash and the rest in products.

Counterpurchase

Under the counterpurchase agreement, the seller receives the full payment in cash but agrees to spend an equivalent amount of money in that country within a specified period. A classic example of this kind of an agreement was Pepsi Cola's trade with the USSR. Pepsi Cola got paid in Rubles for the sale of its concentrates in the USSR but spent this amount for purchase of Russian products like Vodka and wine.

The array of countertrade transactions reported in the trade press is intriguing. Cocoa Cola has traded its syrup for cheese from a factory it built in the Soviet Union, for oranges from an orchard it planted in Egypt, for tomato paste from a plant it installed in Turkey, for Polish beer, and for soft drink bottles from Hungary. A Swedish band was paid in coal for its concerts in Poland, Boeing exchanged ten 747s for 34 million barrels of Saudi Arabian oil. Argentina awarded a fertiliser factory contract to Czechoslovakian firms with the stipulation that suppliers buy vegetables and other agricultural goods produced with fertiliser.[20]

Many countertrade deals involve more than two parties and the process becomes complex and intricate. If the seller can get in exchange from the buyer the products which he wants or for which he has a ready market, the countertrade deal would be very smooth. However, in several cases the buyer will not be in a position to offer in exchange goods which the seller really needs. In such cases, it may become necessary, for the deal to be struck, for the seller to accept the products the buyer can offer and hunt for buyers for such products. Kotler, for example, cites a very interesting case: Daimler Benz agreed to sell thirty trucks to Romania and accept in exchange 150 Romanian made jeeps, which it sold in Ecuador in exchange for bananas which it brought back to West Germany and sold to a West German super market chain in exchange for deutsche marks. Through this circuitous transaction, it finally achieved payment in German currency.[21] Such complexities involved in many countertrade deals have given an important role to the international trading houses in such transactions. The insurmountable problem of finding suitable goods in return by the exporters has redefined the importance in Japan of the trading house and "Japan's nine major general trading houses have all now established divisions specifically to research countertrade opportunities."[22] Countertrade deals were used by the Japanese trading houses as a means to boost their business with hard currency strapped to China and the former USSR. These trading houses can take massive and complex countertrade deals in their strides as they possess expertise in almost every field, practice every conceivable trading pattern, and can mobilise everything from staff to technology to finance. In addition, most

are under the umbrellas of Zaibatsu that include powerful banks and/or construction firms. As if these were not enough, the trading houses are prepared to join forces with each other if necessary under the auspices of the awesome Nihon Boekikai, the body they set up themselves for the handling of joint ventures.[23]

Growth of Countertrade

A significant volume of international trade is covered by countertrade. Countertrade, of course, is not a new phenomenon but the nineteen seventies and eighties witnessed a remarkable growth in this type of international trade, encouraged by many governments and actively involved by many trading houses, both private and public, although organisations like GATT (WTO) and IMF do not favour it.

According to one report, the number of countries practising countertrade increased from 27 in 1973 to more than 90 by mid-1980s. A study by the US Departments of Commerce found that countertrade covered 38 per cent of East-West trade in 1981 compared to 28 per cent in 1976. According to the estimates made by the economist quite some time ago, countertrade accounted for one-fourth of all world trade. However, the GATT in a report had noted that in 1983 countertrade accounted for about 8 per cent of the global trade. A source in the US Department of Commerce expected sometime ago that countertrade would be reflected, in one way or the other, in 50 per cent of the world trade by the end of the 20th current century.[24] The political and economic changes in the former USSR and Eastern Europe do not appear to adversely affect the growth of countertrade.

Countertrade has been growing with government patronage. According to one report, more than 81 countries across the world had actual pro-countertrade government policies.[25] Countertrade has been made mandatory by a number of countries including Indonesia, South Korea, Malaysia, and Australia in case of government/public sector purchases of above certain specified value. Even though a number of other countries like Bangladesh, Burma, China, Pakistan, Philippines, Singapore, Thailand and Taiwan have no mandatory provisions, all encourage their importers to settle transactions on countertrade basis.[26] Indian public sector agencies like STC and MMTC are active in countertrade. Government of India set up a special cell in the Ministry of Commerce to monitor international developments in countertrade and to develop appropriate policy to enable Indian canalising agencies to make best use of opportunities available to boost India's exports through countertrade.

It may be noted that the South Commission has advocated countertrade as a useful mechanism for overcoming difficulties of payments, export credit and foreign exchange which might otherwise be serious obstacles to the expansion of trade between developing countries. As the Commission points out, so far the bulk of countertrade between developing countries has been conducted mostly through intermediaries in the industrial countries. It is the developed countries who have benefited most from this type of trade, and they obviously have no interest in helping the indirect trading partners in the LCDs to establish direct contacts and develop durable trading relationships. Therefore, the developing countries need to organise themselves of countertrade, as this can also pave the way for the growth of more conventional trading relations.[27]

Reasons for the Growth of Countertrade

There have been several reasons for the countertrade to become popular. Obviously, the countries or companies concerned have encouraged or involved in countertrade due to certain specific advantages, although some of the benefits may be purely temporary.

(*i*) Countertrade was very common between the communist countries. It also became popular in respect of trade between the Communist Block and many developing countries because many developing countries were eagerly looking towards this block for increasing their exports, among other

things, and this naturally led to the acceptance of the trade practice preferred by these centrally planned economies.

(*ii*) Countertrade became popular in the East-West trade mainly due to the foreign exchange problems faced by the East Block. Pepsi Cola is just one example of a multinational corporation which made considerable international business with the USSR by countertrade.

(*iii*) When the foreign exchange problem became more severe for the developing countries following the oil price hikes, they began to actively pursue countertrade in a frantic bid to increase their exports by all means.

(*iv*) Many companies in the advanced countries have resorted to countertrade for various reasons like selling obsolete products, increasing the sale of capital goods, increasing the aggregate business etc. Countertrade has also been resorted to by several companies to mitigate the effects of recession. Such recessionary situations in the capital goods industries in the advanced countries gave the developing countries an opportunity to push their exports by tying the imports of capital goods with exports by countertrade.

The results of a survey of 35 British companies involved in international countertrade by Shipley and Neale accorded with the descriptive literature insofar as the Eastern Bloc countries were the main group of countertrade customers, reflecting their acute currency and international debt problems. Nevertheless, substantial portions of the firms conducted countertrade in the world's less developed regions while there was some limited support for the claims that developed nations countertrade among themselves.[28]

(*v*) The results of the above survey also suggest that countertrade enables firms to penetrate difficult markets, to increase sales volume and to achieve fuller capacity utilisation. It has also been revealed that countertrade enables firms to dispose of declining products, which is particularly important given the very rapid pace of technological advance. 37 per cent of the companies surveyed reported this benefit.

(*vi*) Some countries have also made the countertrade a means to increase sales through disguised undercutting of the cartel prices (for example, the oil price fixed by the OPEC).

(*vii*) Having realised the potential of increasing the business by engaging in countertrade, many international trading corporations became active in the countertrade. Their trading with many countries enabled them even to take up such complex transactions as the case of Daimler Benz cited earlier.

It may be noted here that, after the deintegration of the erstwhile Soviet Union, when the Government of India has been finding it difficult to establish two-way trade flows, the Pepsi Foods Private Ltd. made an attractive offer to the Government to enter into countertrade deals with individual enterprises in the Commonwealth of Independent States to import the much needed oil, non-ferrous metals, fertilisers and newsprint.

Drawbacks

Although countertrade has several justifications, particularly in the short run, it suffers from a number of disadvantages and problems, particularly in the long run.

Firstly, countertrade encourages bilateralism at the expense of multilateralism.

Secondly, it adversely affects export market development.

Thirdly, although several developing countries regard countertrade as an easy route to export, they often stand to lose in terms of price. For instance, Poland bought Libyan oil at a discount and sold it at a higher price on the Rotterdam spot market.

Fourthly, it very adversely affects competition.

ENTRY STRATEGIES OF INDIAN FIRMS

India's economic integration with the rest of the world was very limited because of the restrictive economic policies followed until 1991. Indian firms confined themselves, by and large, to the home market. Foreign investment by Indian firms was very insignificant.

With the new economic policy ushered in 1991, there has, however, been a change. Globalisation has in fact become a buzz-word with Indian firms now and many are expanding their overseas business by different strategies. Indian industry can move towards globalisation by different strategies such as developing exports foreign investments including joint ventures and acquisitions, strategic alliance, licensing and franchising, etc.

Exporting

Exporting is, by far, the most important entry route employed by Indian firms. Because of the inward looking economic policy pursued until 1991, the progress made on the export front was not, in general, something commendable. With the economic liberalisation, an environment for globalisation of Indian exports, however, is slowly emerging. In a truly globalised environment, the exports will also be very much global: the sourcing of finance, materials and managerial inputs will be global, based on purely business considerations.

Several Indian companies have entered foreign markets targeting their exports at the ethnic population. West Asia, with a large expatriate Indian population, naturally is the first target in many of these cases.

The Mumbai-based American Dry Fruits (ADF) which began selling a range of packaged foods like chutneys, spices, canned vegetables, ready-to-eat dals etc., under different brand names, later moved to other countries with large Indian population.

As foreign firms, generally, have neither the expertise nor interest in the ethnic products, Indian firms do not have to face competition from them, making market entry and growth fairly easy.

A firm which makes the ethnic segment of the market its entry point may, in due course, after gaining experience in doing business and establishing a foothold in the foreign market, take up marketing of non-ethnic products and to non-ethnic consumers.

Food products are not the only category being targeted at ethnic population. Raymonds and Birla-VXL, for example, have a number of showrooms in West Asia top sell their range of textile items. Shaw Wallace launched a beer brand called Lal Toofan in UK, through Shaw Wallace Overseas; the target consumers of this brand sold at the upmarket Indian restaurants are Indians.

India has potential for significantly increasing the exports of many products if appropriate measures are taken. As a matter of fact, in case of number of products, several other developing countries which started their exports later than India have gone much ahead of India while India's progress has been slow. With the right policy and procedural reforms and institutional support, with technological upgradation and modernisation and enlargement of production facilities, with thrust on quality and value-added products, with improvements in infrastructural facilities and with right marketing strategy great strides could be made in the export of a number of products. Broadly, there are three strategies to increase the export earnings, viz.,

(*i*) Increase the average unit value realisation.

(*ii*) Increase the quantity of exports.

(*iii*) Export new products.

One of the most important considerations in exports should be to achieve maximum unit value realisation. Value-added exports is a much needed graduation for India to enhance the foreign exchange

earnings. A very disquieting fact is that India's agricultural exports still are mostly commodity exports, i.e., they are exported mostly in bulk form and the progress achieved in value-added exports is not anything significant.

Value-added exports assume greater significance particularly in view of the stagnation or fall in the exportable surplus of several commodities — like pepper, cardamom, tea, coffee etc.

The major part of India's manufactured exports end up in the low-price segments of the foreign markets. Quality upgradation and marketing efforts are needed to reach the upper segments and to achieve enhanced value realisation. Technology imports or foreign collaborations are required for this in many cases.

In many cases, what comes in the way of increasing exports is the supply constraints. This is true of a number of manufactured products as well as agricultural commodities. Given the constraints for area expansion, increase in agricultural production should come mostly from increase in productivity which is very low in India. In respect of many industrial products, the production capacity is very low and highly fragmented so that there are a large number of cases of Indian firms not being able to accept offers from abroad for purchase of large quantities of the products which are far beyond the capacity of these firms to supply.

One of the important ways to increase exports is to expand the export basket by adding new products and achieving substantial sales of them abroad. The share of non-traditional items in India's exports has increased very significantly. However, a lot of potential still remains untapped.

For identifying new products for exports, there are two important courses: (*i*) Explore the export opportunities for products currently produced in India, (*ii*) Identify products with good demand abroad which can be competitively produced and supplied by India.

An important export opportunity for India and other developing countries is provided by the vacation of certain industries or market segments by the developed country firms due to various reasons like environmental consideration, lack of competitiveness, declining industry attractiveness etc. For example, the developed countries are phasing out production of a wide range of chemicals due to increased expenditure on overheads and high labour costs.

Given the capabilities and limitations of the Indian companies and the international environment, appropriate strategies should be formulated to market different products abroad.

Market niching is the right strategy for many Indian companies. Several Indian companies have indeed successfully used this strategy in the foreign markets.

In some cases a company can adopt the strategy of *straight extension,* i.e., extending the same product as marketed in the home country to the foreign markets. It is particularly relevant in respect of other developing countries with similar market characteristics as that of India. A large number of the cases, however, demand quality upgradation, product modification or product development.

Foreign Investment

As pointed out in Chapter 1, it is simply not possible to maintain substantial market standing in an important area unless one has a physical presence as a producer. Otherwise, one will soon lose the 'feel' of the market. Besides, the advantage of getting a feel of the market, offshore investments are encouraged by such factors as cost advantage, trade barriers etc. The demand for 'local content' is also satisfied by production in the respective countries. In many cases, exporting is the beginning stage of international business which in, due course, will be replaced by production in the foreign market.

Foreign investment by Indian companies has so far been very limited. The attractiveness of the domestic market, lack of global orientation, government regulations etc. have been responsible for this.

By the beginning of 1995, a total of 300 wholly owned subsidiaries (58 in operation and 242 under implementation) were established by Indian companies. The operational ventures were dispersed in 40 countries.

With the economic liberalisation and growing global orientation, many Indian companies are setting up manufacturing/assembling/trading bases abroad, either wholly or in partnership with foreign firms. These would help these companies to increase their international business. Indian companies have also been making huge investments abroad on acquisitions.

The leader in establishing manufacturing bases abroad is the Aditya Birla group. Aditya Birla, whom the Forbes called India's only international businessman, made this strategic move as early as 1970s. The group's drive to set up business overseas is that "we want a predominance in the industries that we enter. The objective is to be a low cost, high quality and global standard player."[29]

A number of large and small Indian companies are investing abroad as part of their globalisation strategy. Several of these overseas investments aim not only at expansion of production base and business abroad but also at consolidation of the domestic business. The Ballapore Industries of the Thapars are setting up a giant paper mill in Indonesia at an estimated cost of ₹ 1,800 crores. A plantation put up on 2,50,000 hectares of land will feed the mill. Any surplus pulp may be exported to India to feed Thapar paper mills here. The significance of it should be viewed aganist the possible wood and pulp shortage in future in India. The Ceat expects that when the tariff barriers between the SAARC countries come down, part of the South Indian market could be served by its tyre plant in Sri Lanka.

Indian companies are also establishing production facilities abroad to get an easy entry into the regional trade blocs. For example, a base in Mexico opens the doors to the NAFTA region for the Aravind Mills. Similarly Cheminor Drugs, one of the Dr. Reddy's Labs Group of companies, has set up a subsidiary in New Jersey.

Mergers and Acquisitions

Mergers and Acquisitions (M&As) are very important market entry as well as growth strategy. M&As have certain advantages. It may be used to acquire new technology, M&As would have the effect of eliminating/reducing competition. One great advantage of M&As in some cases is that it provides instant access to markets and distribution network. As one of the most difficult areas in international marketing is the distribution, this is sometimes the most important objective of M&As. For example, Vijay Mallya's U.B. group acquired a small British company, Wiltshire Brewery. The attraction of Wiltshire for U.B. was that the former offered a ready made chain of 300 pubs throughout Britain which could be used for the marketing of U.B.'s brands of beer like *Kingfisher, Kalyani* etc. The U.B. group has gone for such acquisitions in USA and South Africa. A number of other Indian companies have also resorted to acquisition of companies abroad to gain a foothold in the foreign market and to increase the overseas business. Apart from the big players, a host of lesser known companies have bought out cash strapped plants in Europe, USA etc.

Joint Ventures

Joint venturing is a very important foreign market entry and growth strategy in the context of the deficiencies of the Indian firms in resources, technology and marketing. This indeed a is very important strategy employed by Indian firms. It is an important route taken by pharmaceutical firms like Ranbaxy, Core, Lupin, Reddy's etc.

In several cases of joint ventures, as in the case of foreign subsidiaries, help Indian firms to stabilise and consolidate their domestic business, besides the expansion of the foreign business. Essar Gujarat's joint ventures in countries like Indonesia and Bangladesh to manufacture cold rolled (CR)

steel have resulted from a strategy to create an assured market for its hot rolled (HR) coil mother plant at Hazaria (HR coils are inputs for manufacturing CR steel products).

The Essel Packaging has taken the joint venture route to expand its business abroad. The joint ventures abroad convert the laminate into tubes to be marketed in foreign markets. The centralisation of the laminates production in India enables the company to reap enormous economies of scale. The high cost of transportation of tubes over laminates makes the conversion of laminates into tubes in the foreign markets more profitable. Further, the establishment of tube production facilities in foreign markets helps to pre-empt competition.

The liberalisation of policy towards foreign investment by Indian firms along with the new economic environment seems to have given joint ventures a boost. At the beginning of 1995 although there were 177 joint ventures, (with a total equity of ₹ 179 crores) in operation, there were 347 (total investment ₹ 1400 crores) under implementation. Not only the number of joint ventures is increasing but also the number of countries and industries in the map of Indian joint ventures is expanding. Further liberalisation, like enhancement of the investment limit of automatic clearance, is needed for a fast expansion of the Indian investment abroad.

Strategic Alliance

Strategic alliance provides enormous scope for the Indian business to enter/expand the international business. This is particularly important for technology acquisition and overseas marketing. Alliance is indeed an important international marketing strategy employed by several Indian firms.

Licensing and Franchising

Licensing and franchising, which involve minimal commitment of resource and effort on the part of the international marketer, are easy ways of entering the international market.

Many Indian firms can use licensing or franchising for the overseas market; particularly the developing countries. For example, Ranbaxy has licensing arrangement in countries like Indonesia and Jordan.

Conclusion

The limitations of national markets, the diversity and unevenness of resource endowments of different nations, complexity of technological developments, differences in the levels of development and demand patterns, differences in production efficiencies and costs, technological revolution in communication and other fields etc. mandate globalisation.

The intent of globalisation is efficiency improvement and market optimisation taking advantage of the opportunities of the global environment. Therefore, in many cases, Indian companies have to globalise to survive and grow in the emerging competitive environment.

The restrictive economic policies of the past severely affected the competitiveness and growth of the Indian industry in general. The new economic policy, *albeit* suffers from certain defects, is a welcome change.

If the Indian firms have the facility to obtain the latest technology in the world, to raise finance from the cheapest source and procure the materials from the best source in the world, they are on equal footing with the foreign firms in many respects. And if the Indian firms can muster some edge ever the foreign firms in respect of labour cost, productivity, product quality/features etc. that could be a competitive advantage.

In many cases, size is an important factor which influences the competitive power. The economic liberalisation by pruning down the list of industries reserved for the public sector, delicensing and amending the MRTP Act has provided an environment which enables companies to grow fast, both

internally and externally. The growth plans of many Indian companies indicate a great leap forward. The increase in the size could keep the companies on a strong footing to make further dent into both the domestic and foreign markets. In short, the Indian industry is where they can make jumps compared to the past situation of limping forward.

Several Indian companies are already leading players. The Ispat group of the Mittals which has units in countries like the US, Canada, Indonesia, Trinidad and Tobago is the largest sponge iron producer in the world. The Aditya Birla group is the world's largest player in viscose fibre and carbon black and also the largest refiner of palm oil. The Essel packaging which is already the world's second largest integrated producer of laminated tubes is aiming to climb up to the number one position. Arvind Mills, one of the world's largest producer of denim cloth, is making further thrusts. When its ongoing projects are fully implemented, Reliance Industries would be the second largest texturiser in the world to be fully integrated from naphtha to fabrics. India is also a major player in two-wheelers and bicycles. India is the largest producer of several agricultural commodities.

The liberalisation in India and in other countries pose a real challenge to the Indian business to prove its mettle.

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7

INTERNATIONAL ORGANISATION

There are different organisational structures for doing international business. The structure is determined by factors such as the extent of commitment of the organisation to the international business and the nature of its international orientation, the size of international business and expansion plans, the number and consistency of product lines, characteristics of the foreign markets etc.

The nature of the organisational structure is also influenced by the relative sizes of the domestic and foreign markets or their relative importance. Taggart and McDermott point out that while during the 1960s many US MNCs established an international division to oversee their growing overseas operations, the international division was largely redundant for European MNCs.[1] This was because the US MNCs still relied upon their large domestic market whereas the European MNCs — especially those from the smaller countries (like the Netherlands, Sweden, and Switzerland) — did not have a large domestic market. International sales often accounted for the bulk of their turnover, rather than a small proportion, as was the case in the 1960s for many US MNCs. The European MNCs were, thus, more disposed to internationalisation.

The organisational structure would undergo changes during the different stages of the evolution of a domestic firm into a transnational one.

The common organisational types are described below:

Built-in Export Department

The built-in export department is the simplest form of export organisation and, therefore, the easiest to establish. Under this arrangement, as the name indicates, the export organisation is built into the regular domestic system. The function of the special department is usually confined to the actual selling or directing; and all such different functions connected with export transactions as advertising, credit, traffic, shipping and accounting are handled by the appropriate domestic departments.

The built-in export department is suitable under certain conditions, such as when the export business is small, the company is new to international marketing, the management philosophy is not oriented towards growth in overseas business, the company resources are limited, etc.

The built-in export department may also be regarded as the initial arrangement to do export business. In course of time, as the business expands, it may be developed into a separate export department.

The built-in export department suffers from some disadvantages. Under this arrangement, many of the activities connected with international business are carried out by domestic departments. Sometimes, therefore, there may be a tendency to regard export activities as subsidiary to domestic business. Further, the personnel of the domestic departments may not have sufficient knowledge or experience to deal with matters connected with the overseas market. Another danger is that the export manager may not get the required amount of cooperation from the personnel of other departments who are not under his control.

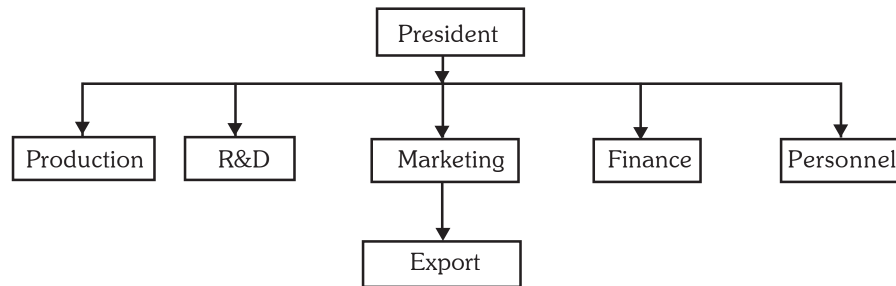

Fig. 7.1: Export Department Structure

Separate Export Department

Although, a relatively large volume of export business may be handled by a built-in form of organisation, this arrangement, when the overseas business substantially increases, becomes unsatisfactory. A separate export department may, therefore, be established to take effective care of all the activities connected with the export business. Further, a company which wants to expand its international business substantially would find a separate export department more useful than the built-in arrangement.

Unlike the built-in department, the separate export department is essentially self-sufficient; and it is well equipped to handle all the activities connected with the export business. It is not, therefore, at the mercy of domestic departments.

The organisational structure of the export department may vary between companies. The internal organisational structure of a separate export department may be based upon functions, territory, product or a combination of these. Needless to say, any such orientation of the internal organisational structure of the department will depend primarily upon how the marketing task varies.

A separate marketing department avoids some of the problems of the built-in department, such as the clash between the international and domestic sides of the firm regarding the time to be spent by domestic marketing personnel on overseas business matters. As a separate department is a full-fledged department, it can do the job more efficiently. It can have personnel trained to perform the international marketing functions. A separate department will also impart an export orientation to the company. Another advantage is that a separate export department may, unlike the built-in department, be located at the most suitable place, which may not be the headquarters of the company.

Fig. 7.1 and Fig. 7.2 show two alternate organisational structures. In Fig. 7.1, the export is a division of the marketing department which undertakes both domestic marketing and exports.

Fig. 7.2 depicts an organisational structure with a separate, full-fledged, export department.

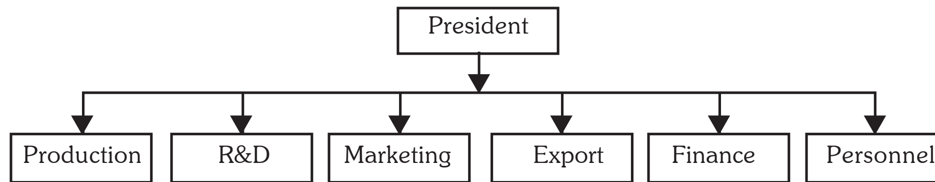

Fig. 7.2: Export Department Structure

Export Sales Subsidiary

Firms with large export business may establish export subsidiary companies and divorce international marketing activities from domestic operations because of certain advantages associated with it.

Although an export sales subsidiary is a separate company, it is wholly owned and controlled by the parent company and is quasi-independent. The subsidiary company purchases products from the parent company and markets them abroad. The subsidiary may even deal in some non-competing products of other companies.

An export sales subsidiary enjoys certain advantages. It is more independent than a department, and, therefore, more flexible and adaptable to changing situations. It can more easily develop export marketing facilities and expertise and organise international marketing tasks more effectively. Another advantage of establishing a separate company and dividing the total business is a lower burden of tax.

In terms of internal organisation and the specific activities performed, the sales subsidiary differs very little from a separate export department.

Some companies establish subsidiary companies with the main objective of developing export markets and doing export business in a big way. The HMT (International) Ltd., the export marketing subsidiary of the HMT Ltd., has been assigned the tasks of exploring, developing and expanding export markets and enlarging international business.

International Division

An export department or export subsidiary may be suitable for handling large exports but they may not be sufficient for managing the non-exporting international market entry modes. So companies having foreign subsidiaries whose role is not confined to sales alone tend to establish an international division to manage the international business.

Fig. 7.3 depicts one possible organisation structure with international division. An international division will facilitate concentrated attention on the international business. However, creating an international division may generate internal problems. Coordinating activities may prove difficult because domestic activities are organised on a product line basis, while international side is organised on an area basis, i.e., non-domestic."[2] The global organisational structures like the global product structure and global geographical structure which seek to integrate domestic and international operations emerged as a solution to this problem.

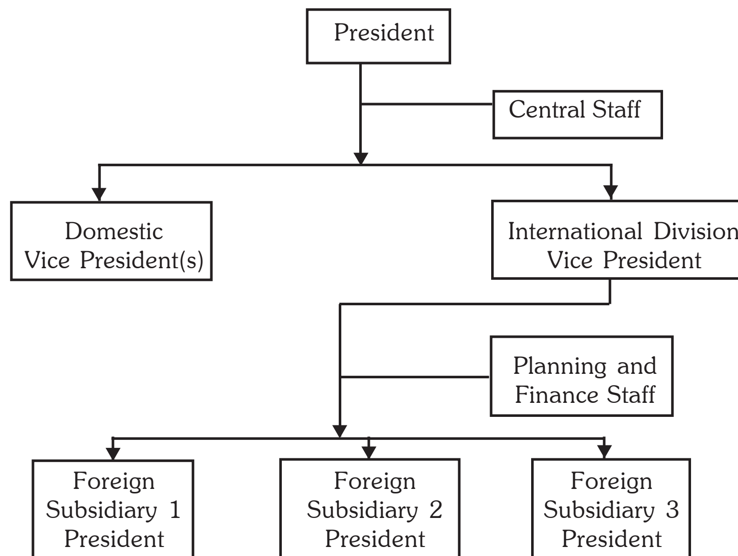

Fig. 7.3: International Division Structure

Global Organisational Structures

The growth of business into global dimensions and the competition on a global basis resulted in the development of different global structures. The basic types of global structures are described below.

Global Product Structure

The product division structure is popular with large conglomerates with multiple, unrelated, business. Under this structure, different subsidiaries pertaining to different products within the same foreign country report to the head of different product groups at the headquarters. Fig. 7.4 illustrates a product-based global organisational structure.

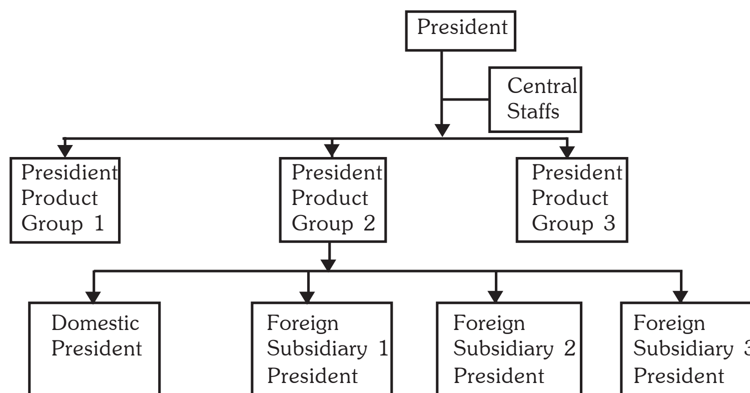

Fig. 7.4: Global Product Structure

The product division structure enhances coordination between different areas for any one product line but it reduces coordination of all product lines within each zone.

Global Geographic Structure

Under the global geographic divisional structure, the market is divided geographically. For example, when the Ranbaxy has restructured its organisation as a part of its global orientation, its export department has been abolished and the world market has been divided into four regions (India along with the Middle East forms one of the four regions). Fig. 7.5 depicts a global geographic divisional structure.

In contrast to the product division structure, the geographic division structure is appropriate for MNCs with narrow product lines. Naturally, this pattern tends to improve coordination of all product lines within each zone but to reduce coordination between areas for any one product line.

Global Functional Structure

Under the functional structure, the head of functional areas, such as production, marketing, finance and personnel, are responsible for the worldwide operations of their own functional areas. Fig. 7.6 depicts a functional structure.

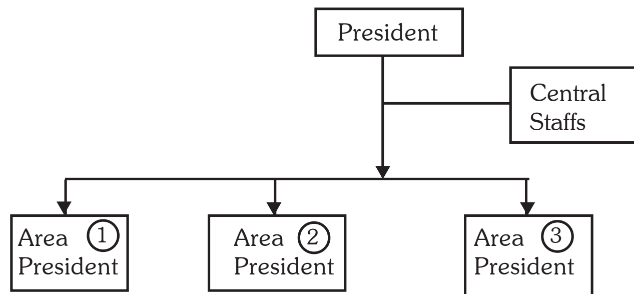

Fig. 7.5: Global Geographic Structure

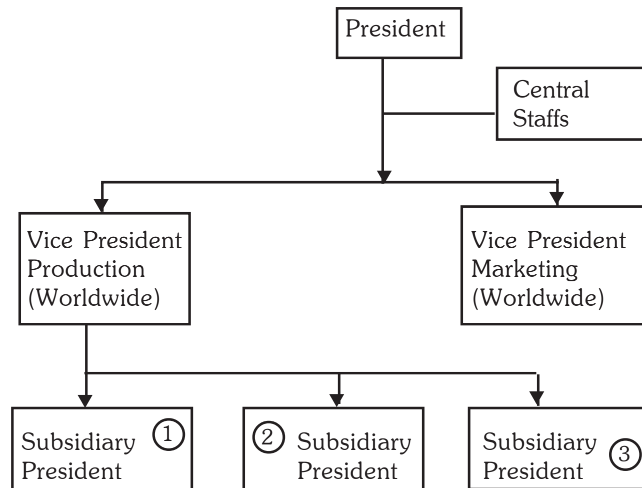

Fig. 7.6: Global Functional Structure

In certain industries like energy and mining, a variation of the functional structure known as the process structure, which uses processes as the basis for the structure, is common.

Global Customer Structure

If the global customer groups are so diverse requiring distinctive approaches, the organisational structure may be based on the diversity of the customer groups.

This structure would not be appropriate if the product lines are very diverse making customer groups different for each product group.

Global Matrix Structure

All the global organisational patterns depicted above have certain advantages and disadvantages. The mixed, hybrid or matrix structure seeks to combine the advantages and overcome the disadvantages of other alternative structures.

Fig. 7.7 shows a simplified matrix structure involving each subsidiary in a dual system.

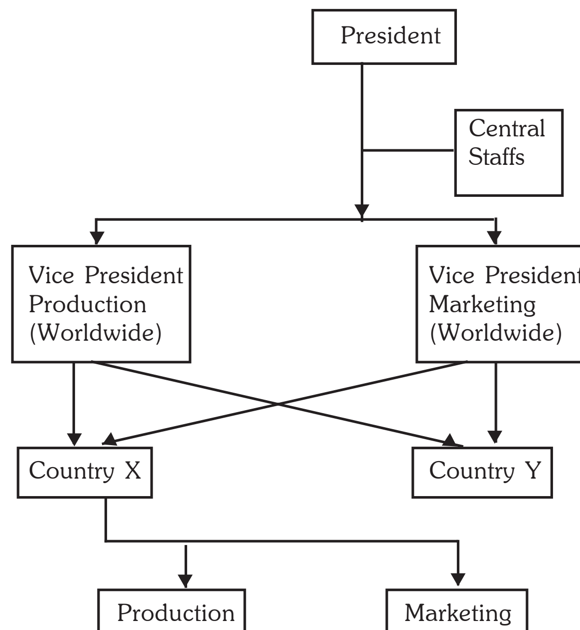

Fig. 7.7: Global Matrix Structure

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8

MARKET COVERAGE STRATEGIES

One of the important decisions to be made in international business is the market coverage strategy. Like other strategic decisions, this is also determined by consideration of external and internal factors.

A company should decide whether it should concentrate on one or a few markets or should spread over all the markets (or the major part of it). If it decides for the second, the next decision is whether the whole market be reached with a single marketing mix or whether each of the different markets be reached with a separate marketing mix.

There are, thus, three alternate market coverage strategies, viz.,

(*i*) Concentrated marketing strategy.

(*ii*) Undifferentiated marketing strategy.

(*iii*) Differentiated marketing strategy.

CONCENTRATED MARKETING STRATEGY

As Majaro succinctly puts it, "the concentrated marketing approach is based on a decision to achieve a maximum penetration in one or more segments to the exclusion of the rest of the market. Instead of spreading itself thinly in many parts of the world, it decides to concentrate its forces on a few clearly defined areas."[1] The company may be able to attain a strong position in this market by concentrating its resources and competencies over it. As Stanton observes, a small firm with limited resources might compete effectively in one or two market segments, whereas the same firm would be buried if it aimed for the total market. By employing the strategy of market segmentation, a company can design products that really match the market demands."[2]

Companies with ethnocentric orientation may sometimes adopt a concentrated marketing strategy in respect of the foreign markets by the product extension strategy, i.e., the company may concentrate on those foreign market/markets or segments where it can sell the same products as sold in the home market.

Concentrated marketing may, sometimes, go well with polycentric orientation also.

The advantages of concentrated marketing have already been indicated above. The major disadvantage of it is the risk of keeping all the eggs in one basket.

Niche Marketing

The concentrated marketing strategy sometimes takes the form of niche marketing, i.e., concentrating on a market segment that is not satisfactorily served or which is ignored by the major players. Such a strategy avoids a direct and immediate competition with major firms. There may also be niche markets with virtually no competition.

Market niching is a strategy very successfully employed by many Japanese companies in the foreign market. This was in fact a foreign market entry strategy resorted to in the past by several large Japanese companies of today. After consolidating its position in the niche market and after gaining experience and resources, a company may enter other segments and may even become a major player in due course.

A number of Indian companies have also used niching as a foreign market entry strategy. For example, in the US toothpaste market, dominated by large multinationals, Balsara identified a niche for a herbal dental product. Similarly, the Vicco identified a niche in the overseas market for a sugar-free toothpaste (Vicco SF). Several Indian companies have found a niche in the ethnic population abroad. (More details and examples of this are available in the author's *International Business* (Wheeler Publishing).

Kotler observes that in many cases the nicher achieves *high margin* whereas the mass marketer achieves a *high volume.* "The main reason is that the market nicher ends up knowing the target customer group so well that it meets their needs better than other firms that are casually selling to this niche. As a result, the nicher can charge a substantial mark-up over costs because of added value."[3]

While selecting a niche, the firm should ensure that:

1. The niche should be of sufficient size to be profitable and it has growth potential.
2. There is no much competition and that it is not of interest to major competitors.
3. The firm has the capabilities to serve the segment so well that it will have an edge over other firms.
4. The firm will be capable of defending its domain.

Kotler points out[4] that nichers have three tasks: *creating niches, expanding niches* and protecting niches.

When a niche proves to be very profitable, it is likely to attract a lot of competition both from small and large firms. A nicher should, therefore, try to maintain its dominance by innovation and maximum customer satisfaction.

Niching has become so popular that many large firms are adopting this strategy. A number of them like Johnson & Johnson, EG&G and Illinois Tool Works, have set up business units or companies to serve niches.

MARKET SEGMENTATION AND DIFFERENTIATED MARKETING

Undifferentiated marketing is characterised by market aggregation, i.e., treating a whole market as a single unit whose parts are alike in all major respects. The entire market is sought to be tapped with a single marketing mix.

Differentiated marketing, on the other hand, essentially involves market segmentation, the opposite of market aggregation.

Market segmentation is the process of dividing heterogeneous market for a product into groups of customers so that each such segment is amenable to a separate marketing mix. The objective of market segmentation and differentiated marketing strategy is to increase the business of the company by more effectively serving the needs of the different segments of the consumers.

Thus, while market aggregation and undifferentiated marketing take a *shotgun* approach, market segmentation and differentiated marketing is a *rifle approach*.

Market aggregation and undifferentiated marketing are appropriate when the market is homogeneous, i.e., when customer characteristics are the same. Market segmentation may be desirable when the market is heterogeneous, i.e., when the relevant customer characteristics differ. "In the language of economic theory, in market aggregation, the seller assumes there is a single demand curve for his product. In effect, the product is assumed to have a broad market appeal. In contrast, in market segmentation, the total market is viewed as a series of demand curve. Each one represents a separate market segment calling for a different product, promotional appeal, or other elements in the marketing mix."[5]

Differentiated marketing is based on the appreciation of the heterogeneity of the market, i.e., income levels, tastes and preferences, usage conditions, purposes of use and other consumer characteristics relevant to marketing differ between different groups of consumers.

There are a number of common bases for segmentation.

Market may be segmented geographically if consumer/market characteristics differ from region to region.

Globally, the market may be segmented geographically such as Middle East, North America, Western Europe, Eastern Europe, South Asia etc. An international firm may resort to geographical segmentation of even individual countries, particularly when the country is very large in size like India or USA or when the weather and climatic conditions, topographical features, demographic characteristics etc. vary significantly between different regions of a nation.

Demographic factors such as age, sex, income, religion form bases for market segmentation for a number of products. For products such as apparel, footwear, cosmetics and toiletries, ornaments etc., markets are often segmented on the basis of, *inter alia,* age, sex, and income. Income is a common basis for segmenting the consumer durables market too. Markets for dress, cosmetics, ornaments etc., may be segmented also based on ethnic and religious factors.

In some cases, markets are segmented psychographically on the basis of factors like lifestyle, social class and personality. For example, products for the executive class, suiting for the connoisseur, cigarette for men of action etc. Another common basis for segmentation is behavioural. For example, the market may be segmented on the basis of the benefits desired (benefits looked for by consumers in toothpaste, for instance, include protection of gums, fighting cavity, brightness of the teeth, freshness of breath etc.). Markets may also be segmented with reference to the usage occasions (like official/formal wear, casual wear, special occasions etc.).

In some cases, market is segmented on the basis of the nature of the consumers (Example: institutional consumers, individual/household consumers etc.) when the characteristics of such segments are different demanding different marketing strategies.

It is normally in the growth and maturity stages of the product in the product life cycle (PLC) that segmentation assumes importance because of the expansion of the market and increase in competition. In fact, the marketing mix strategy may also undergo modification through the different stages of the PLC.

Market segmentation is necessary not only for differentiated marketing but also for selecting the appropriate market segment/segments to concentrate on.

Whatever may be the basis of segmentation, a market segment should possess certain essential characteristics. A market segment shall be:

1. *Measurable*, i.e., it should be possible to estimate the size of the segment.
2. *Substantial*, i.e., the segment should be large enough to be profitable.
3. *Differentiable,* i.e., a segment should be different enough to justify a specific marketing mix that is different from those for other segments.
4. *Accessible and Actionable,* i.e., it should be possible to clearly identify the consumers of the segment and effectively reach them with a specific marketing mix.

Segmentation is common in international marketing.

A survey[6] of 68 American companies, of different sizes, exporting a variety of industrial products, revealed that over 70 per cent of them differentiated their activities between domestic and international customers. Further, almost a quarter of the companies differentiated their selling activities among international customers.

The above survey also revealed that when determining the marketing mix combination for various segments of the market, different strategies are used when differentiating between domestic and international customers or when differentiating among international customers. The most often used marketing mix elements for differentiating in both instances was price. Distribution was altered by about half of the companies that differentiated between domestic and international customers but much more often by companies which differentiated among international customers. The product elements (product, product specification and product and service) were used to differentiate marketing strategies more often among international customers than when differentiating strategies between domestic and international customers. The element of promotion differed in several ways. The sales force was very often different between domestic and international customers but was not varied as often among international customers than when differentiating between domestic and international customers.

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9

INTERNATIONAL PRODUCT DECISIONS

The uniqueness of product in the marketing mix is that all the other elements of the marketing mix, viz., price, promotion and place are designed to achieve successful exchange of the product for consumer satisfaction and income. If the product fails to satisfy the consumer, any amount of effort to boost the sales will not have long-term success. It is also true that, however good a product may be, it may not succeed if the other ingredients of the marketing mix are not appropriate. There is, however, no denying the fact that the success of marketing depends, *inter alia,* on the success of the product in satisfying the consumers.

Although the terms product strategy, product planning and product management are often used interchangeably, they are not really one and the same.

Product Strategy involves the managerial decisions about the product mix and the positioning and communication.

Product Planning, used in a broad sense, involves not only the product strategy described above but also the product development measures. Some people, however, confine the use of the term product planning to the different aspects and functions of product development and exclude the product strategy.

Product Management refers to the managerial decisions pertaining to product development and the product strategies through the different stages of the product life cycle.

As our discussion of the product is related to international business, it would be more appropriate to use the term product decisions which is more comprehensive to involve all the above.

Product Decisions

Important product decisions in international marketing management are:

1. Market segment decision.
2. Product mix decision.
3. Product specifications.
4. Positioning and communications decisions.

Market Segment Decision

The first product decision to be made is the market segment decision because all other decisions — product mix decision, product specifications, and positioning and communications decisions — depend upon the target market. Details about the market segment selection is given in the Chapter on *Market selection*.

Product Mix Decision

Product mix decision pertains to the type of products and product variants to be offered to the target market.

Product Specifications

This involves specification of the details of each product item in the product mix. This includes factors like styling, shape, size and other attributes and factors like packaging and labelling.

Positioning and Communications Decisions

Positioning is the image projected for the product. For example, a toilet soap may be positioned as a baby soap, a beauty soap, a deodorant soap, a freshness soap or a skin-care soap. Communication refers to the promotional message designed for the product. Obviously, both positioning and marketing communication are very much interrelated. For the same product, some times the positioning and communication strategies differ between markets. For example, *Beefeater* is a low priced gin in the UK (its home market); but when the company wanted to introduce it in the US it found that there was no room in the minds of the consumers for another low priced gin. So in the US, the *Beefeater* was positioned as a high priced gin and became very successful.

PRODUCT

Philip Kotler defines a product as *anything that can be offered to a market for attention, acquisition, use or consumption that might satisfy a want or need.*[1] includes physical objects, services, persons, places, organisations and ideas.

The above definition is very broad indeed. As our major concern is with goods, the following two definitions given by William Stanton[2] will be more suitable for our purpose.

In a very narrow sense, a product is a set of tangible physical attributes assembled in an identifiable form. Each product carries a commonly understood descriptive (or generic) name, such as apples, steel, or baseball bats.

A broader interpretation recognises each brand as a separate product.

Components and Levels of Product

A very elaborate and comprehensive picture of the dimensions of the product is drawn by Kotler by presenting the components of the product as consisting of three levels. These levels are the following:

Core Product

The core product which is the most fundamental level of the product refers to the core benefit the consumer derives from the product.

In the context of international marketing, it is important to note that in some cases although the basic physical product remains the same, the core product differs between markets because the purpose for which product is used is different in these different markets. For example, in India and several other developing countries, bicycles mostly serve the basic purpose of transportation but in several advanced countries they are used mostly for sporting and exercising. This calls for modifications of product design, positioning and communication strategies. Similarly, in some countries beer is regarded as an alcoholic drink; in some others it is a soft drink.

Tangible Product

Tangible product is the actual form with all its attributes, in which the product is offered to the consumer. For example, Lux toilet soap, *Godrej* refrigerator, *Bajaj Chetak* scooter, *Good Knight* mosquito mats, etc., are tangible products.

The tangible product has certain characteristics like a quality level, features, styling, a brand name and packaging.

In many cases, modifications to the tangible product are required for marketing in different countries. In some cases, such modifications may be necessitated by legal requirements pertaining to quality levels, packaging, labelling etc. Competitive and economic conditions may also call for such modifications. For example, for selling a product in an advanced country, an Indian manufacturer may have to upgrade the product quality and improve the packaging. Sometimes, it may be the cultural factors which necessitate modification. For example, different cultures have different beliefs or notions associated with certain colours, numbers etc. Further, in several cases, the same word has different meanings in different languages or countries.

Augmented Product

Augmented product refers to certain additional services or benefits offered with the product such as installation, delivery and credit facilities, after sales service and warranty.

What the well-known Marketing expert Theodore Levitt observed nearly three decades ago is very relevant about a competitive market: "The *new competition* is not between what companies produce in their factories but between what they add to their factory output in the form of packaging, services, advertising, customer advice, financing, delivery arrangements, warehousing and other things that people value."[3]

An Indian firm which ventures to sell its products in the foreign markets which are very competitive should bear these factors in mind. Product augmentation may not be important in a seller's market but they are very important in the competitive markets which are buyer's markets.

PRODUCT MIX

The product mix is the full list of all the products offered for sale by a company.

The product mix may consist of one or more product lines. A product line is a group of products that are closely related either because they satisfy a class of need, are used together, are sold to the same customer groups, are marketed through the same types of outlets, or fall within given price ranges.

A specific version of a product that has a separate designation in the seller's list is known as a product item.

The product mix has certain *width, depth and consistency.*

The *width* refers to the number of different product lines in the product mix.

The *depth* refers to the average number of items offered by the company within each product line.

The *consistency* refers to the extent to which the various product lines are closely related in end use, production requirements, distribution channels, or in some other ways.

One of the important decisions in international business is the width and depth of the product mix and the length of each product line. It may vary between markets depending upon the market characteristics. It is generally observed that companies do not introduce their full range in some countries, particularly in the developing countries for reasons such as limited competition, lack of

demand etc. It has also been a common practice to introduce products in some markets, especially the developing countries, only at a later stage — sometimes only after the product has become obsolete or has reached the maturity or declining stage in the product life cycle.

PRODUCT LIFE CYCLE

Like living beings, products have life cycle. The Product Life Cycle (PLC) is depicted by the sales curve of the product since its introduction.

A product normally passes through (i.e., a PLC has) four different stages namely, introduction, growth, maturity and decline. Fig. 9.1 depicts a typical product life cycle.

Introduction

The introduction stage of the PLC which starts with the launching of the new product is characterised by:

1. Low sales because it generally takes some time for a new product to get wide acceptance by consumers and it also takes time to expand the marketing of the product.
2. High costs per unit because of the low sales and high promotional expenditure.
3. Absence of or low competition if the product is entirely new.
4. Loss or negligible profits because of low sales and high costs.

Growth

The growth stage which follows the introduction stage is characterised by:

1. Fast growth in sales because of increasing consumer acceptance and expansion of marketing.
2. Growing profits because of growing sales and fall in the incidence of fixed production cost and marketing cost per unit.
3. Increasing competition.
4. Market segmentation and the introduction of different versions (models) of the product.

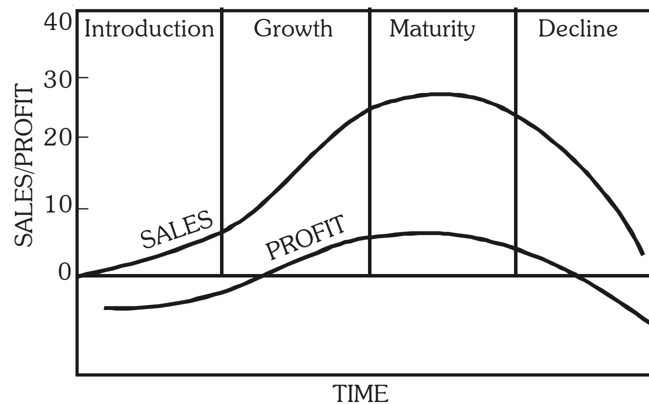


Fig. 9.1: Product Life Cycle

Maturity

The maturity stage is characterised by:

1. Saturation of sales (in the early part of this stage, sales may grow slowly but at the later part there could even be a fall in sales).
2. Intense competition.
3. Falling profits because of high promotional expenditure and falling margins.

Decline

The last stage is characterised by:

1. Entry of new products which compete with the product.
2. Decline in sales.
3. Decline in profits: profits may even become negative.
4. Exit of some of the firms.

PLC and International Marketing

International marketing may enable a firm to alter the shape of the PLC. Even after the sale in one market has reached the maturity stage, the sales could be kept growing by exporting it to foreign markets, like the developing countries, where the product is not yet introduced or where the sales is negligible.

It is also a fact that in several cases technologies/products are introduced in developing countries when they have become obsolete in the advanced countries.

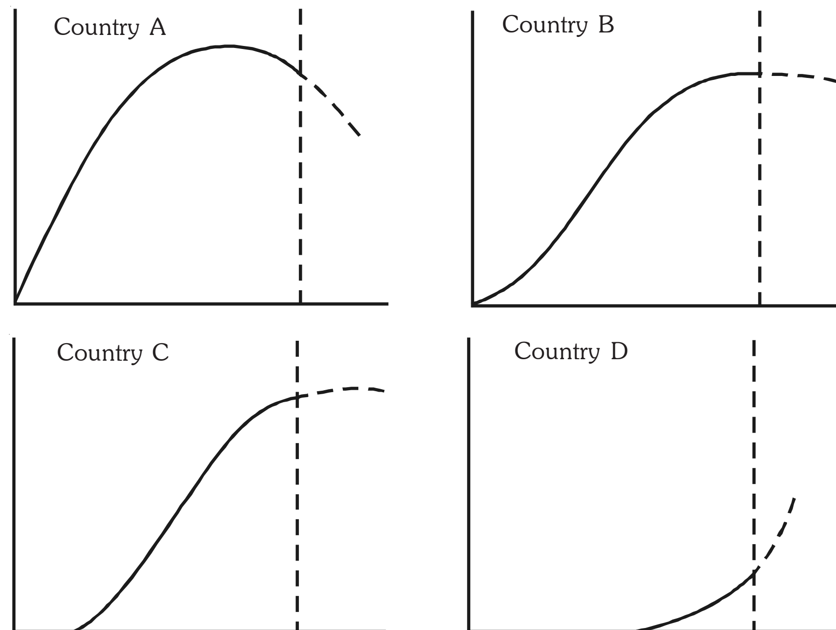
Figures 9.2 to 9.5 show the PLC for a product in different countries. In country A the product is in the declining stage, in country B it is in the maturity stage, in country C in the growth stage, in country D in the introductory stage, while the product is not yet introduced in country E.

Fig. 9.6 shows the effect of international marketing on the shape of the PLC

In Fig. 9.6, DS is the domestic sales curve. The shaded area shows the foreign sales. In the absence of international marketing, there would have been a fall in the total sales of the company but because of the exports this was prevented. TS represents the total sales comprising domestic sales and foreign sales.

It may be noted that many products are introduced in different countries at different times. In some cases, when a product is in the maturity stage or decline stage in one country, it may be in the growth stage in some countries and in the introduction stage in some others.

There is often a time lag between countries in the adoption and diffusion of technologies. The developing countries often lag behind the developed ones. Even among the developed countries, the technology or new product absorption is not simultaneous or similar. For example, the black and white television extensively penetrated households in the United States nearly a dozen years before they reached comparable number of viewers in Europe and Japan. In the case of colour television, the time lag was five or six years for Japan and a few more for Europe. In the case of video cassette recorders, there was a difference of three or four yeas — but in this case Europe and Japan led the way, the US with its focus on cable TV followed.[4]



Figs. 9.2 - 9.5: PLC for a Product in Different Countries

Fig. 9.6: International Business and PLC

It may be noted that the black and white TV was introduced in India nationally only after it had reached the declining stage in advanced countries. When the colour TV was in the introduction and growth stages in India, it was in the maturity or decline stage in several countries.

The product life cycle model developed by Vernon shows how the roles of different categories of countries as exporters or importers reverse over different stages of the product life cycle. According to this model, an innovative product is first introduced in an advanced country like the USA (because of certain favourable factors

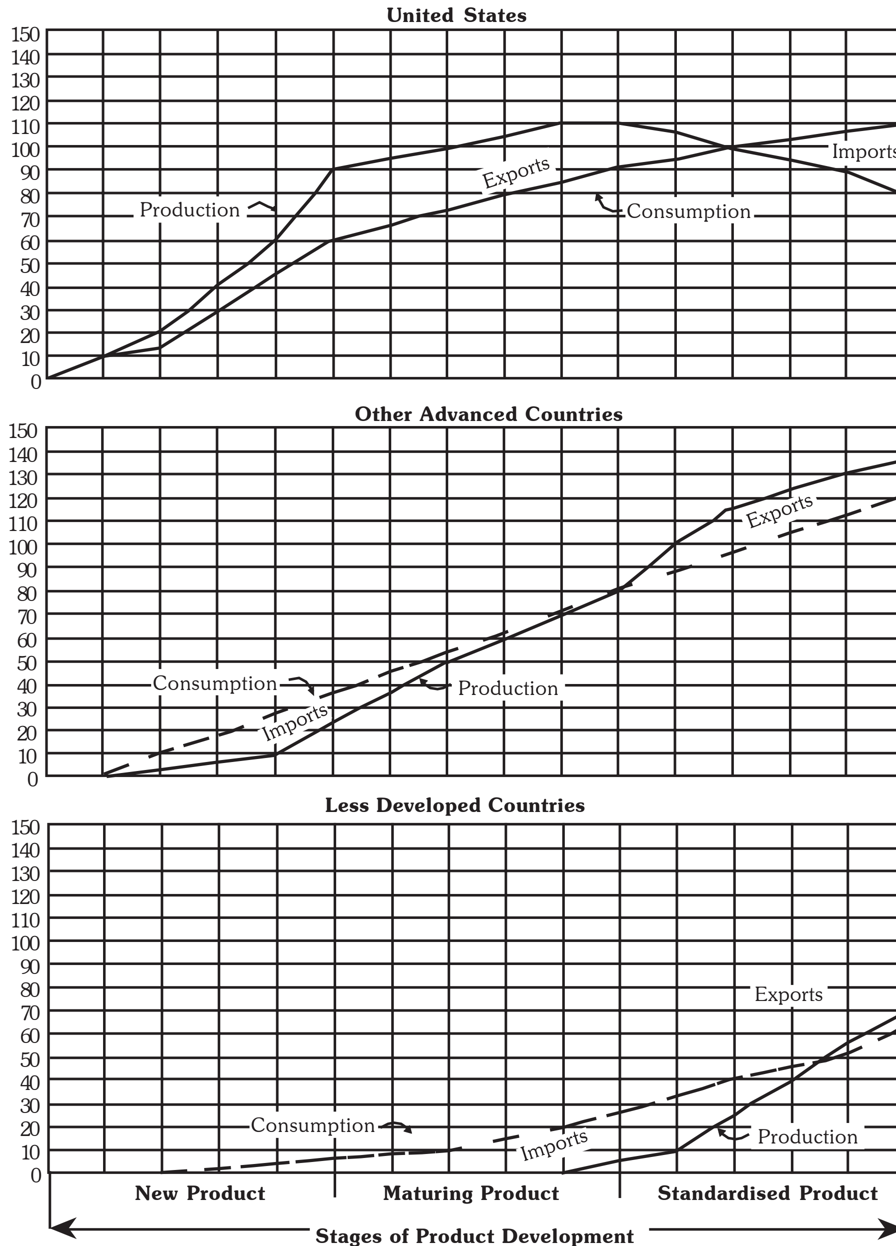


Fig. 9.7: International Trade and Production in the Product Cycle

(Reproduced by permission of Prentice-Hall, Englewood Cliffs, New Jersey, from Raymond Vernon and Louis T. Wells Jr., *Manager in the International Economy.)*

like a large market, ease of organising production etc). The product is then exported to other developed countries like the West European countries and Japan. As the market in these countries enlarge, production facilities are established there. These subsidiaries, in addition to catering to the domestic markets, export to the developing countries and to the United States. Later, production facilities get established in the developing countries. When the technology/product gets standardised, the developing

countries get some edge over others because of the low cost of production). They would then start exports to the developed countries. The situation is portrayed in Fig. 9.7.

NEW PRODUCT DEVELOPMENT

If a company finds that good opportunity exists for products it does not manufacture now, to exploit that opportunity new product development becomes essential.

From the point of view of a company, there are three types of new product.

1. *Innovative Product,* i.e., a product which is entirely original and new to the market.
2. *Significantly Modified Product*, i.e., a significant modification of an existing product (of either the company or others).
3. *Copy of the Existing Product,* i.e., exactly or almost the same type of product currently marketed by other companies.

In fact, opportunities exist for all these three categories of products.

Copying

There are many products without patent or other legal hurdles which can be copied and marketed. As a matter of fact, in the case of a number of products, particularly labour intensive products, manufacturers in the developed countries have been losing their competitiveness. Developing country firms have been emerging as exporters of these products. Many developed country firms (manufacturers and marketers) are eager to form alliances with firms in the developing countries for the manufacture of such products. Firms in developing countries may obtain technology and/or marketing support from the developed country firms.

Product Modification

Lot of export opportunities exist by product modifications. This requires enterprise and innovativeness. It is known that one of the reasons for the success of the Japanese is their skill in product improvements.

Innovation

Development of an entirely new product is a real challenge. In many cases, it involves a lot of research and development expenditure. Considering the low success rates of the new products, one should consider it as very risky. But, then, profit is the reward for risk-bearing. There are also cases of successful new product innovation without any significant R&D expenditure or other investments.

Steps in New Product Development

The different stages of development of an innovative product are the following:

1. *Idea Generation:* The first step in the product development is the generation of as many new product ideas as possible. The important sources of new product ideas are company's market research facility, company sales force, customers, competitors, scientists and technocrats, research and educational institutions, etc.

2. *Evaluation and Selection:* The second step is to evaluate the ideas generated and to select the idea or ideas which is/are worth pursuing further.

3. *Concept Testing*: Concept testing involves conceptualising the product idea into a product and testing its suitability and customer acceptance. For example, if the new product idea is of a new type of emergency lamp, concept testing would involve deciding about its size, weight, shape and other features like convenience in use, lighting specifications, etc.

4. *Business Analysis:* Analysis of commercial feasibility of the product involves estimating production and marketing costs, sales potential and profit.

5. *Product Development:* If the business analysis reveals that the product is a profitable proposition, the next stage is development of the product in its physical form. This stage comprises the technical aspects of product development.

6. *Market Testing:* It is common to conduct a market testing of the product before it is commercialised. The objective is to measure the consumer reaction to the product. Product quality, features, packaging, price etc., may be subjected to test. The feedback from the test marketing would enable the firm to improve the product and increase the customer acceptance. Test marketing is normally conducted with a representative sample of potential consumers or in some select markets like some cities/towns which are regarded as representatives.

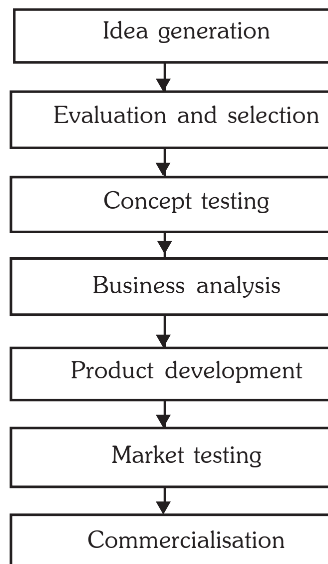


Fig. 9.8: Steps in New Product Development

It is important that the physical and the consumer testing are done in the foreign markets concerned. The physical factors like weather and climatic conditions, geographical conditions etc., may affect the product. Similarly, the characteristics of the consumers and middlemen may differ between markets.

Small firms developing products for foreign markets may find market testing difficult. They may not have the facilities, resources and experience to do this. The firm may, therefore, buy the services of marketing research firms and firms offering testing services. Even large firms may find it more convenient. Organisations like the Export-Import Bank of India, other export promotion organisations and marketing research firms in India would be able to help the exporter to identify the right marketing research or testing service firms abroad.

7. *Commercialisation:* Market testing would help the management to decide whether the new product should be taken up and if yes, whether it should be improved or launched as it is. If the decision is in favour of the new product, improvements, if needed, are made and measures are taken for its production. The product is then launched in the market.

Some important marketing decisions pertaining to commercialisation are:

1. *When* to launch the product.
2. *Where*, i.e., in which market (s) to launch the product.

3. *Whom* to target the product first.
4. *How* to market the product.

BRANDING

A *brand* is a name, term, sign, symbol, or design or a combination of them, intended to identify the goods or services of one seller or group of sellers and to differentiate them from those of others.

That part of the brand which can be vocalised — the utterable — is known as the *brand name*.

That part of the brand that is given legal protection for exclusive use by a seller is known as the *trade mark*.

Branding Decisions

Export marketing may involve several decisions related to branding. Important branding decisions are the following:

(i) *To Brand or Not to Brand:* The first decision is to brand or not to brand. Branding, although provides several advantages, is costly and risky. But a company's product would be devoid of an easy identity in the absence of a brand. There is, however, lot of export opportunities for non-branded goods. One trend noticed in the advanced countries is the consumer shift in favour of non-brand goods. Sales of non-brand goods in the supermarkets and departmental stores are reported to be increasing. What consumers look for are reasonable price and quality.

(ii) *Manufacturer's Brand or Private Brand:* A manufacturer may use for his products, his own brand (also called national brand) or private brand, i.e., the distributor's brand. Many Indian firms are manufacturing products for private brands of the foreign sellers. It will be very difficult, particularly for the small exporters, to sell their products abroad under his own unknown brand name. In several cases, even goods exported under Indian brand names are repacked abroad and sold under foreign brand names.

Exporting under the private brand may be used as a market entry strategy. The exporter could think of marketing the product under his own brand after having established a credibility and having gained sufficient experience. This has been the route adopted by several Japanese companies which have become very successful international marketers.

(iii) *Same Brands or Different Brands:* If the exporter decides to use his own brand name, a major decision to be made is whether to use the same brands in the domestic and foreign markets. Again if different brands are to be used for the foreign markets, whether there should be separate brands for the different foreign markets?

Global Brands

Some brands like *Coca Cola, Pepsi, McDonalds,* etc. have become so popular all over the world that they are regarded as *global brands.* Such global brands certainly give definite advantage to develop markets.

Because of cultural and other factors, it may not always be possible to use the same brands in all the markets. For example, colours, numbers, symbols etc., have different connotations in different cultures. Similarly, sometimes the same word has different meanings in different languages. For example, the brand name Nova in Spanish means 'it does not move'.

As stated earlier, a number of brands of multinational companies have become global brands. Such global brands possess some advantages.

1. It makes market entry easy — for example, Pepsi was well-known in India even before it came to India.
2. It reduces the promotional expenditure as the brand is well-known.
3. It helps to generate good sales since the very beginning.
4. It provides a competitive edge over other firms.

One important thing, however, about some of these global brands is that although the product is sold throughout the world under the same brand, the product does not remain the same everywhere. For example, Lux marketed in India is different from the product in other countries. Further references to this are given under the section *Globalisation vs. Localisation* later in this chapter.

Branding Problems in International Marketing

There are number of difficulties involved in branding in export marketing.

1. It is very difficult for a small firm to promote its brand in foreign markets because of the heavy cost of brand promotion.

2. Established foreign importers and distributors discourage use of exporter's brand because they prefer to sell the products under their own brand name. Using the exporter's brand name would mean undermining the market power of the importers/distributors. So they strongly resist the use of exporter's brand name.

3. As pointed out earlier, the cultural and other factors make branding decision complicated in international marketing.

4. One interesting problem faced by some multinational companies when they wanted to market their products in some countries is that they found that their world renowned brands had been registered in these countries by somebody else with the result that these firms had to pay a fee to the registered holders of these brands in these countries for permission to use these brands.

5. In some countries, there are restrictions on use of foreign brands. Until recently, there were such restrictions in India. However, companies sought to overcome this problem by prefixing or suffixing an Indian word to the foreign brand name (Examples: Lehar Pepsi, L.M.L Vespa, Swaraj Mazda etc.)

Scope for Use of Indian Brands

Although there are problems in selling abroad Indian brands, there is considerable prospects for promoting Indian brands abroad.

1. Indian brand names may be used when niche marketing strategy is employed (see Chapter 8 for an explanation of niche marketing).

2. Indian brand names may be used when the export is made to foreign firms who do not have their own brands or when goods are sold by distributors who do not have their own brand names. In this case, the push strategy will be necessary to push the unknown Indian brands.

3. After gaining credibility and gaining experience in export business by being suppliers to foreign firms, the Indian exporter may start selling under its own brand name while continuing the exports without its brand name.

4. An Indian firm may buy a foreign brand or take over a foreign firm with established brand name. This is an easy way of possessing a brand name in the foreign markets. It may be noted that some times, firms take over even sick units in foreign countries because of the marketing infrastructure, market share, or brands the foreign firms own. It may be mentioned that recently a number of firms in the foreign countries were taken over by Indian companies. The Arvind Mills, for example, bought

over, in 1994, *The Big Mill,* one of Europe's largest and most premium denim brands, and their entire marketing network so that today it sells 10 million metres of branded denim across Europe. In 1996, Government of India decided to establish a *Brand Acquisition Fund* to help Indian companies to acquire foreign brands put on sale.

5. There are several Indian industrial houses and firms which have reputation even in foreign countries. They may promote their brands in the foreign markets.

6. Indian companies may also use mixed brands, that is, combining their brands with foreign brands (Example: *Tata-Tetley*). This is advisable and easy particularly in joint ventures including strategic alliances.

7. Another possibility for promotion of Indian brands is the consortium approach. That is, several firms may jointly promote a common brand.

8. Promotion of a logo by export promotion agencies and permission to use this logo along with the brands of firms who will strictly adhere to the quality and other norms will also help promotion of Indian brands abroad. The logo assures quality and improves the image of the Indian product. The Tea Board has, for example, successfully promoted the *Darjeeling* logo in the foreign market. Similarly, the Spices Board has promoted the *Indian Spice* logo. More details are available in the author's *International Business* (Wheeler Publishing).

PACKAGING AND LABELLING

Although the terms packing and packaging are generally used in a broad sense and are synonymous, they are distinct in the marketing parlance.

Packing (also known as transport packing) refers to the protective covering used for shipment of the goods, while packaging (also known as product packaging or consumer packaging) refers to the package in which the product reaches the consumer.

In export marketing, packaging, including packing, is a factor which demands very careful attention. It has been widely accepted that poor packaging is a serious handicap from which the exports from developing countries suffer. There are reported to be many instances where the exports were handicapped due to defective packaging although the quality of goods was very satisfactory.

Packaging in international marketing is a much more serious problem than in domestic marketing because of the varying physical conditions and situations the cargo is exposed to and subjected to; difference in the tastes, preferences and practices; differences and peculiarities in packaging requirements and regulations; etc.

Functions and Importance of Packaging

Packaging has grown in importance over the years. Apart from the basic functions of packaging, certain developments in the marketing system and market characteristics have enlarged the role of packaging. The important functions and reasons for the growing importance of packaging are given below:

(*i*) *Protection:* Protection to the product is an essential function of packaging. Handling requirements and methods of handling, climatic and weather conditions, etc., are, therefore, among important considerations in packaging decision-making.

(*ii*) *Preservation:* The packaging should preserve the quality of the product. The packaging material should not pass or absorb any flavour or odour to the product or react with it. This is particularly important in cases like food and pharmaceutical products. The interaction between the product and packaging should be totally eliminated.

(*iii*) *Presentation:* Packaging has been widely recognised as an independent and potential selling tool. In other words, packaging also performs a promotional function. "The increased use of branding and the public's rising standards of health and sanitation have contributed to the growth of packaging. The major factor, however, is the importance of packaging as a real competitive force in today's struggle for markets. The widespread use of self-service and automatic vending methods of selling means that the package must do the selling job at the point of purchase. It is no simple task for manufacturers even to get their products placed on display in a retail outlet. Shelf space is at a premium and retailers are inclined to cater to producers who have used effective packaging."[5]

The need to make packaging attractive and acceptable is, thus, obvious. These can be achieved by giving proper attention to packaging features like shape, design, size, surface-graphics, colour schemes, labelling, branding packaging materials, etc.

The following developments have increased the importance of packaging and the need to make packaging very impressive.

(a) *Self-service:* The method of self-service has spread in the advanced countries. Under such a marketing environment, "instead of confronting a salesman, the consumer first confronts a package. The package must now perform many of the sales tasks. It must attract attention, describe the product's features, give the consumer confidence and make a favourable overall impression."[6]

(b) *Consumer Affluence:* The steady rise in incomes, particularly in the developed countries, has caused the consumers "to attach increasing importance to non-price features. They are willing to pay a little more for convenience, appearance, dependability and prestige. Packaging is an important vehicle for protecting these qualities."[7]

(c) *Integrated Marketing Concept*: "Companies are increasingly trying to endow their brands with distinctive personalities. These personalities are conveyed through the general company image through advertising messages and media, and through the choice of brand name. It does not make sense to stop short at packaging. Packaging must support and reinforce the brand personality the company is trying to build."[8]

Factors Influencing Packaging Decision

There are a number of factors that influence decisions in respect of packaging features like size, shape, design, surface graphics, colour schemes, labelling, materials, etc.

(*i*) *Physical Characteristics:* Packaging decisions are influenced by certain physical characteristics of the product like the physical state, weight, stability, fragility, rigidity, surface finish etc.

(*ii*) *Physical Characteristics:* Certain physio-chemical factors like the effect of moisture, oxygen, light, flame, bacteria, fungi, chemical action, etc., on the product are very important factors to be considered while making packaging decisions.

(*iii*) *Economy:* While packaging is very important in marketing, it is costly too. Indeed, there are a number of cases where the cost of packaging is more than the cost of the content. The rising cost of packaging has become a matter of serious concern. Every effort should, therefore, be made to reduce the packaging costs as much as possible without impairing the packaging requirements.

(*iv*) *Convenience:* Packaging should also necessarily possess the quality of convenience from the point of view of consumers, distributors and producers. Hence, apart from the functional needs, a good package should possess certain features like ease to open and close, ease to dispense, ease to dispose of, ease to recycle, ease to identify, ease to handle, convenience to pack, convenience to stack, convenience to display etc.

(*v*) *Miscellaneous Factors:* Apart from the factors mentioned above, packaging decisions may be influenced by a number of other factors. For example, if there is any statutory regulation in

respect of packaging, it will have to be abided by. As has already been indicated elsewhere in this book, the socio-cultural factors could influence packaging decision. Consumer attitudes also have to be given due consideration. The growth of consumerism in a number of countries, *inter alia*, also suggests that packaging decisions should be made with meticulous care.

Special Considerations in International Marketing

In addition to the general considerations in packaging mentioned above, there are certain special factors to be considered in export packaging decision. Important among them are the following:

(*i*) *Regulations in the Foreign Countries:* Packaging and labelling may be subject to government regulations in the foreign countries. Some countries have specified packaging standards for certain commodities. The trend toward requiring labelling in a country's native language is growing. If such regulations are not strictly followed, the goods may be confiscated or may attract some other punitive action.

(*ii*) *Buyer's Specifications:* In some cases, buyers, like the importers, may give packaging specifications. While incorporating such specifications, it should also be ensured that packaging satisfied other requirements like the statutory requirements.

(*iii*) *Socio-cultural Factors:* While designing the packaging for a product, socio-cultural factors relating to the importing country like customs, traditions, beliefs, etc., should also be considered. For instance, in Chapter 2 we have pointed out certain beliefs or values attached with different colours in some societies.

(*iv*) *Retailing Characteristics:* The nature of retail outlets is a very important consideration in packaging decision. For instance, as pointed out earlier, in some of the foreign markets, as a result of the spread of supermarkets and discount houses, a large number of products are sold on a self-service basis. The package has, therefore, to perform many of the sales tasks and hence it must attract attention, describe the product's features, give the consumer confidence and make a favourable overall impression.

(*vi*) *Environmental Factors:* Packaging decisions are also influenced by certain environmental factors like weather and climatic factors. The impact of such factors in the place where the product originates, while the product is in transit and while in the market etc., should be considered. The package should be capable of withstanding the stresses and hazards of handling and transporting, stacking, storing, etc., under diverse conditions.

(*vii*) *Disposability:* Attention should also be paid to the aspects relating to the disposal of the packaging. One of the qualities required for good package is that it could be easily disposed of or recycled. In some of the developing countries like India, many packaging materials easily find some other use or are recycled, but the situation is different in other countries. Indeed, the disposal of packaging materials is causing environmental problems in a number of countries. Reusable packages carry the risk of misusing it for selling bogus products.

Importance and Requirements of Export Packing

Appropriate packing facilitates safe and easy transport of the products, particularly in bulk. Good packing will ensure that safety of the product and the package. If the goods are not properly packed, it may cause a lot of problems. For example, the shipping company may issue a claused bill of lading (like "goods not packed properly") which means that the shipping company will not be responsible for damages due to poor packing. Similarly, the insurance company also will not bear the risk arising out of defective packing.

Packing to be satisfactory should satisfy the following conditions:

(*i*) It should be capable of withstanding the hazards of handling and transport. The cargo may be handled manually and mechanically. The handling methods may differ between places. When manually handled, it may be tilted, dropped, thrown, pulled, pushed, rolled etc. Further it may also be subject to compression due to stacking. The packing should, therefore, be capable of withstanding such hazards of handling and transportation.

(*ii*) It should be easy to handle. To facilitate easy handling, bulk packs may be provided with handling facilities like hooks, handles, grippers etc. In case of products which shall not be turned upside down, the position should be clearly indicated like marking 'this side up'. In case of fragile article which shall not be subject to rough handling, the size, shape and weight of the pack should be amenable for smooth handling. Further, it should also be indicated on the pack (for example, 'glass with care').

(*iii*) It should be amenable to quick examination of contents. It may be remembered that the customs authorities of the exporting and importing countries may want to examine the contents.

(*iv*) It should be easy to identify.

(*v*) It should be adequately marked.

(*vi*) Unless it is necessary, the contents shall not be disclosed (so as to discourage, pilferage and theft).

(*vii*) It should be easy to dispose of.

(*viii*) Packing must conform to the buyer's specifications, if any, and the regulations in the exporting and importing countries, guidelines and regulations by the shipping company, etc. Care should be taken to observe the established packing and marking standards. The Bureau of Indian Standards has prescribed packing standards for certain goods. The British Standard Packing Code, published by the British Standards Institution and the Exporter's Encyclopedia, USA, give detailed packing instructions. Shipping companies also give certain packing instructions especially for highly dangerous products.

Indian Institute of Packaging

The Indian Institute of Packaging (I.I.P.) was set up as a National Institute jointly by the Ministry of Commerce, Government of India, and the Indian packaging industry and allied interests in 1966 with its headquarters and principal laboratories in Mumbai.

The Institute's endeavour is to improve the standards of packaging needed for promotion of exports, conservation of resources, prevention of losses and damages to the products distributed in the domestic and export markets and help create infrastructural facilities for achieving overall packaging improvement in India through research and development, problem-solving, consultancy, training and education, testing, information dissemination and other promotional efforts.

Developments in Packaging

Fast developments are taking place in packaging. Success in the international market depends, *inter alia*, on keeping pace with such developments and in being innovative. India's market failure due to poor packaging have been conspicuous in many cases. An EEC Study Team is reported to have observed, for instance, that "although the Indian products are of a better standard, their packaging failed to attract common customers in Western countries, necessitating an improvement in it".[9]

It is now well recognised that the successful introduction of consumer packs is very much essential to realise maximum unit value and to consolidate the market position in respect of many export items of India like spices, marine products etc.

Flexible packaging which offers a combination of technological, economic, aesthetic and performance advantages unavailable from any other packaging form is regarded as “the most dynamic segment of today’s packaging industry.”[10] Stand-up pouch which can be used for packing of liquids, powders, paste and granules “has proved to be the most cost-effective functional flexible package. In the developed countries, stand-up pouches are extensively used and its share is continuously growing.”[11]

Packaging which pays due attention to the product characteristics, consumer convenience and appeal, market characteristics and economy is obviously an important determinant of success in international marketing. Being pragmatically innovative in marketing could be highly rewarding. Three most important considerations in packaging now and in future will be safety, convenience and environmental impact.

The material used for food packaging shall properly preserve the properties of the product and shall not have any harmful effect on health. Further, it shall impart maximum convenience to the consumer. In addition, environmental concerns have created a demand for social responsive packaging materials. Source reduction, reliability and similar attributes are now seen as highly positive.

Consumers, particularly in the advanced countries, today want more than plain food — they want convenience, in the form of fast, easy to prepare meals with fresh taste and quality of home cooking. It is said that a modern housewife in advanced countries is not prepared to spend more than 15 minutes to cook the evening meal; in the past it used to be 2 to 3 hours. It is also reported that anything which requires a cooking time of more than five minutes will not be preferred by customers in the age of microwave ovens. Thus, freezer to oven meals have a great appeal. The presentation should be in readily microwavable containers where the same container in which the food is sold can be used for cooking and after cooking the food can be served in the same container, thus avoiding the need to transfer the food to another container or vessel or dish for cooking and serving. This also saves the consumer from the botheration of washing the containers etc. Consumers in several parts of the world are indeed seeking a wider range of food presented in forms that need minimum preparation.

Increased worldwide awareness of environmental issues which has led to the banning of styrofoam and limiting of plastics is creating a growing need for packaging. Solid bleached sulfate (SBS) board which is composed of bleached kraft fibers and which is highly versatile, is an environmentally preferred material because it helps reduce the amount of landfill space consumed by packaging. It lends itself readily to the four major methods used to reduce or eliminate waste: source reduction, recycling, incineration and composing.[12]

All unit packaging material in direct contact with food should have adequate barrier properties to protect the product from dehydration, oxidation, discolouration and off flavour. POP packaging should be in the form of one piece unstapled cartons with easy opening features.

In short, processors and exporters must pay sufficient attention to the requirements of modern packaging and must find better ways to present and differentiate their products in order to compete effectively in major world markets. The demand for eco-friendly packaging is growing, particularly in developed countries.

Labelling

Labelling may be regarded as part of packaging because packaging decision- making also involves the consideration of the labelling requirements.

Sanitary obligations are a very important aspect of labelling. Many countries have laid down labelling requirements in respect of a number of commodities. According to the regulations in many countries, labelling of food items should disclose information about a number of aspects like date

of manufacturing, expiry date or optimum storage period for goods which do not have an indefinite storage period, composition, storage conditions, if necessary, method of use, etc. In some countries, labelling of certain products like cigarettes should also include a statutory warning that cigarette smoking is injurious to health.

As indicated earlier, many countries insist that labelling should be done in the popular languages of the country. This should preferably be done even in the absence of such a statutory requirement.

Besides satisfying the statutory and social requirements, labelling should help promote sales. For example, in self-service stores labelling should impart, to the extent desirable and feasible, the services of a salesman in informing and attracting the customers.

BUSINESS ENVIRONMENT AND PRODUCT STRATEGIES

As indicated in the chapter on *International Business Environment*, a very important factor which influences the marketing mix strategy is the Business Environment.

The product strategies of a company is shaped, *inter alia*, by the business environment. As noted in Chapter 2, in several cases, what may appear to be trivial matters like colour, brand name etc. may become very important factors which affect product success.

William Sugg of the Westinghouse Electric International Company states that the problem which his company "encounters in marketing new as well as old products are strongly rooted in cultural differences from country to country. These take effect along with economic and technical differences."[13] Numerous product experiences confirm this. Because of the environmental differences, products which flourish in one market may fizzle elsewhere.

It would be appropriate to cite the experiences of two American companies with marketing of cake mixes in the British market. Company A, the undisputed leader in cake mixes, failed in the British market while Company B became successful. Company A executives relied on their SRC[14] in assuming that the most popular American cake mix would also be popular in Britain. In fact, the British eat most of their cakes with tea, not for dessert. The fancy iced cakes that Americans favour are generally considered extra special in Britain and are purchased from a bakery or "made from scratch" at home. Company A introduced their "easy" mix that was very popular with Americans, but the British felt it was just not good enough for these special occasions. Company B executives had not relied on their (American) SRC, but investigated the British market. They found that the most popular cake was a dry sponge cake and introduced that as an easy expressed a need, Company B was quite successful.[15]

It may also be noted that, sometimes a company may find the introduction of a better material a problem because of certain peculiar convictions of the consumers. For example, use of plastic parts which are economic but sturdy can make two-wheelers cheaper. In fact, in foreign countries, plastic parts are successfully used for two-wheelers. The original model of Kinetic Honda had plastic material in it (used for shield, mud-guard etc.) but the Indian company had to change those parts to make it click in the domestic market as it was felt that Indians were averse to plastic parts.[16]

There are many instances of national regulations prohibiting the marketing of certain products. For example, Pepsi, and Coca Cola could not introduce the *Diet Colas* in India because two sweetners used in the manufacture of Diet Colas internationally, namely, aspartame (APM) and acesulfame K (ASK) were banned for use in India. Similarly, regulations pertaining to environmental protection, child labour, health and safety etc. make the marketing of a number of products impossible or very difficult in several countries.

In short, whether the same product without any modification can be marketed in foreign countries or whether the product can be promoted the same way in different national markets or whether

modifications are needed in the marketing mix depend on the marketing environment. Product modifications are called for when the use, conditions of use, tastes and preferences of the consumers, purpose of the use or need satisfaction, regulatory environment, the buying capacity of the consumers etc. are not the same in the different markets.

Even when people of different cultures use the same basic product, the mode of consumption, conditions of use, purpose of use or perceptions of the product attributes may vary so much that product attributes, method of presentation, positioning, or strategy of promotion may have to be varied to suit the characteristics of the different markets.

Chocolate provides an example. In France, chocolate is used mostly in cooking. In Italy, chocolate is served as a snack to children, a slab of chocolate is placed between two slices of bread and a sort of sandwich is created. Germans, who appreciate the taste of pure chocolate, find both these other uses quite unappealing.[17] In short, the purpose and mode of use, preferences etc. are very important factors to be considered in product planning and promotion, including positioning. Coffee provides another example. While coffee and tea are regularly consumed twice or more in a day in some countries, coffee and tea are considered luxury beverages in Japan where drinkers require not only authentic flavour and aroma but a good atmosphere — "comfort while drinking", "pleasure of conversation", "a modern, urban atmosphere", etc. The annual per capita consumption of coffee in Japan is only half a gram compared to 18 pounds in Sweden. While in some countries, coffee or tea is taken with lunch, in some countries it is taken in the early morning, with breakfast, and even in between during coffee/tea break. The type of product and the product form used, the method of brewing, the attribute preferences, mode of consumption etc. also vary between cultures. In short, the purpose and mode of use, preferences etc. are very important factors to be considered in product planning and promotion, including positioning.

PRODUCT STRATEGIES

Broadly, there are three alternative product strategies between the domestic and foreign markets, viz., product extension, product adaptation and product development.

Product Extension

Under the product extension strategy, the same product as marketed domestically is extended to the foreign market without any significant modification. This is possible when certain significant factors like consumer tastes, product use conditions etc. are the same in both the home and foreign markets. Another important condition for this strategy is that there is no legal requirement necessitating product modification for the foreign market.

Many companies now follow this strategy. They do business with globally standardised products (for details see the section *Globalisation vs. Standardisation*).

This strategy is popular with companies with ethnocentric and regiocentric/geocentric orientations.

While in case of companies with regiocentric/geocentric orientation this strategy is part of the massive international business, in the case of the ethnocentric companies this is a strategy for some additionality in business with logical incrimination, i.e., without any significant deviation from the traditional line of business.

An example of the ethnocentric company employing the product extension strategy is an Indian firm selling Indian curry powders, pickles etc. to the ethnic population (i.e., Indians) abroad. Similarly, some Indian mixies like Sumeet mixie fitted with powerful motor to do heavy duty work like grinding rice, dal etc. are very popular with Indian's abroad.

Ethnocentric firms may employ this strategy by identifying suitable market niches abroad.

More about the product-communication strategies.

Product Adaptation

Under the product adaptation strategy, the product is properly modified to suit the environment of the foreign market. Important factors which necessitate such product modification for the foreign market *vis-a-vis* the domestic market are:

Difference in the consumer tastes, consuming habits etc.

Differences in the conditions of use of the product.

Differences in the use facility characteristics.

Differences in the purpose of use or need satisfaction.

Differences in the cultural environment.

Differences in the natural environment like geo-physical characteristics, weather/climatic conditions etc.

Differences in the regulatory environment.

Differences in income levels and standard of living.

Differences in the competitive environment.

In several cases, considerable and appropriate modification of the product is required to make it suitable for the foreign market. The Boeing presents a very good example of success in foreign markets by suitable product modification. In the early 1970s, the sales of the Boeing 737 began to tail off because of decline in orders from the airlines of developed countries like the US. Therefore, the company turned its attention to the underdeveloped countries, mainly the middle East, Africa and South America. But it needed to adapt the plane to the idiosyncrasies of the Third World aviation. The company redesigned the wings to allow shorter landings and added thrust to the engines for quicker takeoffs. It also redesigned the landing gear and installed low pressure tyres so that the plane would stick to the ground when it touched down. The gambit worked. The company sold one or two 737 at a time to airlines throughout the world compared to batches of 20 or 30 to the US airlines in the past. As fledgling Third World airlines grew, they began buying Boeing's larger planes. Recently, the 737 became the best selling commercial jet in the history.[18]

Audco India Ltd., a leading manufacturer of industrial valves in India, carried out minor product adaptation in the form of redesign, patterns and tooling to suit the exclusive requirements of customers in the US. Establishment of recognised quality management system was essential to inspire confidence in the users. With training conducted by experts from P.E. Batalas, Audco implemented quality management system as per ISO 9000 standards. Inspection and testing of the valves was undertaken at laboratories in USA which were approved by major buyers. For valves used in the oil production industry, license and authority to use API (American Petroleum Industry) monogram was a prerequisite.

Similarly, for marketing the hand tools in the US, Mascot India has to upgrade the product quality. It had to change from carbon steel to chrome vanadium. Market specific packaging was developed by appointing a packaging consultant.

Many Indian products had undergone quality upgradation and other modifications to enter the foreign markets. Marketing research enables a firm to identify the type of product modifications required. Sometimes, detailed product specifications are provided by the foreign buyer.

More about product adaptation is given in the section *Product-Communication Strategies.*

Product Development

Many firms develop new products for the foreign market. As pointed out elsewhere in this chapter, from the point of view of a firm, there are three types of new products, viz., (*i*) an innovative product, i.e., a product which is quite new to the market, (*ii*) an imitative product, i.e., a product which is

already in the market but new to the company's product mix; and, (*iii*) a significantly modified product (of either the company or others).

An innovative product serves an unserved need of the consumer or serves a need better, in some way, than existing products.

A firm may enter the market with the same sort of products as marketed by other companies if it can have some edge over the competitors in respect of price, promotion, distribution or product.

A number of opportunities exist for developing country firms to enter the foreign market with imitative products because of the production cost advantage they enjoy.

In many cases, a significant modification of the existing products provide an opportunity for international marketing. In several cases, the new product development which is significant modification of the existing product and product adaptation amount to one and the same.

Many innovative products can have the advantage of the monopoly power conferred by patent protection. Many firms interested in foreign markets try to identify potential market segments and develop suitable products.

PRODUCT-COMMUNICATION STRATEGIES

In International marketing, product and communication strategies are usually considered together because the need satisfaction, purpose of product use or usage occasion and the product communication are rather inseparable. Keegan has identified the following five alternative product communication strategies in international marketing with reference to modification of product and communication (i.e., promotional theme).[19]

Straight Extension

The theme of the straight extension strategy is one product, one message, worldwide. In other words, under this strategy, the firm markets the same product and communicates the same message in all the markets. This strategy has been successfully employed by Pepsi. In every country in which it operates, Pepsi sells exactly the same product, and does it with the same advertising and promotional themes and appeals that it uses in the United States (except in India where it has been recently introduced).

Two important sources of cost savings are associated with this strategy. There are considerable manufacturing economies of scale and elimination of R&D costs. Further, substantial economies are associated with the standardisation of marketing communications. Pepsi Co. international marketers had estimated, for example, that production costs for specially prepared advertising for foreign markets would be $ 8 million per annum, which was considerably more than the amounts spent by them for advertising the product in these countries. India is probably the only country where a commercial was made locally with local stars (Remo Fernandez and Juhi Chawla). Even in China when the Pepsi was introduced, the commercial was an international one. The approximate cost of production of the commercial for product launch in India was ₹ 40 lakh.

The product-communications' extension strategy would prove successful for products like soft drinks. Pepsi Cola and Coca Cola are living testimonials to this fact. However, this easiest strategy will not succeed in many cases. For example, when Campbell tried to sell its US tomato soup formulation to the British, it discovered, after considerable losses, that the English taste was different.

As Keegan suggests, the product-communications' extension strategy may be successfully employed only if the product function (need satisfaction) and the conditions of the product use are the same in all the markets, and the customers in all the markets have the financial capability of buying the product at the same price.

Product Extension, Communications Adaptation Strategy

Under this strategy, the firm markets the same product but employs modified communication about the product in foreign markets. For example, bicycles are used mainly for sporting and exercising in several developed countries, but in many other countries of the world they provide basic transportation. When this strategy is employed, the communication appeal used in the foreign markets would be quite different, depending upon the particular product use that is promoted.

In effect, when this approach is pursued (or, as is often the case, when it is stumbled upon quite by accident), a product transformation occurs, points out Keegan. The same physical product ends up serving a different function or use from that for which it was originally designed. An actual example of a very successful transformation is provided by a US farm machinery company, which decided to market its US line of suburban lawn and garden power equipment as agricultural implements in less developed countries.

The appeal of the product extension, communications adaptation strategy is its relative low cost of implementation, for it involves only communication changes.

Product Adaptation, Communications Extension Strategy

Under this strategy, essentially the same promotional message is used abroad as at home; but the product is modified to suit the foreign market conditions. This strategy assumes that the product will serve the same function in foreign markets under different use conditions. Esso followed this approach when it adapted its gasoline formulations to meet the weather conditions prevailing in foreign market areas, but employed without change its communications appeal "Put a Tiger in Your Tank". Many manufacturers vary the size or contents of their goods, like fertilisers or clothing or appliances to meet local conditions.

Of course, this strategy involves expenditure on R&D, and additional engineering and production costs; but in the long run, it may be better than introducing an unaltered product having less appeal.

Dual Adaptation

The dual adaptation strategy involves a modification of both the product and communication to meet the foreign needs and considerations of the foreign market. This strategy is called for when differences exist in the environmental conditions of use and in the function which a product serves. For example, the National Cash Register Company took an innovative step backward by developing a crank-operated cash register that would sell at half the price of a modern cash register. They developed special advertising that emphasised its low cost. This unit caught on greatly in the Philippines, the Orient, Latin American and Spain.

Dual adaptation is very expensive but is worthwhile if markets in the various countries promise to be large enough.

Product Invention

The product invention strategy involves the development of new product suitable for tapping a foreign market, for example, low cost products may have to be developed for low income countries. A product invention strategy may even mean "inventing backward." This was the case when a leading manufacturer of mechanical washing machines was asked to apply its know-how not to produce a better automatic machine, but to develop a better manual washer. The result was an inexpensive ($ 10) hand-powered plastic washer with the tumbling action of an automatic machine.

In sum, as Keegan points out, the choice of product and communications strategy in international marketing is a function of three key factors:

(i) The product itself defined in terms of the function or need it serves;

(ii) The market defined in terms of the conditions under which the product is used, including the preferences of potential customers and their ability to buy the products in question; and

(iii) The costs of adaptation and manufacture to the company considering these product-communications approaches.

MERITS AND DEMERITS OF DIFFERENT PRODUCT-COMMUNICATION STRATEGIES

	Merits	***Demerits***
Straight Extension	1. Economics of scale in production 2. No additional investment in R&D 3. No additional expenditure on development of commercials	1. Not suitable when the relevant marketing environments are different 2. Not suitable when the need satisfaction or purpose of use of the product is different
Product Extension, Communication Adaptation	1. Economies of scale in production 2. No cost of product modification 3. The appropriate strategy in certain situations	1. Costs of communication modification
Product Adaptation, Communication Extension	1. Helps to increase product acceptance	1. R&D costs 2. Costs of product modification 3. High costs of production if level of demand does not permit economies of scale in production
Dual Adaptation	1. Most suited strategy in some cases	1. R&D costs 2. Costs of product modification 3. Costs of communication modification 4. High costs of production if level of demand does not permit economies of scale in production
Product Invention	1. Advantages of a right product for the market	1. Costs of marketing research 2. Costs of innovation and product development 3. Costs of new product promotion and market development.

GLOBALISATION VS. LOCALISATION

An important issue in international marketing is globalisation vs. localisation or standardisation vs. customisation. The issue, in other words, is whether a company should follow a strategy of geocentrism or polycentrism. The question is whether all the markets should be regarded as a single homogeneous market that can be successfully tapped with a globally standardised marketing strategy or whether there should be specifically designed strategy for each of the distinctive market.

As Sands remarks,[20] in literal sense, multinational standardisation would mean the offering of identical product lines at identical prices through identical distribution systems, supported by identical promotional programmes, in several different countries. At the other extreme, completely "localised" marketing strategies would contain no common elements whatsoever. Obviously, neither of these extremes is feasible or desirable and in practical marketing these terms are not used in the literal sense. In many cases, the issue boils down to what extent localisation or standardisation is appropriate. In a number of cases, what is appropriate is neither localisation nor globalisation but regionalisation.

The most staunch advocate of globalisation is Theodore Levitt who has indeed been described as the guru of global marketing and the champion of world brands. According to Levitt, the world is becoming a common marketplace in which people — no matter where they live desire the same products and lifestyles. Global companies must forget the idiosyncratic differences between countries and cultures and instead concentrate on satisfying universal drives.[21]

Citing the examples of many high-tech and high-touch standardised products being sold in the same way everywhere, Levitt argues that "World's needs and desires have been irrevocably homogenised and that this makes the multinational corporation obsolete and the global corporation absolute."[22]

While "the multinational corporation operates in a number of countries and adjusts its products and practices in each — at a high relative cost, the global corporation operates with resolute constancy — a low relative cost — as if the entire world (or major regions of it) were a single entity; it sells the same thing the same way everywhere."[23]

Levitt further argues that the modern global corporation contrasts powerfully with the aging multinational corporation. Instead of adapting to superficial and even entrenched differences within and between nations, it will seek sensibly to force suitably standardised products and practices on the entire globe. They are exactly what the world will take, if they come also with low prices, high quality, and blessed reliability. The global company will operate, in this regard, precisely as Henry Kissinger wrote in *Year of Upheaval* about the continuing Japanese success — "voracious in its collection of information, impervious to pressure, and implacable in execution."[24]

The following developments tend to favour globalisation:

(*i*) *Technological Advance*: It is argued that the proletarianisation of communication and travel by the technological revolution drives the world toward a converging commonality.

The very fast changes in technology also makes products obsolete very soon, i.e., the product life cycle is very short in many cases. Customisation involves time and the resultant delay in introducing the product in different markets may make the product life cycle even more shorter in an environment of fast changes and come in the way of fast recouping the cost of products with short life cycles due to technological obsolescence or other reasons like changes in fashion.

(*ii*) *Travel and Communication:* Transnational travel encourages globalisation in two ways. First, it helps diffusion of product information. Second, transactional travellers become customers for a product in different countries. International migration also has similar effects.

Developments in the field of education and communication have a tremendous impact on product promotion. The spread of English education has increased the international circulation of English

publications. Media from one country — newspapers, magazines, radio, TV etc. — may reach audience in many other countries. For example, consider the following cases.[25]

German television broadcasts are received by 40 per cent of Dutch homes with TV sets.

Paris March has a circulation of 85,000 in Belgium, 26,000 in Switzerland, and a substantial readership in Luxembourg, Germany and Holland.

On an average day, over 4 million French housewives tune in to Radio Luxembourg, the same broadcast reaches 620,000 Belgian housewives, 30,000 in Switzerland, and 100,000 in Holland.

In short, "worldwide," communications carry everywhere the constant trumbeat of modern possibilities to lighten and enhance work, raise living standards, divert and entertain. The same countries that ask the world to recognise and respect the individuality of their cultures insist on the wholesale transfer to them of modern goods, services and technologies.[26] As far as comforts of life are concerned, people's attitudes are becoming more and more secular.

(*iii*) *Product Image:* Consumers are becoming more price and quality conscious. "Competitors in the 1990s will not be marketing magicians. They will rely on two rather universal needs of their customers — reliable products and low prices."[27] Standardisation makes production more cost efficient, leading to low prices. Standardisation reduces costs because of the economies of scale in production and marketing and because of the savings on R&D and product development. Levitt concedes that by translating benefits of enormous economies of scale in production, distribution, marketing and management into reduced world prices, the corporations geared to standardisation can decimate competitors that still live in the disabling grip of old assumptions about how the world works.[28]

(*iv*) *International Standards:* The laying down of international standards for many products also encourage standardisation. Many such industrial products which perform the same function every where lend themselves for standardisation.

There are, thus, several factors which tend to encourage globalisation. Levitt feels that standardisation can help expand the market. "When the global producer offers his lower costs internationally, his patronage expands exponentially. He not only reaches into distant markets, but also attracts customers who previously held to local preferences and now capitulate to the attractions of lesser prices. The strategy of standardisation not only responds to worldwide homogenised markets but also expands those markets with aggressive low pricing.[29]

Critic of Levitt's Views

Many academicians and marketers do not subscribe to the thesis of Levitt. Hundreds of documented cases of international marketing blunders bear testimony to the failure of standardisation in many cases. Studies have shown, for instance, that the American companies which entered the Japanese market with differentiated marketing strategies have generally done well while those who have not done so have presented a poor show. Few examples of these are given elsewhere in this book.

Philip Kotler holds that Levitt's theory that the world is becoming one market- place is a lot of bunk.[30] According to Kotler, setting up marketing in each country is like an organ transplant — the question is will it take. What works in one country may not work in another. Kotler also points out that Levitt blundered in his assessment of the overseas success of certain products cited by him as examples of successful globalisation. The success of these products is based on variation, not offering the same product everywhere. McDonald's, for example, sells differently in Germany, where it offers beer and Japan where it offers sake. Until McDonald's made these variations, its only real customers were American tourists.[31] Thus, we find that the product that is available under the global brand may not be same everywhere. The Lux marketed in India is different from the product in other markets. The Liril in India is different from that in Japan. Similarly, Procter and Gamble markets

worldwide products like Camay soap, Crest toothpaste, Head and Shoulders shampoo and Pampers diapers; but the smell of Camay, the flavour of Crest and the formula of Head and Shoulders differ from region to region and so do the advertising.

In short, as McCann-Erickson worldwide says, "our experience suggests that, even though the world is busily defining new similarities, the nuances of differences are still critical. A global theme is often fine, but fine turning is even finer. Otherwise all you finish up with is a very low common denominator indeed — all things to few people."[32]

It may also be noted that there are also differences in the perception of what constitutes product modification. What is regarded as product modification by certain people is not considered so by others. Levitt observes, for instance, that to say that Japanese companies are not global because they export cars with left side drive to the US and the European continent, while those in Japan have right side drivers, or because they sell office machines through distributors in the US but directly at home or speak Portuguese in Brazil is to mistake a difference for a distinction.[33]

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10

INTERNATIONAL PRICING

Right price is one of the important determinants of business success. Right price, however, does not necessarily mean a low price. What is the right price will depend upon a number of factors like the nature of other elements of the marketing mix, nature of the market, including demand and competitive situations. The price has to be consistent with other elements of the marketing mix. At the same time, it has to be very responsive to the demand.

The uniqueness of price in the marketing mix is that it is the only element that generates revenue, all other elements of the marketing mix incur costs. It should, at the same time, be appreciated that the other three Ps are also designed to help the firm to realise revenue through an appropriate, comprehensive, marketing strategy, of which the pricing strategy is an ingredient.

At the outset, one may think that price must cover at least the full cost of production and marketing. If that were always the case, there would not have been firms incurring losses. Demand or competitive conditions sometimes make the absorption of the full cost into price impossible.

Sometimes companies price the product very low, even below the full cost, with certain specific objectives like market penetration, using price as a strategic marketing variable to achieve the firm's objective. It has been observed that in foreign markets the strategy of Japanese firms, in general, was to build market share rather than early profits.

Sometimes the low price is the result of the predatory pricing strategy. This is a practice of temporarily selling at prices below cost with the intention of driving out existing competitors or warding off new competitors. Predatory pricing is a restrictive trade practice under the MRTP Act which is unlawful.

It is common with firms having idle capacity to adopt marginal cost pricing (that is considering only the variable costs — costs of labour and material which directly go into the production of the product concerned — and ignoring the fixed costs) to facilitate the utilisation of the idle capacity.

EXPORTER'S COSTS

Cost, obviously, is one of the most important considerations in export pricing. Export prices, like domestic prices, are determined by the cost and supply conditions and the demand and competitive conditions. The cost and supply conditions dictate the minimum price the exporter must get while the demand and competitive conditions determine the maximum price he can charge.

Pricing for export market, however, is more complex and difficult than for the domestic market. Export pricing will have to accommodate into itself the trade practices and the regulations of the

overseas market. Export prices should take into account the additional costs involved in respect of packaging, packing, labelling, marking etc., transportation and storage, covering export risks and so on. Export incentives, like duty drawback, may also influence the export prices. Export pricing, thus, involves the careful consideration and incorporation of a variety of factors.

Types of Costs in Export Marketing

There are broadly two types of costs in export marketing, namely,

(*i*) Production costs; (*ii*) Selling and delivery costs.

Production Costs

There are two types of costs in production, namely,

(*i*) Fixed costs; (*ii*) Variable costs.

Fixed Costs

Fixed costs are costs which remain fixed irrespective of the level of production, like investment in land, building and plant and machinery. Besides these, there may be some other types of fixed costs. For example, even if there is no production, some people may have to be employed to look after the factory and premises and there may be some minimum fixed expenses like electricity costs etc.

Fixed cost is the cost which remains the same over a range of output. That is the total fixed cost remains same whether there is no production at all or whether there is maximum possible level of production.

As the production increases, the average fixed cost per unit falls. For example, if the total fixed cost is ₹ 10 lakh, the average fixed cost per unit will be ₹ 10 lakh if the production is only one unit but will be ₹ 5 lakh if output is two units and ₹ 1 lakh if output is 10 units. If output is 100 units, the average fixed cost per unit will be ₹ 10,000 and it will be only ₹ 1,000 if the production is 1,000 units. In Fig. 10.1, TFC represents the total fixed cost and AFC represents the average fixed cost per unit.

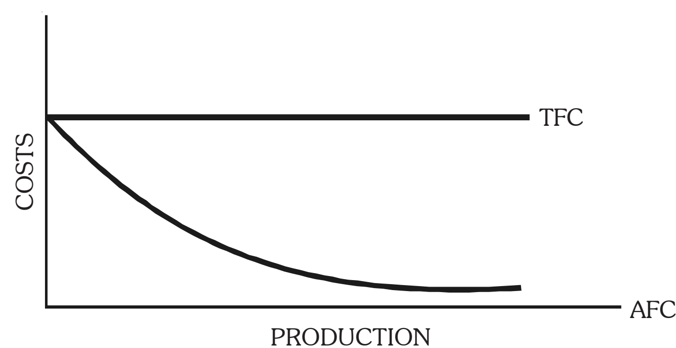

Fig. 10.1: Total Fixed Costs and Average Fixed Costs

Variable Costs

Variable costs are costs which vary with the variation in the level of output and includes costs of factors like labour, material etc. Although the average variable cost per unit may remain same for different levels of output, the total variable cost will vary with the level of production.

In Fig. 10.2, TVC represents the total variable cost for different levels of output.

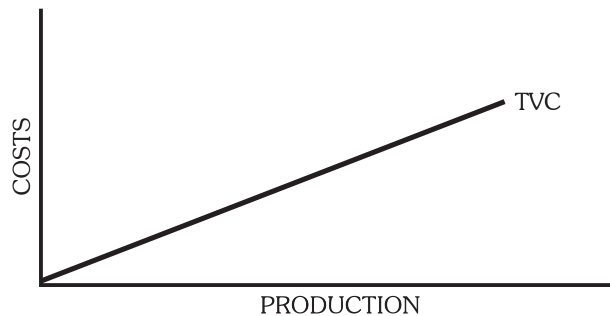

Fig. 10.2: Total Variable Cost

In Fig. 10.3, FC represents total fixed cost and TC represents the total cost (fixed costs + variable costs) for different levels of output. The gap between FC and TC represents the total variable cost at different production levels.

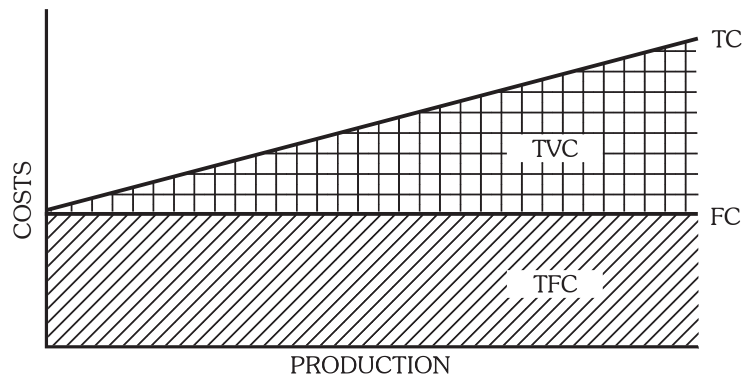

Fig. 10.3: Fixed Cost, Variable Cost and Total Cost

As fixed cost is cost which is already incurred, it remains there even if there is no production. Hence, sometimes (for example, when there is idle production capacity) the price may be decided taking into account only the variable costs. This is known as marginal cost pricing, which is detailed later in this chapter.

Selling and Delivery Costs

Besides the production costs, there are several other costs which an exporter may incur and sometimes this is as important or even more important than the production costs.

The selling and delivery costs include the cost of holding stocks, packing, transport, documentation, preshipment inspection, insurance and marketing costs like costs of advertising, personal selling etc.

Selling and delivery costs may also be divided into fixed and variable costs. For example, salesman's salary is fixed cost, while his commission and travelling and incidental expenses are variable costs.

Variable costs are also known as direct costs (or primary costs) because they vary directly with the variations in the level of production.

Cost which cannot be directly apportioned to any product, like costs of plant maintenance, lighting etc. are called indirect costs.

PRICING OBJECTIVES

Price is a strategic marketing tool to achieve certain objective(s). The pricing objective, naturally, is one of the very important determinants of price. A firm's pricing policy may be guided by any one or more of the following objectives:

(*i*) *Market Penetration:* Market penetration may be a very important objective, particularly for new exporters. A firm may attempt to penetrate the market with a low price.

(*ii*) *Market Share:* The price may be manipulated to increase the market share. In many cases, it is a corollary of market penetration.

(*iii*) *Market Skimming:* This is often the case with innovative products. The product is introduced with a high initial price to skim the cream of the market. The price may be subsequently reduced to achieve greater market penetration.

(*iv*) *Fighting Competition:* Sometimes, price is a tool to fight competition. A price reduction by the competitor may have to be countered by price cuts. Sometimes, price cuts may be affected to discipline the competitor or to compel the competitor to reduce prices so that his cash flows will be affected.

(*v*) *Preventing New Entry:* A firm may charge a low price even when there is scope for high price so that the industry does not look very attractive to new entrants.

(*vi*) *Shorten Payback Period:* When the market is uncertain and risky because of factors like swift technological changes, short product life cycles, political reasons, threat of potential competition etc., recouping the investment as early as possible would be an important objective.

(*vii*) *Early Cash Recovery:* A firm with liquidity problem might give priority to generate a better cash flow. Hence, it would adopt a pricing that might help it to liquidate the stock and/or encourage prompt payment by the channel members or buyers.

(*viii*) *Meeting Export Obligation:* A company with specific export obligation may be compelled to adopt a pricing policy that enables it to discharge its export obligation. Sometimes it may even imply a price lower than the cost.

(*ix*) *Disposal of Surplus:* A company confronted with a surplus stock may resort to exporting to dispose off the surplus. In such cases, exports sometimes takes the form of dumping.

(*x*) *Optimum Capacity Utilisation:* Exporting is sometimes resorted to enable the firm to achieve optimum capacity utilisation so as to minimise the unit cost of production. In such a case, achieving the required quantity of exports could be the objective of export pricing.

(*xi*) *Return on Investment:* Achieving the target rate of return is the most important pricing objective in a number of cases.

(xii) Profit Maximisation: In many cases, the primary pricing objective is maximisation of profits.

FACTORS AFFECTING PRICING

The important factors affecting pricing policy decision are the following:

International Marketing Objectives

The objective of marketing is a very important factor determining the price. For example, when the objective is market penetration, the price charged may be low. Similarly, when a firm exports to make use of the excess capacity, marginal cost basis may be adopted for pricing. But if profit maximisation in the short run is the objective of a firm having good domestic demand for its products, it would not export at a price which does not provide a profit margin at least equivalent to that on the domestic sales.

Costs

The pricing decision, quite obviously, is influenced by the costs — the fixed and variable costs of production and the transportation and marketing costs. Although in the short run, in certain situations the export price may be lower than the full cost, in the long run a firm which exports a substantial share of its production is normally expected to cover the full costs.

The flexibility a firm can enjoy in pricing depends to a large extent on its cost efficiency, i.e., how favourably its fixed and variables costs compare with those of the competitors.

Competition

Competition is a very important factor affecting pricing. A monopolist normally has high degree of freedom in pricing. That is why patented products could be sold at high prices. The severe the competition the lower the pricing freedom.

Product Differentiation

The extent of product differentiation is another factor influencing price. This is in fact an aspect of competition. If the company's product is highly differentiated than those of the competitors or if the product has some strong unique features, the company will have more freedom to manipulate the price.

Exchange Rate

The exchange rate of the currency may also influence pricing. For example, if the Rupee is steadily appreciating, the Indian exporter would be constrained to quote high dollar prices because an appreciation of the rupee means a fall in the rupee realisation for every dollar earned by exports.

Market Characteristics

Apart from competition, there are certain other market characteristics which are relevant to pricing. They include:

1. Demand trends
2. Consumer income levels
3. Importance of the product to the consumers
4. Trade characteristics like trade margins.

Image

The price which a firm may charge also depends on the image of the firm and the country. It may be easier for a well reputed firm to charge a higher price than others. Pricing freedom also depends on the image abroad of the country. India has a poor quality image abroad, in general, even in comparison with some other developing countries. The poor quality image comes in the way of obtaining a better price.

Government Factor

Export pricing is sometimes influenced by government policies and regulations. The Government influence on export pricing may take any one or more of the following forms:

Regulation of Margins: Sometimes the government may dictate the margins or mark-ups by the producers or distributors. The marketers, thus, lose, by and large, the freedom in pricing.

Price Floors and Ceiling: There are a number of cases in different countries involving price floors and ceilings. When there are such regulation, the price shall not fall below the floor price or shall not exceed the price ceiling, as the case may be. Until recently, several textile items were subject to minimum export price (MEP) in India.

Subsidies: With a view to making export price competitive, government sometimes grant subsidies. A subsidy enables the seller to reduce his price to the extent of the subsidy without incurring any loss. For example, in India, certain select export items were eligible for Cash Compensatory Support (CCS).

Tax Concessions and Exemptions: In countries like India, the export sector enjoys certain tax benefits which help to quote a lower price for exports. For example, under the duty drawback scheme, an exporter is entitled to refund of certain specified duties he has paid, like import duty or excise duty on raw materials used in export production.

Other Incentives: A number of other incentives and assistances like cheap credit, supply of raw materials etc., at regulated prices, marketing assistance, etc., may also influence export prices.

Government Competition: Government may even compete directly in the market to control prices. For example, the US Government could effectively combat the increase in aluminium prices by three companies by announcing the government's decision to release two or three hundred thousand tonnes of aluminium from its strategic stockpile.

Taxes: Taxes like customs duties also influence export pricing. For example, an import duty in the foreign market may compel the exporter to reduce the price if the foreign market will not take a high price, because duty will have the effect of increasing the price in the foreign market. So, to maintain a particular consumer price, the price the exporter gets will have to be reduced when there is an impost or increase of import duty. An export duty also may have similar effect. Governments often impose countervailing import duties to combat dumping, export subsidy, etc.

International Agreements: International prices of certain commodities are sought to be controlled by means of international commodity agreements like quota agreements, buffer stock agreements and bilateral/multilateral contracts, as explained in Chapter 2.

PRICING METHODS / APPROACHES

Different methods or approaches are followed in export pricing. A brief account of the common methods are given below:

Cost Based Pricing

Cost based pricing, also known as cost plus pricing, is a common method of pricing. Under this method, the price includes a certain percentage of profit margin on the sum total of the full cost of production, marketing costs and an allocation of the overheads. That is, Price = [fixed costs + variable costs + overheads +marketing costs] + specified percentage of the total costs.

Advantages

Advantages of the cost plus approach are:

(*i*) It covers all the costs.

(*ii*) It is designed to provide the target rate of margin.

(*iii*) It is, generally, a rational and widely accepted method.

(*iv*) It is an easy to comprehend and simple method.

Disadvantages

The cost based pricing, however, has several disadvantages:

(*i*) The cost calculations are based on a predetermined level of activity. If the actual level of activity varies from this estimated level, the costs may vary, rendering this method unrealistic.

(*ii*) If the costs of the firm are higher than its competitors, this method would render the firm uncompetitive in relation to price.

(*iii*) Another drawback of the cost plus method is that sometimes the opportunity to charge a high price is foregone.

(*iv*) It ignores the price elasticity of demand.

(*v*) The cost based pricing would not be helpful for some of the objectives or tasks like market penetration, fighting competition etc.

(*vi*) It imparts an inbuilt inflexibility to pricing decisions.

Market Oriented Pricing

This is a very flexible policy in the sense that it allows the prices to be changed in accordance with the changes in market conditions. The product may be priced high when demand conditions are very good and the price may be lowered when the market is sluggish if that helps in increasing sales. This method is sometimes referred to as what the traffic will bear method, i.e., charging the maximum possible price given the market conditions.

Advantages

The major advantages of this method are:

(*i*) It is a very flexible policy.

(*ii*) Price is based on the market conditions.

(*iii*) When the product life cycle is expected to be relatively short, 'what the traffic will bear' is an appropriate policy because it will enable the firm to recoup the investment fast.

Disadvantages

(*i*) It is difficult to estimate what the traffic will bear.

(*ii*) Under this method, there is a chance of ignoring the elasticity of demand factor.

(*iii*) If what the traffic can bear in one market is significantly lower than what it is in another, it could lead to the development of a grey market.

Following Competitors

Many firms follow the dominant competitors, particularly the price leader, in setting the price. The price leader is the firm which initiates the price trends.

The important alternative ways of following the competitor are:

(*i*) Setting the price at the same level as that of the competitor.

(*ii*) Setting the price below that of the competitor.

(*iii*) Pricing higher than that of the competitor's.

The choice of the alternative has to be based on such factors as the comparative quality of the product, the image and reputation of the firm, the uniqueness or similarity of the product etc.

Advantages

The main advantages of this method are:

(*i*) It is a very simple method.

(*ii*) It follows the main market trend.

(*iii*) It has relevance to the competitive standing of the firm.

Disadvantages

The major disadvantages and limitations of following the competitors are:

(*i*) If the competitor's price decisions are unrealistic, the follower will also be going wrong on the price.

(*ii*) The cost factors of the follower may not be similar to that of the competitor's.
(*iii*) The pricing objective of the firm could be different from that of the competitor's.
(*iv*) Sometimes the competitor may initiate price change for wrong reasons.

Negotiated Prices

Deciding the price by negotiation between the seller and the buyer is common. This is popular with government and institutional purchases.

Advantage

The major advantage of deciding price by negotiation is its great flexibility and the opportunity to put across and understand the points of both the buyer and seller.

Disadvantage

The major disadvantage is that if the bargaining power of the seller is weak, he may not be able to get a good price.

Customer Determined Price

In a number of cases, the foreign buyer specifies the price at which he is prepared to buy the product. Whether a price quotation given by the buyer will be acceptable to seller or not will depend on factors like his cost structure, conditions of business, objectives etc.

Break-even Price

Break-even price is the price for a given level of output at which there is neither any loss nor profit. In other words, if the total costs of production and selling a particular quantity of the product is divided by that quantity, we get the break-even price. If the exporter sells below this price, he makes a loss and if he sells above this price he makes a profit. If he sells more than the break-even volume, he makes a profit and if the sale is less than the break-even volume, the result will be loss.

Break-even analysis helps to understand the minimum sales required to avoid any loss and also the profit or loss at various levels of sales.

As stated above, the Break-even Point (BEP) is the point (i.e., the level) of sales at which there is neither any loss nor any profit. In other words, at the break-even point, the total revenue will exactly equal the total cost — hence, the term break-even.

The break-even point may be expressed either as a percentage of capacity utilisation (for example, 60 per cent of the installed capacity) or as a number of physical units of the output (for example, 25,000 units of the product) or as the volume of sales revenue (for example, ₹ 7.2 million).

The difference between the break-even point and the expected capacity utilisation (which is higher than the BEP) is the margin of safety. For example, if the BEP is at 50 per cent of the installed capacity and the expected level of capacity utilisation is 80 per cent, the safety margin is 30 per cent.

The lower the break-even point, the higher is the chance of the project making profit and lower is the risk of incurring loss. Lower the BEP, the higher the margin of safety.

If the BEP is very high, the risk will also be very high. For example, if the BEP is at 80 per cent of the capacity, the project will make loss if for any reason (such as demand constraints; production bottlenecks like shortage of raw materials, power cut, breakdown, labour problem etc.), it is not possible to achieve 80 per cent capacity utilisation.

Calculation of BEP

The break-even point can be calculated in terms of physical units and in terms of sales turnover.

(i) In Terms of Physical Units: The number of units required to be sold to achieve the break-even point can be calculated using the following formula:

$$BEP = \frac{FC}{SP - VC} \text{ or } \frac{FC}{C}$$

where

FC = Fixed Cost

VC = Variable Cost

SP = Selling Price

C = Contribution per unit (C = SP – VC)

Example, if:

FC = ₹ 1,00,000

VC = ₹ 2 per unit

SP = ₹ 4 per unit, and

Maximum productive capacity = 1,00,000 units per year

BEP= 100,000 = 50,000 units (i.e., 50% of the capacity)

(ii) In Terms of Sales Volume: BEP in terms of sales volume can be calculated using the following formula:

$$BEP = \frac{FC}{SP - VC}$$

Example, if:

FC = ₹ 1,00,000

SP = ₹ 4 per unit

VC = ₹ 2 per unit

$$BEP = ₹\ 4 \times \frac{1{,}00{,}000}{4 - 2} = ₹\ 2{,}00{,}000$$

The BEP can be reached at a lower volume by raising the selling price (the variable cost per unit remaining constant) or by reducing the variable cost (the selling price remaining constant).

Calculation of Break-even Price

The break-even price for a given volume of output can be calculated by dividing the sum total of fixed costs and variable costs by the quantity of output.

Example, if:

FC = ₹ 100,000

VC = ₹ 2 per unit

Quantity (Q) = 50,000 units

$$\text{Break-even price} = \frac{FC + VC}{Q}$$

$$= \frac{₹10{,}000 + 1{,}00{,}000}{50{,}000}$$

$$= \frac{2,00,000}{50,000} = ₹\ 4$$

Break-even Price for Predetermined Profit

If the firm wants to fix the selling price in such a way as to get a certain fixed amount of total profit for a given volume, for estimating the price which will yield this level of profit, what he has to do is to add this profit figure to the fixed cost and then calculate the break-even price.

Example:

Fixed Cost = ₹ 100,000

Required Profit = ₹ 50,000

VC = ₹ 2 per unit

Order quantity = 50,000 units

$$\text{Break-even price} = \frac{FC + RP + VC}{Q}$$

$$= \frac{₹1,00,000 + 50,000 + 1,00,000}{50,000}$$

= ₹ 5

Break-even Chart

The break-even chart is a chart or graph portraying the likely profits or losses at different levels of output.

In the break-even chart given in Fig. 10.4, the difference between FC and TC represents total variable cost at different output levels. The line TR represents total revenue at various volumes of sales. The break-even output is 'Q' because at this level of output the total costs equal the total revenue.

It is also very clear from the chart that with the help of the break-even chart the loss or profit at different output levels can be easily measured.

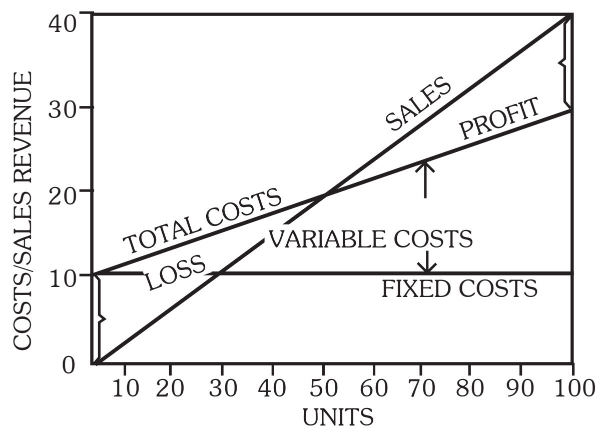

Fig. 10.4: Break-even Chart.

Marginal Cost Pricing

Marginal cost pricing approach is common in evaluating the profitability of new orders in case of firms with excess (i.e., idle) capacity.

Under the marginal cost pricing, the relevant cost considered for pricing is the variable cost, the fixed cost is excluded from the calculation of the cost of the product.

An order which may appear to be unprofitable and, therefore, unacceptable because of adopting the full cost approach (i.e., both fixed and variable costs) may appear to be profitable if marginal cost approach is adopted.

Example:

Maximum production capacity	=	100,000 units
FC	=	₹ 100,000
VC	=	₹ 2 per unit
Domestic price	=	₹ 5
Domestic demand	=	50,000 units
Then, break-even price	=	₹ 4
Domestic Profit	=	₹ 50,000
Export order	=	30,000 units
Price offered by the importer	=	₹ 3 per unit
Break-even price for export order under conventional method	=	$\frac{₹1,00,000+1,60,000}{80,000}$
	=	₹ 3.25
Loss on export order	=	(₹ 3 – 3.25) 30,000
	=	₹ 7,500
Break-even price according to marginal costing approach	=	$\frac{\text{VC of export order}}{\text{quantity of export order}}$
	=	$\frac{60,000}{30,000}$ = ₹ 2
Contribution (Profit)	=	(₹ 3 – 2) 30,000
of export order	=	₹ 30,000

The above example shows that if the conventional method of costing is adopted, a wrong feeling that acceptance of the export order will result in a loss and hence the order is likely to be rejected.

On the other hand, if a realistic approach is taken (i.e., the marginal costing) it can be seen that the acceptance of the export order will increase the profits of the firm by ₹ 30,000. It may be noted that the fixed cost is recouped by the domestic business.

Even if the domestic business does not fully recoup the fixed cost, marginal costing is still relevant for export pricing as long as idle capacity exists. If the price is higher than the marginal cost, there will be some contribution.

In short, the key to marginal costing is to view home sales and export sales as separate compartments and to consider export sales as extra sales. If the exporter recovers his fixed costs from his home sales, he can consider the extra cost (i.e., the marginal cost) of the additional production to be only the variable costs involved. This means that break-even price can be far lower than if the price were calculated on the basis of both fixed and variable costs.

The difference is indicated in Fig. 10.5, by the space between the dotted and solid lines.

Creative Pricing

Marginal costing may give scope for creative pricing. Creative pricing means taking advantage of the flexibility between the lower limit of break-even price and the upper limit of the competitor's price for similar product.

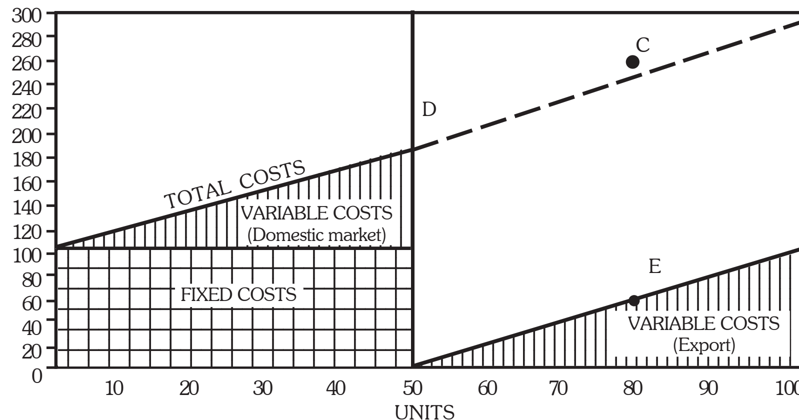

Fig. 10.5: Break-even Points According to Full Costing Approach (C) and Marginal Costing (E)

If the marginal cost is very low when compared to the competitor's price, it gives the exporter scope for aggressive pricing policies or for heavy expenditure on initial or continuing promotion or for absorbing the extra costs involved in exporting (provide that the company breaks even with the domestic business).

Advantages

Following are the main advantages of marginal cost pricing:

(i) When idle capacity exists marginal costing is a realistic approach to evaluating an export order.

(ii) When fixed costs are recouped from domestic operation, exporting can increase the total profits if the price is higher than the marginal cost; rejection of the order on the basis of full costing would deny this chance of increasing the profits.

(iii) Marginal cost pricing will make the firm more price competitive.

(iv) Marginal cost pricing may help the firm in market penetration.

(v) Marginal cost pricing may help the firm to increase its total sales turnover.

Disadvantages

The major disadvantages of marginal cost pricing are:

(i) It is normally advisable only when idle capacity with no opportunity cost exists.

(ii) It has limitations in applying to export-oriented units, i.e., units whose whole or the major part of the output is exported.

(iii) Once the products are sold at a low price, it will be difficult to increase it substantially later.

(iv) If the proportion of the variable costs in the total cost is very high, there is not very significant gap between the marginal cost and full cost.

TRANSFER PRICING

Transfer pricing or intracompany pricing refers to the pricing of goods transferred from operations or sales units in one country to the company's unit elsewhere.

The appropriate basis for intracompany transfers often depends on the nature of the subsidiaries, the market conditions and government policies and regulations. Some studies show that, in most cases, setting up transfer prices remains the absolute prerogative of the parent company executives regardless of the firm's nationality.

The important general objectives of the intracompany pricing system are:

(i) To maximise the total profits of the company;

(ii) To facilitate parent-company control; and

(iii) To offer management at all levels, both in the product divisions and in the international divisions, an adequate basis for maintaining, developing, and receiving credit for their own profitability.

There are four common pricing arrangements for intracompany transfer of goods. They are:

(i) Sales at the local manufacturing cost plus a standard mark-up.

(ii) Sales at the cost of the most efficient producer in the company plus a standard mark-up.

(iii) Sales at negotiated prices.

(iv) Arm's length sales using the same prices as quoted to independent customers.

Transfer pricing, however, has become a controversial issue. From the point of view of the company, the criterion for fixing the price is a complicated issue. The arm's length transfer is perhaps the most acceptable to the tax authorities and most likely to be acceptable to foreign divisions. However, quite often the predominant consideration in intracompany pricing is maximisation of overall profits of the company. To achieve this, prices have to be adjusted as to mitigate the effects of taxes on profits. Hence, it is natural to quote low price for intracompany transfers where taxes are high and enhance the price where the tax rates are low. The following strategies are, therefore, often associated with transfer pricing:

(i) When goods are shipped to high-tariff countries, minimal transfer prices are quoted to reduce the effect of duty.

(ii) To reduce income tax, goods are overpriced when transferred to units in high-tax countries.

(iii) When dividend repatriation is curtailed by government policy, income may be taken out in the form of high prices for products or components shipped to units in that country.

Companies, thus, tend to manipulate transfer prices to circumvent tax and dividend regulations to maximise their profits. As the multinational enterprises are increasing their business, national governments are becoming more concerned about such aspects.

DUMPING

Dumping refers to selling in the foreign market at a price below the home market price. According to some economists, however, dumping means selling in the foreign market at a price below the cost of production.

If the foreign price is above the home market price, it is referred to as reverse dumping.

Dumping may be sporadic, intermittent or long period. The explanation of these concepts given below would also make clear the reasons for dumping.

Sporadic dumping is resorted mostly to sell out the excess stock that may arise occasionally. Firms indulging in sporadic dumping may not have any great interest or commitment in the foreign market; their main interest may be to liquidate the excess stock.

Intermittent dumping refers to the periodic sale abroad of goods at prices below the home market price. Intermittent dumping may be resorted to gain a foothold in the foreign market (predatory dumping); to combat a new competition in order to retain a long held position; to eliminate or discipline a competitor, etc.

Long-period dumping may be resorted to facilitate the utilisation of the full capacity of the plant continuously. Operation at full capacity lowers the average cost and increases profits in the home market. The foreign market price must at least recoup the marginal cost of the product and the home market price must be above the average cost.

Dumping is generally condemned. Most nations take measures to combat dumping like imposing anti-dumping import duties.

Also see the section on dumping under the Uruguay Round Agreement in Chapter 2.

STEPS IN PRICING

The setting up of an appropriate export price involves various steps which are outlined below:

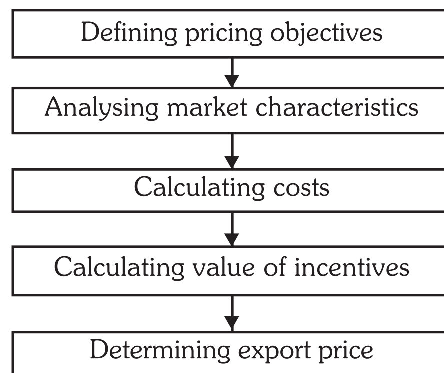

Fig. 10.6: Steps in Export Pricing

Defining Pricing Objectives

As pointed out in an earlier section of this chapter, the export objective has an important bearing on pricing. For example, if the objective is to utilise excess capacity, even marginal cost pricing may be acceptable. But if a firm has a good domestic market to sell its full capacity output, the export price may be influenced by the short-run vs. long-run objectives.

Further, pricing may be used as a means to achieve certain marketing objectives. For example, the price may be set low to achieve market penetration as is often done by the Japanese companies. It has been observed that a key characteristic of the Japanese "entry strategy is to build market share rather than early profits. The Japanese are patient capitalists who are willing to wait even a decade before realising their profits."[1] If the company intends to give the product a high profile positioning, the price would have to be, accordingly, set high.

Pricing for the foreign market is, thus, influenced by a number of marketing/pricing objectives.

Analysing Market Characteristics

There are several market characteristics which affect pricing. Competitive condition is one such important factor. If competition is very intense, price would be very sensitive. On the other hand, if competition is not severe, the company is likely to have more flexibility in pricing.

Competition can be direct or indirect. A direct competitor sells a product that is similar, while an indirect competitor sells one that is considerably different but that competes for the same buyer's end usage. When the product is 'substitute', the cross elasticity of demand is an important factor to be considered.

Analysis of the characteristics of the different market segments including the customer characteristics is also very important.

Information needs to be collected also about the prevailing price ranges and trade practices and customs like credit and payment terms, discounts, distribution margins etc.

Calculating Costs

To ascertain whether a given price is acceptable or not, it is very much essential to have an accurate estimate of the cost.

The main elements that should be covered in a calculation of export costs are:

Direct Production Costs: Materials, labour and other expenses that are required to produce the goods.

Production Overheads: Materials, labour and the expenses that are indirectly involved in producing the goods.

Marketing and Distribution Costs: Materials, labour and other expenses necessary for getting orders, handling orders, packing the goods and sending them to customers.

Estimating the Value of the Incentives

There may be several export incentives like duty drawback, Cash Compensatory Support (CCS), Replenishment license/Exim Scrip, premium on the foreign exchange, income tax benefits etc., which either enable the exporter to reduce the price without incurring any loss or increase the profitability.

Establishing Target Price and Ascertaining Export Feasibility

The next step is to establish a target price based on the analysis of the market characteristics and to ascertain whether it will be possible to export at that price.

The estimates of the cost, and the value of the incentives and the export/pricing objectives enable the company to estimate the minimum amount it must realise, after allowing for the marketing and distribution costs, so as to make the export feasible. To know whether export at the estimated market price is feasible, the company must work backwards from this market price. This is known as retrograde pricing which is summarised below. The gap that remains between the costs and the price presents the exporter with his profit and/or contribution to overheads.

EXPORT PRICE STRUCTURE*

Working backwards from a given market price to ascertain whether the export will be profitable or not is known as retrograde pricing. When an export order is received with the buyer specifying the price or when the exporter has to accept the prevailing market price method, this process will help to find out the profitability.

The important steps in retrograde pricing are shown in Fig. 10.7.

RETROGRADE PRICING

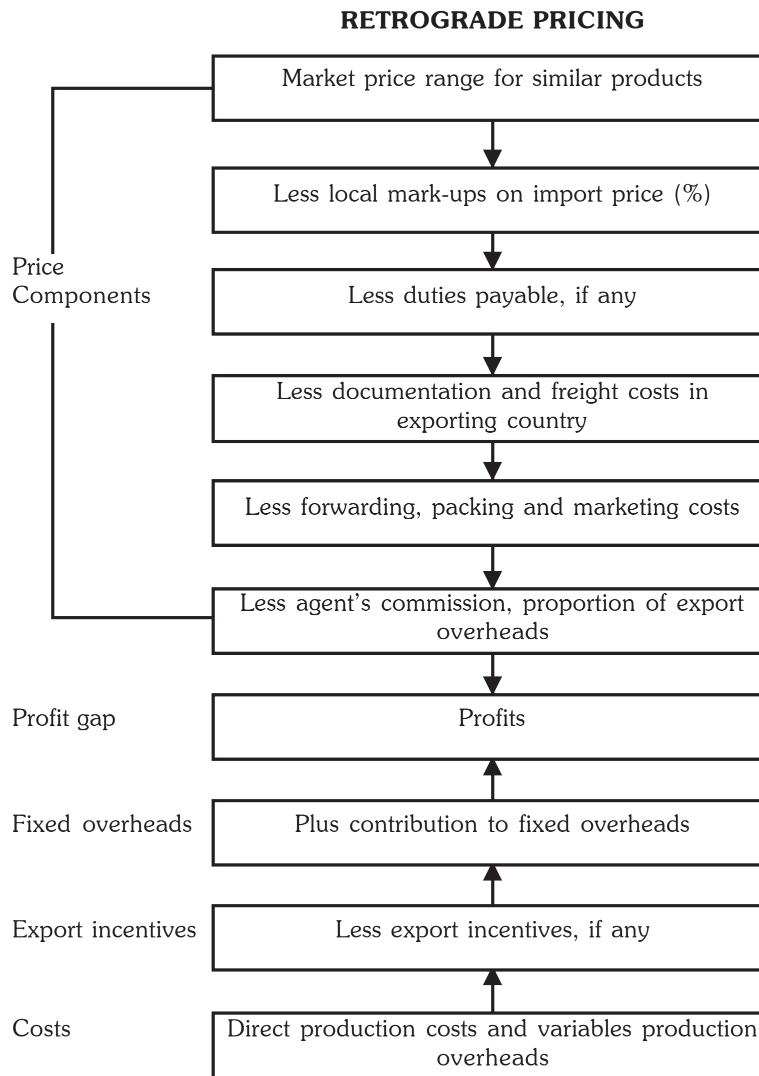

Fig. 10.7: Steps in Retrograde Pricing

1. Elements of the export price structure

Once a policy decision on pricing has been made, the next step is to establish individual prices. This must be done before fixed quotations are prepared for the importer. The most important tool at this stage of pricing is the price structure, which gives a detailed picture of all cost elements from factory gate to the consumer price.

The price structure enables the producer/exporter to:

(*i*) Build up his final price stage by stage;

(*ii*) Compare his pricing at all stages with that of his competitors;

(*iii*) Analyse his prices to find out whether cost savings can be achieved in one or more elements.

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* Reproduced with permission from ITC, *Costing and Pricing for Exports* (Geneva: ITC, 1993)

A typical export price structure is the following:

(*a*) Factory cost of product
(*b*) Producer's profit
a + b = price, ex-factory gate
(*c*) Export packing and marking
(*d*) Loading at factory
(*e*) Transport to docks, rail head or airport
(*f*) Port/rail/airport handling charges and fees
(*g*) Cost of documents (bill of lading, airway bill)
(*h*) Consular invoice, certificate of origin
(*i*) Export duty if any
a to i = C & F price
(*j*) Insurance premium and cost of policy
(*k*) Sea or air freight charges
(*l*) Dock/rail/airport handling charges and fees
a to l = CIF price
(*m*) Unloading charges at destination
(*n*) Import duties and taxes
(*o*) Clearing agent's fees
a to o = Landed price
(*p*) Transport to importer's warehouse
(q) Importer's margin or mark-up
(*r*) Wholesaler's margin or mark-up
(*s*) Retailer's margin or mark-up
a to s = Price to consumer

2. Margins or mark-up

(a) Mark-up and mark-down pricing

Important components of an export price are the importers', wholesalers' and retailers' margins (or mark-ups) which inflate the price before the product reaches the final consumers. Because of the margins and other *ad valorem* duties or charges, a small reduction in the FOB or CIF price may result in a much larger reduction in final price to the consumer (not in percentage but in absolute amount).

For example, a dozen boxes of confectionery:

	Index	$	10% reduction in CIF New Prices	price Difference
CIF price	100	29.00	26.10	–2.90
Customs duty	20%	+20	+5.80	
Landed price	120	34.80	31.32	
Importer's mark-up	35%	+42	+12.18	
Price to wholesaler	162	46.98	42.28	
Wholesaler's mark-up	25%	+40	+11.75	
Price to retailer	202	58.73	52.85	
Retailer's mark-up	50%	+101	+29.36	
Price to consumer	303	88.09	79.28	– 8.81

In retrograde pricing, the reverse calculations are performed:

Price to consumer		100	88.09
Retailer's mark-up	50%	– 33	– 29.36
Price from wholesaler		67	58.73
Wholesaler's mark-up	25%	– 14	–11.75
Price from importer		53	46.98
Importer's mark-up	35%	– 13	–12.18
Landed price		40	34.80
Customs duty	20%	– 6	– 5.80
CIF price		33	29.00

(b) Examples of actual profit margins

Consumer goods

Confectionery	**Mark-up**	
Landed duty-paid price	100	
Importer to wholesaler	135	(35 per cent on 100)
Wholesaler to independent retailer	169	(25 per cent on 135)
Wholesaler to chain and department stores	150	(11 per cent on 135)
Independent retailer to consumer	253	(50 per cent on 169)
Chain and department stores to consumer	250	(67 per cent on 150)

The importer's mark-up of 35 per cent covers the following costs: warehousing, broker's commission, delivery to wholesaler, overheads and profit.

Leather goods	**Mark-up**	
Landed duty-paid price	100	
Importer to retailer	167	(67 per cent on 100)
Retailer to consumer	304-334	(82-100 per cent on 167)

The importer's margin covers the following costs: Warehousing, reshipping, advertising, travelling and commission. The commission is 16 per cent on sales.

Hardware	**Mark-up**	
Landed duty-paid price	100	
Importer to wholesaler	110	(10 per cent on 100)
Wholesaler to retailer	160	(45 per cent on 110)
Retailer to consumer	250	(56 per cent on 160)

Toys	**Mark-up**	
Landed duty-paid price	100	
Importer to wholesaler	115	(15 per cent on 100)
Wholesaler to retailer	150	(30 per cent on 115)
Retailer to consumer	250	(67 per cent on 150)

The importer's 15 per cent is made up of 5 per cent for salesmen's commission and 10 per cent to cover costs of warehousing, reshipping, promotional expenses and profit. When the importer sells direct to the retail trade, he gives himself a mark-up of 50 per cent on the landed duty-paid price, out of which he has to allow a 10% commission to his salesman, as against the 5 per cent he allows on sales to the wholesaler.

Toiletries and cosmetics	**Mark-up**	
Landed duty-paid price	100	
Importer to wholesaler	270	(170 per cent on 100)
Retailer to consumer	500	(85 per cent on 270)

The importer, in marking up his price to the retailer from the landed price, accounts for the following costs: Warehousing, breaking bulk, reshipping in small lots, soliciting and serving accounts, administration, overheads and profit. The very high final mark-up over the landed price — five times that price — is customary in this type of trade; the same margin of five times the factory cost is also usual in the domestic market.

STANDARD CAPITAL GOODS COMPRESSORS

	Price schedule	
Importers delivered price to distribution	50	
Distributor to wholesaler	56	(12 per cent on 100)
Distributor to dealer	75	(50 per cent on 50)
Dealer to user (i.e., list price)	101	(35 per cent on 75)

The user pays twice charged by the importer to the distributor.

EXPORT PRICE QUOTATIONS AND INCOTERMS

There are a number of common sale or trade terms used in international trade to express the sale price and the corresponding rights and responsibilities of the seller and the buyer. These are terms defined by the International Chamber of Commerce.

The purpose of Incoterms is to provide a set of international rules for the interpretation of the most commonly used trade terms in foreign trade. Thus, the uncertainties of different interpretations of such terms in different countries can be avoided or at least reduced to a considerable degree.

Frequently, parties to a contract are unaware of the different trading practices in their respective countries. This can give rise to misunderstandings, disputes and litigation with all the waste of time and money that this entails. In order to remedy these problems, the International Chamber of Commerce first published in 1936 a set of international rules for the interpretation of trade terms. These rules were known as "Incoterms 1936". Amendments and additions were later made in 1953, 1967, 1980, 1990 and 2000 in order to bring the rules in line with current international trade practices.

When exporter and importer agree on terms of delivery, they are legally binding themselves to four legal aspects of the transaction.

(i) Which costs are paid by the exporter, which by the importer.

(ii) Which documents the exporter will obtain at whose expense.

(iii) When the title to the goods and the responsibility for them passes from the exporter to the importer.

(iv) Where and when the goods are delivered.

The key features of each of the Incoterms 1990 is given below:

EXW — Ex Works

The seller's obligation to deliver the goods under this term is complete when he places the goods at the disposal of the buyer at his own premises or another place named therein, i.e., works, factory, warehouse, etc. not cleared for export and not loaded on any collecting vehicle. This term thus enjoins the minimum obligation for the seller. The buyer has to bear all costs and risks. This term should, therefore, not be used if the buyer cannot carry out the export formalities himself. The FCA term will be the best option. If the parties, however, agree in the contract of sale by their explicit wording, the seller could be made responsible for the loading of the goods on departure and bear the risk and the cost of such loading.

FCA — Free Carrier

Here, the seller's obligation to deliver the goods is complete when he delivers to the carrier nominated by the buyer at the named place cleared for export. If a person other than the carrier is nominated, the seller's obligation is deemed to have been fulfilled when the goods are delivered to that person. If the chosen place of delivery is the seller's premises, then he is responsible for loading. If it occurs at any other place, the seller is not responsible for unloading. This term can be used for any mode of transport including multimodal transport.

FAS — Free Alongside Ship

The term FAS has been modified in Incoterms 2000. Under the new terms, the seller clears the goods for export which is reversal from the previous Incoterms version requiring the buyer to arrange for export clearance. Under the term FAS, the seller delivers the goods by placing them alongside the vessel at the named port of shipment. The buyer bears all costs and risks of loss of or damage to the goods from that moment. This term can be used only for sea or inland waterway transport.

FOB — Free on Board

Under this term, the seller fulfils his obligation of delivery when the goods pass the ship's rail at the named port of shipment. From that point onwards, the buyer bears all costs and risks. The seller clears the goods for exports. If the intention is not to deliver the goods across the ship's rail, the FCA term should be used. This term can be used only for sea or inland waterway transport.

CFR — Cost and Freight

In CFR also, obligation of delivery is fulfilled when the goods pass, just as in FOB, the ship's rail in the port of shipment. The only addition is that the seller also pays freight necessary to bring the goods to the named port of destination but the risk of loss of or damage to the goods as also any additional costs occurring after the time of delivery are transferred from the seller to the buyer. Under this term, the seller clears the goods for export. This term can be used only for sea or inland waterway transport. If the parties do not intend to deliver the goods across the ship's rail, the CPT term should be used.

CIF — Cost, Insurance and Freight

Here again the delivery point is the goods passing the ship's rail in the port of shipment. The seller, however, pays the cost and freight necessary to the named port of destination and contracts

for insurance and pays the insurance premium and the risk of loss of or damage to the goods and additional costs occurring after the time of delivery are transferred from the seller to the buyer. The seller obtains insurance only for minimum cover. Should the buyer wish to have a greater cover he would either need to agree with the seller expressly or to make his own extra insurance arrangement. Clearance of goods for export is the responsibility of the seller under this term as well. It can be used for sea and inland waterway transport. If the parties do not intend to deliver the goods across the ship's rail, the CIP term should be used.

CPT — Carriage Paid To

CPT denotes that the seller delivers the goods to the carrier nominated by him. If subsequent carriers are used, the risk passes when the goods have been delivered to the first carrier. The seller must in addition pay the cost of carriage to bring the goods to the named destination. The buyer bears all risks and any costs occurring after the goods have been so delivered. Here too obtaining export clearance is the responsibility of the seller. It can be used for any mode of transport including multimodal transport.

CIP — Carriage and Insurance Paid To

This term corresponds to CPT except that under CIP the seller also has to procure insurance against the risk of loss of or damage to the goods during the carriage. The seller has, therefore, to obtain insurance and pay the insurance premium for a minimum cover. For any additional cover, the buyer need to either have express arrangement with the seller or make his own arrangement. Here again if subsequent carriers are used, the risk passes when the goods have been delivered to the first carrier and clearance of goods for export is the responsibility of the seller. The term can be used for any mode of transport including multimodal transport.

DAF — Delivered At Frontier

Under this term, the seller delivers by placing the goods at the disposal of the buyer on the arriving means of transport not unloaded, cleared for exports but not cleared for import at the named point/place at the frontier but before the customs border at the adjoining country. Since the term "frontier" includes the frontier of the country of export naming the point and the place in the term is of vital importance. For making the seller responsible for the unloading of the goods and to bear the risk and cost therefor explicit wording to this effect need to be included in the contract. The term can be used for any mode of transport when goods are to be delivered at a land frontier. When delivery is to take place in the port of destination on board a vessel or on the quay, the DES or DEQ terms should be used.

DES — Delivered Ex Ship

This term implies that the seller delivers the goods by placing them at the disposal of the buyer on the board the ship not cleared for import at the named port of destination. The seller bears all the costs and risks involved in bringing the goods to the named port of destination before their discharge. If the parties intend the seller to bear the costs and risks of discharging goods, then the DEQ term should be used. This term can used for sea or inland waterway or multimodal transport on a vessel in the part of destination.

DEQ — Delivered Ex Quay

The point of delivery under this term moves to the quay not cleared for import at the named port of destination. The sellers bears the cost of discharging the goods at the quay in addition to the cost and risk involved as per the term DES. The term DEQ has been modified in Incoterms 2000 and is a total reversal from the previous Incoterms version, in that under the modified DEQ

term the buyer clears the goods for import and pays all formalities, duties, taxes and other charges. If the buyer still wants the seller to undertake import clearance it should be made clear by adding an explicit wording. This term can be used only when the goods are to be delivered by sea or inland waterway or multimodal transport on discharging from a vessel on to the quay in the port of destination. If the parties intend to include in the seller's obligation the risk and cost of the handling of the goods from the quay to another place (warehouse, terminal transport station, etc.) in or outside the port, the DDU or DDP terms should be used.

DDU — Delivered Duty Unpaid

This term can be used irrespective of the mode of transport, but when delivery is to take place in the port of destination on board the vessel or on the quay the DES or DEQ terms should be used. Under this term, the seller delivers the goods to the buyer not cleared for import but not unloaded from any arriving means of transport at the named place of destination. The seller bears the costs and risks involved in bringing the goods thereto other than, where applicable, any duty for import in the country of destination. The term duty includes the responsibility for and the risk of the carrying out of the customs formalities, the payment of such formalities, customs duties, taxes and other charges. Such duty has to be borne by the buyer, so also any costs and risks caused by his failure to clear the goods for import in time. If the intention is to make the seller carry out customs formalities and bear the cost and risk resulting thereform as well as some of the costs payable upon import of goods, this should be made clear by adding explicit wording to this effect in the contract of sale. The responsibility, risk and cost for unloading or reloading will depend on whether the chosen place of delivery is under the control of the buyer or the seller.

DDP — Delivered Duty Paid

Under this term, the seller delivers the goods to the buyer cleared for import but not unloaded from any arriving means of transport at the named place of destination. Thus, all the costs and risks involved in bringing the goods thereto including, where applicable, any duty for import in the country of destination. Thus, this term represents the minimum obligation to the buyer and the maximum obligation to the seller. It should, therefore, not be used if the seller is unable to obtain the import clearance. If the parties wish the buyer to bear all risks and costs of the import, the DDU term should be used.

DOCUMENTS REQUIRED UNDER VARIOUS TERMS

EXW - Ex Works

- Commercial Invoice
- Buyer' receipt

FCA - Free Carrier

- Commercial Invoice
- Documents evidencing delivery to the carrier
- Export licence

FAS - Free Alongside Ship

- Commercial Invoice
- Documents evidencing delivery to the carrier
- Export licence

FOB - Free on Board

- Commercial Invoice

— Documents evidencing delivery to the carrier
— Export licence

CFR - Cost and Freight

— Commercial Invoice
— Documents evidencing delivery to the carrier
— Export licence

CIF - Cost, Insurance and Freight

— Commercial Invoice
— Documents evidencing delivery to the carrier
— Export licence
— Insurance policy

CPT - Carriage Paid to

— Commercial Invoice
— Transport documents
— Export licence

CIP - Carriage and Insurance Paid to

— Commercial Invoice
— Transport documents evidencing carriage of goods
— Export licence
— Insurance Policy

DAF - Delivered At Frontier

— Commercial Invoice
— Customary transport document warehouse warrant, block warrant or delivery order
— Export licence

DES - Delivered Ex Ship

— Commercial Invoice
— Bills of lading or
— Delivery order

DEQ - Delivered Ex Quary

— Commercial Invoice
— Bills of lading or Delivery order
— Import licence

DDU - Delivered Duty Unpaid

— Commercial Invoice
— Bills of lading or Delivery order

DDP - Delivered Duty Paid

— Commercial Invoice
— Bills of lading or Delivery order
— Import licence

Optional Documents

EXW, FCA, FAS, FOB, CFR, CIF, CPT, CIP, DES, DEQ, DDU

— Documents needed for export or transit of the goods through another country or for import clearance.

DAF - Delivered At Frontier

— Through transport documents and other documents needed for transit of the goods through another country or for import clearance.

INCOTERMS — A WORKED EXAMPLE*
(RESPONSIBILITIES OF AND COST TO THE EXPORTER)

A customer in Frankfurt, Germany, asks for a quotation for 3,000 pairs of shoes. You decide on a unit price of $ 2, giving a total price of $ 6,000 for the goods alone.

What are the additional costs of getting the goods to the customer? How is your quotation affected by the terms of delivery?

If you QUOTE	Price includes	Additional Cost ($)	Price ($)
EXW	**Ex works** Export packing, marking crates with shipping marks	300	6,300
FCA	**Free carrier** Carriage and insurance for delivery to railway station by road transport including insurance	100	6,400
FAS	**Free alongside ship** Rail transport to port (including insurance) and getting goods alongside ship	310	6,710
FOB	**Free on board** Dock dues, loading goods on board ship. Preparing shipping documents	100	6,810
CFR	**Cost and freight** Sea freight to Hamburg (nearest port Frankfurt) CIF Cost, insurance and freight Sea freight + marine marine insurance (port to port)	875 100	7,685 7,785
DEQ	**Delivered ex quay** Landing charges at Hamburg	90	7,875
DDP	**Delivered duty paid** — Import duty on 3,000 pairs of shoes — Transport by rail (Hamburg/ Frankfurt)	1,200 150	9,225
		1,350	

* Reproduced from ITC, *op. cit.*

INFORMATION REQUIREMENTS FOR EXPORT PRICING*

Type of Information Required

To explore the extent to which a producer/exporter can be competitive in selling its products, information is required on:

Costs

To enable comparative calculations to be made for each country of sale, which would show the extent to which the exporter can be competitive in each of the markets selected.

The costs to consider are made up as follows:

1. Factory Costs

These include prime costs, factory overheads. These include direct materials, direct labour, other direct cost or expenses, indirect materials, indirect labour, factory supplies and other indirect costs or expenses.

2. Selling and Distribution Costs and Margins

These cover:

(*a*) The manufacturer's or exporter's cost of selling his products, including salaries for all sales staff, travelling expenses, etc. Some selling and distribution costs are direct, such as sales commission and freight charges. Most, however, are indirect, such as salesmen's salaries, advertising, vehicle costs and salaries of distribution personnel.

(*b*) The cost of transporting the product to the market, including freight (sea, rail, air), insurance, port and landing fees, cost of documents, etc. These costs are related directly to the weight and/or value of the products exported and can therefore be considered as variable, or fixed on a unit basis.

(*c*) The cost plus profit charged by the importers and others in the chain of distribution for the performance of their specialised functions (selling, transport, storage, financing, invoicing, etc.). These costs are normally expressed as percentages on the landed cost or on intermediate selling. The margins or mark-ups added by importers and other distributors are usually firmly established. They vary from one product group to another, but variations within a product group tend to be slight. In effect, margins and mark-ups may be considered as variable costs or fixed on a unit basis.

3. Cost of Marketing Support and Development

This includes expenditure for advertising, sales promotion and similar activities. The total marketing support costs will depend on the exporter's advertising policy and may be fixed or variable accordingly.

4. Administrative Costs

These include salaries, office expenses, audit and legal fees, stationery printing, etc.

Foreign Markets

The size and nature of demand, and the nature and extent of competition.

The sources of information are the Ministry of Trade or the Export Promotion Organisations (in the exporting country), trade associations and chambers of commerce, commercial attaches, international organisations such as ITC, trade directories, technical journals, shipping agents and freight forwarders.

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* Reproduced from ITC, *op. cit.*

Prices

Constant review of prices is necessary, as pricing is by no means a simple affair. Modern marketing practice now generally accepts that products should be priced at what the market will bear. It is no longer wise to work on straightforward cost plus basis. Opportunities for profit can be lost if figures arrived at in this way are too low; sales opportunities can be lost if they are too high, relative to market levels as a whole.

Comparative price patterns may seem chaotic if considered by themselves. Published price lists may be misleading when they do not show special discounts, volume rebates, etc.

A manufacturer should use his own sales staff or department, and internal and external market research facilities, to build up a detailed body of knowledge of competitive activity in the home and overseas markets. He should also study competitors' reactions to his own price changes, which may give a clue to their pricing policies.

Good sales staff may elicit from customer contacts why orders are lost: price? quality? service? etc.

Checklist of Information Required

In the development of pricing information, the firm must:

(i) Examine the market in which it distributes its product;

(ii) Examine its own industry and other industries competing with it;

(iii) Consider government activities both from the legal view and the market to be serviced.

The above information requirements are shown below:

Information on the Total Market

What are the markets in which the product is sold?

Who are the significant competitors?

What is the size of the market?

What are the growth prospects?

How do different market segments interact?

Information on Competition

What are the competing products?

What do buyers require?

How much room is there for price changes?

What share of the market is held by competitors?

Are market shares changing?

What is the financial position of competitors?

What are the expected reactions to changes in the market?

Information on Prices

What are the price for competing products?

Is there a price leader?

What is the relationship between price and volume?

What are the expected reactions to changes in the market?

Information on Government Policies

How is the market influenced by government?

How are individual firms influenced by government?

Which firms are important suppliers to government?

Information on Production and Costs

What is the firm's present level of production, inventory?

What are the costs associated with these levels?

What effects would production and inventory level changes have on these costs?

What costs are relevant for the pricing decision?

If methods of cost allocation are not appropriate for pricing, is it possible to obtain different cost information which is relevant?

Information on Revenue and Profits

What are the revenue, profit, cost relationships for the product and the effect on other products?

What is the effect of volume on revenue and profit?

What are the firm's profit margins? Are they different from competitor's margins?

The list should be examined and gaps in information available filled in. Sources of information are not always accessible and specialist marketing research services may be needed. Information must be reliable. The degree of uncertainty should be minimised as much as possible.

REFERENCE

1. Philip Kotler, *Marketing Management* (New Delhi: Prentice-Hall of India Pvt. Ltd., 1994), p. 427.

11

INTERNATIONAL DISTRIBUTION

Place, i.e.placing the product, is one of the four Ps of marketing and it refers to the distribution of the product covering channels of distribution and physical distribution. Effectiveness of marketing depends, among other things, on making the product available at the right places and at the right time at the minimum possible distribution cost. It is well acknowledged that one of the most difficult areas in international marketing is distribution. In many markets, a very hard barrier to market penetration is the problem of distribution. The economic liberalisation in India has removed to a large extent the political barrier to entry; but many multinationals find it very difficult to penetrate the market. That is why many MNCs go in for joint ventures. It was mainly to get an access to the distribution system that the P&G forged an alliance with the Godrej Soaps. Joint ventures are very common in international business.

A distribution channel may be defined as "the path traced in the direct or indirect transfer of title to a product as it moves from a producer to ultimate consumers or industrial users". A distribution channel, in other words, is "the set of firms and individuals that take title, or assist in transferring title, to the particular good or service as it moves from the producer to the consumers."[1]

The above definition makes it clear that channels of distribution may consist of two categories of intermediaries or middlemen, viz.,

(*i*) Merchants who take title to the goods.

(*ii*) Agents who do not take title to the goods but who assist in the transferring of the title.

"Each member of a channel is a link in a distribution network of organisations that extends from the producer to the end-users of products or services. Although some firms perform all channel functions, typically several organisations are linked together in a distribution channel to carry out the various activities of storage, transportation, sales contract, service, sorting and repacking."[2]

INTERNATIONAL CHANNEL SYSTEM

Where international marketing involves exporting, two categories of marketing channels are involved, viz., *channels between the nations* and *channels within the foreign market.*

The International distribution system consists of two subsystems, namely, the domestic system and the foreign system. The nature of the channel system is affected by, among other things, by the method of exporting.

There are broadly two ways of exporting, namely, direct exporting and indirect exporting.

The indirect export involves home based independent middlemen who constitute the domestic subsystem. No such independent middlemen is involved in direct export. When the export is direct, the producer makes direct sale to any one or more of the foreign customers. The important kinds of foreign customers (Here, the word customer is used to refer to the firm/person who buys the product from the exporter) are importers, distributors, government departments, state buying organisations, industrial buyers, wholesalers, retailers, joint ventures/licensees and consumers. If any of these customers is not a final consumer, he is a marketing middlemen or channel member between the producer and the final consumer. Fig. 11.1 depicts an international marketing channel system.

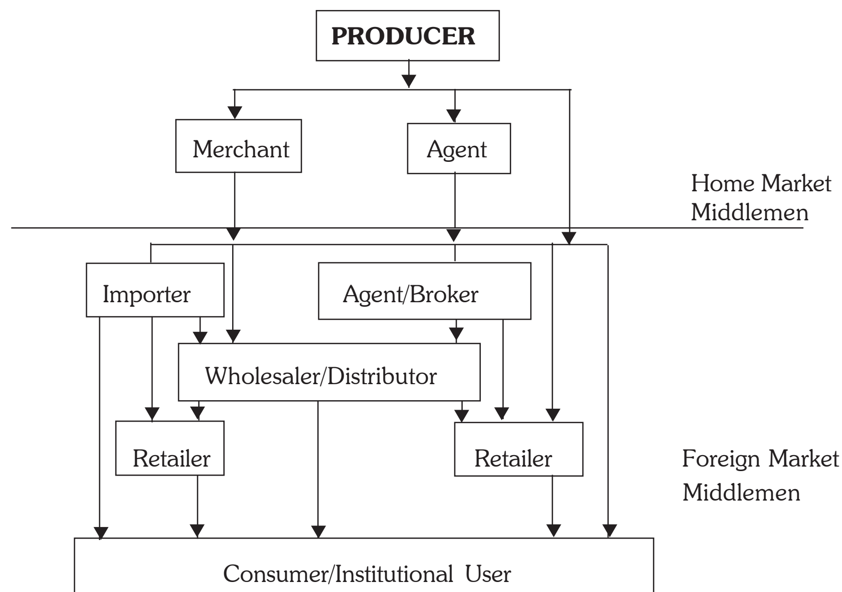

Fig. 11.1: International Marketing Channel System

Indirect Exporting

The distinction between direct exporting and indirect exporting is on the basis of how the exporter carries out the transactions flow between himself and the foreign importer or buyer. In indirect export, the manufacturer utilises the services of various types of independent international marketing middlemen or cooperative organisations. In other words, when a manufacturer exports directly, he transfers the responsibility for the selling job to some other organisation. On the other hand, in direct export, the responsibility for performing international selling activities rests on the producer. These activities are carried out by so-called dependent organisations that are administratively a part of the manufacturer's company organisation.[3]

The indirect method is more popular with firms which are just beginning their exporting activities and with those whose export business is not considerable. Indirect exporting has this advantage that

the firm does not have to build up an overseas marketing infrastructure. The risk involved is also less. This method is, therefore, advantageous for firms with small means and for those whose limited export business does not justify large investments in developing their own international marketing infrastructure.

The main disadvantage of the indirect method of exporting is that the development of the overseas market depends to a very large extent on middlemen and not on the firm producing the export goods.

Broadly, two alternative channels are available for indirect exporting, viz.,

(*i*) International marketing middlemen; and

(*ii*) Cooperative organisations.

1. Marketing Middlemen

There are two important middlemen — merchants and agents. The basic distinction between the merchant and the agent is that the merchant takes title to the product he sells, while the agent does not.

Export Merchants

The domestic based export merchant buys the manufacturer's product and sells it abroad on his own. When this type of middlemen is used in an international marketing channel, the marketing job of the manufacturer is reduced to essentially domestic marketing, and except for certain modifications in the product mix which are sometimes required to suit the international market, all aspects of the international marketing task are handled by this merchant.

Export/Trading Houses: In India, there are a number of merchant exporters including export houses and different categories of trading houses who export products procured from many manufacturers. Some companies have established their own export marketing subsidiaries (for example, HMT International Ltd.).

Trading Companies: A very important intermediary in international trade is Trading Company. Unlike an export house which concentrates on exports, a trading company is active both in exports and imports. In Japan, the general trading companies are known as sogo shosba and include such well-known MNCs as Mitsubishi, Mitsui and Itochu. The nine largest trading firms handle roughly half of Japan's imports and exports. Even large Japanese domestic companies buy through trading companies.[4]

Export Drop Shipper: In some countries, there is a special kind of export merchant known by such names as export drop shipper, desk jobber or cable merchant. "Upon receipt of an order from overseas, the export drop shipper in turn places an order with a manufacturer, directing the manufacturer to deliver the product directly to the foreign buyer. The manufacturer collects payment from the drop shipper who in turn is paid by the foreign buyer. Export drop shippers are common in the international marketing of bulky products of low unit value like coal and construction materials.[5]

Agents/Brokers

The second type of marketing middleman in indirect exporting is the domestic based agent. Unlike the merchant middleman, the agent does not take the title to the goods; he simply seeks overseas buyers for a commission. In this case, the manufacturer assumes all the financial risks.

There are different types of agent middlemen in the international marketing field. There are export commission houses or export buying agents who are representatives of foreign buyers residing in the exporter's home country. Then there are brokers, whose chief function is to bring the buyers

and sellers together, for which they are paid a commission, either by the buyer or seller. Finally, there are manufacturers' export agents, who represents several exporters whose interests are non-competing, and who offer selling and other services.

In some countries, there are export management companies (EMCs) who manage, under contract, the entire export activities of a manufacturer. An EMC is sometimes known as a combination export manager (CEM) because it may function as an export department for several allied but non-competing manufacturers. "When compared with export agents, the EMC has greater freedom and considerable authority. The EMC provides extensive services, ranging from promotion to shipping arrangement and documentation. The EMC provides extensive services ranging from promotion to shipping arrangement and documentation. Moreover, the EMC handles all, not just a portion, of its principal's products. In short, the EMC is responsible for all of the manufacturer's international activities.[6] EMC may be compensated in the form of a commission, salary or retainer plus commission.

2. Cooperative Organisations

The cooperative exporting organisations, which represents a cross between indirect and direct export, carries on exporting activities on behalf of several producers, and is partly under the administrative control of the manufacturers.

There are two distinct types of cooperative international marketing organisations:

(*i*) Piggyback marketing; and

(*ii*) Exporting combinations.

Under Piggyback marketing, also known as mother-henning or allied company arrangement, one manufacturer uses its overseas distribution facilities to sell the products of one or more other company/companies as well as his own.

As exporting combination is more or less a formal association of independent and competitive business firms, which are organised for the purpose of export marketing for the mutual benefit.

Direct Export

As the name indicates, direct export refers to the sale in the foreign market directly by the manufacturer. The manufacturer may make the sale directly to the foreign customers or to a middleman or middlemen located in the overseas market. In both the cases, the export is direct — manufacturer does not use any independent middleman in the channel between the home country and the overseas market.

Firms with considerable export business usually resort to direct exporting. Of course, the investment and risk involved in direct exporting are great; but so are the potential returns.

A number of organisational arrangements are available to a company for carrying on direct exporting.

(*a*) The export business may be conducted by a domestic based export department or division. There are four important types of domestic-based export organisations. (*i*) Built-in export department; (*ii*) Separate export department; (*iii*) Export sales subsidiary; and (*iv*) Export combination, or cooperative export company.

(*b*) The company may establish overseas sales branches or subsidiaries in addition to, or instead of, a domestic marketing department. An overseas sales branch enables a company to carry out the marketing activities in the foreign market more effectively. As a part of overseas sales branch, the company may also establish storage or warehousing facilities and place marketing on a strong footing.

(*c*) A company may employ travelling salesmen for the overseas market. These travelling salesmen may be home based or may be attached to the foreign branches or subsidiaries.

(*d*) Direct exporting may also be carried out by establishing contacts with foreign based distributors or agents. The distributors would buy the goods from the manufacturer and sell them in the overseas market, whereas the agents would sell on the manufacturer's behalf on commission basis.

The Direct exporting channels are shown in Fig. 11.2.

As mentioned earlier, if the buyer from the producer is not the final consumer, in several cases there will be other member(s) between the final consumer and the exporter as shown in Fig 11.1.

Channel(s) for the distribution of a product may be different in different countries. A channel which is effective in one country may not be effective or available in another country. For example, direct marketing has become very popular in the US but it is not significant in many other countries.

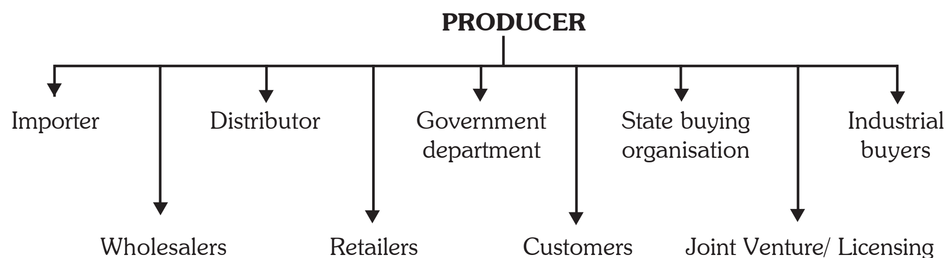

Fig 11.2: Direct Exporting Channels

Before discussing the influence of marketing environment on the choice of the distribution channel, let us take a general look at the common distribution channels or channel levels.

The channel levels refer to the number of intermediaries involved in the channel. The following are the channel levels:

(*i*) *Zero level channel,* also called direct marketing channel, is essentially characterised by the producer making a direct sale to the ultimate buyer. The three important ways of direct selling are: (1) Door to door; (2) Mail order and (3) Manufacturer-owned stores.

(*ii*) *One-level channel* is characterised by one selling intermediary like the retailer or the agent.

(*iii*) *Two-level channel* contains two intermediaries, e.g., wholesaler/distributor and retailer.

(*iv*) *Three-level channel* has three intermediaries, i.e., agents, wholesalers and retailers.

There are also higher level channels. Different channel levels are shown in Fig. 11.1. It should be noted that more than one channel are used by several companies (multi-channel strategy). For example, a book publisher may sell direct to the ultimate buyer and at the same time, use one-level (retailer) and two-level (distributor and retailer) channels. Similarly, textile companies like the Reliance and Bombay Dyeing make direct sales through their exclusive showrooms and at the same time use other channels.

In several cases, the distribution system is very complex and the extent of complexity may vary between markets.

TYPES OF FOREIGN INTERMEDIARIES

A brief account of the important foreign intermediaries is given below:

Importers

Although all the foreign customers who buy directly from the exporter are technically importers, here the term importer refers to one who imports the product in large quantities either as an agent

for a foreign buyer or for resale. Such importers include, among others, large import houses and trading houses like the Japanese trading companies mentioned earlier.

The importers who buy on their own account may sell the product to the distributors, industrial and other institutional customers, wholesalers etc.

Distributors

A distributor who buys directly from the exporter and holds large stocks of a product has an exclusive right to sell the product in a particular area or to a particular type of customer.

The distributor may resell the product to the wholesalers, retailer or consumers.

Wholesalers

Although wholesalers often buy from the importers or distributors, there are also wholesalers who buy directly from the exporters.

Retailers

Large retailers may buy directly from the exporters. Department stores, supermarkets or other types of chain stores are among the most important direct retail buyers. Other retailers may depend on distributors or wholesalers.

Multiple Channels

In some cases, an exporter may use multiple channels, i.e., more than one channel for a product. For example, an exporter may sell directly to the wholesalers, large retailers and institutional consumers, even while having dustributors.

Government Departments

In some countries, government departments buy large quantities of certain goods, often on a long-term basis. These are generally essential goods of mass consumption or for use in government departments.

State Buying Organisations

In some countries, the imports of goods are done by the government organisations, like state trading organisations. This was the case until recently in the centrally planned economies. In India, imports of several commodities are canalised, i.e., only designated government agencies can import these goods.

Joint-ventures and Licensees/Franchisees

A very important export marketing channel that is growing in popularity is the collaborative arrangement between exporter and foreign firm.

Joint-ventures, i.e., enterprises in which both ownership and management are shared by firms from two or more countries, are very common between firms from developed and developing countries.

Firms from developed countries may supply technology and participate in the equity in joint ventures in developing countries. The collaboration with the developed country firm becomes very helpful in marketing the product in the foreign countries. Such joint-ventures are very common in several industries including food processing industry.

Another type of international collaboration is the licensing or franchising.

MARKETING ENVIRONMENT AND INTERNAL DISTRIBUTION

As indicated earlier, the nature of the distribution system in a market is generally influenced by the relevant business environment. It is, therefore, quite natural that sometimes the nature of the physical distribution system in the foreign market is quite different from that in the domestic market. An international marketer from an advanced economy may find that some of the physical distribution facilities available to him in his home market are non-existent in the foreign market, especially in the less developed economies.

A particular distribution channel best suited for a product in one market may be inappropriate in another market. Sometimes, the exporter will have to take the existing distribution system in the foreign market for granted. For instance, when customers are accustomed to buying a particular product from a particular source, it is not easy to switch them to a different source.

Within-country channels of distribution vary considerably from country to country for consumer goods. As Fayerweather points out,[7] there are striking differences in the size distribution of retailing units. For example, food channels in the USA are dominated by the large supermarket chains; in France, supermarkets are progressing, but food retailing is still dominated by small merchants with modest stores; in India, food is sold mainly through thousands of individual tradesmen squatting in open markets or selling in tiny shops.

Second, the services provided by retailers vary considerably, with much more personal attention and bargaining in countries such as India than in western countries. As against this, in the high income countries like the USA, self-service is the dominant pattern. Third, the assortment of goods handled by retailers varies, tending toward greater specialisation in lower-income economies. Fourth, the retailing system tends to be stratified in levels that parallel the class structure of society. There will be exclusive stores that cater to the wealthy, others that serve the middle class, and still others, usually open markets and “hole in the wall shops” that sell goods to the low-income groups.

While supermarket and chain stores play a dominant role in certain markets like the US and Japan, in Europe they are not so well developed and in many countries they are either absent or are insignificant. The Daiei Inc., Japan’s largest retail group (and one of the world’s top three), which operates through nearly 200 superstores and thousands of convenience and speciality affiliate stores throughout Japan, is regarded as the retail outlet through which products of reputed quality from many countries reach 40 million Japanese households.

The large distribution firms are increasing their might in certain areas. For example, it is reported that ten years ago one large retail organisation took 10 per cent of the output of a major American food product; today one large retailer takes 45 per cent. Obviously, this leaves the manufacturer very vulnerable.[8]

Such mass merchandisers as the US giants *Sears and K-Mart* place huge orders with suppliers and keep large inventories. In Europe, however, there are not so many huge chain store operations. The buyers tend to be small, and they don’t stock much inventory. So when they want some inventory, they want it urgently. So exporters who are accustomed to selling the US; giants, encounter a different situation in Europe. However, the economic integration of Europe is likely to result in some restructuring of the channel system including the emergence of large chain stores.

The international retailing firms, i.e., firms operating in two or more countries, have been growing in importance. These include both general merchandise retailers and specialised retailers. There has also been a growth of international mail order business. *Sears, F.W. Woolworth, K. Mart* and *Marks* and *Spencer* are among the important general merchandise retailers. International specialised retailers include *Mothercare* (clothes and related items), Roche and Bobois (furniture) etc. There are also several international fast-food franchisers like *McDonald’s Pizza Hut, Burger King* and *Kentucky Fried Chicken.*

Because of the critical importance of distribution in developing business, several companies have been investing to build up a strong distribution infrastructure. For example, during 1974-84, the Japanese investment in the US grew at an average annual rate of 33 per cent. The bulk of this investment, over two-thirds, was in the wholesale sector and as such was geared towards building a distribution and marketing infrastructure for the Japanese imports.[9]

The distribution system of a country may have some other peculiarities too. For example, the trade in one or other product in several countries is characterised by ethnodomination which is defined as "a situation where an ethnic group occupies a majority position in a channel of distribution with respect to the ownership and control of physical and financial resources, or through the manipulation of social environment. The control is manipulated through the familiar coercive and collusive practices such as price setting (in both product and factor markets), exclusive dealing arrangements and discrimination among customers or suppliers.[10]

It is pointed out that a common model is an ethnic group, often a "stranger or sojourner minority, selecting or happening into a trade opportunity in a particular commodity. Members of the ethnic group then master the intricacies of supply and demand in world market for that commodity while learning the mechanics of foreign trade in the host country. Then, through time they become established and widely recognised as a reliable buyer or seller of the commodity. From this solid base, dominance is then established". In many cases of ethnodomination, it would be beneficial for the international marketer to co-opt rather than compete with the dominant ethnic group."[11]

Foreign companies often find it difficult to understand the complexities of the distribution system and to achieve effective distribution all by itself in many markets. It is particularly so in Japan. It is pointed out that Japan's distribution system is among the most complex and difficult in the world. In Japan, there tends to be a greater degree of involvement on the part of wholesalers. A rough estimate published by Japan's Manufactured Imports Promotion Organisation shows that, until recently the ratio of wholesale to retail sales was four to one in Japan, as compared to 1.6 to one in the US; 1.9 to one in Great Britain; 1.7 to one in West Germany and 1.2 to one in France.[12]

Many foreign affiliated companies failed in the Japanese market due to the difficulty of getting their goods out to the retailers. It is therefore, felt that choosing a right partner for a joint-venture arrangement can have a major impact on a firm's competitiveness. The right partner can serve as a cultural bridge between the manufacturer and the market. Nabisco is a good example of a company that has dealt appropriately with cultural differences. Establishing a joint venture with Yamazaki Bakery and using Yamazaki's distribution power, Nabisco then gave Yamazaki the initiative to develop new products for Japan. Knowing the tastes and preferences of the Japanese people, the company introduced cream sandwich crackers and followed traditional promotion methods on dealing with wholesalers and retailers. Sure enough, the new product was a big hit throughout the nation.[13]

In short, the distribution strategy for a market should be based on, among other things, the relevant environmental factors, as has been brought out by the different cases cited above. However, the basic factors which influence the choice of distribution channels within the foreign markets are the same as in the domestic market.

Factors Influencing Channel Selection

The important factors influencing the choice of channel(s) are the following:

(*i*) *Product Characteristics:* Product characteristics, like unit value, perishability, bulk, degree of product standardisation, complexity and service requirements, determine, to some extent, the way the product should be distributed.

(*ii*) *Market and Customer Characteristics:* Market and customer characteristics, such as the size and location of the market, the number and geographical dispersal of the customers, the frequency of purchase and the typical size of the purchase, customers' buying habits and susceptibility to different selling methods are important factors to be considered in the choice of the channel.

(*iii*) *Middlemen Characteristics:* Middlemen differ in their ability and willingness to carry out promotional activities and to push the product. The margin or commission for the middlemen is another important issue. The type of products dealt with by a particular intermediary should also be an important consideration. Further, the marketer may be restricted in his choice of channel by the non-availability of particular middlemen.

(*iv*) *Company Characteristics and Objectives:* The choice of the channel is also influenced by such factors as the company's size, financial strength, product mix, past channel experience, overall marketing policies and channel objectives.

(*v*) *Competitors' Characteristics:* Like any other marketing decision, the channel decision is influenced by the nature of the competitors. Sometimes, it may be appropriate to adopt a channel policy similar to that of the competitor, but sometimes it may be more profitable to design quite a different channel policy.

(vi) *Environmental Characteristics:* The channel design is also influenced by such environmental factors as the economic situation, social and cultural factors, the physical environment and government policies and regulations.

INTERNATIONAL LOGISTICS

The cost and efficiency of the distribution have direct relationship with the logistics. Logistics, therefore, is a factor which affects the competitiveness of a firm.

International logistics is defined as "the designing and managing of a system that contracts the flow of materials into, through, and out of the international corporation. It encompasses the total movement concept by covering the entire range of operations concerned with product movement."[14]

It follows from the above definition that logistics comprises of:

(*i*) Management of movement of raw materials, parts and supplies into and through the firm; and

(*ii*) Management of movement of finished products to the consumer.

The major objective of the logistics management is to make the physical distribution as effective as required at the lowest cost possible. Attempts to increase the effectiveness of the distribution may sometimes tend to increase the cost and attempts to cut costs may impair distribution effectiveness. The trade-off and optimisation, therefore, are often a complex problem.

Components of Logistics Management

Logistics management comprises of five major interdependent areas.

Fixed Facilities Location: The major consideration is the location of fixed facilities like production and warehousing in such a way as to maximise the total efficiency of the logistics system. Factors like future potentials of the markets, future plans of the company, competitive factors, political stability etc. are also import considerations.

Transportation: The modes of transportation, frequency of shipping etc. are determined on consideration of several factors such as the cost, speed, safety, lead time, transit time, type of product, natural environmental factors etc.

Inventory Management: The main objective of inventory management is to minimise the cost of the inventory while ensuring smooth supplies. Developments in inventory management by the customers, order processing and in the total logistics system have made inventory management both challenging and efficient.

Order Processing: The efficiency of order processing by the client as well as the company have important implications for inventory levels and other aspects of the logistics. Rapid order processing shorten the order cycle and allows for lower safety stocks on the part of the client. Exporters from developing countries like India face the challenge of coping up with such situations.

Materials Handling and Warehousing: Materials handling and warehousing are also an important part of the logistics management. The technologies in use in materials handling and transportation may be different in different countries. Differences in natural factors like climatic and weather conditions may also make warehousing requirements varied.

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12

INTERNATIONAL PROMOTION

Marketing Communication, or promotion, plays a very important role in marketing, both domestic and international. Even if a product is very good, it may not achieve full success unless the promotion is appropriate and adequate.

Simon Majaro aptly describes: "The word communication in marketing simply means the transmission of a message, to the buyer or the consumer or the channel of distribution, in which the supplying company aims to tell each one of these receivers why they should buy or handle the product. In other words, in its least sophisticated form communication aims to make potential buyers (or middlemen) more favourably disposed toward's the firm's offerings. It seeks to achieve these objectives by informing the recipient of the message of the existence of the product and its unique details or by modifying his attitude towards such a product or by enhancing his preference for one product against another."[1]

Communication performs one or more or all of the following functions:

(*i*) Making the potential consumers aware of the product.

(*ii*) Persuading the consumers to buy the product.

(*iii*) Motivating the consumers to buy the product by special incentives.

(*iv*) Reassuring the consumers and helping to overcome the post-purchase dissonance.

(*v*) Informing the channels about the product.

(*vi*) Motivating the channels to handle the product.

(*viii*) Promoting the image of the product.

(*ix*) Promoting the image of the company.

(*x*) Promoting the image of the country.

Promotion, being one of the four Ps of the marketing mix, to be successful, should be consistent with the other three ingredients of the mix.

MARKETING ENVIRONMENT AND PROMOTION STRATEGIES

Because of the differences in the marketing environment, promotion is often a very complex problem in international, particularly in multinational, marketing. As in the case of product, the SRC can result in the failure of the promotion.

As noted in Chapter 10, even when the same product is marketed in other countries without any modification, sometimes it is necessary to modify the promotional theme.

Reference has already been made in an earlier chapter to the governmental regulations of promotion. The governmental regulations can, however, be ascertained. What is often more difficult to understand is the socio-cultural environment. To drive home the message that making cake with its cake mix is a very easy task, a foreign company advertised in Japan that making cake with its cake mix was as easy as cooking rice. The Japanese housewives, who entertained a feeling that cooking rice was a skilled task, however, got agitated by this. This shows how the cultural factors make promotion too delicate a task.

Promotion is an area where many marketers do blunders. Foreign countries have their own customs, traditions and practices regarding trade promotion, gift-giving etc. Ignoring them could be disastrous. A foreign affiliated company, a joint venture formed with a Japanese partner, received clear instructions from the head office to advertise heavily at the initial stage. The Japanese partner accepted this proposal but at the same time proposed that allocations be made for promotional rebates to wholesalers and retailers. The foreign partner, however, did not accept this. In spite of heavy advertising, in TV and other media, there was not enough of the product out on the retailers' shelves because neither the wholesalers nor the retailers had been given any incentive to push the company's products. Not surprisingly, the company was burdened with a colossal loss.[2] Similarly, the Procter & Gamble also blundered in the Japanese market. In the beginning P&G tried to work with virtually every wholesaler and used its tried and true US style price of promotions. As a result, the company failed to establish close relationship with wholesalers and sparked devastating price wars among wholesalers. The company found itself with poor distribution and little in-store display support. P&G, however, became successful later after it has revamped its marketing strategy. The company then worked closely with 100 wholesalers, down from the original score of 400 and no longer offers discount promotions.

It may be noted that the Japanese rebate, entertainment and gift-giving practices differ significantly from Western practices and it is particularly important that these be recognised and understood. Some of the rebate or kick-back practices unique to Japan, such as those for purchasing agents, have evolved from the traditional custom of giving special monetary gifts on occasions of celebration or mourning in order to strengthen ties of fellowship.

In the United States, many retailers ask for 'slotting allowances' which are really payments by manufacturers to get their lines into the cabinet. There are also promotional allowances and penalties for lack of movement in the cabinet for new product.

Thus, each market may have its own characteristics relevant to promotion, be it dealer promotion or product promotion in general. What works well for one market may not suit another market. In the mid-1970s when the Poloroid introduced its path-breaking SX.70 camera in Europe, the company employed the same advertising strategy — including TV commercials and print ads — it had used in the triumphant launch of the product in the US. Although the product was really universal, the TV commercials featuring testimonials from personalities well-known in the US did not produce results in Europe. Having learnt a lesson from this experience, when, decade later, Poloroid launched a programme of Pan European advertising to reposition the product, the company looked for inspiration in the various advertising practices of European subsidiaries. Although the product was universal *communication* adaptation was the appropriate strategy and not *straight extension*.

Besides the socio-cultural factors, standardisation of the promotional strategy are made difficult or impossible by government regulations or non-availability/under- development of certain promotional media. For example, although in many countries, TV is a very important medium, particularly for

promotion of consumer goods, in several developing countries telecast coverage is limited and this is either a government monopoly or under strict government control and ad space available is limited.

Similarly, while direct marketing has become very important in some countries, it is very insignificant in many countries. Now coming second only to TV in market share of the US advertising, direct sales brings in more sales per annum than all US department stores combined. Once reserved for consumer products, it is now also extensively used in business sales, promoting everything from computers and copiers to heavy industrial, farm and construction equipment. Integrated direct marketing (IDM) which combines various media — TV, radio, print ads, direct mail, telemarketing etc. is also growing in importance in countries like the United States.

It may be possible to overcome some of the barriers by employing suitable strategies. A US company, Cascade Corporation, thus got around the distribution barrier in Japan by using a pull-through strategy that focused on visits directly to end-users. The company had to sell its lift truck attachments primarily through a network of several hundred Japanese dealers. As most of them were promoted by the competitive Japanese manufacturers, the dealers promoted the competitor's, products at the expense of Cascade. To overcome this problem, the company started talking directly to the end-users, through its eight sales people and two service representatives. This strategy along with the improvements in deliveries, after sales service and pricing enabled the company to double its market share in three years from 15 per cent to 30 per cent.[3]

When the electronic giant Matsushita Electric Industrial Company, manufacturers of electronic goods under the brand names of National and Panasonic, planned to introduce rice cooker in India, as National Nippo, it was felt that there would not be many consumers who would be willing to pay ₹ 1450 for a gadget which was just a rice cooker. Therefore, a promotional strategy that would increase its utility to make it worth the price containing recipes of a host of dishes ranging from pulaos, biriyanis, soups, stews, fried or roasted chickens and desserts that could be cooked, the rice cooker was given free with it. Thus, an ordinary rice cooker has been converted into a versatile appliance without any modification to the product. It may also be recalled here that the western concept of mixer got modified in India by using a heavy motor to grind rice, dal etc.

In short, in many cases, the promotion strategy will have to be tailor-made to suit the particular marketing environments.

MAJOR DECISIONS IN INTERNATIONAL MARKETING COMMUNICATION

The important steps in developing an effective communication are the following:

Identifying the Target Audience

Even for the same product, the target audience may be different in different countries. For example, certain consumer durables which are used even by the low income groups in the advanced countries may be used only by high income groups in the developing countries. In several cases, the need satisfaction by the product varies between markets. For example, bicycles are basic means of transportation in countries like India and the important category of consumers are small farmers, blue-collar workers and students. In some of the advanced countries, bicycles are used for sporting and exercising and hence the target audience is different. Again the decision-making roles of different categories of people are not the same in all the markets. All these indicate that the target audience may not be the same in all the markets.

Determining Communication Objectives

The communication objectives also may be different in some cases. For example, when the product is in the introduction stage in a market the emphasis of communication could be on consumer

education and creation of primary demand. In a market where the product is at other stages of the life cycle, the communication objectives would be different. If there is a serious new competition in one market, fighting competition could be a major objective of advertising in that market at that time.

Determining the Message

Kotler points out that "formulating the message will require solving four problems: what to say (message content), how to say it logically (message structure), how to say it symbolically (message format), and who should say it (message source)".[4]

Quite obviously, the decisions regarding the message content, message structure, message format and message source are influenced by certain environmental factors like cultural factors and legal factors. The differences in the environmental factors among the countries may, therefore, call for different messages so as to be appropriate for each market.

Budget Decisions

The size of the total promotional expenditure and the apportioning of this amount to the different elements of the promotion mix are very important but difficult decisions.

The common methods used to set promotion budgets are the following:

Affordable Method: Set the budget at what the company thinks it can afford.

Percentages of Sales Method: A certain percentage of the sales is set apart for promotion.

Objective and Task Method: Involves determining the communication objectives and the tasks involved in achieving the objectives and estimating the expenditure requirements for performing these tasks.

Competitive Parity Method: The budget is set at that level which matches the promotional expenditure of the competitors.

Communication Mix Decision

Difference in the marketing environment may necessitate variations in the communication mix because a channel or medium that is very effective in one market may not be so effective in another market. Some channels which are effective in certain markets may not be available or underdeveloped in some other markets. More about the communications mix is given in the next section.

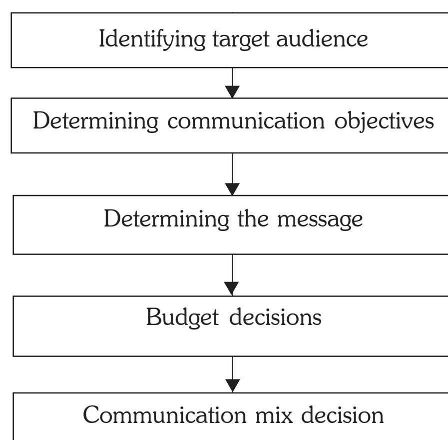

Fig. 12.1: Steps in Developing Marketing Communication

COMMUNICATION MIX

The communication mix, also called promotion mix, has four major elements (or tools or channels), viz., advertising, sales promotion, personal selling and public relations. Which communication tool or tools should be used or the nature of the mix is determined by the marketing environment and the company's objectives and resources.

Advertising

Advertising is defined as any paid form of non-personal presentation and promotion of ideas, goods or services by an identified sponsor.

Advertising regulations differ between countries.

The relative effectiveness of different media may be different in different countries. Similarly, media availability and efficiency may also vary.

Mass Media Advertising and Direct Advertising

Given the resource constraints and the small volume of business of Indian exporter, in many cases direct advertising is preferable to mass media advertising.

Mass media are media which reach large number of the general public like TV, newspapers, magazines etc.

Direct advertising is marketing communication addressed directly to the specific customers targeted.

Indian exporters would have difficulties to compete with the large mega-budget mass media advertisers in the foreign markets.

Important types of direct advertising are sales literature and samples and gifts.

Sales Promotion

Sales promotion is defined as short-term incentives to encourage purchase or sale of a product or service.

Sales promotion includes many things like trade fairs and exhibitions, samples, gifts, contests, games, lotteries etc.

Regulations regarding sales promotion differ between countries.

Trade fairs and exhibitions are effective promotion methods for small exporters. Details are given in a separate section in this chapter.

Personal Selling

Personal selling is defined as oral presentation in a conversation with one or more prospective purchasers for the purpose of making sales.

Personal selling may be preferable when the product is technical in nature, is of high unit value, and the number of customers is limited.

Sometimes, personal selling could be an effective promotion tool for consumer goods also. Details about personal selling is given later in this chapter.

Public Relations

Public relations include a variety of programmes designed to improve, maintain, or project a company or product image.

An important form of public relations is getting positive news and reports about the product or company released through media. This is of particular significance to new products.

The export promotion organisations in India have a great role to play in promoting India's exports through public relations.

ROLE OF EXPORT PROMOTION ORGANISATIONS

Export promotion organisations like Export Promotion Councils (EPCs), Export Development Authorities, Commodity Boards, India Trade Promotion Organisation (ITPO), Exim Bank etc. can play a very important role in promoting Indian products abroad.

These organisations undertake export marketing communication by:

(*i*) Advertising

(*ii*) Sales Promotion

(*iii*) Public Relations.

Export marketing communication by these organisations is not for the benefit of any particular firm. These organisations aim at promoting the Indian products.

These organisations can be instrumental in:

(*i*) Creating awareness about India's export potentials.

(*ii*) Impressing foreigners about India's industrial advances and technical capability.

(*iii*) Improving the quality image of India.

The role of these organisations assume greater importance in the light of the small size and resources of the Indian exporters.

Apart from the publicity for the Indian products by advertising and public relations, they play a very important role in sales promotion. The Export Promotion Councils, Trade Development Authorities and Commodity Boards sponsor trade fairs. For example, the Marine Products Export Development Authority organises, in collaboration with the Seafood Exporters' Association, an Indian Seafood Fair in India every alternate year which attracts potential buyers from different countries. The Spice Fair and Spice Congress organised by the Spices Board have considerably helped in promoting Indian Spices. Similarly, other organisations sponsor international fairs of the respective products.

These organisations also help in the participation of Indian exporters in the fairs held abroad.

The export promotion organisation could be of help to the exporters in formulating communication strategies.

They can also play an important role in sponsoring buyer-seller meets.

The *strategic market entry support* scheme of the Export-Import Bank of India helps Indian firms in identifying products with export potential and right market segments and in formulating suitable promotion strategy.

The *Darjeeling logo* promoted by the Tea Board and the feature on the Darjeeling tea telecasted in some foreign countries helped to boost the image and sale of the Darjeeling tea and to check the sale of bogus products.

The functions of ITO are described in the chapter on *'Export Promotion.'*

In short, export promotion organisations can play an important role in promoting abroad the Indian products.

TRADE FAIRS AND EXHIBITIONS

Trade fairs and exhibitions, by bringing potential buyers and suppliers in contact and imparting information about the relevant development around the world, play an important role in international

marketing. In certain cases, they have a special significance. For example, in Libiya, where media advertisement for products is not permitted, the annual Tripoli International Trade Fair is very important means to promote business. Friendly countries are also permitted to hold single country/single product exhibition and trade fair.

A trade fair, as its name implies, is target directed. It is staged for the purpose of selling goods or demonstrating new ideas and techniques. An exhibition, on the other hand, is not specifically for trade but for the public.

There are two type fairs, viz.,

(*i*) *General fairs*, also known as *horizontal fairs;* and

(*ii*) *Specialised fairs,* also known as *vertical fairs* and *solo fairs.*

At a general fair, the goods displayed cover many different fields. A specialised fair concentrates on products of a particular industry or group of industries. Within that industry or group, a large number of products may be on display.

The general fairs attract visitors of all ages, tastes and types and, therefore, is a good place to show consumer goods or new products that needs to be seen and accepted. National pavilions are often built for general fairs and in them the government organises an exhibition that gives the visitors a good idea of country's industry, agriculture, way of life and tourist attraction as well as products it wishes to sell abroad. In other words, the purpose is largely to build up an image of the country in the public mind.

If the product that an exporter, actual or potential, wishes to display is one that interests a specific group of buyers and especially if it is technical in nature, the specialised fair is probably the better choice. Many prefer the specialised fair because it is not open to general public (or open only at specific times) and people who come have both an interest and some knowledge of the product.

There are many well-known international trade fairs held at regular intervals like the *Anuga Food Fair* at Cologne, *Hannover Engineering Fair, Sport Goods Fair* held in USA etc.

Trade fairs are beneficial in the following ways:

In countries where media advertising is not permitted, fairs and exhibitions have a particularly important role in trade promotion.

International fairs bring together at a convenient place potential buyers and sellers from all over the world and facilitate broader communication and information dissemination.

Fairs and exhibitions provide the sellers opportunity to promote their products and to contact both existing and potential customers. They get an opportunity for direct interaction and feedback.

Fairs and exhibitions provide an opportunity to know the developments and trends in the industry concerned. In trade fairs/exhibitions, participants include not only the manufacturers/sellers of the final products but also the suppliers of machinery and technology, raw materials and intermediates, packaging devices and materials etc.

They also often enable participants and visitors to know about business opportunities, government policies, assistance packages etc. For example, at the Indian Seafood Fair, the Seafood Exporters Association and the Marine Products Export Development Authority seek to give wide publicity about the government policies and assistance for the development of India's seafood export industry, including the scope for foreign participation.

Fairs and exhibitions facilitates gathering of competitive information.

Fairs and exhibitions may help the manufacturers in improving the sourcing of technology, materials and buyers. Similarly, they help the buyers in improving the sourcing of supplies.

Trade fairs and exhibitions, thus, provide multiple benefits to both the manufacturers/marketers and the buyers. Fairs and exhibitions often generate considerable amount of business inquiries and business for many participants.

Broadly, there are three categories of trade fairs/exhibition visitors. They are:

(i) Those who may be curious or show an interest but are not potential customers. This category includes different types of "nuisance" visitors.

(ii) Those who demonstrate a genuine interest. This category includes potential customers and influential people like VIPs and journalists.

(iii) Those with a keen interest in the product or service now and who are definitely prospective customers.

PERSONAL SELLING IN INTERNATIONAL MARKETING

As Stanton says, "personal selling is the personal communication of information to persuade prospective customer to buy something — a product, service, idea or something else. This is in contrast to the mass, impersonal communication of advertising, sales promotion and other promotional tools."[5]

Personal selling may involve personally contacting, for promotion, the prospective final consumers and/or the members of the channels of distribution.

Importance and Advantages of Personal Selling

Personal selling is one of the most effective methods of marketing communication. Stanton observes: "The goal of all marketing efforts is to increase profitable sales by offering want satisfaction to the market over the long run. Personal selling is by far the major promotional method or tool used to reach this goal. More than ever, sales people today are a dynamic power in the business world."[6]

In some situations, personal selling can be an effective method to overcome certain marketing barriers. The success of the US company Cascade Corporation in Japan, mentioned earlier, is a case in point.

Personal selling has contributed to export success of some Indian products. For example, one of the most important factors which contributed to the sales success of the Supermax shaving blades in London was the door-to-door sales.

Stanton points out that the efforts of sales people have a direct impact on such diverse activities as:[7]

(*i*) The success of new products.

(*ii*) Keeping existing products in strong market positions.

(*iii*) Constructing manufacturing facilities.

(*iv*) Opening new business and keeping them open.

(*v*) Generating sales orders that result in shipping products to consumers all over the world.

Besides the five points mentioned above by Stanton, personal selling has several other merits, viz.:

(*vi*) As personal selling involves direct dialogue with the customers, it is the most effective promotional method.

(*vii*) Personal selling also helps in getting a better feedback about the product and company's marketing efforts.

(*viii*) Personal selling also helps in the marketing intelligence.

(*ix*) Personal selling makes customer grievance handling easy.

(*x*) For firms which cannot compete in advertising with megabudget advertisers, personal selling is an effective alternative.

(*xi*) Personal selling can be an effective supplement or follow-up to the lead provided by advertising or other communication methods.

(*xii*) One great advantage of personal selling is its flexibility — it could be made suitable to each customer or situation.

(*xiii*) Another merit of personal selling is its personal touch.

(*xiv*) Unlike mass media advertising or some other promotion methods, personal selling has a specific focus.

(*xv*) Personal selling is the most effective method in explaining product features and clarifying customer doubts.

(*xvi*) Another very important feature of personal selling is that "it results in the actual sale. Advertisements can attract attention and arouse desire, but usually they do not arouse buying action or complete the sale."

Limitations

(*i*) A major limitation of personal selling is its high cost in advanced countries.

(*ii*) The success depends to a large extent on the ability and sincerity of the sales personnel.

(*iii*) If a salesperson quits suddenly, it may cause dislocations and related problems.

MANAGEMENT OF PERSONAL SELLING

Management of personal selling involves several aspects like management of the ways of personal selling, management of the process of personal selling and management of the sales personnel.

Ways of Personal Selling

With reference to where and how the prospects are contacted, there are three broad ways of personal selling.

1. Meeting the Prospects in the Foreign Markets

The foreign prospects are met in their respective places in the foreign markets. This may be done by:

(*a*) *Company's Travelling Salesmen Attached to the Headquarters:* In this case, the salesmen operating from the home country base travel in the foreign markets for personal selling. This is done by companies which do not have offices in foreign countries or by companies which do not require full-time foreign based salesmen.

(*b*) *Company's Salesmen Attached to the Company's Office in the Foreign Market:* This is a common practice with companies having marketing offices abroad and which are in need of the services of full-time sales personnel. Such companies have the advantage that they can employ local personnel (i.e., persons from the respective foreign markets) who may be in a better position to deal with the local market than the persons from the home country.

(*c*) *People Temporarily Hired:* If a company does not need sales personnel permanently, this is the way. In some cases, a company may need personnel selling during certain periods like product introduction, market entry or special marketing drive. Local people may be hired for such short-term requirements. The cost would also be very low as this would not involve several benefits which permanent employees are entitled to.

2. Meeting Prospects at Trade Fairs and Exhibitions

Trade fairs and exhibitions are regarded as very effective method of export promotion because they enable a firm to meet many prospective customers at one place without incurring much expenditure. There are broadly two categories of fairs and exhibitions.

(*a*) International fairs/exhibitions held in India, like the Indian Seafood Trade Fair held every alternate year in India which attracts a large number of foreign customers from different countries.

(*b*) International fairs/exhibitions held in foreign countries like the Anuga Food Fair at Cologne, Hannover Engineering Fair etc., which attract very large number of prospective customers from a number of countries.

3. Visiting Foreign Buyers

Many foreign buyers visit India and other sources of supply of the goods they are interested in. Sometimes, such visits are at the initiative of the foreign buyer who wants to understand well the supply conditions and to enlarge his sourcing. Sometimes, foreign buyers visit at the invitation of the exporter. Export promotion organisations like ITO, EPCs etc., may also arrange buyer-seller meets. An exporter may seize such opportunities to meet the visiting foreign buyers.

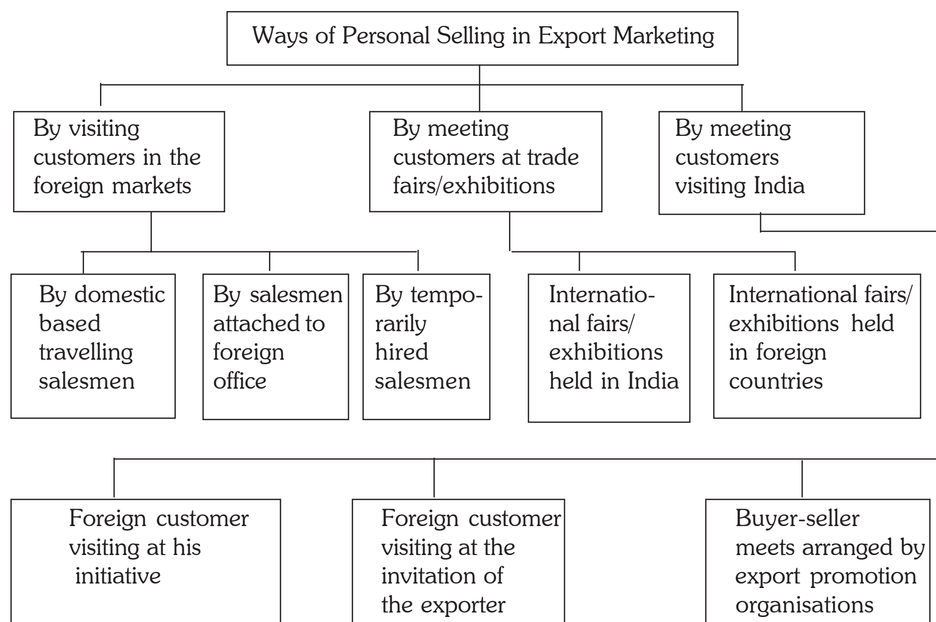

Fig. 12.2: Ways of Personal Selling in International Marketing

MANAGEMENT OF SALES FORCE

Management of sales force encompasses various steps from selection of the sales force to evaluation of their performance.

The important steps are the following:

Selection

The first step in the sales force management is the selection of the right persons for the job.

It is implied that the selection process starts with an appropriate job description and specification of the qualities required for the salespersons.

Due weightage should be given for the special requirements of the international marketing management. The salesmen should be fluent in English and should have working knowledge of the respective foreign language, besides the other qualities required for a salesman. Sufficient relevant previous experience should be a desirable factor.

Induction and Training

The newly hired sales should be familiarised with the company and its environment and given the right training needed for the job. Training is not a one-time affair. Periodic training will be helpful in upgrading the sales force.

Training for international marketing should also include courses in different aspects of the international marketing management, and all relevant details pertaining to the foreign markets. A fairly good understanding of the cultural factors is a must. The ways of greeting people, likes and dislikes, mannerisms, party habits, table manners, adherence to appointment timing, social relationships habits, negotiation styles, etc. may vary widely between different countries. A salesman who does not understand the idiosyncrasies of each of the foreign market he serves, is likely to fail the company.

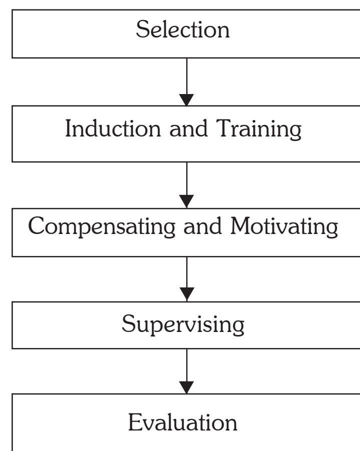

Fig. 12.3: Steps in Management of Sales Force

Supervising

Supervision of the sales force is important because supervision serves both as a method of continuation training and as a devise to ensure that company policies are being carried out. Still another value of sales force supervision is that it affords a two-way channel of communication between management and the sales force.[8]

Motivation is also a part of supervision.

Supervision becomes difficult for companies which do not have offices in the foreign country.

Personal supervision by a field supervisor or some other sales executive is effective but if the number of sales representatives is too small, say one or two, it becomes very costly. Supervision can also be exercised by regular periodic reports by salesman.

Compensating and Motivating

Method of compensation and reward systems is another important ingredient of the sales force management. They should sufficiently motivate and reward the sales force and should produce the desired results for the company.

Companies, generally, offer both financial and non-financial rewards for the sales force. The non-financial rewards include opportunities for advancement, recognition of efforts and a feeling of belonging. There are two types of monetary rewards, namely direct monetary payments and indirect monetary payments like paid vacations, pensions, insurance plans etc.

The direct monetary payment schemes of many companies combine both salary and commission.

Many exporters in India pay, in addition to the salary, a commission to the marketing personnel.

Evaluation and Control

Management of the sales personnel will not be complete without evaluation of their performance. Meeting sales targets is only one of the several criteria for evaluation. Other factors considered for evaluation include relationship with customers, holding of old accounts, opening new accounts etc.

One of the purposes of evaluation is to take corrective measures, if needed, to achieve the objectives.

PERSONAL SELLING PROCESS

One of the important aspects of the management of personal selling is the management of the personal selling process.

Effective personal selling is in fact a process involving a logical sequence of steps or actions described as the five Ps of personal selling. These 5Ps are the following:

Pre-sale Preparation

Effective personal selling has certain prerequisites. One of them is pre-sale preparation. It is not sufficient that a salesperson is conversant with the techniques of selling. It is equally important that he is well acquainted with the selling environment — like the nature of the market and competitors, characteristics of the prospects — in addition to perfect knowledge about the product and the company.

Prospecting

Prospecting involves drawing up a profile of the prospects, i.e., prospective customers, using relevant sources of information. In other words, this step involves identifying the potential customers for personal selling.

Preapproach

This refers to the collection of all relevant information about the customer whom the salesperson intends to call on. This is necessary for formulating a suitable approach for dealing with the customer. Even personal habits of the customer (if the customer is an organisation, the concerned person/ persons in the organisation) may be important.

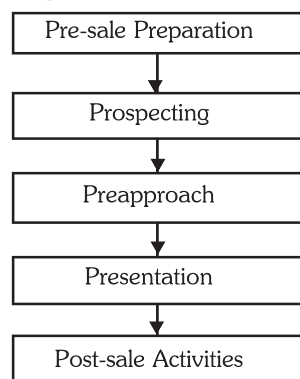

Fig. 12.4: Personal Selling Process

Presentation

The actual sales presentation often aims at the AIDA principle or formula. That is the presentation should attract the attention of prospects, arouse interest, create a desire, which will finally result in the desired action, i.e., sale (or any other predetermined objective).

Post-sale Activities

The personal selling process does not end with making the sale. There are several post-sale factors that the salesman should attend to. Customers should be visited again and if they have any complaints they should be attended to. It is also necessary to minimise the customer's dissonance, if any.

PROBLEMS IN INTERNATIONAL MARKETING COMMUNICATION

Development of appropriate international marketing communications is a difficult task because of several complexities and intricacies. Important problems or factors which make the development of international marketing communication difficult are the following.

(i) Differences in Regulations

Regulations governing promotion vary widely between countries. An exporter has to understand these regulations thoroughly and ensure that the promotion programmes are in conformity with such regulations of each country concerned. A communication strategy or approach that is permitted in one country could be illegal in another country.

(ii) Cultural Differences

Cultural factors have utmost consideration in designing the advertisement strategy, particularly the message design. The cultural factors, however, are very complex and difficult to understand. What may appeal very well to people of one country may be distasteful or even offending to people of some other countries. The differences in the beliefs or attitudes associated with colours, numbers, symbols etc., are well-known. The differences in the consumer behaviour and consumption habits are also very import factors to be considered in designing the communication strategy.

(iii) Media Factors

The effectiveness of media, the availability of media, the cost of media etc. differ between countries and this may call for different promotional media strategies in different countries.

(iv) Infrastructure

Besides the availability and efficiency of the promotional media, there are several other infrastructural factors which affect marketing communications like the availability and equality of advertising agencies, marketing research firms etc.

(v) Cost Factors

The cost of promotion, particularly advertising, in advanced countries is often prohibitively costly for Indian exporters who, in general, are of small means. The advertisement outlay should normally be very large if it should have any impact.

(vi) Language Factors

There are many instances of the language causing problems in international marketing communication. Word by word translation of Ad slogans and the like into certain foreign languages sometimes give different or distorted meanings. Similarly, as mentioned in an earlier section, the same word may have different connotations in different languages. Even some of the English words mean different things in different English speaking countries.

(vii) Home Country Regulations

There may also be home country regulations which affect promotion. For example, Indian exporters are confronted with certain Government of India/Reserve Bank of India regulations regarding promotion abroad like the restrictions on expenditure abroad for promotion.

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6. *Ibid.,* p. 440.
7. *Ibid.,* p. 440.
8. *Ibid.,* p. 454.

13

EXPORT FINANCE

The international market is generally very competitive and sensitive and the credit facilities made available to the buyers are one of the important determinants of export business.

The extent to which credit must be extended to the importer depends on the sale terms. If the exporter gets cash in advance, there will not be any problem in respect of finance; but this is not common. Even if the exporter gets the payment at the time of the shipment of the goods, he has to make his own arrangements to meet his financial needs at the pre-shipment stage. If the sale is on credit, as it usually is, the exporter will be still more constrained financially. It is, therefore, necessary to make institutional credit available to the export sector to meet its pre-shipment and post-shipment financial requirements; for such credit facilities will enable the exporters not only to meet their financial requirements at the pre-shipment stage but also to extend reasonable credit facilities to foreign buyers.

Sometimes, institutional credit is extended to foreign buyers instead of to exporters. The buyer's credit is extended, usually, to the buyers of capital goods.

PAYMENT TERMS

Some knowledge of the important payment terms and methods of effecting payment would be useful to understand the export financing methods and process. The credit requirements of the exporter depends to a very large extent on the sale terms.

A sale contract should clearly specify when the payment will be made, where it will be made and how it will be made. As the payment terms are determined on the basis of the specific circumstances of the particular buyer and seller, it would be difficult to make any generalisation about payment terms. However, there are certain standard terms, which are in common use.

Cash in Advance

The most advantageous payment term from the seller's point of view is the remittance with the order, or sometimes, before the shipment of goods. The remittance may be made by draft, cheque, mail or telegraphic transfer. Very seldom is an importer prepared to make cash payments in advance; but in certain cases it becomes necessary. For instance, advance payment may be insisted upon when goods ordered are those manufactured to order in accordance with the specifications of the buyer. Further, when the buyer is unknown to the seller or his creditworthiness is doubtful, the seller would like to get the payment in advance.

If the seller enjoys a monopoly position or if there is a seller's market, it is easy to obtain advance payment; but when the market is very competitive, it is very difficult to do so.

Open Account

Under trading on open account, the exporter ships the goods with no financial documents to his advantage except the commercial invoice. Under this method, therefore, the seller carries the entire financial burden with little or no documentary evidence. Because of the great risks associated with the open account method, it is generally restricted to cases of transactions between inter-connected companies, or where the exporter and overseas buyers have had a long and well-established commercial relationship, and when there are no exchange restrictions that complicate the settlement. Indian exporters are allowed to sell abroad on the open account basis only with the special permission of the Reserve Bank of India. Normally, this permission is given only to foreign companies operating in India.

Consignment Sale

Under the consignment sale, the exporter consigns the goods to his agent or representative in the foreign markets, who arranges for the sale of the goods and makes payments to the exporter. Goods consigned abroad include tea, coffee, wool, etc., which cannot be easily standardised. Under this method, the exporter retains the title to the goods until the sale of the goods is effected in the foreign market. The consignment sale involves a number of risks for the exporter. As no bill of exchange is involved under this method, the seller is not protected against default. He is also exposed to such risks as exchange fluctuations and the loss that may arise if the consignee is inefficient or is not sincere and honest.

An Indian exporter selling goods on consignment basis must furnish a declaration regarding the full export value of the goods or, if the full export value of the goods is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in the overseas market.

Documents against Payment

Under the D/P terms, also known as cash against documents (c.a.d.), the exporter ships goods to the foreign buyer, but the documents giving title to the goods will be handed over to the buyer through the bank only on payment. Under this type of transaction, until and unless the buyer makes the payment, the ownership of the goods remains with the seller.

The exporter may obtain bank finance against D/P bills. If the bank is satisfied, it may finance the exporter by purchasing the D/P bills, usually on a with recourse basis, so that, in the event of non-payment by the drawee, the bank has recourse to the drawer.

Documents on Acceptance

Under the D/P method, the documents and the title to the goods are handed over to the buyer when he accepts the bill of exchange by signing it. The usuance of the bill of exchange may be 30 days, 60 days or 90 days. The exporter, thus, extends credit to the importer for such period. Under the D/A terms, the exporter relies on the honesty and creditworthiness of the buyer; and, therefore, this facility is normally extended only to parties who have proven business integrity and financial standing. Banks may extend finance to exporters by purchasing the D/P bills *with recourse.*

Documentary Letter of Credit

The documentary letter of credit covers the major part of the export business of the world. A letter of credit is a document containing the guarantee of a bank to honour drafts on it by an exporter, under certain conditions and up to certain amounts. Instead of being drawn on the importer, the

draft is drawn on the importer's bank. A letter of credit eliminates the risk for an exporter, for he will be definitely paid for his shipment provided, of course, that he fulfills his obligations. He, therefore, ordinarily requests the importer to arrange for a letter of credit. Apart from avoiding the risk of non-payment, an important advantage of a documentary letter of credit from the point of view of the exporter is that, immediately after the shipment of the goods, he can present the bill of exchange and other relevant documents and obtain payment from a bank at his own centre. For details of the letter of credit financing of the export business, see the Appendix to the chapter.

We have outlined above the important payment terms. The actual payment term adopted in a particular transaction is influenced by a number of factors, such as the individual circumstances of the buyer and the seller, the nature of the product, the profit margin, customs of the trade, the organisation of the firm, the legal limitations and the cost and availability of credit.

INSTITUTIOINAL FINANCE FOR EXPORT

Even if the exporter gets payment at the time of the shipment of goods, he has to arrange for finance to meet the expenses involved until the time of shipment. These include expenditure on the purchase of materials and components, processing, packaging, packing, marking, transaction, warehousing, etc. In many instances, the exporter is compelled to extend credit to the overseas buyer. In fact, in international marketing, the nature of the sale/credit term offered is a very decisive factor in obtaining business. In many cases, the exporter has to wait for a period of time — short, medium or long — even after the shipment of goods to obtain payment from the overseas buyer. He has, therefore, to arrange for post-shipment finance, covering the period between the shipment of the goods and the receipt of payment. All the countries which are serious about export promotion, have, therefore, made institutional arrangements for the provision of both pre-shipment and post-shipment finance. In India, the export sector is regarded as a priority sector.

Pre-shipment Credit

As the name indicates, pre-shipment finance, also known as packing credit, refers to the credit extended to the exporter prior to the shipment of goods. Pre-shipment credit enables him to meet his working capital requirements for the purchase of raw materials and components, processing, packing, transportation, warehousing, etc. Packing credit is short-term finance. It is also advanced against export incentives.

In India, pre-shipment credit is provided by Indian and foreign commercial banks which are members of the Foreign Exchange Dealers' Association. The packing credit advances by commercial banks in India are governed by the Packing Credit Scheme of the Reserve Bank. The salient features of this scheme are:

To loan is advanced only on receipt of an export order.

To obtain the loan, the exporter should deliver to the bank either a letter of credit established in his favour or a confirmed export order. However, where the letter of credit or the confirmed export order is yet to be received, relevant evidence in the form of a cable, letter etc., is acceptable, provided that such cable, letter etc., contains information regarding at least the value of the order, the quantity and particulars of goods, the date of shipment and name of the buyer.

All the packing credit advances must be repaid from the proceeds of the relative export bills negotiated or from the remittances received from abroad for the relative goods.

Packing credits are eligible for interest subsidy, normally for a period not exceeding 90 days, although the credits may be given for a period of 180 days for specified items, such as engineering goods, with the permission of the Reserve Bank of India. In genuine cases of delay of shipment of specified items, a further period of 90 days may be allowed by the Reserve Bank of India.

Packing credit is also available against certain incentives; such advances should be paid by the exporter as soon as these are realised.

In terms of the Reserve Bank directive, banks are required to provide finance (which includes packing credit facilities) at a concessional rate of interest, which is specified by the Reserve Bank from time to time. No service charges are leviable other than those stipulated by the Foreign Exchange Dealers' Association of India. The premium payable to Export Credit Guarantees may, however, be charged to the exporter.

Where a letter of credit or an export order is received in the name of an export house or any merchant exporter, an advance made even to a sub-supplier falls within the Packing Credit Scheme. In such a case, the sub-supplier should submit to the bank a letter from the export house/merchant exporter, giving details of export house/merchant and of the supply allotted, and confirming that the export house/merchant exporter, will not avail itself/himself of packing credit from any other source on the quantity so allotted. Since export bills are negotiated in the name of the export house/ merchant exporter, the repayment of such packing credit should be made by inland letters of credit opened by the export house/merchant exporter in favour of the sub-supplier, or by proceeds of bills drawn by the sub-supplier on the export house/merchant exporter. Whenever the bill on the export house/merchant exporter is not accompanied by a bill of lading, a certificate should be obtained from the export house/merchant exporter for every quarter, stating that the goods have actually been exported.

An undertaking from the sub-supplier shall be obtained that any advance payment received towards the supply of goods would be adjusted to the packing credit.

Post-shipment Finance

As has already been mentioned, the international market is, by and large, very competitive, and the extension of credit facilities to the buyers is one of the important determinants of the expansion in the export business. Most exporters are not in a position to extend credit to overseas buyers. To promote the export business, therefore, the burden of credit should be shifted from the exporters by either the financial institutions providing credit, directly or indirectly, to the buyers, or by extending credit to the exporters to enable them to extent credit to their buyers. Accordingly, financial institutions provide buyer's credit, line of credit and supplier's credit.

Supplier's Credit

Under the Buyer's Credit system, credit is extended to overseas buyer by either a financial institution or a consortium of financial institutions. This credit enables the buyer to pay for the goods he imports. If the financial institution that provides the buyer's credit is located in the export's country. The loan does not involve a transfer of funds from the supplier's country to the buyer's country; the exporter may obtain the payment directly from the financial institution on presentation of the relevant export documents. Buyer's credit is generally advanced for capital goods.

Line of Credit

When a number of buyers are involved, instead of negotiating credits with each one, the financial institutions in the supplier's country may extend a line of credit to a financial institutions in the buyers' country which, in turn, will disburse the credit to the buyers in respect of approved transactions. Apart from avoiding the problem of dealing with several individual transactions, the great advantage of the line of credit is that the responsibility for judging the creditworthiness of the buyers is shifted to the financial institution in the buyer's country.

Short-term Finance

Short-term post-shipment credit is usually provided by the commercial banks, mainly by negotiating documents under letters of credit, by purchasing D/P and D/A bills, by lending against export bills tendered for collection abroad, and by advancing money against such receivables as export incentives like cash assistance, refund of exercise and customs duty and reimbursement of the differentials between indigenous and international prices of certain raw materials.

Medium and Long-term Finance

In India, commercial banks, which provide most of the short-term post-shipment credit, plays an important role in offering medium and long-term post-shipment finance. The Industrial Development Bank of India (IDB) played a very important role in long-term post-shipment finance. It provided refinance facilities to commercial banks against the long-term export credit extended by them, and had a scheme for direct financial assistance to exporters in collaboration with approved commercial banks. The IDBI was also operating a Buyer's Credit Scheme for the promotion of capital goods exports from India. Under this scheme, it provided credit to eligible foreign buyers for the purchase of goods from India.

With the establishment of the Export Import (Exim) Bank in 1982, export credit functions performed by the IDBI were transferred to the Exim Bank.

EXIM BANK

The Export-Import Bank of India, set up in 1982, for the purpose of financing, facilitating and promoting foreign trade of India, is the principal financial institution in the country for coordinating working of institutions engaged in financing exports and imports.

The Exim Bank is fully owned by the Government of India and is managed by a Board of Directors with representation from Government, financial institutions, banks and business community. The operations are grouped into Project Finance, Trade Finance and Overseas Investment Finance, supported by Planning and Coordination Groups.

Objectives and Functions

The objectives and functions of the Exim Bank include the following:

1. Grant of loans and advances in India solely or jointly with commercial banks to persons exporting or intending to export from India goods which may include the export of turnkey projects and civil consultancy services.
2. Grant of lines of credit to Governments, financial institutions and other suitable organisations in foreign countries to enable person outside India to import from India goods including turnkey projects, civil construction contracts and other services, including consultancy services.
3. Handling transactions where a mix of government credit and commercial credit for exports is involved.
4. Purchasing, discounting and negotiating export bills.
5. Selling or discounting export bills in international markets.
6. Discounting of export bills negotiated or purchased by a scheduled bank or financial institution notified by government, or granting loans and advances against such bills.
7. Providing refinance facilities to specified financial institutions against credits extended by them for specified export or imports.
8. Granting loans and advances or issuing guarantees solely or jointly with a commercial bank for the import of goods and services from abroad.

9. Issuing confirmation/endorsing letters of credit on behalf of exporters in India, negotiating, collecting bills under letters of credit, opening letters of credit on behalf of importers of goods or services and negotiating documents received thereunder.
10. Buying and selling foreign exchange and performing such other functions of an authorised dealer as may be necessary for the discharge of the functions of an export-import bank.
11. Undertaking and financing research, surveys and techno-economic studies bearing on the promotion and development of international trade.
12. Providing technical, administrative and financial assistance to any exporter in India or any other person who intends to export goods from India for the promotion, management or expansion of any industry with a view to developing international trade.

The Exim Bank extends both funded and non-funded assistance for promotion of foreign trade.

The *funded assistance* programme of the Bank includes direct financial assistance to exporters, rediscounting of export bills, technology and consultancy services financing, refinancing of export credit and re-lending facility to banks abroad.

The *non-funded assistance* is in the form of guarantees which are in the form of bid bonds, advance payment and performance guarantees, retention money guarantees and guarantees for raising finance abroad.

The Exim Bank participates with commercial banks in India in the issuance of guarantees in foreign currencies on behalf of Indian exporters/contractors in favour of overseas importers/employers and banks.

In 1983, a scheme known as the Exim Syndication Facility was introduced to attract greater participation in export credit by commercial banks in India who are authorised dealers in foreign exchange. Under this scheme, the Exim Bank provides funds for an export proposal and syndicates the credit risks to commercial banks, and the banks for assuming the risks earn a commission of 0.5 per cent annum from the Exim Bank.

The Exim Bank also provides information and advisory services to enable exporters to evaluate the international risks, export opportunities and competitiveness. These include country studies, merchant banking services, advice on international marketing and data to enable effective participation in opportunities offered by projects by multilateral institutions.

Further, the Bank carries out Research and Analysis on specific industry sub-sectors with export potential and international trade related subjects. These are widely disseminated amongst exporters, academicians, industry and trade organisations and government.

Thus, the Exim Bank follows a three-pronged strategy to promote Indian exports. More than export finance, the Bank is engaged in export capability creation.

Lending Programmes

The Exim Bank promotes exports through a variety and range of lending programmes. These programmes are tailored to meet the needs of different customer groups, viz., Indian exporters, overseas entities and commercial banks.

To the Indian exporters, the Bank offers finance at various stages of the export cycle, viz., export product development, export production, export marketing and export credit at pre- and post-shipment stages. Figure 13.1 gives a summary view of the lending programmes of the Exim Bank.

APPENDIX 13.1
LETTER OF CREDIT AND FINANCEING OF FOREIGN TRADE

A letter of credit is an undertaking by a bank to pay or to arrange to pay for specified merchandise, provided that certain stipulated conditions are met by the beneficiary. The International Chamber of Commerce has defined a banker's documentary credit as "an arrangement, however named or described, whereby a bank (the issuing bank), acting at the request and in accordance with the instructions of a customer (the applicant to the credit), is to make payment to or to the order of a third party (the beneficiary), or is to pay, accept or negotiate bills of exchange (drafts) drawn by the beneficiary, or authorise such payments to be made or such drafts to be paid, accepted or negotiated, by another bank, against stipulated documents and compliance with stipulated terms and conditions."

The letter of credit arrangement offers advantages to both the seller and buyer. As far as the seller is concerned, a letter of credit ensures him payment for the goods he sells, provided, of course, he follows the instructions. Though the buyer has to have the botheration of arranging for the letter of credit, it may enable him to obtain more liberal discounts and a lower price from the seller. Further, the buyer is assured that the shipment will be made by the date specified in the letter of credit, or else the credit will expire.

Parties to the Letter of Credit

The Opener: The opener is the buyer (the importer). The letter of credit is opened at the initiative and request of the buyer.

The Issuer: The issuer, also called the opening or issuing bank, is the bank in the importer's country issuing the letter of credit at the request of the importer.

The Beneficiary: The beneficiary is the party in whose favour the credit is issued, that is, the beneficiary is the seller or exporter.

The three parties mentioned above are regarded as the fundamental parties to a letter of credit. However, the following parties are concerned with a letter of credit transaction.

The Confirming Bank: The confirming bank is a bank in the exporter's country which guarantees the credit at the request of the issuing bank. The confirming bank undertakes all the obligations of the issuing bank as a primary party to the credit, and even if the issuing bank fails during the currency of the credit, the confirming bank is obliged to honour its commitment.

The Notifying Bank: The notifying bank is the bank which, at the request of the issuing bank, notifies the beneficiary that the credit has been opened in his favour. If the letter of credit is confirmed, the confirming bank advises the beneficiary accordingly.

The Paying Bank: The paying bank is the bank on which the draft or bill of the exchange is to

Programme	Use
For Indian Exporters	
Export (Supplier's) Credit	Enables Indian exporters to extend term credit to importer overseas, of eligible Indian goods.
Finance for Consultancy and Technology Services	Enables Indian exporters of consultancy and technology services to extend term credit to importers overseas.
Finance for EOUs and Units in EPZs	Enables Indian companies to acquire indigenous and imported machinery and other assets for export production.

Programme	Use
Foreign Currency Lines of Credit for Imports	Enables eligible export-oriented units to acquire imported machinery for export production.
Production Equipment Finance	Enables eligible export-oriented units to acquire equipment.
Export Marketing Finance	Enables exporters to implement market development programmes and finances productive capabilities through loan financing.
Export Product Development	Enables Indian firms to undertake product development, R&D for exports.
Overseas Investment Finance	Enables Indian promoters to finance equity contribution in joint ventures set up abroad.
Project Preparatory Services Overseas	Enables Indian consultancy firms to undertake project preparatory studies in developing countries by grant/loan financing.
Business Advisory and Technical Assistance Services Overseas	Enables Indian consultancy firms to undertake specific assignments in select countries through grant financing.
Africa Project Development Facility	Enables Indian consultancy firms to undertake specific assignments in Sub-Saharan Africa though grant financing.
EC International Investment Partners' Facility	Enables setting up of joint-ventures in India between Indian companies and enterprises in the European community.
For Commercial Banks Refinance of Export (Supplier's) Credit	Enables banks to offer credit to Indian exporters of eligible goods, who extend term credit over 180 days to importers overseas.
Export Bills Rediscounting	Enables banks to rediscount export bills with usuance not exceeding 180 days.
Relending Facility	Enables banks overseas to make available term finance to their clients, for import of eligible Indian goods.
Refinance of Term Loans to EOU	Enables banks to offer credit to eligible export-oriented units to acquire indigenous and imported machinery and other assets for export production.
Refinance of Term Loans for Computer Software Exports	Enables acquisition of imported and indigenous computer systems, and project related assets.
Small Scale Industry (SSI) Export Bills Rediscounting	Enables banks to rediscount export bills of their SSI customers with usance not exceeding 90 days.
Bulk Import Finance	Enables banks to offer finance to importers for bulk import of consumable inputs.
For Overseas Entities Line of Credit	Enables overseas financial institutions, foreign governments, their agencies to extend term loans to finance import of eligible goods from India.
Buyer's Credit	Enables overseas buyer to import eligible goods from India on deferred credit terms.

be drawn under the commercial credit. The paying bank may be the issuing bank, the confirming bank or the notifying bank.

The Negotiating Bank: The negotiating bank is the bank which pays or accepts the drafts of the exporter. If no paying bank is specified in the credit, the beneficiary may go to any bank and present the draft and related documents under the credit; and if the bank agrees to negotiate the documents, it becomes the negotiating bank. By negotiating drafts, the negotiating bank becomes "an endorsee and bonafide holder" of the draft and has resource on the drawer of the bill until it is accepted and paid by the drawee.

Kinds of Letters of Credit

There are different kinds of letters of credit. The important classifications are mentioned below:

Clean Letter of Credit: This kind of letter of credit may be negotiated against a clean draft. A clean draft is a draft without any documents attached to it.

Documentary Letter of Credit: Under the documentary letter of credit, the draft must be accompanied by the documents specified in the letter of credit.

Assignable Credit: Under this kind of L/C, the beneficiary may assign his rights to another beneficiary, either within a stated period or before the expiry date of the credit.

Non-Assignable Credit: As opposed to the assignable credit, the named beneficiary of a non-assignable L/C cannot transfer his rights to another party.

Cash Credit: Under the cash credit, the exporter may draw a sight draft on the bank. The great advantage of this type of credit, therefore, is that the beneficiary will receive cash for his draft as soon as the goods are ready for shipment and the relevant documents in proper order are represented to the bank.

Acceptance Credit: Under this arrangement, the bank merely "accepts" the drafts drawn by the exporter. After it has been accepted by the bank, the draft becomes a bank acceptance, which may be readily discounted or sold by the exporter to the accepting bank, to other banks or to exchange dealers.

Revocable Credit: The revocable letter of credit may be revoked or cancelled at any time without the consent of, and without notice to, the beneficiary. As the revocable L/C does not adequately protect the beneficiary, exports on the basis of this type of L/C are not common.

Irrevocable Credit: An irrevocable L/C is one which cannot be revoked, amended or modified by the issuing bank without the express consent of all the parties concerned. An irrevocable credit is a definite undertaking on the part of the issuing bank and constitutes the engagement of that bank to the beneficiary or any bonafide holders of the drafts drawn under the credit, provided that the terms and conditions of the credit are complied with.

Confirmed Credit: If the L/C is confirmed by a bank in the beneficiary's country, it becomes a confirmed credit. In this case, the bank issuing the L/C sends it through its branch or correspondent bank located in the beneficiary's country with the request to add its confirmation to the credit. Confirmation constitutes a definite and legal undertaking on the part of the confirming bank that it will duly honour the payment or acceptance, as the case may be, on presentation of stipulated documents.

Back-to-back Credit: A back-to-back credit is essentially a secondary credit, opened by a bank on behalf of the beneficiary of an original credit, in favour of a domestic supplier. The original credit backs another credit and facilitates the purchase of the goods from a local supplier by the beneficiary of the original L/C.

Revolving Credit: A revolving credit is designed to obviate the need for establishing new credit for each shipment when the transactions are more or less continuous. Under the revolving credit, provision may be made for making available the credit again as soon as the importer reimburses the issuing bank with the drafts already negotiated by the paying bank.

Red Clause Credit: The red clause L/C enables the beneficiary to draw a predetermined value of the L/C as soon as it is established. the "red clause" is an authority to the negotiating bank to make advances to the beneficiary for the purpose of purchasing the relevant goods. The conditions on which such advances may be made are incorporated in the L/C.

Modus Operandi of L/C

The use of a letter of credit in financing international trade may be illustrated with the following example:

Suppose a US-based buyer wants to purchase goods from an Indian seller. Suppose, further, that the Indian exporter, instead of drawing directly on the US importer, requests him to arrange an irrevocable confirmed letter of credit. The US importer then applies to his bank in the USA to issue an L/C. In his application for the L/C to the bank, the importer will set forth the terms of sale and will mention the documents which shall accompany the draft, the usance, the final date of shipment, etc. If the bank is prepared to issue the credit, the importer will sign the L/C contract, in which he will have agreed to reimburse the bank for all outlays and to give such security as the bank demands.

The issuing bank will now notify its correspondent bank in the exporter's place and will request the latter to confirm the credit to the exporter. The notifying bank will now inform the exporter that an irrevocable and confirmed letter of credit has been arranged, and will describe the terms under which the shipment must be made before the draft is honoured. This will make the contract binding on both the issuing bank and the confirming bank.

The exporter will now ship the goods to the US buyer, draw a time draft on the issuing bank and may still sell the draft with documents attached to his own bank in India. The Indian bank will mail the draft and documents to its own correspondent bank in the USA which, in turn, will present it to the drawee bank for acceptance. The accepting bank will deliver the documents to the importer, usually against a trust receipt, an instrument under which the bank retains title to the merchandise. The importer is expected to make the full payment when the draft matures.

14

EXPORT RISK INSURANCE

The maritime perils and commercial and political risks the exporters are exposed to and the credit risks the exporters and export financiers encounter are among the serious problems affecting export business. Such risks, therefore, need to be covered so as to protect the interests of the exporters and financiers and to encourage national exports.

The Marine Insurance Act (MIA), 1963, provides for the insurance of maritime perils and the Export Credit Guarantee Corporation (ECGC) provides for covering the commercial and political risks associated with credit sales and export financing.

MARINE INSURANCE

The Marine Insurance Act, 1963, defines marine insurance as follows: "A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the assured, in the manner and to the extend thereby agreed, against marine losses, that is to say, losses incidental to marine adventure." "A contract of marine insurance may, by its express term, or by usage of trade, be extended so as to protect the assured against losses on inland waters or any land risk which may be incidental to sea voyage."

Insurable Interest

Marine insurance may be extended to any person who has insurable interest. The essential features of an insurable interest are:

1. There must be a physical object exposed to maritime perils; and

2. The assured must have a legal relationship to the object in consequence of which he benefits by its preservation, and is prejudiced by its loss or damage thereto, or incurs liability in respect thereto.

There are a number of people with insurable interest. A merchant may insure his cargo, while the owner of the ship or carrier may have an insurable interest in respect of his liability for damage to the cargo. The person at whose risk the freight is, may insure the freight, and an agent to whom goods are consigned for sale may insure. An underwriter has an insurable interest in respect of any reinsurance that he may desire to effect.

Unlike other types of insurance, assured need not have an insurable interest at the time of effecting marine insurance; but in order to recover under this policy he must be interested at the time of the loss.

Maritime Perils

Marine insurance covers only losses caused by maritime perils. The loss or damage occasioned by these perils must be fortuitous or accidental and must have happened during the period insured.

The maritime perils which may be insured against are the following.

Perils of the Sea: These include only fortuitous accidents and causalities of the sea such as stranding, foundering, collusion or contact, and heavy weather damage. The ordinary action of wind and waves is not a peril of the sea.

Fire: Damages caused by smoke, or by the heat of fire, or damage by water used to put out or prevent the spread of fire, or fire resulting from lighting, spontaneous combustion, explosion, negligence of the master or crew etc. may be covered by marine insurance.

Men-of-war and Enemies: It covers all losses or damages caused by the hostile acts of enemy provided that such acts formed part of an enemy compaign.

Pirates, Rovers and Thieves: Loss or damage caused by assailing thieves and by passengers who mutiny as well as by rioters who attack the ship from the shore are insurable.

Jettison: Jettison is throwing over board a part of the cargo of the ship or any other goods or vessel's equipment in order to lighten the ship in an emergency and save it.

Letters of Mart and Countermart, Surprisals, Taking at the Sea: Letters of mart are State authorised commmissions granted to individuals to give them authority to attack an enemy's merchant shipping, while letters of countermart are the counter-blast to authorise reprisals for such attacks. Surprisals refer to capture (take or obtain as a prize, by force, trickery, skill, etc.). Taking at sea refers to stopping and taking into port a ship for examination on suspicion that it is carrying contraband of war to the enemy. All these risks may be covered by marine insurance policy.

Capture at Sea: This covers arrests, restraints, and detainments of all kings, princes, and people of what nation, condition or quality whatsoever.

Barratry: Barratry includes every wrongful act willfully committed by the master or crew in contravention of their duties, thereby causing prejudice to the owner or character of the vessel. Setting fire to a vessel, or running it ashore, or smuggling are examples of barratry. The barratry must have been committed without the connivance of the owner.

Other Perils: The term all other perils is subject to the rule of *ejusdem generis* (of a like kind), which has the effect of limiting "all other perils" to include only perils similar in kind to the perils specifically set out in the policy.

Types of Policy

The following are the various types of marine insurance policy:

Time Policy: Under this policy, the subject is insured for a period of time.

Voyage Policy: This policy insures the subject matter from one place to another, irrespective of the length of time taken.

Mixed Policy: This covers both the voyage and period of time.

Construction Policy or Building Risk: It insures a vessel while it is being built, irrespective of the length of time taken.

Floating Policy: It is an ordinary cargo policy expressed in general terms to cover the number of shipments to be declared.

Marine Insurers

The marine insurance in India are done by the subsidiaries of the public sector General Insurance Corporation (GIC), viz., National Insurance Company; New India Assurance Company; Oriental Fire and General Insurance Company; and, United India Insurance Company.

ECGC AND EXPORT CREDIT RISK INSURANCE

The Export Credit Guarantee Corporation of India Ltd., a company wholly owned by Government of India and which functions under the administrative control of the Ministry of Commerce, have a number of schemes to cover several risks which are not covered by the general insurers.

The primary role of ECGC is to support and strengthen the export promotion drive in India by:

(*i*) Providing a range of credit risk insurance covers to exporters against loss in export of goods and services, and

(*ii*) Offering guarantees to banks and financial institutions to enable exporters to obtain better facilities from them.

In other words, the objectives of ECGC are:

1. To provide insurance cover to exporters against political risks and commercial risks.
2. To provide insurance cover to exporters against the risk of exchange rate fluctuations in respect of deferred payments.
3. To provide insurance cover to banks against export credit and guarantees extended by them.
4. To provide insurance cover to Indian investors abroad against political risks.

Insurance Covers

The covers issued by ECGC may be broadly divided into the following four groups:

1. Standard policies issued to exporters to protect them against payment risks involved in exports on short-term credit.
2. Specific policies designed to protect Indian firms against payment risks involved in exports on deferred terms of payment, services rendered to foreign parties, and construction works and turnkey projects undertaken abroad.
3. Financial guarantees issued to banks in India to protect them from risks of loss involved in their extending financial support to exporters at the pre-shipment as well as post-shipment stages.
4. Special schemes.

Standard Policies

ECGC has designed four types of Standard Policies to provide cover for shipments made on short-term credits.

1. *Shipments (Comprehensive Risks) Policy* which covers both commercial and political risks from the date of shipment.
2. *Shipments (Political Risks) Policy* which covers only political risks from the date of shipment.
3. *Contracts (Comprehensive Risks) Policy* which covers both commercial and political risks from the date of contract.
4. *Contracts (Political Risks) Policy* which covers only political risk from the date of contract.

Risks Covered by Standard Policies

The risks covered under the standard policies are:

Commercial Risks

1. Insolvency of the buyer;
2. Buyer's protracted default to pay for goods accepted by him; and
3. Buyer's failure to accept goods, subject to certain conditions.

Political Risks

1. Imposition of restrictions on remittances by the government in the buyer's country or any government action which may block or delay payment to the exporter;
2. War, revolution or civil disturbances in the buyer's country;
3. New import licensing restrictions or cancellation of a valid import license in the buyer's country, after the date of shipment or contract as applicable;
4. Cancellation of export license or imposition of new export licensing restrictions in India after effective date of contract (under contracts policy);
5. Payment of additional handling, transport or insurance charges occasioned by interruption of diversion of voyage which cannot be recovered from the buyer; and
6. Any other cause of loss occurring outside India, not normally insured by general insurers, and beyond the control of the exporter and/or the buyer.

Risks not Covered

The Standard Policies do not cover losses due to the following risks:

1. Commercial disputes including quality disputes raised by the buyer, unless the exporter obtains a decree from the competent court of law in the buyer's country in his favour;
2. Causes inherit in the nature of goods;
3. Buyer's failure to obtain necessary import or exchange authorisation from the authorities in his country;
4. Insolvency or default of any agent of the exporter or of the collecting bank;
5. Loss or damage to goods which can be covered by general insurers;
6. Exchange rate fluctuations; and
7. Failure of the exporter to fulfill the terms of the export contract or negligence on his part.

Extend of Cover

It is customary in credit insurance to make the insured share a small percentage of the risk. ECGC normally pays 90 per cent of the losses on account of political or commercial risk. In the event of loss due to repudiation of contractual obligation by the buyers, ECGC indemnifies the exporter upto 90 per cent of the loss if final and enforceable decree against the overseas buyer is obtained in a competent court of law in the buyer's country. The Corporation, at its discretion, may waive such legal action where it satisfied that such legal action is not worthwhile and in that event also losses are indemnified upto 90 per cent. Recoveries made after the payment of claim are shared with the ECGC in the same proportion in which the loss was borne.

Whole Turnover Principle

ECGC expects a fair spread of risks insured. Therefore, an exporter is required to insure all the shipments that may be made by him during the next 2 years, except those made against advance payment or Irrevocable Letters of Credit confirmed by banks in India. Exclusions are, however, possible where items are not of an allied nature.

Consignment Exports

Exports on Consignment basis may be covered under Shipments (Comprehensive Risks) Policy by a suitable endorsement thereon. While political risks are covered from the date of shipment till the date of reciept of payment in India, commercial risks are covered only after the Agent/Stockholder submits the "Account Sales" to the exporter. The risk of the Agent/Stockholder not returning the unsold goods is not covered under the policy.

Specific Policies

The Standard Policy is a whole turnover policy designed to provide a continuing insurance for the regular flow of an exporter's shipment of raw materials, consumer goods and consumer durables for which credit period does not exceed 180 days. Contracts for export of capital goods or turnkey projects or construction works or rendering services abroad are not of a repetitive nature. Such transactions are, therefore, insured by ECGC on a case-to-case basis under specific policies.

All contracts for export on deferred payment terms and contracts for turnkey projects and construction works abroad require prior clearance of Authorised Dealers, Exim Bank or the Working Group in terms of powers delegated to them as per exchange control regulations. Applications for this purpose are to be submitted to the Authorised Dealer (the financing bank) which will forward applications beyond its delegated power to the Exim Bank.

1. Specific Policy for Supply Contracts

Specific Policy for suply contracts may take any of the following four forms:

(*i*) Specific Shipments (Comprehensive Risks) Policy to cover both commercial and political risks at the post-shipment stage;

(*ii*) Specific Shipments (Political Risks) Policy to cover only political risks at the post-shipment stage in cases where the buyer is an overseas Government or payments are guaranteed by a government or by banks, or are made to associates;

(*iii*) Specific Contracts (Comprehensive Risks) Policy; and

(*iv*) Specific Contracts (Political Risks) Policy.

Contracts Policy provides cover from the date of contract. Losses that may be sustained by an exporter at the pre-shipment stage due to frustration of contract are covered under this policy in addition to the cover provided by the Shipments Policy.

2. Insurance Cover for the Buyer's Credit and Line of Credit

Financial institutions in India, like those in several other countries, have started direct lending to buyers or financial institutions in developing countries for importing machinery and equipment from India. This kind of financing facilitates immediate payment to exporters and frees them from the problem of credit management as well as from the fear of loss on account of overseas credit risks.

Financing may take the form of Buyer's Credit or Line of Credit. Buyer's Credit is a loan extended by a financial institution, or a consortium of financial institutions to the buyer for financing a particular export contract. Under Line of Credit, a loan is extended to government or financial institutions in the importing country for financing import of specified items from the lending country.

ECGC has evolved schemes to protect financial institutions in India which extend these types of credit for financing exports from India. Insurance agreement will be drawn up on case-to-case basis, having regard to the terms of the credit.

3. Services Policy

Where Indian firms render services to foreign parties, they would be exposed to payments risks similar to those involved in export of goods. Services Policy offers protection to Indian firms against such payment risks. The policy has been designed broadly on the lines of ECGC's insurance policies covering export of goods.

A wide range of services like technical or professional services, hiring or leasing can be covered under the policies.

The Comprehensive Risks Policy covers the following risks:

1. Insolvency of the buyer;
2. Protracted default in payment;
3. Restriction on remittances in the buyer's country or any Government action which may block or delay payment to the exporter;
4. War between India and the buyer's country;
5. Revolution or other civil disturbances in the buyer's country;
6. Government action in India or in buyer's country which prevents the performance of the contract; and
7. Any other cause of loss occurring outside India and beyond the control of the buyer or the seller.

4. Construction Works Policy

The construction works policy covers civil construction jobs as well as turn-key projects involving supplies and services.

There are two types of policies to cover contracts with: (*i*) Government buyers and (*ii*) private buyers. The former covers political risks in respect of contract with overseas governments or where the payments are guaranteed by Government and the latter comprehensive risks.

Financial Guarantees

The financial guarantees are designed to protect the banks against the risk of extending funded and non-funded assistance to the exporters. The ECGC has the following six schemes:

1. Packing Credit Guarantee
2. Export Production Finance Guarantee
3. Post-shipment Export Credit Guarantee
4. Export Finance Guarantee
5. Export Performance Guarantee
6. Export Finance (Overseas Lending) Guarantee.

Special Facilities

The ECGC provides certain special facilities to certain categories of exports/ exporters. For example, it offers higher percentage of cover and procedural relaxations to small scale exporters under its policies and guarantees.

Special Schemes

1. Transfer Guarantee

The Transfer Guarantee is designed to safeguard banks in India against the risks of confirming letter of credit issued by a foreign bank. The bank has the option to cover either political risk alone or both political and commercial risks.

2. Overseas Investment Insurance

This scheme seeks to provide protection for Indian investments, made by way of equity capital or untied loan for the purpose of setting up or expansion of overseas projects. As the investor would be having a hand in the management of the joint venture, no commercial risk would be covered under this scheme.

3. Exchange Fluctuation Risk Cover Scheme

This scheme is intended to provide a measure of protection to exporters of capital goods, civil engineering contractors and consultants who have often to receive payments over a period of years for their overseas business. Where such payments are to be received in foreign currency, they are open to exchange fluctuation risk; the forward exchange market does not provide cover for such deferred payments.

15

QUALITY CONTROL AND PRE-SHIPMENT INSPECTION

The international market is very competitive and quality of export products is one of the important determinants of business. Inferior quality of exports damages the credibility of not only the exporter but also the nation. Hence, there shall not be any compromise on quality of exports. Exporters shall become quality conscious and the governments shall spare no efforts to assist quality improvements and to ensure that only products of satisfactory quality are shipped to foreign markets.

One of the important problems faced by many countries, particularly developing countries including India, in increasing exports is the poor quality of products. Quality improvement is a prerequisite for successfully competing in the highly competitive international market. One of the important factors contributed to Japan's spectacular export performance after the Second World War is the meticulous attention paid to quality. As a matter of fact, before the post-war era, Japan had earned a bad name because of the inferior quality of her exports. The comprehensive export inspection law introduced in Japan in 1948 and several measures taken to improve quality of export products contributed in no small measure in securing for her a pride of place in the international market. In short, quality, quality control and pre-shipment inspection have an important role in improving the export performance.

Quality control is defined as "a deliberate and planned activity having for its object the determination of the quality of a product with a view to accepting it as such in case it satisfies the stipulated requirements, or in case it does not satisfy these requirements to take necessary measures to correct the quality appropriately. Control of quality is best exercised during the course of production of an article, actually starting with the raw materials, going through the various processing stages and ending up with the final product paying due attention to packing, storage and transport."

"Pre-shipment inspection is the process of inspection of a batch of goods just prior to shipment to determine whether it satisfies the conditions for shipment, which may be concerned either with the quality, weight, packaging, contraband character, etc."

Objectives of Quality Control

The following are some of the objectives of quality control for exports:*

1. Promoting and ensuring the image of Indian goods exported to other countries.
2. Ensuring goods of assured quality only move into the export markets.
3. Sustaining the foreign markets where Indian goods are already favoured and developing new markets with competitive quality.
4. Inspiring confidence in the minds of foreign buyers with the assurance provided by the third party guarantee.
5. Adhering strictly to technological requirements accepted by foreign buyers of the product.
6. Ensuring sound and safe performance of the products without causing any health or safety hazards.
7. Observing conformity of rules and regulations of the importing countries.
8. Maintaining proper packaging for the safety of the product during transit.
9. Eliminating the causes of complaints from the foreign buyers and making every effort to spread quality consciousness in the country to improve overall quality of Indian products.
10. Maximising production and effecting economies by standardisation.

Quality Standards

Standards or specifications of quality are prerequisites of quality control because unless quality characteristics are assessed, specified and measured, quality control cannot be implemented. Sometimes, specifications are given by the buyer himself. For several products, there are Indian Standards specified by the Bureau of Indian Standards, national standards of the importing countries, and international standards specified by bodies like International Standards Organisation (ISO) and International Electrochemical Commission (IEC). The exporter will have to conform to any of these standards or specifications depending upon the situation.

Several goods are not allowed to be exported out of India unless they conform to specified standards. The Export Inspection Council has laid down minimum standards for a number of products. ISI Mark or Agmark as the case may be is a must for permission for export of a number of products. In some cases, the specifications given by the buyer, or the national standards of other countries or international standards will have to be conformed to.

Export (Quality Control and Inspection) Act, 1963

The Export (Quality Control and Inspection) Act, 1963, which is intended to provide for the sound development of the export trade of India through quality control and inspection and for matters connected therewith, empowers the Central Government to:

1. Notify commodities which shall be subject to quality control or inspection or both prior to export;
2. Specify the type of quality control or inspection which will be applied to a notified commodity;
3. Establish, adopt or recognise one or more standard specifications for a notified commodity;
4. Prohibit the export of the notified commodity unless it is accompanied by a certificate to the effect that the commodity satisfies the conditions relating to quality control or inspection.

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* C.R. Rama Rao, "Quality Control for Export."

Other Laws

Apart from the Export (Quality Control and Inspection) Act, 1963, there are certain other laws which empower the governments to enforce quality control. These legislations are:

1. Statutory regulations which regulate only the goods identified for exports. These included the Tea Act, 1963; and Sea Customs Act read with Indian Aircrafts Rules;
2. Statutory provisions applied to productions for sale within India, but which would automatically apply to the exports also in view of the fact that statutory provisions provided for control at a stage earlier than the actual exports. These include the Drugs Act, 1940; Essential Commodities Act, 1955; Prevention of Food Adulteration Act, 1956; etc.
3. Facilities for quality control and pre-shipment inspection made available for voluntary use by exporters or importers. These are provided under legislations like the Agricultural Produce (Guarding and Marketing) Act, 1937, and ISI (Certification Mark) Act, 1952.

Institutional Set-up for Quality Control and Inspection

Export Inspection Council: Under Section 3 of the Export (Quality Control and Inspection) Act, Government of India established, in 1964, the Export Inspection Council (EIC). The functions of the council are to advise the Government regarding measures for the enforcement of quality control and inspection in relation to commodities intended for export and draw up programme therefor. The Council may also make arrangements for voluntary pre-shipment inspection of commodities not covered by the compulsory inspection.

Export Inspection Agencies: The Central Government has also established several Export Inspection Agencies, in places like Mumbai, Kolkata, Cochin, Delhi and Chennai under the administrative and technical control of EIC. They have a number of sub-offices at different ports and cities. Testing laboratories/facilities are available in all the regional offices and sub-offices.

The basic functions of the Export Inspection Agencies is to conduct pre-shipment inspection either at the time of export or earlier to determine whether the commodity satisfies the standard specifications laid down in respect of it under the Export (Quality Control and Inspection) Act or any other specifications stipulated in the export contract and to issue certificate that the commodity satisfies the conditions relating to quality control or inspection or otherwise.

Other Agencies: There are a number of other agencies recognised by the Export Inspection Council for carrying out quality control on their behalf. These include government bodies like Bureau of Indian Standards National Test House and private agencies like Italab Pvt. Ltd., Lloyd's Register of Shipping Ltd., etc..

Methods of Quality Control/Inspection

There are mainly two methods of quality control/inspection, viz., in-process quality control and consignment-wise inspection.

1. In-process Quality Control

Certain commodities like paints and allied products, linoleum, ceramic sanitary wares, printing ink, chromefignments, etc., come under the purview of the system of In-process Quality Control.

In the case of the In-process Quality Control, the manufacturers themselves are entrusted with the entire responsibility of producing export consignments conforming to the standard specification by exercising requisite control on various levels like raw materials control, process control, preservation control and packing control. The EIC and inspection agencies ensure that adequate controls are exercised by periodic inspection and testing of export consignments at random.

2. Consignment-wise Inspection

Under this scheme, each export consignment in packed condition is subjected to detailed inspections to ensure conformity to the recognised specification. If it is found export-worthy, a certificate is issued to the exporter.

In the case of consignment-wise inspection, actual export consignments are taken up for inspection by the recognised agencies. Samples are drawn on statistical basis and tested for conformity to the standard specification.

No consignment of any notified commodity could be exported unless it is accompanied by a certificate issued by the recognised inspection agency or it carries a recognised mark as may be applicable to it. Generally, consignment-wise inspection is made use of by the small-scale manufacturers who cannot afford to have their own facilities and technical personnel.

Product subject to In-process Quality Control may also be sometimes subjected to consignment-wise inspection.

Export-worthy Units

The Export Inspection Council may recognise a manufacturing unit as an "export-worthy unit" only after ensuring that the unit is adequately supported with facilities for the enforcement of the quality control standards required by the Council. The approval of a unit is made on the recommendation of the expert panel constituted for this purpose.

The scheme of certification of units as export-worthy is generally regarded as superior to consignment-wise inspection since the quality is built into the product through inspection at every stage, namely, raw materials, bought-out components, process, product, preservation and packaging.

To have a surveillance of the units certified as export-worthy, officers of the Export Inspection Council/Agency undertake surprise visits periodically.

The export-worthy units are eligible to obtain certificates of quality control and inspection for their export consignments without physical inspection of their consignments.

Voluntary Inspection and Certification Schemes

Apart from compulsory quality control and pre-shipment inspections, the Inspection Agencies are also undertaking voluntary inspection of commodities which are not notified under the Export (Quality Control and Inspection) Act, at the request of the overseas buyers.

Further, there is a scheme for self-affixation of Marks (Certification Marks)/Self-certification.

Role of Bureau of Indian Standards

The Indian Standards Institution (ISI), set up by Government of India in 1947 with the active support of industrial, scientific and technical organisations in the country later renamed as Bureau of Indian Standards, play a very important role in quality control.

The aims and objects of the Bureau include preparation of standards relating to products, commodities, materials and prices and promotion of their general adoption at national and international levels; certification of industrial producers; assistance in the production of quality goods; and circulation of information relating to standardisation.

Indian standards, formulated by a large number of technical committees consisting of experts representing various interests such as producers, consumers, technologists and research and testing organisations both in public and private sectors, are the national standards of the country specifying requirements for the production of quality goods. They deal with raw materials and finished and semi-finished products covering a wide range of fields.

A number of advantages accrue from the implementation of standards such as assuring quality, ensuring safety, minimising wastage, reducing costs, cutting down unnecessary varieties, ensuring interchangeability and increasing productivity. Standards serve as a guide for production of goods and services; provide basis for trade transactions; help technologists judge quality and performance; and provide solutions to recurring problems of the designer and the builder.

The Indian Standards Institution (Certification Marks) Act, 1952, enables the Bureau to grant licences to manufacturers producing goods in conformity with Indian Standards to apply ISI Mark on their products. Every such licence includes a scheme of testing and inspection which the licensee is required to follow strictly. During the operation of the licence, ISI inspectors carry out regular and surprise inspection of the manufacturers' works to make sure that the scheme is being properly adhered to. Samples of certified products are being drawn from the production line as well as from the open market and tested in independent laboratories. As a further safeguard for the consumer, the scheme provides for free replacement of ISI marked goods found to be of substandard quality. Besides, providing a third party assurance of quality to the consumers, quality control operation helps the manufacturer in producing goods of quality, increasing productivity and achieving production economies in diverse ways.

The BIS has its central laboratory at Ghaziabad for testing certified products manufactured in accordance with Indian standard specifications as also those offered by applicants for the grant of licences under the ISI Certification Marks Scheme. Laboratories on a smaller scale have also been established at the Regional Offices at places like Mumbai, Kolkata, Chennai and S.A.S. Nagar (Mahali) near Chandigarh. In addition, laboratories have been set up at Patna and Bangalore Branch Offices in collaboration with the respective State Governments.

For export of a number of products, either ISI Mark or a certificate of conformity issued by the Bureau is a must. Products with ISI Marks may be allowed to be exported without any further inspection. In fact, under various Acts like Sea Customs Act, Tea Act, Export (Quality Control and Inspection) Act, etc., ISI Mark has been recognised for exports. BIS has also been recognised as an agency for carrying out inspections and testing on behalf of certain certifying institutions abroad. Keeping special attention to sea-worthy packing, BIS has prepared standards for sea-worthy packing of tobacco; sea-worthy packing of textiles; code of practice for packaging of steel and steel products for export purposes; etc.

Problems in Maintaining Quality for Exports

There are certain problems in maintaining quality for exports. Important among them are the following:

Lack of quality consciousness is a serious problem. Sometimes, narrow views and the temptation to make money without any regard to the long-term interests and national prestige are also responsible for the lack of attention to quality aspects. Organisations like Bureau of Indian Standards, Export Promotion Councils, etc., have a role to play in spreading quality consciousness.

One of the major problems in adhering to the quality levels required by the importing country is the difficulty in procurement of the right type of raw materials, components, etc., needed for specific application.

Drawbacks and inadequacies of facilities also sometimes come in the way of quality improvements.

Small-scale units may not be in a position to establish in-process quality control system due to the cost factor. Common testing facilities may be arranged, wherever possible, for the benefit of such units so that the burden on these units for investment on testing facilities could be reduced.

Following liberalisation, Government of India relaxed the regulation regarding pre-shipment inspection. Accordingly, export houses, trading houses and star trading houses are exempted from compulsory pre-shipment inspection. Units with in-process quality control (IPQC) facility are also exempted from the need to obtain inspection certificate from a government agency. Other units can also get such exemption if a firm letter from the foreign buyer stating that certification by a government agency in India is not required.

16

TRADE IN SERVICES

Growing Importance of Services

International trade in services, which make up a major share of the invisibles account of the Balance of Payments, has been growing fast. It increased from $ 800 billion in 1990 to over $ 3,780 billion in 2008 and stood at $ 4,860 billion in 2014. Services account for about one-fifth of the total global trade. Economic development is, generally, characterised by an increase of the share of the services in the GDP and total employment. This trend tends to increase the international trade in services.

The services sector which contributes nearly 70 per cent of the world GDP is growing fast. It is the largest sector in most of the economies and it is the fastest growing sector in many of them. The developed economies are primarily service economies in the sense that the service sector generates bulk of the employment and income. The contribution of services to GDP and employment is substantially high in, particularly, the developed economies.

Box 16.1

Significance of Trade in Services

The tremendous growth of trade in services and, more recently, of electronic commerce is also a part of the new trade pattern. Exports of commercial services have been growing on every continent (particularly Asia) throughout the 1990s. This change has its own special significance, as services are frequently used in the production of goods and even other services. Enhanced international competition in services means reductions in price and improvements in quality that will enhance the competitiveness of downstream industries. Both industrial and developing economies have much to gain by opening their markets. Developing countries would derive large gains from an easing of barriers to agricultural products and to labour-intensive construction and maritime services. Over the longer term, electronic business will loom large is an area where expanding opportunities for trade require an expanding framework of rules.

Courtesy: World Bank, *World Development Report, 1999/2000.*

Although, the share of services in the GDP of developing economies is lower than in the developed ones, the service sector has been growing very fast in the developing world. During 1980-1990, the average annual growth rate of value added in the service sector in the developing economies was 3.5 per cent compared to the GDP growth rate of 3 per cent. During 1990-98, these were respectively

3.7 and 3.3. The service sector of India grew at 6.9 per cent and 7.9 per cent during the above periods, compared to the corresponding GDP growth rates of 5.8 per cent and 5.9 per cent. The share of services in the GDP of India increased from 36 per cent in 1980 to about 60 per cent in 2014.[1]

The growing importance of services is reflected in the international trade too.

Major Service Traders

The world trade in services is dominated by the developed economies. See Table 16.1. The five top exporters — USA, UK, Germany, France and China — do more than one-third. Ten countries account for about half and 13 countries nearly 60 per cent of the total service exports. It may be noted that USA which has a huge deficit on the merchandise trade has a huge surplus on the services trade. Some countries like Japan and China which have huge surplus on the goods trade have large deficit on the services account.

Table 16.1

LEADING EXPORTERS AND IMPORTERS OF COMMERCIAL SERVICES, 2014

Rank	Exporters	Value	Share	Rank	Importers	Value	Share
1	United States	686	14.1	1	United States	454	9.6
2	United Kingdom	329	6.8	2	China	382	8.1
3	Germany	267	5.5	3	Germany	327	6.9
4	France	263	5.4	4	France	244	5.1
5	China	222	4.6	5	Japan	190	4.0
6	Japan	158	3.3	6	United Kingdom	189	4.0
7	Netherlands	156	3.2	7	Netherlands	165	3.5
8	India	154	3.2	8	Ireland	142	3.0
9	Spain	135	2.8	9	Singapore	130	2.7
10	Ireland	133	2.7	10	India	124	2.6
11	Singapore	133	2.7	11	Russian Federation	119	2.5
12	Belgium	117	2.4	12	Korea, Republic of	114	2.4
13	Switzerland	114	2.3	13	Italy	112	2.4
14	Italy	114	2.3	14	Belgium	108	2.3
15	Hong Kong, China	107	2.2	15	Canada	106	2.2
16	Korea, Republic of	106	2.2	16	Switzerland	93	2.0
17	Luxembourg	98	2.0	17	Brazil	87	1.8
18	Canada	85	1.7	18	Hong Kong, China	78	1.6
19	Sweden	75	1.5	19	United Arab Emirates[a,b]	72	1.5
20	Denmark	72	1.5	20	Spain	72	1.5
21	Russian Federation	66	1.4	21	Luxembourg	67	1.4
22	Austria	65	1.3	22	Sweden	65	1.4

23	Chinese Taipel[a]	57	1.2	23	Denmark	64	1.3
24	Thailand	55	1.1	24	Australia	62	1.3
25	Macao, China	53	1.1	25	Saudi Arabia, Kingdom of	60	1.3
26	Australia	52	1.1	26	Thailand	53	1.1
27	Turkey	50	1.0	27	Norway	53	1.1
28	Norway	49	1.0	28	Austria	51	1.1
29	Poland	46	0.9	29	Chinese Taipai[a]	46	1.0
30	Greece	42	0.9	30	Malaysia	44	0.9
	Total of above	**4,058**	**83.5**		**Total of above**	**3,871**	**81.7**
	World	**4,860**	**100.0**		**World**	**4,740**	**100.0**

Source: WTO, *World Trade Report*, 2015.

With 3.2 per cent share in services exports, India's global rank in 2014 was 8th compared to 10th rank in imports with 2.6 per cent share.

Major Services

Travel and transportation account for major share of the services trade. In 2011, travel accounted for about a quarter and transportation about one-fifth of the services exports. However, trade in other commercial services (particularly financial services — including banking and insurance, construction services, and computer and information services) has been growing faster than these two categories. While the growth rate of transportation and travel for the last many years was lower than the average for the services as a whole, the sub-category 'other commercial services' increased faster than the average.

Characteristics and Categories of Services

An important characteristic of services that has far-reaching implications for marketing of services is their inseparability. Services cannot be separated from their providers, whether they are persons or machines. This does not, however, mean that all services require the physical proximity of the provider and user.

There are two broad categories of services, viz., (*i*) those that necessarily require the physical proximity of the provider and the user; (*ii*) those that do not, though such physical proximity may be useful.

The services where physical proximity is essential fall into three categories.

The first category is characterised by the mobile provider and immobile user. This involves cases where the mobility of the beneficiary to the place of the provider is not physically feasible. For example, an Indian firm which has a construction contract abroad will have to send the manpower required to the construction site for carrying out the work. Similarly, a technician may have to go to a plant abroad to rectify a problem with the plant.

The second category is characterised by mobile user and immobile provider. This category consists of services which involve some key elements which are not normally transferable to the user's location. For example, certain experiments can be done only in those laboratories equipped for them. A patient who wants an open heart surgery will have to go to a hospital where the required facilities are available.

The third category consists of mobile user and mobile provider; proximity may be achieved by either the provider going to the user or the user going to the provider. For example, dry-docking facilities for ships.

Services for which physical proximity is not essential are known as long distance services. Examples in this category include transmission 'over the wire' of live music concerts or data. In advanced countries, traditional banking and insurance services fall into this category since loans or insurance policies can be secured by mail or phone. The scope for long distance transactions will increase with the advance of technology. As Bhagwati points out, this has important implications for broader issues such as the trend effect of immigration restrictions on the relative wages of skilled and unskilled labour since skilled services can increasingly be transacted over long distances, whereas the latter cannot.[2]

Even with respect to many long distance services, physical proximity between the provider and user will help increase the efficiency of the service. A large number of service firms will, therefore, like to have places of business in countries with a sufficient market. The 'right to establish' is an essential aspect of free trade in services. The right to establish also involves the right to employ people without restrictions of nationality.

International trade in many services involve international factor mobility. There are a number of international transactions involving temporary factor relocation services such as those requiring temporary residence by foreign labour to execute services transactions.

Restrictions

International trade in services, thus, involves intricate issues like right to establish and factor mobility. These are the problems faced in liberalising trade in services as compared to trade in goods.

Due to the special characteristics and the socio-economic and political implications of certain services, they are, generally, subject to various types of national restrictions. Protective measures include visa requirements, investment regulations, restrictions on repatriation, marketing regulation, restrictions on the employment of foreigners, compulsion to use local facilities, etc. Heavily protected or restricted services in different countries include banking and insurance, transportation, television, radio, film and other forms of communication, and so on.

LDCs vs. MDCs

The international trade in services is subject, in general, to a lot of restrictions. The developing countries, in particular, have problems in liberalising the trade in services.

Services were outside the scope of the General Agreement on Tariffs and Trade (GATT). Therefore, the GATT which tried to liberalise the trade in goods could not do the same for services. However, the Uruguay Round has made a beginning in liberalising trade in services (See Chapter 2).

The conflicts of interests or differences of opinion between the developed and developing countries have come to the fore at the Uruguay Round when the developed countries have sought to extend the GATT negotiations to services and to liberalise the international trade in services. The developing countries have strongly opposed this move, particularly in the early stages of the Round. India and Brazil were among the prominent opponents.

The fear of the developing countries is that the liberalisation of trade in services will lead to domination of the services sector in the developing countries by multinationals from industrialised countries. As a matter of fact, the trade in services is already dominated by the developed countries. The developing countries are net importers of services and their deficit has been growing. The apprehension is that a liberalisation of trade in services will accentuate the problem.

Although many services are labour intensive and, therefore, the developing countries should be expected to have an advantage here, there have been several constraints in benefiting from this advantage—technical, organisational, financial and legal. Moreover, immigration laws of developed countries restrict the manpower inflow from developing countries. This severely limits the scope of developing countries in benefiting from their comparative advantage. It may be noted that the industrial countries did not like to bring up this issue at the Uruguay Round.

"In reality, the service sector offers industrial countries the opportunity to exercise their traditional strengths—their access to finance, their accumulated knowledge and skills, their access to telecommunications and information technologies, as well as a history of established relationships and contacts."[3]

Lack of finance is a very important handicap in developing countries. Several services require a huge amount of finance. International airlines, for example. need ever larger investments in the most modern fleets and reservation systems if they are to compete internationally. Similarly, technology is also playing an increasingly important role in service industries and demanding higher levels of skill. "Here, too, the developing countries are in danger of falling further behind, not only because they lack the necessary human skills, but because many technological improvements in services require substantial financial backup, often missing in banking, construction, engineering design, communications and professional and business design."[4]

Even in areas where the developing countries have lot of development potential, like tourism, shortage of capital and managerial expertise often pose as serious problems.

Construction is an area where the developing countries have had high hopes, much of this market being in the developing countries which represent the largest source of international construction contracts. The construction market, however, shrunk in the 1980s. The developing countries provided 80 per cent of the construction contracts in 1981, but after years of economic crisis this was only 60 per cent in 1988. As construction suppliers, they have played a much less significant role. Since early 1980s, their market share fell from 15 per cent to 5 per cent in the late eighties.[5] Thus, although the developing countries account for a significant share of the construction contracts, the share of the developing countries' supply of this service has fallen to a very insignificant level.

Some countries like India have made some progress in certain modern areas like development of advanced software.

Some economists argue that liberalisation and the resultant competition will improve the efficiency of the service sector in the developing countries and this will help improve the overall efficiency of the economy and export competitiveness.

It has been pointed out that several developing countries have acquired enough strength in different services to successfully compete with developed countries. For example, countries like Korea, Brazil, India, Lebanon and Taiwan have done well in international construction and design contracts. Several developing countries have great potential in the field of professional services. Some already have considerable export of tourism and shipping.

It has been argued that if developing countries protect more expensive or lower quality services produced by local firms, they run the risk of handicapping their exports of goods. Many services are upstream or downstream services to producers. Access at reasonable cost to quality services can make the difference between success or failure in exporting. In many developing countries, the need for such services calls for at least selective liberalisation. If this encourages the multinational corporations of the industrial countries to provide these services to developing countries, it would help developing countries' exports of manufactured goods in three ways. *First,* it would lower their costs and help them to develop markets. *Secondly,* it would encourage the multinational corporations to move away

from goods in favour of producing more services. *Thirdly,* if industrial nations can sell more services, they may be more willing to lower protective barriers elsewhere.[6]

It is cautioned, however, that unless the developing countries take measures to strengthen their services before liberalisation, it would adversely affect the domestic service industries.

India has great potential in a variety of services. The large number of scientists, professionals and skilled and semi-skilled personnel working abroad is indicative of India's potential in several fields. With such a resource potential, we should be able to develop a number of service industries capable of obtaining customers abroad. For example, can we not provide health care instead of just exporting doctors and other medical personnel? Can we not provide education instead of just exporting teachers?

With proper planning and development, India can make great strides in services trade.

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17

TECHNOLOGICAL DEVELOPMENTS AND INTERNATIONAL MARKETING

Technology is a powerful driving force of globalisation. Several barriers to globalisation have been removed or significantly reduced by technological advances.

THE DEATH OF DISTANCE: TECHNOLOGY AND COMPETITIVENESS

Technology has in fact been a very important compelling and facilitating factor of globalisation "with its rising costs and risks, which makes it imperative for firms to tap world markets and to share these costs and risks. On the other hand, falling transport and communication costs — the "death" of distance — have made it economical to integrate distant operations and ship products and components across the globe in the search for efficiency. This is contributing, in particular, to efficiency-seeking FDI, with important implications for the export competitiveness of countries."[1] "The death of distance as a determinant of the cost of communications will probably be the single most important economic force shaping society in the first half of the [21st] century. It will alter, in ways that are only dimly imaginable, decisions about where people live and work, concepts of national borders, patterns of international trade. Its effects will be as pervasive as those of the discovery of electricity."[2]

The technological revolution has immensely facilitated globalisation of, *inter alia,* the medical and health care sector, for example. Here is a report in a business magazine, for illustration: A hospital in the US performs the required diagnostics — an X-ray and assorted scans. In the next three minutes, a radiologist in Bangalore receives the scanned images and sends his report (tele-radiology). The entire process, from the time the patient was admitted, has taken 20 minutes. The cost of this work is over 30 per cent lower in India compared to USA and the time difference makes it easier for them to look to India.[3] Medical transcription has also emerged as an important business. In short, the long distance online services made possible by the technological developments have given an impetus to globalisation and this presents a great opportunity for countries like India.

The pace of globalisation has been accelerated by several enabling technologies. Technological revolution in several spheres, like transport and communication, has given a great impetus to globalisation by their tremendous contribution to the reduction of the disadvantages of natural barriers like distance and cost.

The IT revolution has made an enormous contribution to the emergence of the global village. Indeed the microprocessor, which enabled the explosive growth of high-power, low-cost computing, vastly increasing the amount of information that can be processed by individuals and firms, has been doing wonders. The microprocessor also underlies many recent advances in telecommunications technology. Over the past 30 years, global communications have been revolutionised by developments in satellite, optical fiber, and wireless technologies, and now the Internet and the World Wide Web. These technologies rely on the microprocessor to encode, transmit, and decode the vast amount of information that flows along these electronic highways. The cost of microprocessors continues to fall, while their power increases (a phenomenon known as Moore's Law, which predicts that the power of microprocessor technology doubles and its cost of production falls in half every 18 months).[4]

The pace of globalisation has been accelerated by several enabling technologies. Technological revolution in several spheres, like transport and communication, has given a great impetus to globalisation by their tremendous contribution to the reduction of the disadvantages of natural barriers like distance and cost. The IT revolution has made an enormous contribution to the emergence of the global village. The developments in the field of air cargo transportation has fostered globalisation by enabling quick and safe transportation of sensitive goods (like perishables and goods subject to quick changes in fashion/taste). Developments of containerisation and refrigeration have also been of high significance. The steep fall in the cost of transportation and communication have considerably accelerated pace of globalisation. All these have contributed to the drastic transformation of the logistical and global distribution of the value chain system. The World Wide Web has a stupendous impact on globalisation.

Technological changes have caused the death of distance and emergence of a global village. That is, because of the shrinking time and shrinking space thanks to the technological revolution and the disappearing borders, thanks to the liberalisation and technological factors the world is evolving into a global village, in several respects. The following paragraphs reproduced from an UNDP Report explains this.

The launching of the Internet's World Wide Web in 1990 followed by the free distribution of Netscape in 1994 turned an established but little known technology for the scientific community into a user-friendly web for people. This not only brought far wider access at lower cost. It also brought a whole new structure of communication, allowing simultaneous transfers of information in words, numbers and images to points around the world. And it shrank the world of communications, making interaction possible at a distance in real time.

The average cost of processing information fell from $ 75 per million operations to less than a hundredth of a per cent in 1960-90. Airline operating costs per mile came down by half in 1960-90. The cost of a three-minute telephone call from New York to London fell from $ 245 in 1930 (in 1990 prices) to under $ 50 in 1960 to $ 3 in 1990 to about 35 per cent in 1999. These innovations in communications technology transformed the possibilities for building social solidarity and for mobilising people across the globe in network societies.

Contacts between the world's people are widening and deepening as natural and artificial barriers fall. Huge declines in transport and communication costs have reduced natural barriers. Shipping is much cheaper. Between 1920 and 1990, maritime transport costs fell by more than two-thirds. Between 1960 and 1990, operating costs per mile for the world's airlines fell by 60 per cent.

Communication is also much easier and cheaper. Between 1940 and 1970, the cost of an international telephone call fell by more than 80 per cent, and between 1970 and 1990 by 90 per cent. In the 1980s, telecommunication traffic was expanding by 20 per cent a year. The Internet, the take-off point for the information superhighway, was used by 50 million people in 1998, with the number of subscribers tapping into it doubling every year.

Some of the changes in international trade and finance reflect advances in technology. The lightning speed of transactions means that countries and companies now must respond rapidly if they are not to be left behind.

Technological change is also affecting the nature of investment. Previously, high technology production had been limited to rich countries with high wages. Today, technology is more easily transferred to developing countries, where sophisticated production can be combined with relatively low wages.

The increasing ease with which technology can accompany capital across borders threatens to break the links between high productivity, high technology and high wages. Further, the availability of higher levels of technology all over the world is putting pressure on the wages and employment of low-skilled workers.

Who Really Benefits from the IT and Communication Revolution?

Financial Dealers are at the pinnacle of connections. Instant communications, free flows of capital and constant updates from around the world enable money markets from London to Jakarta, from Tokyo to New York, to act as a unit in real time.

Multinational Corporations, too are roaming global markets and integrating production. Cross-border mergers and acquisitions (majority — foreign-owned) account for a large chunk of the total foreign direct investment.

NGOs online can campaign around the world, with their messages travelling across borders in seconds. Through e-mail and media networks, people are giving their support to associations across borders—from informal networks to formal organisations.

Skilled Labour also travels the global village. With Internet access in nearly every country, the highly educated are increasingly online and in touch around the world. In 1998, more than 250,000 African professionals were working in the United States and Europe, immigrants with skills in computing technologies are in high demand – in the European Union alone, 500,000 information technology jobs go unfilled because of lack of national skills. The United States offers a special visa to professional immigrants to keep high-tech industries staffed.

Unskilled Labour, by contrast, runs up against hurdles. Many families are divided across international borders as a result of the increasingly tight restrictions in the rich countries in the immigration of unskilled labour. Millions of people do not even have passports — difficult to get in some countries — let alone the visas required to travel abroad.

The collapse of space, time and borders may be creating a global village, but not everyone can be a citizen. The global, professional elite faces low borders, but billions of others find borders as high as ever.[5]

TECHNOLOGY AND COMPETITIVE ADVANTAGE

Technology is one of the eight factors considered by the World Economic Forum to evaluate the global competitiveness of nations. The 1999 *Global Competitiveness Report* of the Forum, which continued to increase its focus on information technology as a new source of competitiveness, observes that there are at least three aspects to this. First, e-mail has greatly expanded the possibilities for interpersonal, inter- firm, and international communication. Second, the Internet has allowed for much more extensive and rapid dissemination of information. Third, the emerging area of e-commerce offers a potentially huge increase in the customer base for companies and huge savings in marketing costs and search costs in finding low-cost suppliers. Competitiveness in all of these areas is closely linked with the competitiveness of the local telephone infrastructure and with the penetration of the computer culture in the local economy. The Report also observes that for a successful internet culture,

the population needs to have computers, telephones need to work, and the country's telecommunications hardware needs to support high bandwidth for Internet traffic.

Innovation is a very important factor that provides competitive advantage and, consequently, determines success.

Joseph Schumpeter, a well-known economist, has given a lot of importance to innovation in economic development. According to him, significant advances in the economy occur by disharmonious leaps and spurts as entirely new investment horizons are exploited. The entrepreneur, who is the innovator is the central figure in the Schumpeterian analysis. Innovation may take any of the following forms: the introduction of a new product; the use of a new method of production; the opening of a new market; the conquest of a new source of raw material supply; the reorientation of an industry. Our concern here is technological innovation; some of the above, obviously, do not represent technological innovation.

In the business context, innovation may be defined as "the technical, industrial and commercial steps which lead to the marketing of new manufactured products and to commercial use of new technical processes and equipment."

Betz classifies innovations into the following types or what is called scales.[6] This is based on how big an impact does a technology change make on the applications.

1. *Radical Innovation* — a basic technological innovation that establishes a new functionality (e.g., steam engine or steam boat).

2. *Incremental Innovation* — a change in an existing technology system that does not alter functionality but incrementally improves performance, features, safety, or quality or lowers cost (e.g., governor on a steam engine).

3. *Next-generation Technology Innovation* — a change in an existing technology system that does not alter functionality but dramatically improves performance, features, safety, or quality or lowers cost *and* opens up new applications (e.g., substitution of jet propulsion for propellers on airplanes).

Innovations may help companies to increase market share, capture new markets, create new market segments or even to create entirely new industries and markets. Although, innovation is expected to give a company a competitive advantage or success in the market, it is not uncommon that some other company or substitute product steals away the show from the innovator. For example, in the US the steel tin plate manufacturers developed the market for cans for soft drinks and the like. However, it was later taken away by the aluminium industry.

Innovation is a very important factor that can contribute to success in international business.

All innovations need not be commercially successful. For example, many new products fail commercially due to a variety of reasons. A combination of factors is often required for the success of a new product — the product itself, R&D support, allocation of required finance and effective marketing. Deficiencies in respect of any of these can cause failure.

As Michael Porter points out in his well-known *Competitive Advantage*, technological change is "one of the principle drivers of competition. It plays a major role in industry structural change, as well as in creating new industries. It is also a great equaliser, eroding the competitive advantage of even well-entrenched firms and propelling others to the forefront. Many of today's great firms grew out of technological changes that they were able to exploit. Of all the things that can change the rules of competition, technological change is among the most prominent."[7]

According to Gorden Pearson, "innovation is the key weapon in achieving a sustaining competitive advantage. To compete successfully, it is vital to use the most appropriate technology to produce and distribute your product or service. Generally, this means using the latest technology, which will

mean using the latest technology, which will incorporate more features, higher performance, greater quality or lower costs. In some cases, this may involve invention as well as innovation. Innovations may be based on inventions or discoveries, but their importance rests on their commercial exploitation."[8]

Porter who observes that the relationship between technological change and competition is widely misunderstood, points out that "technological change is not important for its own sake, but is important if it affects competitive advantage and industry structure. Not all technological change is strategically beneficial; it may worsen a firm's competitive position and industry attractiveness. High technology does not guarantee profitability. Indeed, many high-technology industries are much less profitable than some "low-technology" industries due to their unfavourable structures."[9] It is very important to understand that technology "pervades a firm's value chain and extends beyond those technologies associated directly with the product. There is, in fact, no such thing as a low technology industry if one takes this broader view. Viewing any industry as technologically mature often leads to strategic disaster. Moreover, many important innovations for competitive advantage are mundane and involve no scientific breakthroughs. Innovation can have important strategic implications for low tech as well as high-tech companies."[10]

As Porter points out, technology can alter the nature and basis of rivalry among existing competitors in several ways. Technology affects competitive advantage if it has a significant role in determining relative cost position or differentiation. It can also alter the bargaining power of the suppliers and buyers. Technology, in several instances, is an entry barrier. Thus, technology can influence all the five competitive forces.

According to Porter, technological change by a firm will lead to sustainable competitive advantage under the following circumstances, which he calls the tests of a desirable technological change.[11]

- The technological change itself lowers cost or enhances differentiation and the firm's technological lead is sustainable.
- The technological change shifts costs or uniqueness drivers in favour of a firm.
- Pioneering the technological change translates into first mover advantages besides those inherent in the technology itself.
- The technological change improves overall industry structure.

Porter cautions that technological change will destroy competitive advantage if it not only fails the tests but has the opposite effect contemplated in the tests, such as skewing cost or uniqueness drivers in favour of competitors. A firm may also find itself in the situation where a technological change may meet one test but worsen a firm's position via another.

The IT revolution has brought about very significant changes in the business environment, including the competitive environment.

The computer, considered "the machine that changed the world," and the rapid changes in the related technologies have been making the business environment immensely dynamic.

As Lucas observes,[12] IT:

- Provides new ways to design organisations that can lead to structure like the T-Form organisation.
- Creates new relationships between customers and suppliers who electronically link themselves together.
- Enables tremendous efficiencies in production and service industries through electronic data interchange to facilitate just-in-time production.
- Changes the basis of competition and industry structure, for example, in the airline and securities industries.

- Provides mechanisms through groupware for coordinating work creating a knowledge base of organisational intelligence.
- Contributes to the productivity and flexibility of knowledge workers.
- Provides the manager with electronic alternatives to face-to-face communications and supervision.

As Lucas points out, there are a number of recent trends that have drastically altered the way organisations use technology. These trends make it imperative that a manager becomes familiar with both the use of technology and how to control it in the organisation. He pinpoints the following five major trends.[13]

1. *The use of technology to transform the organisation:* The cumulative effect of what all the technology firms are installing is to transform the organisation and allow new types of organisational structures. This ability of information technology to transform organisations, to create the T-Form firm, is one of the most powerful tools available to a manager today.

2. *The use of information processing technology as a part of corporate strategy.* Firms that prosper in the coming years will be managed by individuals who are able to develop creative, strategic applications of the technology.

3. *Technology as a pervasive part of the work environment:* From the largest corporations to the smallest business, technology is used to reduce labour, improve quality, provide better customer service, or change the way the firm operates. Factories use technology to design parts and control production.

4. *The use of personal computers as managerial workstations:* The personal computer, when connected to a network within the organisation and to external networks like the Internet, it provides a tremendous tool for knowledge workers.

5. *The evolution of the computer from a computational device to a medium for communications:* For many people today, the communications aspects of computers are more important than their computational capabilities.

"Effective use of information technology helps a company to identify and profile customers, reach out to customers quickly and more effectively, and make inventory management and distribution system more efficient."

Firms which fail to keep pace with the fast technological developments will lag behind and may eventually vanish and firms which pioneer innovations are likely to gain a competitive edge.

E-MARKETING

The preceding sub-section (The Death of Distance: Technology and Competitive-ness) has given some indications of the growing importance of e-marketing.

Advances in information technology are revolutionalising the *modus operandi* of marketing and the business system. The business horizon is humming with buzzwords like *internet, world wide web (www), cyberspace, information superhighways* etc. which are changing the way of contacting customers; order receiving and processing; and networking and integrating business system. The revolutionary changes being ushered in by the internet are indeed exciting.

"Technology experts are anticipating that the internet and the www would become the centre of commercial universe. Electronic markets will eliminate the need for intermediaries and that direct contact between manufacturer and customer will bring down the cost of transaction and the cost of the final product. The internet has the potential to evolve into an interconnected electronic marketplace (cyberspace) bringing buyers and sellers together to facilitate commercial exchanges. The internet is fast becoming an important new channel for commerce in a range of business — much faster than anyone who would have predicted in the past. The opportunities presented by this new channel

seem to be readily apparent; by allowing for direct ubiquitous links to anyone anywhere, the internet allows companies build interactive relationships with consumers and suppliers and deliver new products and services at low cost."

Revolutionary changes in information technology have been sweeping across the global business. Developments in telecommunications and information technologies have reduced the barriers to time and place in doing business. It is now possible for customers and suppliers to transact business at any time any part of the globe, without having to come together physically, thanks to the developments in optical fiber technology, videophone and teleconferencing facilities. The net has changed face and pace of business-to-business marketing and retailing.

The *internet* and the *world wide web* have revolutionised the speed, dimensions and volume of information search and dissemination and global business. The net and web promise to develop into the information backbone of tomorrow's global economy. In 1990, fewer than one million users were connected to the Internet. By 1995, the figure had risen to 50 million. In 2001, it reached 490 million. By the year 2005, forecasts suggest that the Internet may have over 1.12 billion users, or about 18 per cent of the world's population.[14] According to one estimate, it would reach one billion mark by 2008.[15]

As Kotler observes, "E-business describes the use of electronic means and platforms to conduct a company business. The advent of the internet has greatly increased the ability of companies to conduct their business faster, more accurately, over a wider range of time and space, at reduced cost, and with the ability to customise and personalise customer offering." E-commerce is more specific than e-business; it means that in addition to providing information to visitors about the company, its history, policies, products, and job opportunities, the company or site offers to transact or facilitate the selling of products and service online. Most company sites are still just providing information and not doing e-commerce. *E-marketing* describes company efforts to inform, communicate, promote, and sell its products and services over the internet. The *e* term is also used in terms such as *e*-finance, *e*-learning, and *e*-service. But as someone observed, the *e* will eventually be dropped when most business practice is online.[16]

E-business and e-commerce take place over four major Internet domains: B2C (business to consumer), B2B (business to business), C2C (consumers to consumers), and C2B (consumers to business).

Benefits of Internet to Business

The Intenet can have the following important benefits:

1. Global Reach. Internet provides a firm global reach and thereby expands its marketing communication horizon and marketing potential.

2. Enhanced Value Proposition. The internet has the potential to enhance the value a firm provides to any given customer. An example of this is Amazon.com, which has provided value to its customers by providing a wide product assortment, a product recommendation engine, e-mail alert technology, and access to product reviews. Similarly, business consumers are able to get more customisation, easier transactional capability, and better value-added services as a result of the Internet.[17]

3. Improved Operational Efficiency. The Internet can help improve operational inefficiency of companies. Many organisations have implemented virtual teams for customer service, sales, and product development. Sales people are using the Internet to give remote presentations to prospects, saving time and money.[18]

4. Streamlined Supply Chains. One of the very important help of the Internet on business is in streamlining the supply chains, which can significantly contribute to improving operational efficiency and cost reduction.

5. Better Connectivity. The Internet is great at linking firms with other firms (e.g., in e-marketplaces), linking firms with their consumers (e.g., by e-mail) and linking consumers with other consumers (e.g., eBay). This creates a dense network, leading to quicker communication among individuals and companies. One consequence of this is that a large-scale virtual collaboration is possible among individuals who are spatially distributed.[19]

6. Making Everything Faster. In the words of Intel's Andy Grovel, "it makes everything faster. Genomics discoveries come faster. You can crack data faster. You can build and correct supply lines faster. You can get information faster…The most direct way of increasing productivity is doing the same thing in a lesser period of time — turning things faster. And productivity is the key to everything — greater productivity increases economic growth."[20]

7. Death of Distance. A great contribution of Internet is to overcome some of the problems of distance and time.

There, however, are several categories of products which are difficult to be sold on the internet. They fall into four categories:[21]

1. Experience and sensory products (high-touch products) like clothing and jewellery.
2. Products that are hard to transport.
3. Products with delivery problems such as those having a very large number of customers who are spread out across wide areas.
4. Services where face-to-face interaction matters.

COMPONENTS OF THE GLOBAL ELECTRONIC SUPPLY CHAIN

As Schary and Larsen observe, "managing the supply chain is vital for international business. The ultimate objective is to deliver products to market with variety, responsiveness, timeliness and efficiency. Corporate strategy must include organising, coordinating and executing the process of product flow as a competitive necessity and as a source of potential competitive advantage. The strategic requirements of international business determine the extent, characteristics and strategic direction of the supply chain. Some businesses are only involved with international operations to secure a supply of materials and components; marketing is domestic. Other businesses manufacture and export from a home base and procure materials overseas. Some corporations serving global markets rationalise production using international factory networks for supply."[22]

According to Houlihan, the underlying concept of the supply chain embraces the following points.[23]

- The supply chain identifies the complete process of providing goods and services to the final user.
- It includes all parties and logistics operations from supplier to customer within a single system.
- The scope of the supply chain includes procurement, production and distribution operations.
- The supply chain extends across organisational boundaries.
- It is coordinated through an information system accessible to all members.
- The primary objective of the supply chain is service to customers. This must be balanced against costs and assets.
- Objectives of individual supply chain members are achieved through the performance of the chain as a whole.

Managing the supply chain is also managing the value chain. As Michael Porter points out, a firm's value chain is an important determinant of competitive advantage.[24]

As noted earlier, the technological changes which have brought about the death of distance resulting in huge reduction in the cost of communications and speed and efficiency of performing certain activities has been encouraging a reconfiguration of the value chain globally. The technological developments permit an organisational structure in which not all parts of the value chain need to be *physically* present in each country, although they may be viewed as *virtually* present from the perspective of suppliers and customers.[25] Keegan points out that major part of the attractiveness and dynamics of the new technological environment stems from the ability to "modularise," "segment," or "fragment" the value chain into small and distinct customer-oriented processes. ICT facilitates the coordination between these modules in largely non-hierarchical systems and increases the scope for outsourcing specific modules.[26]

The emerging global electronics value chain consists of a network of specialists, which permits participants to focus on their respective core values. The important components of this value chain are the following:[27]

Context Suppliers

Context suppliers, also called *portals,* support the use of the electronic channel both for customers and suppliers. Their key functions are to offer access to the channel and reduce the complexity of the electronic environment. Among the most important context providers are Internet online services such as America Online, Web browsers such as Netscape Communicator and Microsoft Explorer, or search engines such as Yahoo! and Lycos.

Sales Agents

Sales agents are those who support suppliers primarily through offering high quality address banks of potential customers, often with a wealth of information about customer preferences, demographics, and other data.

Purchase Agents

On the customers' side, electronic purchase agents help the Internet shopper to find desired goods or services.

Market Makers

Market makers are mediators that bring together buyers and sellers and increase market efficiency like the auction sites.

Payment and Logistic Specialists

These are firms which facilitate payments for products ordered online and the delivery of such products to the buyer. Development of digital payment system will be a conducive factor for the growth of e-marketing.

TARGETING THE INDIVIDUAL CUSTOMER: BEYOND SEGMENTATION

Market segmentation and targeting was developed as a strategy to overcome some of the limitations of mass marketing. This strategy too has its limitations because segmentation amounts to aggregation of customers on the basis of homogeneity, ignoring some of the factors of heterogeneity. It was impossible or very difficult to target individual consumers because of absence/inadequacy of relevant data and difficulty of practically accessing the individuals. Recent technological developments have, however, brought about a revolutionary change in the marketing environment. "Almost overnight, the World Wide Web has emerged as a powerful new tool for accomplishing what in the past was only a theoretical possibility in marketing: creating marketing programme that target a segment of one. With the Internet, that theoretical possibility has become a reality. Indeed, the whole notion of

segmentation has to be reconsidered. Segmentation was a goal in marketing because it was too expensive to address the individual customer. With the available tools of the Internet and IT, it is now possible to respond to the individual customer regardless of where the customer is located."[28]

The last half a century or so has witnessed the steady progression from mass marketing to segmented marketing to niche marketing to the individualised marketing.

As Stan Rapp and Tom Collins observe in their well-known *The Great Marketing Turnaround: the age of individual — and how to profit from it*, individualised marketing does not literally mean one company addressing a special advertising message to just one Individual, although in a few instances we are beginning to see this happen. But rather, a *very personal form of marketing* that *recognises, acknowledges, appreciates,* and serves the interests and needs of selected groups *of consumers whose individual identities and marketing profiles are or become known to the advertiser*.[29]

Undoubtedly, it is the communication revolution that has so swiftly and stupendouslly expanded the scope of individualised marketing. As Rapp and Collins point out, "it uses the newly affordable power of the computer to target — contact — persuade — sell — and build a profitable relationship with — individual prospects and customers known to the marketer by name, address, and other characteristics stored in a database. It constantly redefines the market in terms of current consumer behaviour and selects just those individuals best suited to receive the product or service message leading to the sale."[30]

The exciting developments in the way data can be gathered, analysed, stored, retrieved disseminated, and used, made possible by the advances in the information technology have added new dimensions to marketing strategies and practices. "The computer, by capturing, storing, and combining bits of information about who we are, where we live, what we like, what we need, what we buy, is making countless niches in the marketplace identifiable and accessible — creating what economist Robert J. Samuelson has dubbed computer 'communities'...today the number of existing computer communities or niche markets where people with common characteristics or interests can be found or assembled is mind-boggling." [31]

Indeed, "the trend toward individualised marketing is not an isolated commercial phenomenon. It is part of a broad societal shift in our times.[32]

Individualised marketing has been strengthened by the development of customer relationship marketing (CRM). Advances in information technology have contributed to the development and thereby the popularity of CRM. "The Internet has opened up immense new possibilities for creating a relationship with global customers, potential customers, suppliers, and channel members. The end of segmentation means that marketers can now focus on delivering value to the individual customer."[33]

Database Marketing is an essential ingredient of CRM. A customer database is an organised collection of comprehensive information about individual customers or prospects that is current, accessible, and actionable for such marketing purposes as lead generation, lead qualification, sale of product or service, or maintenance of customer relationships. A business database ideally would contain past purchases of business customers; past volumes, prices, and profits; buyer-team member names (and their ages, birthdays, hobbies, and favourite foods); status of current contracts; an estimate of the supplier's share of the customer's business; competitive suppliers; assessment of competitive strengths and weaknesses in selling and servicing the account; and relevant buying practices, patterns, and policies.[34]

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18

INTERNATIONAL NEGOTIATON

Negotiating with international customers, partners and regulators often requires a lot of meticulous preparation and skill.

In a number of cases, the foreign market entry and strategy implementation involve negotiation with the government of the foreign country and/or foreign firm. International business plans "are always often implemented through face-to-face negotiations with business partners and customers from foreign countries. The sales of goods and services, the management of distribution channels, the contracting for marketing research and advertising services, licensing and franchise agreements and strategic alliances — all require managers from different cultures to sit and talk with one another to exchange ideas and express needs and preferences. Executives must also negotiate with representatives of foreign governments who might approve a variety of their marketing actions or in fact be the actual ultimate customer for goods and services. In many countries, governmental officials may also be joint venture partners, and in some cases vendors."[1]

Successful negotiation demands threadbare analysis and evaluation of the commercial and their impressive presentation and proper understanding and appreciation of the cultural nuances of the negotiating party and skillfully navigating the negotiation process accordingly. It is rightly said that "negotiation is both an art and a science. The science of it requires analysing the relative bargaining strengths of each party and the different strategic options available to each party and assessing how the other party might respond to various bargaining ploys. The art of negotiation incorporate interpersonal skills, the ability to convince and be convinced, the ability to employ a basketful of bargaining ploys, and the wisdom to know when and how to use them. In the context of international business, the art of negotiation also includes understanding the influence of national norms, value systems, and culture on the approach and likely negotiating tactics of the other party as well as sensitivity to such factors in shaping a firm's approach to negotiations with a foreign government."[2]

4Cs of Negotiation

The negotiation process has been characterised as occurring within the context of four Cs.[3] They are:

- Common interests
- Conflicting interests
- Compromise
- Criteria.

Quite obviously, only when there are some perceived common interests that the question of negotiating a project arises. If both parties conceive substantial benefits from the proposal, both the parties would be keenly interested to negotiate. If the mutual benefits are very unbalanced, the extent of interest of the parties would also vary.

There are a number of possible areas of conflict between the interests of both the parties. These include the quantum of investment, proportion of equity participation by the two parties, method of financing, choice of technology, sourcing, local content/value addition, location of the project, terms and conditions of sales, management and so on.

When there is conflict, it will have to resolved by a trade-off or compromise. The trade-off will be influenced by factors such as the relative importance of the project to the negotiating parties, the alternatives available to both the parties, their relative bargaining power etc. There should also be proper criteria laid down for implementation and evaluation.

Stages of Negotiation

A negotiation normally involves the following five stages.

1. Preparation. This stage involves background research, collection and analysis of data and preparation of the plan and strategy for presentation and negotiation. Understanding the cultural nuances of the negotiating party and the dynamics and other characteristics of the negotiating team or individual is also an essential part of this stage. It is observed that the best negotiators are the Japanese because they will spend days trying to get to know their opponents. The worst are Americans because they think everything works in foreign countries as it does in the USA."[4]

2. Non-task Sounding. This refers to the time at the beginning of the negotiation meeting devoted to introduction and getting acquainted. In other words, it is the time spent on interpersonal relationship building by talking subjects other than the task or business, such as personal and family matters and general subjects of common interests. The nature of non-task sounding may be influenced by cultural differences. For example, the non-task time is normally short in respect of the Americans who would like to get into the business straight away quickly, but people of several cultures would like to have long informal time.

Non-task sounding is very useful. It helps one to understand the characteristics of the persons with whom to negotiate. "Learning about a client's background and interests also provides important cues about appropriate communication styles… There is a definite purpose to these preliminary non-task discussions. Although most people are often unaware of it, such time almost always is used to size up one's clients. Depending on the results of this process, proposals and arguments are formed using different jargons and analogies. Or it may be decided not to discuss business at all if clients are distracted by other personal matters or if the other person seems untrustworthy."[5]

3. Task-related Information Exchange. Task-related information exchange starts after establishing a good personal relationship. This stage involves exchanging information in an effort to provide the background, establish common facts, and set the contexts of negotiations. This stage is expected to provide both the parties by each other with all the information required in sufficient detail and clearly. However, cultural differences often create problems. All the required information may not be divulged, deliberately or otherwise, the language and expression may create problems of understanding sometimes even feeding misunderstanding.

4. Persuasion. This stage is characterised by attempts to make the other party accept the counterparts desired set of exchanges. Both the parties normally try this with each other. "This step of negotiations is considered by many to be the most important. No side wants to give away more than it has to, but each knows that without giving some concessions, it is unlikely to reach a final agreement. The success of the persuasion step often depends on: (1) how well the parties understand each other's position; (2) the ability of each to identify areas of similarity and differences; (3) the ability to create new options; and (4) the willingness to work toward a solution that allows all parties to walk away feeling they have achieved their objectives."[6]

There may not be a clear separation between the third and fourth stages as the task-related information exchange stage may be characterised by each side defining and refining the needs and preferences.

Persuasion requires a lot of tact based on a clear understanding of the organisational, cultural and personal characteristics of the negotiators.

5. Agreement. The negotiation is finally concluded if a mutually acceptable exchange is agreed upon. As indicated in the four Cs of negotiation, conflicts of interests would be resolved by trade-offs or compromise leading to the agreement.

Prerequisites for Effective Negotiation

Cateora and Graham suggest four steps which can lead to more efficient and effective international business negotiations. They are:[7]

1. Selection of the appropriate negotiation team.
2. Management of preliminaries, including training, preparations, and manipulation of negotiation settings.
3. Management of the process of negotiations, that is, what happens at the negotiation table.
4. Appropriate follow-up procedures and practices.

Cultural Problems in International Negotiations

Important problems in international negotiations caused by cultural differences include those pertaining to the following:

1. Language and non-verbal behaviours
2. Values
3. Thinking and decision-making processes.

Some problems may arise when negotiators are not able to properly communicate in a common language. Even when the same language is used, problems may arise due to different meanings for the same word in different cultures or because of different connotations when used in different contexts.

Cross-cultural differences in non-verbal communication are sometimes very perplexing. A particular gesture or symbol may have quite different connotations in different cultures. For example, the symbol *thumbs up* signals approval in the United States, Britain and Russia, but regarded highly offensive in Iran and is considered a rude gesture in Australia.

There are also significant cross-cultural differences in values. For example, people differ in their adherence to time, promises etc. Similarly, business ethics vary substantially.

Culture can also have a significant impact on by whom and how decisions are made. Research has identified at least three fundamental aspects of decision-making that differ significantly by culture.[8] Decision by consensus is characteristics of collectivist-oriented cultures such as Japanese. Secondly, how decisions are made also varies by culture. One of the key factors that influence decisions is the

role of information in the decision-making process. In the United States and Sweden, managers emphasise rationality and utilise quantitative information. By contrast, French, Italian, and Argentinean managers emphasise past experience and qualitative information over quantitative data in making decisions. These examples further illustrate that the type of information that managers pay attention to and utilise in decision-making can vary. Thirdly, culture also seems to play a significant role in the extent to which managers are comfortable in making decisions in uncertain environments. For example, managers from the United States, Germany, and Scandinavia seem to have the highest tolerance, while managers from Italy, Iberia, and Japan seem to have much lower tolerance for making decisions in circumstances of uncertainty. These differences in tolerance can have a variety of implications. For example, if managers from Germany and Iberia are trying to come to an agreement concerning a joint venture in the context of significant uncertainty, they may clash and differ in their willingness to make decisions.

NEGOTIATING WITH REGULATORS

In many instances, government is a party in international business negotiations. There are several governmental factors which are difficult to change and therefore will have to be taken as given. However, the relative bargaining powers can influence the terms. Governmental versus company strength in negotiations, therefore, is an important factor.

There are two viewpoints of the governmental authority, viz., the hierarchical view and the bargaining view.

Hierarchical View

In a hierarchical view of governmental authority, companies accept international business regulations as “givens,” in which case they comply with, circumvent, or avoid operating because of the regulations. Companies will comply when the regulations don’t unduly constrain their desired mode of operations, when benefits are sufficiently attractive in spite of regulations, and when they cannot practically alter the regulations to their benefit. Companies will circumvent regulations they find unacceptable through loopholes, legal or illegal. Avoidance is simply the reverse of compliance as a company decides not to operate in a given locale because of its regulations.[9]

Bargaining View

The bargaining school theory holds that the negotiated terms for a foreign investor’s operations depend on how much the investor and host country need each other’s assets.[10] If either a company or a country has assets that the other strongly desires and if there are few (or no) alternatives for acquiring them) negotiated concessions may be very one-sided.[11]

The bargaining relationship between companies and governments depends very much on whether the parties see agreements as zero-sum (one party’s gain equals the other party’s loss) or positive-sum (both parties have net benefits) gains. In the former, relationships may conflict because the parties think they lose by making any concessions. In the latter, the relationship may be seen as a partnership of cooperation and interdependence.[12]

Determinants of Bargaining Power

Negotiation is defined as “the process of bargaining with one or more parties to arrive at a solution that is acceptable to all”.[13] The relative bargaining strength would, therefore, influence the terms and conditions of the agreement.

The important factors which determine the relative bargaining power are the following:

1. Relative Importance of the Project. If the project negotiated is very important for one party and not very important for the other, the relative bargaining power of the former would be weak. It may be noted that the importance may depend not only on the intrinsic value of the project negotiated, but also on other factors such as the strategic importance of it. For example, a project that gives an entry to a country may have a lot of strategic importance.

2. Alternatives. The number of alternatives available to each party is another important factor that determines the relative bargaining power. If one party has several options (for example, several other parties are keenly interested in the project under negotiation) and the other party does not have this advantage, the former would have a stronger bargaining power.

3. Urgency. The time available for taking up and executing the project is another influencing factor. If the time left for this is very short, this is likely to weaken the bargaining power of the project sponsor/owner. Longer time would facilitate exploring more alternatives and better evaluations.

4. Strengths. The strengths, including reputation, is another factor that influences the bargaining power. For example, a company which is very resourceful and reputed would have greater bargaining power than one which is weak on these.

Company Strengths include factors such as financial soundness, technological capabilities, previous experiences, particularly in the project area considered, track records, business diversity (for example, a host country government may prefer company in diverse businesses, other things being equal, because of the possibility of several businesses getting benefited in different ways), marketing expertise, ability to export the products from foreign investment and of others, etc.

The Country Bargaining Power depends on factors such as political stability, level of economic development and size of the national market, economic policies and business friendliness of the nation, the ability to act as a regional or global hub, etc.

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19

TRADE POLICY AND REGULATION OF INDIA

TRADE STRATEGIES

The trade strategy of a nation has impact not only on the volume and composition of foreign trade, but also on the pattern of investment and direction of development, entrepreneurial and business behaviour, consumption pattern etc.

There are mainly two trade strategies, viz., outward oriented and inward oriented strategies. The trade strategy is only one of the elements of the macroeconomic policy mix; all the elements of the mix should be mutually supportive for the development strategy to be successful.

An outward oriented or outward looking strategy is one in which trade and industrial policies do not discriminate between production for the domestic market and exports, nor between purchase of domestic goods and foreign goods.

As Krueger observes, an outward oriented strategy is "not a government decree that exports are desirable...Rather, it is an entire set of policies oriented toward encouraging the production of goods and services efficiently."[1]

An outward oriented strategy is, thus, a neutral strategy and it does not mean an export oriented or export promotion strategy as it is sometimes mistaken, although such a strategy could pave way for an export-led growth as experienced by some of the South-East Asian countries. An outward oriented policy discriminates neither in favour of exports nor against import substitution. It is an open policy. Neutrality is its essence.

An inward oriented or inward looking strategy is characterised by the bias of the trade and industrial policies in favour of domestic production and against foreign trade. As import substitution is the key element of the inward oriented strategy, it is often described as the 'import substitution industrialisation strategy'.

Protection of domestic industries from foreign competition is an essential feature of the inward oriented strategy. Protection may be accorded by tariffs, quantitative methods etc. However, quantitative methods and such administrative restrictions as licensing are very dominant under the inward looking strategy.

An inward oriented strategy does not intend a bias against exports, of course. This strategy, however, has an inherent bias against exports. It discourages exports in the following ways.

The cost of some exportables increases because of the high cost of imported items (due to reasons like import duty) used in exportables.

Cost of exportables increases also because of the general rise in prices in the economy due to protection.

The lucrativeness of the protected domestic market discourages exports.

The sellers' market that emerges from protection often results in the neglect of cost and quality. This also adversely affects exports.

The emphasis on import substitution may lead to the relative neglect of industries with export potential. For example, Manmohan Singh points out that, in the mid-fifties, while export industries like jute and cotton textiles were denied foreign exchange for their much needed modernisation, a much too liberal approach was followed in India in allocating foreign exchange to many non-essential industries in the name of import substitution.[2]

In short, the import substitution strategy, by breeding a high cost and uncompetitive economy and by the protected market, in effect, has a bias against exports. The bias of this strategy against imports is quite explicit. The inward oriented strategy, thus, is biased against foreign trade.

Countries which adopt inward oriented strategy are often eager to encourage exports. In fact, one of the major reasons for adopting an import restriction policy is the foreign exchange problem. Export promotion, naturally, is another way to overcome this problem. The inherent contradiction, however, is that the inward looking strategy is export discouraging, as pointed out earlier. Countries following inward oriented strategy often try to overcome these disadvantages by offering export subsidies and other incentives. However, several factors like the complexity of such a regime, the administrative cost of the regime, the burden on the exchequer of the subsidies etc., the existence of certain disadvantages of the inward oriented strategy which are not offset by the export incentives etc. limit the success of the export promotion regime.

TRADE STRATEGY OF INDIA

In the four decades since the commencement of planned development in 1951, India followed a strong inward oriented policy. With the adoption of the import substitution industrialisation (ISI) strategy in the Second Five Year Plan, the inward orientation became very powerful.

Outright ban on the import of many products, quantitative restrictions, tariff wall which was one of the highest in the world, administrative restrictions like import licensing, foreign exchange regulations, etc. were important instruments used to pursue this strategy. In addition, regulations like local content requirement, phased manufacturing programme, export obligation and restrictions on domestic sales, etc. were also stipulated.

Import orientation was, of course, necessary in the early stages of development. The import substitution has significantly contributed to industrial development until the late 1960s.

There is, however, a general feeling that the Indian policy had an overemphasis on import substitution and that the import substitution strategy followed in India was a rather indiscriminate one (i.e., the strategy was not a selective one as practiced in countries like Korea where industries for import substitution were selected on consideration of their potential comparative advantage and resources were concentrated on their development). It is also felt that in India protection was not limited to a reasonable period.

Due to factors like export pessimism of the Indian planners, export development was neglected in the First and Second Plans. Although several measures were taken since the Third Plan for export promotion, they were not adequate enough to provide the needed incentives for exports. Krueger observes that although import substitution countries like India had special policies to promote exports and provide export subsidies for individual manufacturing commodities if they were exported, those policies really served only to offset the very strong incentive to produce for the domestic market, and they could lead to the same chaotic set of high rates of implicit subsidy and protection for the exporters as existed for import substitution firms. Careful analysis suggests that these export incentives were really for import substitution industries to export some part of their output.[3]

Some studies have shown that exporting was unprofitable in absolute terms without export incentives and even with the incentives they were relatively unprofitable for many Indian firms doing exporting.

The overemphasis on import substitution had a very adverse effect on exports. As pointed out earlier, while foreign exchange was easily available even for indiscriminate import substitution because of the respectability attached to import substitution, genuine needs of the export sector were overlooked.

Import substitution and the associated protection of domestic industries had other adverse effects too. The sheltered domestic market acted as a deterrent to efficiency improvement and thus the "prospects of newly established industries becoming at some stage earners of foreign exchange are further diminished."[4] The Committee on Import-Export Policies (Mudaliar Committee), Committee on Import-Export Policies and Procedures (Alexander Committee), Committee on Export Strategy for the Eighties (Tandon Committee) and the Committee on Trade Policies (Abid Hussain Committee), among others, have commented on the adverse effects of import substitution and the indiscriminate protection on the productive efficiency and exports.

The high input costs due to protection, production units of uneconomic size and certain other factors have increased the cost of exportables. World Bank's various studies have identified such cases as a price premium of 300 per cent on synthetic fabrics for garment manufactures; prices of basic chemicals and raw materials for the chemical industry averaging 90 per cent above world prices; prices of batteries, tyres and electrical equipment which are inputs to commercial vehicles and tractors, all two to three times above c.i.f. prices; prices of forging quality steel from 50 to 60 per cent above international level; and prices of high speed steel for cutting tools also above 50 per cent above the international level.[5] Import restrictions have starved the export sector of quality raw materials and components at competitive prices and, thus, the unpragmatic trade policy had discouraged export development.

The sheltered domestic market did not compel producers to achieve cost reduction, improve quality and to innovate.

The inward oriented strategy has had very adverse effects on India's export performance and economic development. It may be noted that, as pointed out in the Chapter on *India's Foreign Trade*, the export performance of India has been very poor even in comparison with that of several developing countries.

Some critics of the Indian economic policy, particularly those with a leftist political orientation, argue that since the early 1980s, especially since Rajiv Gandhi became the Prime Minister, India was following an export oriented strategy. Even in the eighties the Indian policy was, undoubtedly, strongly inward-oriented. It is true that several incentives were offered for export promotion. But, to argue that the incentives or other export measures taken in India amounted to export-orientation is quite wrong. Exports is just one of the several priority sectors, like small industry, agriculture, backward area development, which is given incentives. Further, the so- called export incentives were mostly

aimed at compensating the Indian exporters for the disadvantages which they suffered in comparison with their counterparts in other countries and, as the Abid Hussain Committee pointed out, the element of incentive, if any, was very negligible.

It is true that there was some liberalisation of the imports in the 1980s. This enabled to strengthen the export sector to a certain extent by technological upgradation and easy access to some of the inputs. One of the factors which contributed to the acceleration of export growth of the late eighties is believed to be this. The liberalisation has also made the domestic economy more competitive to the benefit of the consume` The fact, however, is that even after these liberalisations of the 1980s, the Indian economy was strongly inward oriented.

The trade policy regime of India since independence has three distinct phases.

It has been rightly observed that the "Indian export policy has evolved over the period from indifference, pessimistic neglect, and, for several major items, even a constellation of measures adding upto positive discouragement to growing encouragement via escalating subsidisation (culminating in the 1966 devaluation) and promotional measures undertaken by the government. These two periods broadly correspond to the first two Five Year Plans (1951/56 and 1956/61) and the period thereafter".[6] In 1991, India moved towards a more liberal system.

Period of Export Pessimism

As a matter of fact, the first two Five Year Plans were formulated under the assumption that it would not be possible to achieve significant increase in exports during the early stages of development of the economy. The Second Plan document observed: "On the whole, the fact remains that the increase in exports that we visualise over the plan period is not very striking. India's export earning are derived from a few commodities. Three of them, namely, tea, jute and cotton textiles, account for nearly one half of the total. These major exports are meeting increasing competition from abroad. This limits the scope for any substantial increase in exports in the short run. While every effort has to be made to promote exports of new items and to develop and diversity the markets for the country's major exports, it has to be recognised that it is only after industrialisation has proceeded some way that increased production at home will be reflected in larger export earnings."[7] The Third Plan document has indeed admitted that "one of the main drawbacks in the past has been that the programme for exports has not been regarded as an integral part of the country's development effort under the Five Year Plans."[8]

The Import-Export Policy Committee (Mudaliar Committee) pointed out, in 1962, that if we were to discard historical times, for the moment, it could be said that the country had no great export tradition. Nor has one been developed so far — much less have we developed the necessary export apparatus... so far the country has touched only a fringe of the export problem. An important lacuna in the export effort is that whereas targets of a high order have been, theoretically, drawn up, adequate steps have not yet been taken to dovetail the import-export targets with the plans and projects of development in the private and in the public sector and to pay the foundation of a big trade".[9] The committee further added: "There is no clear picture as to what items, specially non-traditional items, would be available at a given time for export; how they would be available and in what quantities; and by what measures and means, and where, would these quantities be outletted."[10]

The above anecdotes from the official documents clearly evince the official pessimism and the resultant failure to take adequate development measures on the export front. "This bearishness with regard to exports is attributable to two specific perceptions. Exports of primary products or of traditional manufactures based on them were seen as facing poor demand prospects in the world market. At the same time, it was felt that other newer manufactures had little likelihood of securing a sizable

export market until industrialisation itself was well under way. The natural consequence of such export pessimism was a conviction that, in the long run, industrialisation could lead to a viable balance of payments only if it was based on a programme which minimised imports. Much of the policy was dominated by a feeling of export pessimism. Thus, import substitution, particularly in basic intermediate and machine building, became a major element of trade policy in the late fifties, while exports suffered relative neglect".[11]

In short, as Manmohan Singh observes, "on the one hand there was a widespread feeling that not much could be done to increase export earnings in view of the stagnant demand for India's major exports. On the other hand, responsible economists were assuring the country that import substitution, wherever it meant, would by itself be able to solve India's balance-of-payments difficulties, so that India would, in fact, not need a greatly intensified export in the long run. The result was a neglect of exports and, ...even the available opportunities were missed out."[12]

It is quite clear that it was the export pessimism which resulted in the neglect of export promotion and certain government measures which biased against exports which were responsible for the stagnation of India's export earnings in the 1950s. As several authors[13] have pointed out, the domestic policies of the Indian government via export controls and quotas, export duties, inflationary pressures and policies aimed at promoting domestic consumption were inhibiting the expansion of export earnings.

In short, the export pessimism and the resultant indifference to export development in the earlier plans resulted in the neglect of several sectors with tremendous export potential, like textiles, fisheries etc. Further, even after recognising the export potential of many products, the failure to effectively harness the potential has been more conspicuous than achievements in several cases.

The increasing trade deficit during the Second Plan pointed to the need to promote exports and since the middle of the Second Plan period a series of measures had been initiated with the object of stepping up exports. These included organisational changes, increased facilities and incentives and diversification of trade. However, as the Third Plan document observes, these measures were not adequate in relation to the underlying factors inhibiting exports and one of the main drawbacks was that the export promotion programme was not regarded as an integral part of the country's development effort under the Five Year Plans.[14]

Era of Export Promotion and Import Restriction

The period of about three decades, 1961-91, extending from the beginning of the Third Five Year Plan to the eve of the Eighth Plan is characterised by import restriction and the adoption of a number of measures for export promotion. The early part of this period, particularly, also witnessed vigorous import substitution efforts. Although there was some liberalisation of the imports since the mid 1980s, imports were, in general, highly restricted. Further, many of the import liberalisation measures were for export promotion.

During the Third Plan, the institutional framework for promoting exports was broadened and strengthened and certain fiscal incentives like drawback of import duty and refund of excise duty and income tax concession were introduced. A major factor was the operation of special export promotion scheme providing import entitlement against exports in respect of a number of manufactured and processed products. A limited scheme of direct subsidies for about 22 products was also operated to promote exports of non-traditional products. Another important aspect of the trade policy during the Third Plan was the importance given to diversification, both country-wise, and product-wise, of the foreign trade.

It is pointed out that despite their proliferation, the incentive schemes implemented during the Third Plan period "failed not only to generate self-sustaining exports but also generated widespread

manipulations in the form of over-invoicing of exports, export of shoddy goods, besides the obvious distortions in the pattern of resource allocation in the country."[15]

A major development soon after the Third Plan was the devaluation of the Indian rupee (on June 6, 1966) by 36.5 per cent which was resorted "partly to obviate the need for administering a system of export incentive schemes which became increasingly complex and partly due to the failure of the schemes to generate self- sustaining exports."[16]

With the devaluation, export promotion schemes like import entitlement and cash subsidy were withdrawn (but were reintroduced later, in modified form), and the import and industrial policies were liberalised with a view to removing bottlenecks in production.

Subsequent to the devaluation, further modifications, adjustments and extensions in export promotion schemes were made. These took the form mainly of adjustments in export duties and in cash assistance, modifications of import facilities for exporting units and industries and strengthening of credit arrangements for exports.

Realising the country's potential for achieving a rising level of exports and recognising the need for the adoption of appropriate policies and measures designed to promote investment in promising sectors to generate exportable surplus and the need for providing adequate facilities and incentives to promote the growth of the export trade, an Export Policy Resolution was announced by the Government of India in 1970.

The Export Policy Resolution, presented with the hope that "the export effort will be viewed as one of the highest national commitments" reflected the government's resolve (*i*) to strengthen the domestic production base so as to generate more exportable surplus in a variety of sectors; (*ii*) to strengthen and develop the export marketing infrastructures; (*iii*) to develop overseas markets; and (*iv*) to provide incentives to give a boost to the export sector.

It has been argued that "the policy decisions taken subsequently by the Government, their rapid implementation and the results achieved have amply proved that the policy has been adumbrated after a very careful study. This is evident from the rate of growth in exports in the subsequent yea` Between 1950-51 and 1970-71, the average annual increase in exports was only 3 per cent whereas it was as high as 25.4 per cent between 1971-72 and 1976-77. Even though a part of this may be attributed to inflation, it is no means achievement."[17]

With the burgeoning trade deficit since the emergence of the oil price hike in the early 1970s, export promotion assumed added importance and export promotion measures have been sought to be enlarged. These measures aim, in general, to expand and strengthen the export production base, diversify export markets and products, develop export markets, improve export marketing and export competitiveness and to give incentives for exports.

The rationale, efficiency and adequacy of different export promotion measures and their implementation have been subject to several criticisms. The committees referred to earlier in this chapter and several committees on particular export promotion schemes or problems have critically examined trade policies, procedures, promotion schemes etc. and in the light of their recommendations efforts have been made to improve the system.

A number of measures were taken in the eighties to promote exports. These included liberalisations of industrial and import policies to encourage production of export goods, development of export processing zones, promotion of hundred per cent export oriented units (EOUs), rationalisation and simplification of schemes of export assistance and incentives etc.

During the Seventh Plan (1985-90) efforts were made to identify sectors, industries and products which have a good export potential and to provide a suitable policy framework. Fourteen broad

sectors were identified by the Government in consultation with the export promotion councils and commodity boards, for making special thrusts in the overseas markets without minimising the importance of increased exports from other sectors as well. The fourteen thrust sectors included tea (especially in packaged and value added form); cereals (in particular wheat); processed foods (including fruits and juices, meat and meat products and fresh fruits and vegetables); marine products (especially in the value added form); iron ore; leather manufactures; handicrafts and jewellery; capital goods and consumer durables, electronic goods and consumer software; basic chemicals; fabrics, piece goods and made-ups; ready-made garments; woollen fabrics and knit wear; and projects and services.

As a result of these measures and some other favourable factors, the export growth accelerated in the late 1980s.

Towards an Open System

Trade policy reform has been an integral part of the economic policy reform ushered in India since July 1991.

The trade policy cannot be viewed in isolation; it should be seen in the context of the overall economic policy. One of the important features of the new economic policy is a move towards a more open economy by liberalising the foreign investment policy and imports.

ECONOMIC POLICY LIBERALISATION IN INDIA

Until June 1991, India followed a very restrictive economic policy characterised by exclusion of private sector from many important industries, monopoly or dominance of public sector in a number of important industries and sectors, entry and growth restrictions on private, particularly large, enterprises and limited role of and stringent restrictions on foreign capital and technology. The economic liberalisation ushered in June 1991, changed the scenario very substantially. The salient features of the liberalisation are the following:

1. Abridgement of the role of public sector and expansion of the scope of private sector

Until the liberalisation, the development of 17 of the most important industries were exclusively reserved for the public sector, and in 12 of the remaining important industries the public sector was assigned a dominant role, the role of the private sector being a supplementary one. The scope of the private sector was, thus, limited. The new economic policy has substantially expanded the scope of the private sector by drastically bringing down the number of industries reserved for the public sector.

2. Removal of Entry and Growth Restrictions

There had been several entry and growth restrictions on the private sector under the licensing regulations and Monopolies and Restrictive Practices (MRTP) Act. A licence was required for establishing a new undertaking with investment above certain limit, or manufacture of a new item and for substantially expanding an existing undertaking. Besides, large undertakings (i.e., those with assets, including those of interconnected undertakings, of ₹ 100 crores or more) and dominant undertakings (i.e., undertakings with a market share of 25 per cent or more) had to obtain a clearance under the MRTP Act, for substantial expansion, establishment of new undertaking and for take-overs and mergers and amalgamations.

The new policy has substantially reduced the entry and growth restrictions by delicensing all but a limited number of industries and scrapping the MRTP restrictions on growth.

3. Liberalisation of Foreign Investment

Earlier, foreign investment required prior approval of the government. Foreign equity was not allowed, normally, to exceed 40 per cent of the total.

Since 1991, there has been a substantial liberalisation of the foreign investment policy.

4. Import Liberalisation

There has been a substantial liberalisation of imports. As tariffs have been cut across the board, the average tariff rate (unweighted) has fallen from 127% in 1990-91 to less than 50% in 1995-96. There has been further reduction in subsequent years Quantitative barriers have also been substantially reduced.

Reform of Trade Policy

The salient features of the trade policy reform have been the following:

1. *Exchange rate adjustment:* To make the exchange rate more realistic and to encourage exports and discourage imports, the Rupee was devalued.

2. The role of subsidies in export promotion was substantially reduced by abolishing the cash compensatory support (CCS). The import entitlement scheme for exporters known as Replenishment Licence (REP) which was modified as Exim scrip was also withdrawn.

3. Liberalisation of imports by substantially eliminating licensing, quantitative restrictions and other regulatory controls. There has also been a considerable reduction in the import duties.

4. Procedural simplification.

5. *Convertibility of the Rupee:* As a first step towards free convertibility of rupee, a scheme of partial convertibility of the Rupee was introduced in March 1992. Accordingly, exporters got 40 per cent of the foreign exchange earnings converted into rupee at the official rate determined by the Reserve Bank of India. The remaining 60 per cent of the export earnings could be converted at the free market rate quoted by the authorised dealers Full convertibility on trade account was introduced in 1994.

FOREIGN TRADE POLICY 2015-20

Government of India has been announcing five year Foreign Trade Policy (FTP). A new FTP should have come into effect on April 1, 2014 on the expiry of the FTP 2009–14. However, a new Policy was announced only on April 1, 2015, nearly a year after the Narendra Modi Government assumed office, as the new Government needed time to recast the Policy.

While unveiling the Policy for 2015-20, Commerce Minister Nirmala Sitharaman stated that it is in line with the initiatives 'Make in India', 'Digital India' and 'Skill India' announced by the government earlier. There will be a mid-term review of the Policy, compared to the past practice of annual reviews.

SALIENT FEATURES

Some of the salient features of the foreign trade policy 2015-20 are outlined below.

Objective

According to the Commerce Minister, the FTP 2015-20 aims at making the country a bigger player in global trade by improving the business environment and simplifying trade transactions in the wake of trade facilitation agreement of the World Trade Organisation. It seeks to provide a stable and sustainable policy environment for foreign trade in merchandise and services and to promote diversification of India's export basket.

Export Growth Targets

The FTP 2015-20 aims at almost doubling the merchandise exports of India from $466 billion in 2013-14 to $900 billion by 2019-20, by raising India's share in world exports from 2 per cent to 3.5 per cent during this period.

Simplification and Restructuring of Reward Schemes

The FTP for 2015-20 has restructured existing incentive schemes and introduced certain new schemes.

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

Rewards for eligible export of goods to notified markets under MEIS shall be payable as percentage of realised FOB value (in free foreign exchange). The debits towards basic customs duty in the transferable reward duty credit scrips would also be allowed adjustment as duty drawback. Earlier, only the additional duty of customs/excise duty/service tax was allowed adjustment as CENVAT credit or drawback, as per Department of Revenue rules.

The current Policy has replaced the earlier scheme known as Served From India Scheme (SFIS) with Service Exports from India Scheme (SEIS). SEIS shall apply to 'Service Providers located in India' instead of 'Indian Service Providers'. Thus, SEIS provides for rewards to all Service providers of notified services, who are providing services from India, regardless of the constitution or profile of the service provider.

Incentives under MEIS and SEIS have been extended to units located in SEZs also.

For the first time, exports by e-commerce firms will be provided incentives while under the MEIS.

New Trade Promotion Agency

Apart from the existing Board of Trade, a Council for Trade Development and Promotion will be set up comprising representatives from States and Union Territories.

Status Holders

For a long time, the Government has been recognising large exporters as Status Holders and given special treatment and privileges to facilitate their trade transactions, in order to reduce their transaction costs and time. (Also see *Export Houses and Trading Houses* in Chapter 20).

The current Policy has changed the nomenclature of Export House, Star Export House, Trading House, Star Trading House, Premier Trading House certificate to One, Two, Three, Four, Five Star Export House. The criteria for export performance for recognition of status holder have been changed from Rupees to US dollar earnings. The new criteria is as under:

Table 19.1

CATEGORIES OF EXPORT HOUSE

Status category	Export Performance FOB/FOR (as converted) Value (in US $ million) during current and previous two years
One Star Export House	3
Two Star Export House	25
Three Star Export House	100
Four Star Export House	500
Five Star Export House	2000

New Initiatives for EOUs, EHTPs and STPs

According to the Foreign Trade Policies of the past, units undertaking to export their entire production of goods (except permissible domestic tariff area [DTA]) were permitted under Export Oriented Unit (EOU) Scheme, Electronic Hardware Technology Park (EHTP), Software Technology Park (STP) Scheme, Bio-Technology Park (BTP) Scheme for manufacture of goods including repair, remaking, reconditioning, reengineering, and rendering of services. The FTP 2015-20 has modified these schemes. Important modifications include the following, among others:

(a) EOUs, EHTPs, and STPs are allowed to share infrastructural facilities among themselves. This will enable units to utilise their infrastructural facilities in an optimum way and avoid duplication of efforts and cost to create separate infrastructural facilities in different units.

(b) Inter-unit transfer of goods and services are allowed among EOUs, EHTPs, STPs, and BTPs. This will facilitate group of those units which source inputs centrally in order to obtain bulk discount. This will reduce cost of transportation, other logistic costs and result in maintaining effective supply chain.

(c) EOUs are allowed facility to set up warehouses near the port of export. This will help in reducing lead time for delivery of goods and will also address the issue of unpredictability of supply orders.

(d) STP units, EHTP units, and software EOUs are allowed the facility to use all duty free equipment/goods for training purposes. This will help these units in developing skills of their employees.

Boost to 'Make in India'

To encourage domestic production, Export Obligation (EO) for domestic procurement under EPCG scheme has been reduced from 90 per cent of the normal export obligation (6 times at the duty saved amount) to 75 per cent, in order to promote domestic capital goods manufacturing industry.

Further, it is proposed to give higher level of rewards to products with high domestic content and value addition, as compared to products with high import content and less value addition.

The government also extended tax breaks to exporters of defence, pharma and environment-friendly products. The government will focus on branding India's products for which campaigns would be started soon in sectors including pharma and engineering. Traditional exports like handloom alongside yoga in services would also be promoted.

Evaluation

The BJP Government took one year to do required homework for a new five year Foreign Trade Policy instead of coming out with a new Policy (which was due in April 2014) in a hurry soon after coming to power. Considerable thought has gone in to the making of the new Policy. However, it may be said that the new Policy reflects the general trend of the past of rationalising existing export promotion schemes and introducing new ones zeroing in the emerging business environment.

Although catchy terms of the favour of the present government such as 'Make in India', 'Digital India' and 'Skill India' are used in the Policy, they are more or less extensions of initiatives of the past. Indeed, every successive Policy has been a step forward from the previous Policy. It is true of the Foreign Trade Policy 2015-20 too. The endeavours towards procedural simplification and digitalisation have been carried further forward by the current Policy.

The Policy document evinces a serious homework. The success of the policy in achieving the objectives will depend on the efficiency of the implementation. The foreign trade environment in particular and the business environment in general being characterised by frequent changes and,

some times, even turbulence, the Policy should be amenable to needed flexibility. In this context, the replacement of the Annual Review by Mid-term Review may not be appreciated by everybody.

REGULATION AND PROMOTION OF FOREIGN TRADE

The Export-Import Policy (Exim Policy) reflects the foreign trade policy of India. The policy is implemented mostly by means of the regulatory framework provided by the Foreign Trade (Development and Regulation) Act, 1992.

Control of foreign trade in India dates back to the early years of the Second World War. Import Control was introduced in 1940 as a war-time measure under the Defence of India Rules with the primary objective of conserving the foreign exchange resources and restricting physical imports so as to reduce the pressure on the limited available shipping space. Initially, the import of only 68 commodities, mainly consumer goods, were brought under control. Subsequently, with the increasing pressure on the foreign exchange resources, import control was extended to other commodities as well.

After the end of the war, the Defence of India Rules lapsed and hence in September 1946, the Emergency Provisions (Continuance) Ordinance, 1946, was promulgated to continue the import trade control. This was ultimately replaced by the Imports and Exports (Control) Act, 1947, which came into force with effect from 25th March, 1947. This Act gave the Government enormous powers of control over the foreign trade of India. This imports and exports was controlled by the Government under the Imports (Control) Order and Exports (Control) Order issued under this Act. The Imports and Exports (Control) Act, 1947, was replaced by the Foreign Trade (Development and Regulation Act), 1992 (FTDRA).

Besides the FTDR Act, there are some laws which control the trade in certain items. For instance, the export of antiquities is regulated under the Antiquities and Art Treasures Act 1972; export of coffee is regulated by the Coffee Board under the Indian Coffee Act 1942; export of tea is regulated under Tea Act, 1953, etc. The export and import currency notes, bank notes and coins have been controlled by the Reserve Bank of India under the Foreign Exchange (Regulation) Act, 1973 (FERA).

The major concern of Government in the past was restriction of imports with a view to controlling the trade deficit and protection of domestic industries against foreign competition. Imports were, therefore, very much restricted by prohibition of imports of many items, import licensing, very high import duties and foreign exchange restrictions. The foreign trade policy was characterised by the overtone of negativism.

The Foreign Trade (Development and Regulation) Act, 1992

This Act which replaced the Imports and Exports (Control) Act, 1947, came into force on 19th June, 1992.

No export or import shall be made by any person except in accordance with the provisions of this Act, the orders and rules made under this Act and the export and import policy.

***Objective*:** The objective of the Act is to *provide for the development and regulation of foreign trade by facilitating imports into, and augmenting exports from India and for matters connected therewith or incidental thereto.*

Main Provisions: The main provisions of the FTDR Act are the following:

Development and Regulation: The FTDRA empowers the Central Government to make provision for the development and regulation of foreign trade by facilitating imports and increasing exports.

Prohibition and Restriction: The Act also empowers the Central Government to make provision for prohibiting, restricting or otherwise regulating the import or export of goods as and when required. All goods which are so regulated under this sub-section shall be deemed to be goods the import or

export of which has been prohibited under Section 11 of the Customs Act, 1962, and all the provisions of that Act shall have effect accordingly.

It may be noted that it is according to this sub-clause that the Government has provided for negative lists of exports and imports in the Exim policy.

Exim Policy: The Act lays down that the Central Government may, from time to time, formulate and announce the export and import policy and may also amend that policy.

Directorate General of Foreign Trade: The Act provides for the appointment by the Central Government, of a Directorate General of Foreign Trade for the purpose of this Act. The DGFT shall advise the Central Government in the formulation of the export and import policy and shall be responsible for carrying out that policy. [The corresponding authority under the Imports and Exports (Control Act), 1947, was called the Chief Controller of Imports and Exports (CCIE)].

Importer-Exporter Code Number: The Act lays down that no person shall make any import or export except under an Importer-Exporter Code (IEC) Numbers granted by the DGFT or the Officer authorised by him in his behalf.

The Directorate General is empowered to suspend or cancel the Importer-Exporter Code Number granted to any person if there is valid reason to do so, like contravention of law relating to Central excise or customs or foreign exchange or having conducted import/export in a manner gravely prejudicial to the trade relations of India with any foreign country or in a way detrimental to the interests of the country.

Issue and Suspension/Cancellation of Licence: The Director General or any other Officer authorised under this Act is empowered to suspend or cancel a licence issued for export or import of good in accordance with this Act for good and sufficient reasons, after giving the licence holder a reasonable opportunity of being heard.

Search, Inspection and Seizure: Where any contravention of any condition of the licence of authority under which any goods are imported is suspected or made, any person authorised by the Central Government may search, inspect and seize such goods, documents, things and conveyances subject to such requirements and conditions as may be prescribed.

Penalty for Contravention: Where any person makes or abets or attempts to make any export or import in contravention of any provisions of this Act or any rules or orders made under this Act or the Exim policy, he shall be liable to a penalty not exceeding one thousand rupees or five times the value of the goods involved, whichever is more.

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20

EXPORT PROMOTION

Government of India, like almost all other nations, has been endeavouring to develop exports.

Export development is important to the firm and to the economy as a whole. Government measures aim, normally at the general improvement of the export performance of the nation for the general benefit of the economy. Such measures help exporting firms in several ways.

The benefits of exports to the economy are many.

When the domestic market is small, foreign market provides opportunities to achieve economies of scale and growth. Secondly, the supply of many commodities, as in the case of a number of agricultural products in India, is more than the domestic demand. Thirdly, exports enable certain countries to achieve export-led growth. Fourthly, export markets may help mitigate the effects of domestic recession. Fifthly, a country may need to boost its exports to earn enough foreign exchange to finance its imports and service its foreign debt. It may be noted that many countries are suffering from trade deficit and foreign debt. Lastly, even in the case of countries with trade surplus, export promotion may be required to main its position against the international competition and the level of domestic economic activity.

The principal objectives of export promotion measures in India are to:

(*i*) Compensate the exporters for the high domestic cost of production.

(*ii*) Provide necessary assistance to the new and infant exporters to develop the export business.

(*iii*) Increase the relative profitability of the export business *vis-a-vis* the domestic business.

ORGANISATIONAL SETUP

Government has established or sponsored a number of organisations to provide different types of assistance to the exporters. Apart from the organisations established exclusively for export promotion, there are also a number of other institutions which assist the export sector. An outline of the important organisations which help to promote exports is given below.

Ministry of Commerce

The Ministry of Commerce, Government of India, is the most important organ concerned with the promotion and regulation of the foreign trade of the country. The ministry has elaborate organisational

arrangement to look after various aspects of trade regulation and promotion. The Department of Commerce in the Ministry of Commerce is assigned a very important role in different matters concerned with foreign trade of the country including commercial relation with other countries, promotion and regulation of foreign trade, state trading etc. Matters related to foreign trade are dealt with by eight divisions in the Department of Commerce, namely, (*i*) Administrative and General Division, (*ii*) Finance Division, (*iii*) Economic Division, (*iv*) Trade Policy Division, (*v*) Foreign Trade Territorial Division, (*vi*) Exports Products Division, (*vii*) Services Division, and (*viii*) Industries Division.

Autonomous Bodies

1. *Commodity Boards:* There are five statutory Commodity Boards responsible for production, development and export of tea, coffee, rubber, spices and tobacco.

2. *Export Inspection Council:* The Export Inspection Council, a statutory body, is responsible for the enforcement of quality control and compulsory pre-shipment inspection of various exportable commodities.

3. *Indian Institute of Foreign Trade:* The Indian Institute of Foreign Trade, registered under the Societies Registration Act, is engaged in the following activities.

(*i*) Training of personnel in modern techniques of international trade;

(*ii*) Organisation of research in problems of foreign trade;

(*iii*) Organisation of marketing research, area surveys, commodity surveys and market surveys; and

(*iv*) Dissemination of information arising from its activities relating to research and market studies.

4. *Indian Institute of Packaging:* The Indian Institute of Packaging is registered under the Societies Registration Act. The main aims of the Institute are to undertake research on raw materials for the packaging industry, to organise training programmes on packaging technology, to stimulate consciousness of the need for goods packaging technology, to stimulate consciousness of the need for good packaging, etc.

5. *Export Promotion Councils:* There are a number of Export Promotion Councils under the administrative control of Ministry of Commerce. These Councils are registered as non-profit organisations under the Companies Act. The Councils perform both advisory and executive functions. These Councils are also the registering authorities under the Import Policy for Registered Exporters.

6. *Federation of Indian Export Organisations:* The Federation of Indian Export Organisations is an apex body of various export promotion organisations and institutions. It also functions as a primary servicing agency to provide integrated assistance to Government recognised Export Houses and as a central coordinating agency in respect of export promotion efforts in the field of consultancy services in the country.

7. *Indian Council of Arbitration:* The Indian Council of Arbitration, set up under the Societies Registration Act, promotes arbitration as a means of settling commercial disputes and popularises arbitration among the traders, particularly those engaged in international trade.

8. *Marine Products Export Development Authority:* The Marine Products Export Development Authority (MPEDA) is responsible for development of the marine products industry with special reference to exports.

9. *Agricultural and Processed Food Products Export Development Authority (APEDA):* The Agricultural and Processed Food Products Export Development Authority, set up in 1986, serves as the focal point for agricultural exports, particularly the marketing of processed foods in value added forms.

10. *India Trade Promotion Organisation:* The ITPO was bought into being in 1992 by merging together the erstwhile Trade Fair Authority of India (TFAI) and the erstwhile Trade Development Authority of India (TDA). The functions of the ITPO are to:

1. Develop and promote exports, imports and upgrade technology through fairs in India and abroad
2. Compile and disseminate trade related information
3. Undertake publicity through the print and electronic media
4. Organise visit of foreign buyers and trade
5. Delegations to industry and trade establishments in India with a view to promoting trade contracts
6. Assist Indian companies in trade development; organise export development programmes, buyer-seller meets; and conduct promotion programmes and integrated marketing promotion programmes for the trade and industry in India.

Public Sector Undertakings

The following trading/service corporations are functioning under the administrative control of the Ministry of Commerce.

- The State Trading Corporation of India and its subsidiaries
- The Minerals and Metals Trading Corporation of India and its subsidiary, viz., Mica Trading Corporation
- The Spices Trading Corporation
- The Export Credit Guarantee Corporation.

Advisory Body

Central Advisory Council on Trade: The Central Advisory Council on Trade, consisting of representatives from different organisations and individuals with business standing and expertise in the field of trade and commerce, advise Government on matters relating to:

(*i*) Export and import policy programme
(*ii*) Operation of import and export trade controls
(*iii*) Organisation and development of commercial services
(*iv*) Export Credit Guarantee Corporation.

The Commerce Minister is the Chairman of this council.

Attached and Subordinate Offices

1. *Office of the Directorate General of Foreign Trade (DGFT):* The DGFT is responsible for the execution of the export and import policies of the Government. Import and Export Licensing of iron and steel and ferro-alloys is also looked after by this Organisation. The DGFT with the head office at New Delhi has subordinate offices located at different parts of the country. Earlier the office of the DGFT was known as the Chief Controller of Imports and Exports (CCIE).

2. *Directorate General or Commercial Intelligence and Statistics:* This Directorate is the primary Government agency for the collection, compilation and publication of the foreign, inland and ancillary trade statistics and dissemination of various types of commercial information. The Directorate brings out a number of publications, particularly on trade statistics which are utilised in framing economic policies, formulating trade agreements with foreign countries and monitoring these agreements. These publications are also used by the trading public and research scholars. The Directorate conducts

studies on various topics relating to promotion of trade. It also helps in the settlement of commercial disputes and provides Indian businessmen going abroad with letters of introduction to Indian Commercial representatives concerned. It maintains Commercial Library which is widely used by the exporters, importers, research scholars and others.

3. *Offices of Development Commissioners, FIZ/EPZs:* For each of the free trade zone/export processing zone in the country, there is an office of the Development Commissioner responsible for the administration of the zone.

INCENTIVES

Export incentives are a widely employed strategy of export promotion. The main aim of these incentives is to increase the profitability of export business. Important export incentives in India include rebate of duties, cash compensatory support, income tax concession, interest subsidies, freight subsidy etc. It has been common to describe these as incentives. However, as the Abid Hussain Committee has observed, they are more a compensation for the comparative disadvantages faced by the Indian exporter than incentives. We give below a very brief account of these ‘incentives’ which serve the first rationale of export promotion mentioned earlier in this section, viz., to compensate the exporters for the high domestic costs.

Duty Exemption/Drawback

The scheme of duty exemption is designed to avoid the incidence of commodity taxes like excise duty and customs duties on the exports so as to make the exports more price competitive. “This is a worldwide practice and the rationale is straight forward. Customs duties and excise duties on inputs raise the cost of production in export industries and thereby affect the competitiveness of exports. Therefore, exporters need to be compensated for the escalation in their costs attributable to such customs and excise duties.”[1]

Duty exemption as an export promotion measure had its origin in India during the Second Plan. Over the years, the scheme has been enlarged and modified.

The exporters are either exempted from the payment of duty while procuring inputs like raw materials and intermediates or, in cases where the duty is paid on the inputs, the duty is refunded. Thus, under the duty drawback system, the exporters are reimbursed for tariff paid on the imported raw materials and intermediates and central excise duties on domestically produced inputs which enter into export production.

Because of a series of modifications to the import policy for registered exporters, particularly the introduction of the advance licensing system, exporters can now make most of the import of inputs without payment of customs duty.

Eligible exporters are entitled to interest-free bank credit against the duty drawback applicable to them upto a period of 90 days or upto the time they realise the drawback, whichever is earlier. Similarly, with the application of MODVAT, a large number of products, covered by the MODVAT, can be exported in bond and in that event, the duty relief in the form of drawback would be restricted only to basic customs and auxiliary duties suffered, if any, by the inputs.

There are two types of drawback rates, viz., all industry rate applicable to a group of products and brand rate applicable to individual products not covered by the industry rate.

The all industry drawback rates are derived from estimates of average quantity of value of materials used in the manufacture of exports, the average amount of duties paid on imported materials or excisable materials used in the manufacture of these goods, and the average amount of duties paid on the materials wasted in the manufacturing process. Such average industry rates are fixed by the Drawback Directorate in the Ministry of Finance.

Income Tax Concession

Besides the exemption/rebate of indirect taxes, a special fiscal treatment granted to exports is the income tax concession according to which earnings from exports are either partially exempted from income tax, or taxed at a lower rate. Such income tax rebates have been provided to exporters in India since the early 1960s.

Awards

A number of awards have been instituted to encourage exports and to recognise excellence in exports. There are separate awards for different categories of exporters. Awards are given on the basis of certain specified criteria such as development of market for products which has not been exported previously, substantial increase in exports, successful introduction of new products, product development, successful breakthrough in foreign markets where conditions have been especially difficult etc. References to some other incentives are made in the sub-section on *Marketing Assistance*.

Other Incentives

Some important incentives were terminated consequent to certain measures taken as part of the economic liberalisation.

The *Cash Compensatory Support* (CCS) was a cash subsidy scheme designed to compensate the exporters for unrebated indirect taxes and to provide resources for product/market development. The CCS enabled the exporters to increase the profit or to reduce the price to the extent of the subsidy without incurring a loss. With the devaluation of the Rupee in July 1991, the CCS was abolished.

Another important incentive was the system of *Import Replenishment* (REP) licenses, which were related to the f.o.b. value of exports. The REP was, for the most part, a facility insofar as it enabled exporters to import inputs where the domestic substitutes were not adequate in terms of price, quality or delivery rates; it was also an incentive insofar as there was a premium on REP license which were transferable. The new trade policy announced in July 1991 which renamed the REP as Exim Scrip significantly modified the scheme. The *Exim Scrip Scheme* was, however, abolished with the introduction of the partial convertibility of Rupee since April 1992.

The *International Price Reimbursement Scheme* (IPRS) was designed to make available specified inputs to exporters at international prices. The scheme which was initially available to steel was later extended to aluminium also and there was a proposal to extend to other items. The IPRS has been replaced by Engineering Products Exports (Replenishment of Iron and Steel Intermediates) Scheme.

PRODUCTION ASSISTANCE/FACILITIES

Exports depend, *inter alia,* on exportable surplus and the quality and price of the goods. Government have, therefore, taken a number of measures to enlarge and strengthen the production base, to improve the productive efficiency and quality of products and to make the products more cost-effective. Measures in these directions include making available raw materials and other inputs of required quality of reasonable prices; facilities to establish and expand productive capacity, including import of capital goods and technology; facilities to modernise production facilities, provision of infrastructure for the growth of export oriented industries etc.

MARKETING ASSISTANCE

A number of steps have been taken to assist the exporters in their marketing effort. These include conducting, sponsoring or otherwise assisting market surveys and research; collection, storage and dissemination of marketing information, organising and facilitating participation in international trade fairs and exhibitions; credit and insurance facilities; release of foreign exchange for export

marketing activities; assistance in export procedures; quality control and pre-shipment inspection; identifying markets and products with export potential; helping buyer-seller interaction, etc. Some of the schemes and facilities which assist export marketing are mentioned below.

Market Development Assistance

An important export promotion measure taken by the Government is institution of the Market Development Assistance (MDA). Assistance under the MDA is available for market and commodity researchers; trade delegations and study teams; participation in trade fairs and exhibitions; establishment of offices and branches in foreign countries; and grants-in-aid to EPCs and other approved organisations for export promotion on Export Credit by commercial banks and approved cooperative banks enjoyed a subsidy out of the MDA. Most of the MDA expenditure in the past were absorbed by the CCS. The CCS helped the exporters to increase the price competitiveness of the Indian products in foreign markets.

Foreign Exchange

Foreign exchange is released for undertaking approved market development activities such as participation in trade fairs and exhibitions, foreign travel for export promotion, advertisement abroad, market research, procurement of samples and technical information from abroad.

Trade Fairs and Exhibitions

As trade fairs and exhibitions are effective media of promoting products, facilities are provided for enabling and encouraging participation of Indian exporters/manufactures in such events. As mentioned earlier, foreign exchange is released for such purpose, the cost of participation is subsidised and the ITPO plays an important role in organising and facilitating participation in trade fairs/exhibitions.

Besides the ITPO, some other promotional agencies also organise trade fairs. For example, the MPEDA organises seafoods trade fair, in India, in every second year, which attracts a number of foreign buyers and others connected with the seafoods industry.

Export Risk Insurance

As international business is fraught with different types of risks, measures have been taken to provide insurance covers against such risks. The Export Credit Guarantee Corporation (ECGC) has policies covering different political and commercial risks associated with export marketing, certain types of risks associated with overseas investments and risks arising out of exchange rate fluctuations. Further, ECGC extends the export credit risks cover the commercial banks. Marine insurance is provided by the General Insurance Corporation and its subsidiaries.

Finance

The export-import bank and commercial banks and certain other financial institutions like specified cooperative banks provide pre-shipment and post-shipment finance to exports. Some of these institutions also provide suppliers' credit, including line of credit, to promote Indian exports. Export credits generally carry concessional interest rates.

Quality Control and Pre-shipment Inspection

A number of steps have been taken by the government to improve the quality of exports and to ensure that only goods of appropriate quality are exported from the country. The Export (Quality Control and Inspection) Act empowers the government to make necessary regulations in this respect.

Institutional Assistance

As mentioned earlier, export marketing is assisted in different ways by a number of organisations like the ITPO, EPCS, Commodity Boards, Export Development Authorities like the MPEDA and APEDA, IIFT, Indian Missions abroad etc.

India Brand Equity Fund

Government of India initiated steps to establish an India Brand Equity Fund with the objective of promoting the 'Made in India' image abroad. It was also proposed to set up a Brand Acquisition Fund to help Indian corporates to acquire big international brands put up for sale and build them up as Indian brands in the international markets.

IMPORT FACILITIES FOR EXPORTERS

Export Promotion Capital Goods

Under the Export Promotion Capital Goods (EPCG) Scheme, manufacturer exporters, merchant exporters tied to supporting manufacturer(s) and service providers are eligible to import capital goods (CG), both new and secondhand, including spares up to specified limit, and computer systems at a concessional/zero rate of customs duty subject to export obligation.

Duty Exemption Scheme

Duty exemption consists of Duty Free Licence and Duty Entitlement Pass Book (DEPB).

Duty Free Licence

Duty Free Licence includes Advance Licence, Advance Intermediate Licence and Special Imprest Licence.

Import of inputs like raw materials, intermediates, components, consumables, parts, accessories, mandatory spares (not exceeding 5% of the CIF value of a duty free licence) and packing materials may be permitted against a duty free licence.

An *Advance Licence* is granted to a merchant/manufacturer exporter for the import of inputs required for the manufacture of goods without payment of basic customs duty. However, such inputs shall be subject to the payment of additional customs duty equal to the excise duty at the time of import.

An *Advance Intermediate Licence* (AIL) is granted to a manufacturer exporter for the import of inputs required in the manufacture of goods to be supplied to the ultimate exporter holding an Advance Licence/Special Imprest Licence.

A *Special Imprest Licence* is granted to a manufacturer exporter for the import of inputs required in the manufacture of goods to be supplied to the specified categories like certain deemed exports.

(*Deemed Exports* refer to those transactions in which the goods supplied do not leave the country and the payment is made in India by the recipient of the goods. They are as good as exports in the sense that they earn foreign exchange or prevent outflow of foreign exchange. Examples include supply of goods against duty free licences issued under the Duty Exemption Scheme; supply of goods to EOU units in EPZs/EHTPs/STPs; supply CGs to holders of licences under the EPCG Scheme; supply of goods to specified projects financed by multilateral or bilateral agencies. Funds under international competitive bidding or under limited tender system etc. Deemed exports are eligible for certain benefits like Special Imprest Licence/Advance Intermediate Licence, deemed exports Drawback Scheme, refund of terminal excise duty and Special Import Licence at the specified rate.)

Duty Entitlement Pass Book

Under the DEPB scheme, an exporter is eligible to claim credit as a specified percentage of FOB value of exports made in freely convertible currency. Any item, except those in the negative list, is allowed to import without payment of customs duties against the credit under a DEPB. Third party exports are also admissible for grant of DEPB.

EPZs, EOUs, TPs AND SEZs

As a part of the export promotion drive, government has, from time to time, introduced several schemes to promote units primarily devoted to exports. These include Export Processing Zones (EPZs), Hundred Per cent Export Oriented Industrial Units (EOUs), and different categories of Technology Parks (TPs). In 2000, a scheme of Special Economic Zones (SEZs) was also introduced.

SPECIAL ECONOMIC ZONES

The Concept

SEZs are conceived as a means to promote exports and economic development by providing quality infrastructure, reducing procedural hassles and providing a level playing field *vis-a-vis* the foreign countries. They are specifically delineated duty-free enclaves, deemed as foreign territory for the purposes of trade operations and application of duties and tariffs. According to Government of India's policy, SEZs can be set up for the manufacture of goods and the rendering of services, production, processing, assembling, trading, repair, remaking, reconditioning, and reengineering. Units for generation/ distribution of power can also be set up in the SEZs. Goods going into the SEZ area from the Domestic Tariff Area (DTA) are treated as deemed exports and goods coming from the SEZ area into DTA are treated as if the goods are being imported. The existing export promotion zones have been converted into SEZs.

As a RBI Report[1] observes, the economic rationale for establishing Special Economic Zones (SEZs) is not clearly laid down in trade theory. It is, however, obvious that these Zones can be justified either on considerations of equity where a less developed area is accorded special tax and non-tax benefits or on considerations of efficiency, where a region has a spatial advantage in terms of costs. SEZ, as an institutional measure, supports the economic policy shift from import substitution to export promotion with a view to promoting export-led growth to facilitate larger incomes and employment. For these reasons, a large number of countries have taken initiatives to set up SEZs over the last half century or so. India followed suit in recent years, with a view to improve its competitive position.

SEZs exist in more than a hundred countries, socialist and capitalist, developed and developing, with differing nomenclatures and have done so for many decades. In some countries, EPZs have close variants like Free Trade Zones (FTZs) or Free Economic Zones (FEZs). There were 176 such zones in 47 countries in 1986 but by 2003 the number of zones increased to more than 3000 in more than 116 countries.[2]

The Evolution of SEZs in India

With the establishment of the Kandla Free Trade Zone (KAFTZ) in 1965 with the triple objective of earning foreign exchange, generating more employment in the backward areas of Kutch and fuller utilisation of the facilities provided by the Kandla port, India became the first Asian country to experiment with Export Processing Zone (EPZ), the forerunner of today's Special Economic Zones (SEZs) which are conceived as growth engines that can boost manufacturing, augment exports and generate employment. (The term free trade zone in the name of KAFTZ was a misnomer — it was indeed an export processing zone). The second EPZ of India, the Santa Cruz Electronics Export Processing Zone (SEEPZ), was set up in 1974. While the KAFTZ was a multi-product zone, SEEPZ was an exclusive zone for electronic products. Four more export processing zones were set up later in the country at Chennai, Cochin, Noida (UP) and Falta (West Bengal) and they commenced exports during the Seven Plan (1985-86). Later, an EPZ was established at Visakhapatnam. All these seven were Central Government projects. Later Government of India permitted private enterprises and State Governments to set up EPZs/SEZs. 12 such zones (besides the 7 Central Government ones) were

operational before the coming into effect of the SEZ Act, 2005. All these were very small in size, both geographically and in terms of investment and exports. Their tardy progress was also due, to a large extent, to the policy and procedural hurdles.

SEZ Policy and Act

The success of the Chinese SEZs has encouraged people in India to think big. With a view to overcoming the shortcomings experienced on account of the multiplicity of controls and clearances, absence of world-class infrastructure and an unstable fiscal regime, and aiming at attracting larger foreign investments in India, a Special Economic Zones (SEZs) Policy was announced by Government of India in April 2000. The principal intention of this policy was to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations.

SEZs in India functioned from 1.11.2000 to 09.02.2006 under the provisions of the Foreign Trade Policy and fiscal incentives were made effective through the provisions of relevant statutes. To instill confidence in investors and signal the Government's commitment to a stable SEZ policy regime and with a view to impart stability to the SEZ regime thereby generating greater economic activity and employment through the establishment of SEZs, a comprehensive Special Economic Zones Act was passed by Parliament in May, 2005. The SEZ Act, 2005, supported by SEZ Rules, came into effect from 10th February, 2006, providing for drastic simplification of procedures and for single window clearance on matters relating to Central as well as state governments.

The main objectives of the SEZ Act are:

- Generation of additional economic activity.
- Promotion of exports of goods and services.
- Promotion of investment from domestic and foreign sources.
- Creation of employment opportunities.
- Development of infrastructure facilities.

The SEZ Policy and Act have been introduced with the expectation that they will trigger a large flow of foreign and domestic investment in SEZs, in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities.

The SEZ Act, 2005, envisages key role for the State Governments in Export Promotion and creation of related infrastructure. A Single Window SEZ approval mechanism has been provided through a 19 member inter-ministerial SEZ Board of Approval (BoA). The applications duly recommended by the respective State Governments/UT Administration are considered by this BoA periodically. All decisions of the Board of approvals are with consensus.

The SEZ Rules provide for different minimum land requirement for different class of SEZs. Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created.

Table 20.1

PHASES OF EVOLUTION OF SEZS IN INDIA

1965-2000	Export Processing Zones	Central Government Projects
2000-2006	Special Economic Zones Guided by Exim Policy	State Govt. and Private Zones Permitted
2006 onwards	SEZs Governed by SEZs Act, 2005	State Govt. and Private Zones Permitted

Advantages, Incentives and Facilities

The SEZ Rules provide for:

- Simplified procedures for development, operation, and maintenance of the Special Economic Zones and for setting up units and conducting business in SEZs;
- Single window clearance for setting up of an SEZ;
- Single window clearance for setting up a unit in a Special Economic Zone;
- Single window clearance on matters relating to Central as well as State Governments;
- Simplified compliance procedures and documentation with an emphasis on self-certification.

The incentives and facilities offered to **the units** in SEZs for attracting investments into the SEZs, including foreign investment include:

- Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units.
- 100% Income Tax exemption on export income for SEZ units under Section 10AA of the Income Tax Act for first 5 years, 50% for next 5 years thereafter and 50% of the ploughed back export profit for next 5 years.
- Exemption from minimum alternate tax under section 115JB of the Income Tax Act.
- External commercial borrowing by SEZ units upto US $500 million in a year without any maturity restriction through recognised banking channels.
- Exemption from Central Sales Tax.
- Exemption from Service Tax.
- Single window clearance for Central and State level approvals.
- Exemption from State sales tax and other levies as extended by the respective State Governments.

The major incentives and facilities available to **SEZ developers** include:

- Exemption from customs/excise duties for development of SEZs for authorized operations approved by the BoA.
- Income Tax exemption on export income for a block of 10 years in 15 years under Section 80-IAB of the Income Tax Act.
- Exemption from minimum alternate tax under Section 115JB of the Income Tax Act.
- Exemption from dividend distribution tax under Section 115O of the Income Tax Act.
- Exemption from Central Sales Tax (CST).
- Exemption from Service Tax (Section 7, 26 and Second Schedule of the SEZ Act).

Evaluation of EPZs

Globally, SEZs present a mixed picture of performance. Although India is one of the first developing nations to experiment with the idea of special zones, its scorecard until recently has been far from satisfactory.

Some Global Observations

While, globally, there are a few zones like the Jebel Ali Free Zone (JAFZ), Dubai, which are regarded as shining examples, there are many unsatisfactory cases. Set up in 1985 as a component of the Jebel Ali port, JAFZ has helped cement Dubai as the key hinterland destination for the Gulf. JAFZ which has emerged as a regional distribution or manufacturing base for about 1,500 global

companies is regarded as one of the world's most successful free zones. Several factors have contributed to the success of JAFZ, besides the quality of the infrastructure and services and global linkages this zone provides. It permits 100 per cent foreign ownership; 100 per cent repatriation of capital and profits; there are no corporate taxes for 15 years; there is no personal income tax, nor any consumption taxes; no policy or obligation for local hire; no currency restrictions or any exchange control.

Special Economic Zones, where even 100 per cent foreign investment is allowed, has been among the measures taken in the People's Republic of China to increase exports and accelerate economic development. Encouraged by the success story of Jebel Ali and the big-bang Chinese experiences, a number of developing countries have pinned great hopes in EPZs/EOUs as a means to increase export, achieve transfer of technology, inter-industry linkages, employment generation and economic development. The achievement of the objectives, however, have been limited in several developing countries.

One of the objectives of SEZs is facilitation of transfer of technology. However, MNCs have not been enthusiastic to effect transfer of technology. It is mostly the assembly stage of production that is located/relocated to the EPZs; the R&D and technology oriented pre-assembly stage of production being done in the developed countries. Further, there has not been scope for forward linkages as the entire output is meant for exports. The scope for backward linkages has been very limited because of heavy reliance on imports for inputs. According to an ILO report, while many zone-operating countries had anticipated that the low-skilled processing and assembling of imported parts would be a necessary, but temporary, first step up the ladder towards higher value-added manufacturing, only a few such as Malaysia, Mauritius and Singapore, managed to develop domestic export industries on the basis of EPZ investment. The generally high import intensity of the exports of EOU/EPZ units limit the net foreign exchange earnings. The report said that "it is a regrettable feature of many zones that both male and female workers are trapped in low-wage and low-skill jobs." It noted that the workforce in EPZs worldwide is usually female in majority and in certain activities, notably textiles, garment manufacturing and electronics assembly, women account for 90 per cent or more of the workers.

The report said that the generous incentives and low costs to entry attract simple processing industries to invest in the zones. Such companies often lack professional management, particularly in human resources management. They also tend to be reluctant to invest in new skills, technology or productivity improvements. The labour-intensive nature of much of the processing and assembly work meant that enterprises compete largely on the basis of price. The report concluded that "labour relations and human resource development remain two of the most problematic aspects of zone functioning." The principal author of the report, Auret Van Heedren, said "the frequent absence of minimal standards and poor labour management relations have predictable outcomes, such as high labour turnover, absenteeism, stress and fatigue, low rates of productivity, excessive wastage of materials and labour unrest which are still too common."

The Indian Scenario

As has already indicated, the Indian picture has not been very bright. When it has reached the threshold of making a leap forward it is mired in a host of political/administrative and developmental debates, controversies, conflicts and confusions.

After the coming into effect of the SEZ Act, 2005, although a large number of SEZ have been notified, most of them were of small size; only a very small number are of more than 1000 hectares in size. The total land area required for the 674 SEZs which have received formal or in principle approval so far is only 1885 sq. km. That the average size of a SEZ in India is only about 2.8 sq. km. is reflective of the tiny size of the SEZs in India. A single SEZ, Hainan, in China stretches over 34000 sq. km. The Shenzen and Xiamen zones of China are 327 sq. km. and 131 sq. km. in size.

Exports In recent years, there has been a significant increase in the export earning from the SEZs. (See table 20.2). The contribution of SEZs to the total exports of India has increased from less than 5 per cent in 2003-04 to more than 29 per cent in 2012-13.

Table 20.2

SEZs EXPORTS AND INDIA'S TOTAL EXPORTS: A COMPARISON

	Exports from SEZs		***Exports from India***		***Share of SEZs Exports in Total Exports***
	Value (₹ crore)	**Growth (%)**	**Value (₹ crore)**	**Growth (%)**	
2003-04	13,854	39.0	2,93,367		4.7
2004-05	18,314	32.2	3,75,340	27.9	4.9
2005-06	22,840	24.7	4,56,418	21.6	5.0
2006-07	34,615	51.6	5,71,779	25.3	6.1
2007-08	66,638	92.5	6,55,863	14.7	10.2
2008-09	99,689	49.6	3,40,755	0.3	11.9
2009-10	2,20,711	121.4	8,45,534	35.1	26.1
2010-11	3,15,868	43.1	11,42,922	35.2	27.6
2011-12	3,64,478	15.4	14,65,959	28.3	24.5
2012-13	4,76,169	31.0	16,34,318	11.5	29.1

Source: Government of India, *Economic Survey* 2010-11, 2011-12, 2012-13 and 2013-14.

Table 20.3

FACT SHEET ON SPECIAL ECONOMIC ZONES IN INDIA

Number of Formal approvals	436 (Excluding 123 SEZs of which approval cancelled)	
Number of Notified SEZs (as on 09-03-2015)	347 (out of 436)+(7 Central Government+11 State/Private SEZs)	
No. of Valid In-Principle Approvals	32	
Operational SEZs (as on 31st December 2014)	199 (Break up: 20 are multi-product SEZs, remaining are IT/ITES, engineering, electronic hardware, textiles,biotechnology, gem and jewellery and other sector specific SEZs)	
Units approved in SEZs (as on 31st December 2014)	3,937	
Land for SEZs	Notified SEZs	Formally Approved (FA) including notified SEZs
	47,190 Hectare	71,502 Hectare
	Land is a state subject. Land for SEZs is procured as per the policy and procedures of the respective State Government.	
Investment (as on 30th June 2012)	Total Investment	
SEZs Notified under the Act	₹ 2,99,320.99 crores	

State/Pvt. SEZs set up before 2006	₹ 10,738.49 crores
Central Government SEZs	₹ 124,22.97 crores
Total	₹ 3,22,481.55 crores
Employment (as on 31st December 2014)	Total Employment
SEZs Notified under the Act	11,07,752 persons
State/Pvt. SEZs set up before 2006	74,812 persons
Central Government SEZs	2,31,271 persons
Total	14,13,835 persons

Source: Special Economic Zones in India, Ministry of Commerce & Industry, Department of Commerce and ITP Division, Ministry of External Affairs, Government of India.

Issues and Concerns

The rationale of SEZ in an era of progressive liberalisation and its social justification are questioned. For example, while renowned development economist Jagadish Bhagawati feels that there is no need to establish SEZs at this stage of post-liberalisation, Raghuram Rajan, IMF's chief economist, holds that India, with its huge fiscal deficit, can ill-afford such huge revenue loss accruing from the scheme.[3]

The Finance Ministry has estimated revenue loss of over ₹ 102,000 crores on the SEZ account for 2006-2010, 54 per cent of it being on account of direct tax concessions. According to industrialist Rahul Bajaj, SEZs provide incentives disproportionate to the incremental benefits to the economy. The Reserve Bank of India (RBI), in a recent annual report, cautioned that SEZs could aggravate the uneven pattern of development by pulling out resources from the less developed areas. Rather than promoting new business ventures, SEZs will merely attract investment that would have come in anyway. Fiscal and monetary giveaways are more likely to generate incentives in no way conducive to economic growth.[4] Mr. C.J. Mathew, Development Commissioner, Cochin Special Economic Zone, however, presents a different perspective: If the tax that is foregone is computed in gross terms, it would appear that the country is a loser. This calculation fails to take into account that universally indirect taxes should not be incorporated in the export product. The existence of various export schemes, implemented by the customs authorities as well as rebates and drawback granted to exporters is in pursuance of this axiom. A calculation of the net duty foregone would shed light on the truth. Income tax benefits accorded are no different from investment allowance already existing and, in any case, is for a limited period. In the past, the State has collected taxes for putting up infrastructure including industrial infrastructure. The delivery systems not having proved satisfactory, it is time to implement this alternative model: do not tax the developer who puts up infrastructure and thus reduces the burden on the governance system.[5]

The Department of Commerce has defended the scheme having an avowed objective of SEZs facilitating $5 billion of FDI inflows by end-2007, creating employment for 5,00,000 by end-2007, in addition to 1.5 million indirect jobs outside the zones, besides fixing the country's infrastructure.[6]

Another major issue pertains to exemption of the SEZs from several laws of the country. In this context, C.J. Mathew points out that contrary to all presumptions, all laws, except the tax laws, are applicable in an SEZ. There is no separate police system. Labour laws are to be enforced

in the zones as they are enforced elsewhere. It is a myth that unions do not exist in zones and that strikes are outlawed. In all zones, we have trade unions who carry on the useful tasks of shop-floor negotiations and collective bargaining.

Strikes have also occurred in SEZs in the manner that they have occurred in industrial and commercial establishments elsewhere.[7]

The problems/issues that have stemmed up from the approval of a large number of new SEZs within a short period and issues that have emerged related to land acquisitions have led the SEZ regime to a state of flux. There has even been a feeling that no more new SEZs be permitted or should at least be frozen for some time.

While any policy should be reasonably and logically flexible, Government and various political parties appear to be very much confused as to what is a right policy in respect of SEZ and land acquisitions. One of the serious concerns is the conversion of agricultural land into SEZ and the farmer's interests. It may be pointed out here that the total land area required for the 531 SEZs which have received formal approval and 143 SEZs which have received in principle approval so far is 1885 sq. km. and this forms only 0.63 per cent of the total land area 0.116 per cent of agricultural land of India.

Mathew observes that much of the controversy regarding the land conversion has been made of local responses at Nandigram and Panvel; without trivialising these movements, it must also be emphasised that the reports in the media have not touched upon the basic issues: archaic compensation systems and utilisation of surplus land. Acquisitions are made by the state not just for SEZs but for all kinds of activity. The sole difference is the inclusion of a private investor who is perceived to be a beneficiary. There is need for a land acquisition system that goes beyond public purpose as prescribed in the ancient Land Acquisition Act. The consent acquisition statute of Karnataka is worth emulating not just for promoting SEZs but for all industrial activity.[8]

While it has been felt that the SEZs as a component of the development strategy can make a significant impact only if large size SEZs come up in different parts of the country, the current Government thinking appears to be taking a reverse direction. Mr. Kamal Nath, the Union Minister for Commerce and Industry had earlier announced that multi-product SEZs should have a minimum area of 1000 hectares and service sector SEZs must have an area of 100 hectares or more. There were proposals for SEZs of vast spread. There was a report, for example, of a proposal for a SEZ of 20,0000 acres in Gurgaon. However, the report of a committee set up earlier under the chairmanship of BJP leader Murli Manohar Joshi recommended that the maximum permissible land area for multi-product SEZs coming up on cultivable land be 2,000 hectares and for zones to be set up on wastelands it be 5,000 hectares. The committee also recommended that “land for the zones should be taken on lease by developers and there should not be transfer of ownership.” The meeting of the Group of Ministers on April 5, 2007 fixed the ceiling on land at 5000 hectares. However, State governments can reduce this even further. A comprehensive rehabilitation policy to provide employment to at least 1 person from each displaced family was also proposed.

Another key decision by the Government recently was to reduce the amount of land available with an SEZ developer for undertaking activities like malls, shopping areas, school and hospitals. Earlier the minimum processing area (for core industrial activity) was 35 per cent of the total land size, with a provision for reducing this to 25 percent in multi-product zones. This rule has now been changed to a fixed and uniform 50 per cent for all types of zones (sector specific and multi-product). This would ensure greater use of the SEZ area for core economic activity and reduce the flexibility for commercial exploitation.

Conclusion

India did not give the special zones scheme a real thrust under the controlled regime when it had much more relevance than today. The belated attempt, inspired by the Chinese experience, to make the SEZ a major vehicle of export growth in particular and economic development in general has given rise to several vital socio-economic and political debates and conflicts. Several political parties show the usual confusion and populist summersaults. Farmers' agitations related to land acquisitions are sought to be put off with iron fist, resulting in several deaths leading to social unrest and political issues. SEZs cannot have a justification if it is not an integral part of the national development strategy. The relevance and rationale of SEZs in an environment characterised by increasing global liberalisation is debatable. What is really needed is a hassle free and conducive policy and procedural environment for the appropriate development of all sectors linked to rational effective utilisation of national resources in accordance with the national priorities.

EXPORT HOUSES AND TRADING HOUSES

From the beginning of the Second Five Year Plan, the foreign exchange problem began to assume serious proportions, and the government began to realise the need for vigorous export promotion. It was very clear that concerted efforts should be made for the promotion of the export of non-traditional items. It was also realised that unless positive steps were taken to build up a number of merchant houses, concentrating almost exclusively on exports and capable of undertaking trade on a sustained basis, it would be impossible to compete successfully against the highly experienced and resourceful trading houses of other countries. The importance of promoting merchant houses was further underlined by the need for providing channels for the export of the products of the small-scale sector.

An export house is defined as a registered exporter holding a valid Export House Certificate issued by Director General of Foreign Trade.

Merchant as well as Manufacturer Exporters, Service Providers, Export Oriented Units (EOUs) and Units located in Special Economic Zones (SEZs), Agri Export Zones (AEZs), Electronic Hardware Technology Parks (EHTPs), Software Technology Parks (STPs) and Bio Technology Parks (BTPs) shall be eligible for applying for status as Star Export Houses. Recognition will be granted depending on the exporter’s total FOB/FOR export performance during the current, plus the previous three years as laid down below.

A Star Export House shall be eligible for several facilities like fast track clearance procedures, exemption from furnishing of bank guarantee, entitlement for consideration under the Target Plus Scheme etc.

The objective of the scheme is to recognise established exporters of different performance levels with a view to build marketing infrastructure and expertise required for promotion. Such houses should operate as highly professional and dynamic institutions and act as important instruments of export growth.

The scheme of export houses has been modified a number of times.

Export House/Trading House/Star Trading Houses/Superstar Trading Houses are entitled to special import licences as per the criteria laid down, related to the export/net foreign exchange earnings. The amount of entitlement is lowest for Export House and highest for Premier Star Trading House.

The Foreign Trade Policy 2015-20 has modified the nomenclature of these status holders. For details, see *Foreign Trade Policy 2015-20* in Chapter 19.

AN EVALUATION

The success of export promotion measures should be judged by the growth of exports and the dynamism of the export sector.

No doubt, India's total exports have been growing and the export sector has achieved some diversification and sophistication. However, the achievements have been, as noted earlier, far below the requirements and potentials and have been very poor in comparison with those of several developing countries. Thus, export development measures in India have not been successful in producing the needed results. The infrastructure for international marketing is not efficient enough.

An effective export promotion should compensate for the disadvantages of the national exporters and should make the export business profitable enough to lure entrepreneurs to this sector and achieve the ultimate objective of boosting the exports.

The general feeling is that the export promotion regime in India has not succeeded in achieving these objectives.

It has also been pointed out that one of the drawbacks of the export incentives regime in India is that it is largely transparent in character.

"While foreign buyers have sharp eyes for them, these constitute an eyesore for the governments particularly of the industrialised importing countries. The importer try to grab these incentives almost in their entirity on the pretext of growing competition, thus depriving the Indian exporters of the benefits of the promotional measures. In fact, these tend to create an unsatiable urge for more and more incentives in extent and magnitude. On the other hand, the governments of the developed countries viewing these as subsidies invoke the provisions of the anti-dumping and countervailing duty laws. The effectiveness and purposesiveness of incentives thus lie in their non-transparent character. This could be possible only by devising a policy framework with inherent and inbuilt, *albeit* latent, promotional incentives."[9]

A major factor necessitating large incentives is the structural weakness and high cost of the Indian economy. It is, therefore, necessary to remove these handicaps to reduce the needs for the exogenous incentives. Further, the institutional inadequacies and procedural complexities and delays need to be urgently attended to. Absence/lack of dynamism and innovativeness in policies, procedures, product development and marketing continue to hamper India's export development.

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21

TRADE AND BOP OF INDIA

Some indications of the comparative export performance of India have been given in the previous chapters. This chapter reviews, briefly, India's performance in respect of merchandise trade, services trade and trends in the balance of payments.

HIGHLIGHTS OF INDIA'S TRADE PERFORMANCE

A review of India's foreign trade since the commencement of planning reveals the following important points:

1. Both exports and imports have grown considerably.

2. Except for two years (1972-73 and 1976-77), in all the years since 1951, imports were larger than exports.

3. Until about the mid 1980s, the export performance of India was very poor in comparison with other countries in general; it was very poor even in comparison with several other developing countries. This is clear from the following facts:

(a) The share of India in the total world merchandise exports fell from about 2 per cent in 1950 to 0.4 per cent in 1980. Since the mid eighties, there has, however, been some improvement. In 2013 and 2014, it was 1.7 per cent.

Table 21.1
SHARE OF INDIA IN WORLD MERCHANDISE EXPORTS

Year	Share (%)
1950	2.0
1960	1.2
1970	0.7
1980	0.4
1990	0.5
2000	0.7
2010	1.4
2013	1.7
2014	1.7

Source: IMF, *International Financial Statistics* (various issues) and WTO, *World Trade Report* (various issues).

(b) India was the 13th largest exporter in 1950, but her rank was only 31st in 2000. There was, however, a significant improvement to 19th rank in the recent years.

(c) India's merchandise exports as a percentage of the GDP had been stagnating around 5 per cent. Although it has improved since the liberalisation, it is still very low (about 16 per cent) even in comparison with many other developing countries. There has been a marked improvement in India's total merchandise trade (exports + imports) ratio to GDP from about 22 per cent in 2000-01 to 44 per cent in 2013-14.

During 2000 to 2012, exports of India grew at a compound annual rate of 17.6 per cent compared to the average of 13.8 per cent for developinng economies and 9.1 per cent for world.

4. The terms of trade have, on the whole, been favourable to India, although there was deterioration in a number of years.

5. There has been a very significant change in the composition of India's exports. Manufactured products increased their share substantially and came to account for over three-fourths of the exports as against the dominance of primary commodities in the early period. However, in the last decade, the share of manufactures declined consequent to the large increase in the share of petroleum products. Manufactures now make up about two-thirds of the total merchandise exports.

6. There have been significant changes in the direction (i.e., the source of imports and destination of exports) of India's foreign trade.

7. The export-import ratio has been very poor.

8. The services exports performance has been, by and large, impressive. India has been enjoying a surplus on the services trade, compared to the huge merchandise trade deficit.

Table 21.2

TRENDS IN INDIA'S EXPORTS, IMPORTS AND TRADE BALANCE

(₹ crore)

Year	Exports (including re-exports)	Imports	Trade Balance
1950-51	606	608	-2
1955-56	609	774	-165
1960-61	642	1122	-480
1965-66	810	1409	-599
1970-71	1535	1634	-99
1975-76	4036	5265	-1229
1980-81	6711	12549	-5838
1985-86	10895	19658	-8763
1990-91	32553	43198	-10645
1995-96	106353	122678	-16325
2000-01	203571	230873	-27302
2005-06	456418	660409	-203991
2006-07	571778	840506	-268727
2007-08	655864	1012312	-356446
2008-09	840455	1374436	-533681
2009-10	845534	1363736	-518202
2011-12	1465959	2345463	-879504
2012-13	1634318	2669162	-1034844
2013-14	1905011	2715434	-810423
2014-15	1896348	2737087	-840738

Source: Unless otherwise specified, the source of Tables of this chapter is Government of India, *Economic Survey* (various issues).

Table 21.3

TRENDS IN INDIA'S EXPORTS, IMPORTS AND TRADE BALANCE

(US $ million)

Year	Exports (including re-exports)	Imports	Trade Balance
1950-51	1269	1273	-4
1955-56	1275	1620	-345
1960-61	1346	2353	-1007
1965-66	1693	2944	-1251
1970-71	2031	2162	-131
1975-76	4665	6084	-1419
1980-81	8486	15869	-7383
1985-86	8904	16067	-7163
1990-91	18143	24075	-5932
1995-96	31797	36678	-4881
2000-01	44560	50536	-5976
2005-06	103091	149166	-46075
2006-07	126414	185735	-59321
2007-08	163132	251654	-88522
2008-09	185295	303696	-118401
2009-10	178751	288373	-109621
2011-12	305964	489319	-183356
2012-13	300401	490737	-190334
2013-14	314405	450200	-135795
2014-15	310338	448033	-137695

DETERMINANTS OF EXPORTS

Analysis of empirical data reveals that India's export performance is affected by certain important factors. They include a set of external factors, a set of internal factors and the real exchange rate.

The external factors are:

1. The rate of growth of the economies of the importing countries.
2. The rate of growth of the world trade.
3. The rate of change in the price level in the importing country.

The internal factors are:

1. The rate of growth of the Indian economy
2. The rate of change in the domestic price level.

The most favourable condition for the growth of the Indian exports is a combination of the high growth rates for all the three external factors, a high growth rate with price stability for the Indian economy and a fall in the real exchange rate for exports (RERx). If some of the above conditions are satisfied and other conditions are not favourable, the export performance should be expected to be determined by the relative strengths of the favourable and unfavourable factors. We will have the worst situation when the reverse of the ideal combination of conditions occurs.

The analysis of the impact of the interrelationship of the above-mentioned variables on India's exports for a period of nearly two decades by G.C. da Costa[1] has revealed the following:

1. Good growth in the economies of the industrial countries has been associated with good growth in in India's exports. This has been very pronounced in those years characterised by good growth in the world trade, sharp fall in the RERx relative price stability in India.
2. Low growth or recessionary conditions in the economies of the industrial countries, along with depressed world trade together with even moderate increases in the RERx did not provide any competitive edge to the country's exports, the volume of India's exports broadly kept pace with the growth in the economies of the industrial countries.
3. In some years, even when the growth in the economies of the industrial countries was low, the country experienced good growth in the volume of exports because of the sharp decline in the RERx.
4. During certain periods, despite modest growth in the industrial countries and in world trade, the volume of India's exports fell because of the rise in the RERx.

DETERMINANTS OF IMPORTS

Besides import regulations, the important factors which determine the volume of India's imports are:

1. The rate of growth of the Indian economy — High rate of growth, *ceteris paribus*, is associated with rise in imports.
2. The relative price of imports (i.e., the relative change in the prices of imports and domestic goods) — an increase in the imports, *ceteris paribus*, is associated with a fall in the relative price of imports.

From the above two factors, it can be inferred that the volume of imports tends to be very high when there is a conjuncture of high rate of economic growth and a sharp fall in the relative price of imports and *vice versa*.

The study by da Costa, referred to above, has revealed that:

1. In a number of years, the volume of imports was kept down by moderate growth of the economy together with relatively high price of imports.
2. For over a fairly long period of 12 years since 1977-78, higher growth of the economy together with a downward trend in the relative prices of imports and with rising imports to India.
3. A sharp decrease in the volume of imports was noticed when there was a combination of low growth of the economy and a sharp decrease in the relative price of imports (and with import liberalisation) were associated with rising imports to India.
4. On the other hand, there was a large increase in imports when there was a combination of good growth of the Indian economy and a sharp decrease in the relative price of imports.
5. Large imports in several years were associated with moderate growth of the economy and substantial fall in the relative price of imports.
6. When change in the relative price of imports has been moderate, low growth of the Indian economy has been associated with low growth in the volume of imports.

MAJOR EXPORTS

After Independence, India has achieved considerable diversification in exports, both product-wise and country-wise.

Reflecting the evolving pattern of economic and industrial development, as also the policy thrust India has gradually transformed from a predominantly primary products exporting country into an exporter of manufactured goods. Today, manufactures account for about three-fourths of the total exports compared to 45 per cent in 1960-61. The share of manufactured goods in India's total exports increased from about 71 per cent during 1987-90 to 75 per cent during 1992-97 and after some further rise, it declined to 72 per cent by 2005-06. It may be noted that the diversification of exports was more prominent in the 1970s. The progress has been very tardy thereafter. This can be attributed to two factors. After a certain level, as a general rule, further improvement would be at a very low pace and may eventually tend to stagnate. Second, the deficiencies and failures of the development strategy in achieving the objectives.

The last one decade has also witnessed some significant changes in the export basket. The share of petroleum crude and products increased from about 4 per cent in 2000-01 to 20 per cent in 2013-14. The share of manufactured products declined from about 79 to 64 per cent and of agricultural products hovered around 14 per cent during this period.

Table 21.4

COMMODITY COMPOSITION OF INDIA'S EXPORTS (PERCENTAGE SHARE)

Commodity Group	2000-01	2005-06	2013-14
1. Primary products	**16.0**	**15.4**	**15.6**
Agriculture & allied	14.0	10.2	13.8
Ores & minerals	2.0	5.2	1.8
2. Manufactured goods	**78.8**	**72.0**	**63.7**
Textiles, including ready made garments	23.6	14.5	9.7
Gems & jewellery	18.6	15.1	13.1
Engineering goods	18.7	20.7	19.8
Chemical & related products	10.4	11.6	13.2
Leather & leather manufactirs	4.4	2.6	1.8
3. Petroleum crude products (including coal)	**4.3**	**11.5**	**20.1**

Some compositional changes within manufactures exports deserve special notice. The biggest losers are labour-intensive manufactures like textiles, leather and leather manufactures, and handicrafts. The biggest gainer is the engineering goods sector.

Box 21.1 highlights some of the weaknesses of the manufactures export sector.

Box 21.1

Need for India's Export Basket Diversification

An internal study of India's exports of world's top import items using the latest UN comtrade data shows the following results:

- In the top 100 imports of the world, India had only 6 items with a share of 5 per cent and above in 2010.
- In the top 100 imports of the world in 2010, India had only 15 items with a share of 2 per cent and above. Of these, only 3 items were in the top 25 and 4 in the top 30. Among these 15 items, there were 9 where India's export growth in 2010 was higher than that of world import growth. There were 3 items, namely iron ores and concentrates, including roasted iron pyrites, diamonds, whether or not worked, but not mounted or set and flat rolled products iron etc. (code 7210) where world import growth was higher than that of India's export growth with no negative growth for India. Of these, there was need to focus on the third item which was manufactured item and world import growth was more than double that of India. There were also three items where India's export growth was negative and world import growth positive. But this was mainly due to the base effect. (See Table 21.6)
- Among the top 100 items, there are many where India has already developed competence but India's share is very small. Some of them are simple items like taps, cocks, valves, and similar parts for pipes, boiler shells, tanks, vats, or the like, including pressure-reducing valves and thermostatically controlled valves; new pneumatic tyres, of rubber; flat-rolled products of iron or non-alloy steel, of a width of 600 mm or more, hot-rolled, not clad, plated or coated; trunks, suit-cases, vanity-cases, executive-cases, briefcases, school satchels, spectacle cases, binocular cases, camera cases, musical instrument cases, gun cases, holsters and similar containers; other toys; reduced-size ('scale') models and similar recreational models, working or not; puzzles of all kinds; flatrolled products of stainless steel, of a width of 600mm or more; electric motors and generators (excluding generating sets); screws, bolts, nuts coach-screws, screw hooks, rivets, cotters, cotter-pins, washers (including spring washers) and similar articles of iron or steel; and many textiles items.
- Thus, there is need for greater export basket diversification by India with a perceptible share in the top items of world demand.

Source: Internal study, Economic Division, Department of Economic Affairs, Govt. of India (cited by *Economic Survey 2011-12*).

The desired pattern of progress of diversification could not be achieved by India, because of, *inter alia*, the deficiencies and failures of the development strategy. The areas in which South-East Asian countries have achieved their highest export growth during the 1980s have been typically labour-intensive, relatively low technology products such as textiles, clothing, shoes, toys, sport goods and the like. Subsequently, during the 1990s, they have graduated up to somewhat higher technology consumer goods and then even higher technology and capital-intensive sectors such as capital goods and petrochemicals. Over the same period, the Indian export pattern has remained stationary with persistent dominance of labour-intensive low technology products such as clothing, textiles, shoes and other leather goods. Adequate quality upgradation has been absent and unit prices have stagnated. The attainment of both higher volume growth and of higher unit value realisation will require both larger scale of operation and higher quality. It is, therefore, essential to loosen constraints in these sectors so that they can grow freely in volume, utilise better machinery, graduate up to higher technology levels, and utilise better international marketing channels. What is observed in other countries in Asia is that production of such consumer goods may be achieved through final assembly operations that are large in scale, but where a great deal of outsourcing to small enterprises is undertaken to preserve their competitiveness. Consequently, freeing of restrictions on the size of small-scale industries

through dereservation is likely to lead to the growth of many more small-scale enterprises than is currently the case, along with a much higher potential for growth in manufacturing employment.[2]

MAJOR IMPORTS

Petroleum oil and lubricants now account for considerable part of India's import bill. POL which accounted for 6 per cent of the total imports in 1960-61 and 8 per cent in 1970-71 amounted to 43 per cent in 1980-81.

As Table 21.6 shows there has not been any significant change in the share of major import categories over the last one decade or so. The share of POL imports, which fell from 31.3 per cent in 2000-1 to 28.6 per cent in 2010-11 rose to about 37 per cent in the first half of 2013-14 due to high prices of crude oil, but declined in 2014-15 due to fall in crude prices.

Although there had been a decline in the share of capital goods in the total import (32 per cent in 1960-61, 25 per cent in 1970-71 and 15 per cent in 1980-81), in the years following the initiation of liberalisation there was a sharp increase. The share of capital goods imports which increased from 10.5 per cent in 2000-01 to 15.5 per cent in 2008-09 started declining again to reach about 11 per cent in the first half of 2014-15.

There was a sudden rise in share of gold and silver imports from 9.3 per cent in 2000-01 to 13.3 per cent in the first half of 2011-12, but was only 8.7 per cent in 2014-15.

Table 21.5

COMMODITY COMPOSITION OF INDIA'S IMPORTS (PERCENTAGE SHARE)

Commodity Group	2000-01	2009-10	2013-14	2014-15
I. Food and allied products, of which	3.3	3.7	3.3	3.9
1. Cereals	0.0	0.0	0.0	0.0
2. Pulses	0.2	0.7	0.5	0.6
3. Edible oils	2.6	1.9	2.1	2.4
II. Fuel, of which	33.5	33.2	40.4	34.7
4. POL	31.3	30.1	36.7	30.8
III. Fertilisers	1.3	2.3	1.4	1.7
IV. Capital goods, of which	10.5	15.0	11.1	11.0
5. Machinery except elec. and machine tools	5.9	7.4	3.2	3.3
6. Electrical machinery	1.0	1.1	2.6	2.8
7. Transport equipment	1.4	4.1	4.3	4.1
V. Others, of which	46.3	42.6	42.9	47.8
8. Chemicals	5.9	5.2	4.4	4.7
9. Pearls, precious, semi-precious stones	9.6	5.6	5.3	5.0
10. Gold and silver	9.3	10.3	7.1	8.7
11. Electronic goods	7.0	7.3	7.4	8.4
Total Imports	100.0	100.0	100.0	100.0

DIRECTION OF TRADE

The direction of India's foreign trade has also undergone substantial changes.

In the early 1950s, the UK accounted for over one-fifth of India's foreign trade; in recent years it has been only about 2 per cent.

Table 21.6

DIRECTION OF INDIA'S TRADE (2014-15)

Region/Country	Share of Exports (percentage)	Share of Imports (percentage)
Europe	18.1	16.5
European Union (EU)	15.9	11.0
NORTH AMERICA	15.3	12.5
USA	13.7	6.5
ASIA	49.6	58.9
West Asia	19.5	24.8
ASEAN	10.3	10.0
China	3.9	13.5
AFRICA	10.6	8.6
LATIN AMERICA	3.7	6.0

Asia's share in India's imports is very high due to the oil imports from West Asia and huge imports from China.

As a single country USA had been our largest trading partner. In 1950-51, the US accounted for 18 per cent of our imports and 19 per cent of the exports. In recent years, the US accounted for about seven per cent of India's trade. An interesting development in the direction of India's trade is that the USA which was in first position in 2007-08 was relegated to third position in the following years, with the UAE becoming India's largest trading partner, followed by China. This position continued from 2008-9 to 2010-11. In 2014-15, UAE, USA and China were the top three trading partners. The US, however, continues to be India's major export market. In 2014-16, it absorbed about 14 per cent of our exports and supplied about 6 per cent of the imports. In that year, about 16 per cent of our exports went to the European Union (27 countries) and 11 per cent of the imports originated in the EU.

Table 21.7

EXPORT AND IMPORT SHARES OF REGIONS/COUNTIRES IN INDIA'S TRADE

Region/	Exports countries			Imports			Exports to Imports Ratio		
	2004-05 to 2007-08	2010-11 to 2013-14	Change in share	2004-05 to 2007-08	2010-11 to 2013-14	Change in share	2004-05 to 2007-08	2010-11 to 2013-14	Change in share
Europe	**23.3**	**19.0**	**-4.3**	**21.6**	**18.0**	**-3.6**	**73.6**	**68.6**	**-5.0**
Germany	3.3	2.5	-0.7	3.9	3.0	-0.9	56.5	53.9	-2.5
Belgium	2.7	2.1	-0.6	2.6	2.2	-0.3	73.4	62.4	-10.9
Switzerland	0.4	0.4	0.0	4.5	6.2	1.7	6.7	4.2	-2.5
Africa	**7.8**	**8.9**	**1.2**	**6.3**	**8.5**	**2.2**	**84.0**	**68.1**	**-15.9**
Nigeria	0.7	0.9	0.1	2.1	2.9	0.8	23.8	19.7	-4.1
America	**18.9**	**16.6**	**-2.3**	**10.3**	**11.0**	**0.7**	**124.9**	**98.3**	**-26.6**
USA	14.9	11.6	-3.3	7.1	5.1	-2.0	143.5	148.5	5.0
Asia	**48.5**	**50.2**	**1.7**	**48.9**	**60.2**	**11.3**	**67.7**	**54.4**	**-13.4**
Singapore	4.8	4.5	-0.3	2.8	1.7	-1.2	116.6	177.7	61.1
Indonesia	1.5	1.9	0.5	2.1	3.0	0.9	47.2	41.5	-5.8
United Arab Emirates	9.2	11.7	2.5	4.5	7.6	3.2	140.0	99.2	-40.8

Saudi Arabia	2.0	2.8	0.8	5.1	6.8	1.7	26.6	26.3	-0.3
Kuwait	0.5	0.4	0.0	2.1	3.4	1.3	15.4	8.5	-6.9
Qatar	0.3	0.2	0.0	0.9	2.8	2.0	22.0	5.6	-16.4
Iraq	0.2	0.3	0.2	1.8	3.6	1.9	6.2	5.5	-0.6
China	6.6	5.3	-1.3	9.0	11.2	2.2	50.4	30.8	-19.6
Hong Kong	4.0	4.1	0.1	1.3	1.9	0.6	210.1	137.7	-72.5
Korea	1.7	1.4	-0.3	2.7	2.7	0.0	43.6	33.8	-9.8
Total	**100.0**	**100.0**	**–**	**100.0**	**100.0**	**–**	**68.2**	**65.1**	**-3.1**

Source: Government of India, *Economic Survey, 2015-16.*

* A coefficient of export and import ratio between 0 and 1 implies that India's imports are greater than exports and if the coefficient is greater than one, India exports more than what it imports.

There has been extensive diversification of India's export and import markets. The share of developed countries in India's trade declined substantially while that of the developing countries went up very significantly. The share of Asia and ASEAN in total trade increased from 33.3 per cent in 2000-01 to 57.3 per cent in the first half of 2011-12, while that of Europe and America fell from 42.5 per cent to 30.8 per cent respectively. This has helped India weather the global crisis emanating from Europe and America. In fact, today we have only five advanced western countries among the top 15 trading partners compared to seven in 2000-01. While the top 15 countries still hold a share of around 60 per cent, the top 15 countries themselves have changed over the years. The major changes are the entry of Indonesia, Korea, Iran, Nigeria and Qatar in the new list in place of Italy, Malaysia, France, Japan, and Australia.

SERVICES TRADE

The fast growth of the service sector of India is reflected in the exports of services which grew at a CAGR of 23.4 per cent during 2000-01 to 2010-11 compared to the CAGR of merchandise exports at a 18.6 per cent during the same period. After a contraction of 9.4 per cent in 2009-10 due to the global financial crisis, exports services bounced back recording a growth of 38.4 per cent to US$ 132.9 billion in 2010-11. Table 21.8 shows the status of India's service exports. Software contributes more than 46 per cent of the total service exports, followed by non-software services (about 30 per cent, mostly business services). Travel and transportation contribute more nearly 12 per cent each. As Table 21.8 reveals, the share of travel declined to nearly half during the last decade.

Table 21.8

INDIA'S EXPORTS OF SERVICES

Categopry Service	Percentage Share		
	2000-01	**2010-11**	**2013-14**
1. Travel	21.5	11.5	11.8
2. Transportation	12.6	10.7	11.5
3. Insurance	1.7	1.5	1.4
4. GNIE	4.0	0.4	0.3
5. Miscellaneous	60.3	75.9	75.0
(a) Software services	39.0	41.7	45.8
(b) Non-software services of which:	21.3	34.2	29.1
(i) Business services	2.1	18.1	18.8
(ii) Financial services	2.1	4.9	4.4
(iii) Communication services	7.0	1.2	1.6
Total Services Exports	**100.0**	**100.0**	**100.0**

While India has huge merchandise trade deficit, the nation has been enjoying a favourable balance of services trade, as Table 21.18 reveals. In 2009-10 and 2010-11, the surplus was equivalent to about 37 per cent of the service exports. The surplus of services trade has been financing a large part of the merchandise trade deficit of India. During 2005-6 to 2009-10, surplus in services exports, on average, financed around 41 per cent of merchandise trade deficit. Net services surplus which was increasing over the years registered a dip in 2009-10 with services exports falling due to the global economic crisis but services imports increasing. However, in 2010-11, net services surplus again increased and financed about 49 per cent of the merchandise trade deficit in 2013-14.

BALANCE OF PAYMENTS

Balance of Payments (BoP) comprises current account, capital account, errors and omissions, and change in foreign exchange reserves. Under current account of the BoP, transactions are classified into merchandise (exports and imports) and invisibles. Invisible transactions are further classified into three categories. The first component is services comprising travel, transportation, insurance, government not included elsewhere (GNIE), and miscellaneous. Miscellaneous services include communication, construction, financial, software, news agency, royalties, management, and business services. The second component of invisibles is income. Transfers (grants, gifts, remittances, etc.) which do not have any *quid pro quo* form the third category of invisibles.

Under capital account, capital inflows can be classified by instrument (debt or equity) and maturity (short- or long-term). The main components of capital account include foreign investment, loans, and banking capital. Foreign investment comprising foreign direct investment (FDI) and portfolio investment consisting of foreign institutional investors (FIIs) investment and American depository receipts/ global depository receipts (ADRs/GDRs) represents non-debt liabilities. Loans (external assistance, external commercial borrowings [ECB], and trade credit) and banking capital including non-resident Indian (NRI) deposits are debt liabilities.

The trade balance is often a major determinant of the balance of payments. Merchandise trade deficit has often caused balance of payments deficits for India. However, the effects of the trade deficit has been mitigated to a considerable extent by the invisibles surplus.

Except for brief periods, India's BoP had shown deficit until the impact of the economic liberalisation ushered in 1991 began to become conspicuous on BoP by increased capital inflows.

India has experienced balance of payments problems of varying intensity in twenty-nine out of thirty-five years since the beginning of the Second Five Year Plan. The cost for India of this prolonged BoP problem, caused by the poor export performance, has been heavy. As Jalan observes, "periodic crises have upset the planning process and reduced the room for maneuverability in fashioning macro-economic policies in response to the changing domestic and international environment. These crises have also increased the country's dependence on external capital markets and increased the country's vulnerability to external shocks."[3]

During the First Five Year Plan, India was mostly free from BoP problem because of the large sterling balances India had at the time of Independence which could be drawn down to meet the payment obligations. In 1950-51, the reserves amounted to about 158 per cent of the merchandise imports. Because of the using up of the foreign exchange at levels much higher than the earnings, by 1957-58, the reserves in nominal rupee terms had come down to about one-third of the level in 1950-51. The BoP problem developed since then necessitated aid from the Aid India Consortium and drawals from the IMF. Stringent import controls were also introduced. It may be recalled here that the Rupee was devalued in 1966 in a bid to improve the trade and payments positions. Although there was a slight improvement in the reserves position between 1968-69 and 1973-74, the overall situation remained difficult.

With a trade surplus of ₹ 104 crores in 1972-73, the nation became more optimistic about the future. But the first oil shock, the four-fold increase in the international crude oil price between September 1973 and April 1974, which burgeoned India's oil import bill was a bolt from the blue. Contrary to most expectations, however, the Indian economy coped remarkably well with these developments, and the period 1976-77 to 1979-80 saw a sharp turnaround in India's balance of payments position. Reserves increased from about ₹ 600 crores in 1974-75 to ₹ 5160 crores in 1979-80. In 1979-80, reserves were 54 per cent of imports. During this period, the export growth was good, and in 1976-77, there was a small trade surplus of ₹ 72 crores. The primary reason for the sharp improvement in the BoP, however, was a dramatic improvement in the net invisibles, mainly on account of the large inflow of emigrant remittance.

This 'golden' period for India's BoP did not, however, last long. Problems began to develop in 1979-80, because of the second oil shock. The trade deficit burgeoned from ₹ 2200 crores in 1978-79 to ₹ 6200 crores in 1980-81. Gradual decline in the net receipts from invisibles, as the trade deficit was growing, aggravated the situation and a crisis situation emerged by the dawn of the present decade.

One important source of the BoP problem in the 1980s and afterwards was the change in the source of financing the large current account deficit. In the earlier period, i.e., until the beginning of the 1980s, almost the entire deficit was financed through inflows of concessional assistance, which kept the debt-service burden low. As against this, the eighties were marked by a reduction in the inflows of concessional assistance and an increase in the debt to private creditors, including commercial banks and NRIs.

Invisibles surpluses have traditionally financed a large part of India's trade deficits. There was a steep fall in this since the beginning of the 1980s. Net invisibles financed nearly 73 per cent of the trade deficit in 1980-81. On an average, it financed more than 60 per cent of the trade deficit during the Sixth plan (1980-85). By 1990-91 it dropped to about 13 per cent, compelling the nation to take increasing resource to external sources for meeting the payments obligations. During 2006-07, net services financed, on and average, 38 per cent of the merchandise trade deficit. It was 49 per cent in 2013-14.

This falling trend in respect of the net invisibles was caused by the adverse trends in the invisibles payments on the one hand and invisibles receipts on the other hand. The rise in the invisibles payments has been chiefly contributed by cumulation of interest and service payments on foreign loans and credits.

In short, the BoP problem of India in the past was caused mostly by the following factors:

1. Large trade deficit
2. Fall in the invisibles surplus, caused by:
    - (a) Sharp increase in the invisibles payments due to the increase in the debt service.
    - (b) Setback to the invisibles receipts, mainly the emigrant remittances and travel income.
3. Sensitive behaviour of foreign creditors, including NRI foreign currency depositors.
4. The declining role of concessional external finance.

The economic liberalisation has, however, brought about significant changes. There has been a noticeable structural change towards a more stable and sustainable balance of payments. For a brief period in the beginning of the first decade of this century, there was a current account surplus, but the current account balance again turned adverse and this situation continues.

The capital account has shown a significant structural change. The debt creating flows as a percentage of total capital flows in the balance of payments averaged as much as 97 per cent during

the Seventh Plan but declined to less than 18 per cent in 1994-95. The non-debt creating flows like foreign investments rose substantially. These developments will considerably case India's debt servicing burden.

The substantial increase in the foreign investment, as a result of the liberalisation has been generating significant capital account surplus. Capital account surplus increased substantially over the last decades, although with significant fluctuations, resulting in a huge accumulation of foreign exchange reserves.

The trends in the capital flows over the 1990s reflects a shift in importance from debt to non-debt flows with the declining importance of external assistance and external commercial borrowings (ECBs) and the increased share of foreign investment — both direct and portfolio.

The increase in capital inflows coupled with the improvement in the current account position resulted in a surplus in the overall balance of payments of India from 1993-94 onwards, excepting 1995-96. The surplus amounted to US$ 15 billion in 2005-06 as against a deficit of US$ 0.6 billion in 1992-93.

Impacted by the global economic crisis, the capital account surplus fell steeply in 2008-09 and the year witnessed an adverse BoP as the capital account surplus was substantially lower than the current account deficit. However, the BoP turned favourable in 2009-10 and continued to be so in the subsequent year thanks to the substantial increase in the capital account surplus even as the current account continued to record deficits. Capital account surplus as a percentage of the GDP fell from 8.6 to 0.5 per cent in 2008-09 but improved to 3.8 per cent in 2009-10 and remained near that figure in 2010-11.

MAJOR PROBLEMS OF INDIA'S EXPORT SECTOR

A brief account of the major drawbacks of India's export sector is given below.

Lack of Integrated Approach

An important reason for the poor export performance of India has been the absence of an integrated view of the development potentials and development objectives and a long-term strategy based on such an integrated approach. Needless to say, absence of proper environmental analysis and definite objectives and policy directions are crux of the problem. Had there been a realistic assessment of the overall effect of modernisation and economically efficient development of a sector on export earnings, employment, income generation etc., the development of several sectors would not have been made to suffer by such policies as reservation for small scale sector, import controls, size and growth restrictions, etc. A proper understanding of the multiple benefits of development of a sector would lead to formulation of comprehensive and integrated development plans for the realisation of multiple benefits. Such an integrated development strategy would avoid wasteful fragmentation of development efforts and distortions. Support to exports by such a development strategy would give more respectability to export development because of the realisation and appreciation of the other socio-economic benefits. For example, an understanding of the effects of value-added exports on employment and income generation as well as higher foreign exchange earnings would lead to due attention to the development of such exports. However, such a comprehensive and integrated view of development benefits was not always present under the Indian planning.

Problem Recognition and Action Lags

A major hurdle in India's progress in many fields has been lag in problem/need recognition and the lag in proper action even after the recognition of the need for action.

The role of Industrialisation in India's economic development had been well recognised even much before the Independence; an Industrial Policy Resolution was made shortly after the attainment

of Independence and it was reformulated in 1956. However, no such enthusiasm was shown to deviate from the colonial trade regime and to formulate a comprehensive export development strategy. It was only in 1970, about two decades after the launching of the development planning and 22 years after making the first Industrial Policy Resolution, that the Government of India made an *Export Policy Resolution*, despite facing severe problems like stagnant export earnings and foreign exchange crisis (which led to the devaluation of the Rupee in June 1966) and despite the fact that the Import and Export Policy Committee (Mudaliar Committee), 1961, and several people had pointed out the need for active export promotion.

Innovativeness is, undoubtedly, one of the very important factors that affect position in a competitive situation. One of the major failures of India has been in this respect. Success through pioneering innovation had hardly been a part of the Indian export strategy. The maximum we have aimed at has been to follow the trend. Even in following the trend we often lag very much behind. The failure to keep pace with the trends, let alone leading them, led to the loss of India's market position in several traditional exports and to the unsatisfactory performance of several non-traditionals. The tardiness in the progress of value-added exports is a reflection of this fact.

Value-added exports help better utilisation of domestic resources and maximise export earnings. There is a lot of scope for increasing our export earnings from spices and certain other agricultural products, marine products, leather etc. through value addition. Our failure to market many products in consumer packs, under our brand names, to foreign consumers has caused huge loss of foreign exchange. Several products, unprocessed, semi-processed or processed, exported from India in bulk are processed or repacked by foreign firms, mostly in developed countries, and sold in consumer packs under their brand names. To establish a hold over the foreign market and to get better prices for our products, we must have an effective strategy to get over this problem of our faceless presence in the foreign market.

The Task Force on Spices has observed[4] that India has been very traditional in its approach to export of spices. With the progress of time and development of the industry and improved standard of living, India as the largest spice producing country in the world failed to ensure that the modern development are extended to the field of spices. Similarly, although India has been regarded as the world leader in tea, in product research and formulation we have played virtually no role — instant tea, tea bags, tea drinks have all been developed abroad by the consuming countries.

Technological Factors

Technological problems have had very serious effect on India's exports. The Tandon Committee and Alexander Committee have referred to the adverse impact of technological backwardness on India's exports through poor quality, low productivity, high costs etc.

High Costs

In a large number of cases, high domestic costs is an inhibiting factor. This problem has been succinctly stated by Abid Hussain Committee: "India is often at a disadvantage *vis-à-vis* competing countries because its costs of production, hence export prices, are higher than in competing countries, not only because of the higher prices of importable and non-traded inputs, or because of time and cost overruns implicit in managerial inefficiency, but also because of much lower level of productivity, all of which stem from the aforesaid problems."[5]

References has already been made, in the preceding section, to the high costs and poor quality of inputs and technological backwardness. Besides the material costs, certain other costs like interest rates, port charges etc., are also very high in India. Supply bottlenecks and high inventory requirements also increase costs.

Technological factors and low productivity also contribute to the high cost of production in India. It has been pointed out that productivity in resource use "in a large number of export industries is still very low compared to the levels observed in many other developing and developed countries. Analysis of productivity measured as value added per unit of labour for select sectoral categories and select countries brings out that productivity levels in India are way behind those in many developed and developing countries. Even with regard to productivity of traditional exports, our productivity performance is not satisfactory. The growth rate of productivity in India is also lower than that in many other countries. Further, the advantage of the economies of scale and ability of bulk supplies are not available to the Indian exporters."[6]

Poor Quality Image

India has a poor quality image abroad. Despite the measures taken under the Exports (Quality Control and Inspection) Act and other laws, our exports continue to suffer because of the quality problems. Occasional blacklisting by the US of shrimp and pepper exports from India is a manifestation of the inadequacy of the quality control and pre-shipment inspection system in India. Even the credibility of this system is suspected abroad.

Poor quality/inadequacy of inputs, technology and facilities affect the quality. On several instances, carelessness or lack of commitment on the part of the exporters are also responsible. Adulteration and duping are also not uncommon. There is a general impression that a proper export culture is lacking in India.

Unreliability

Besides quality, Indian exporters have been regarded as unreliable on certain other factors. As the Tandon Committee has observed, a very important black mark on the Indian exporters is reneging — a term used in the USA to refer to going back on a contract and refusing to fulfil it on its original terms.

Indian exporters have been regarded as unreliable also because of their inability to provide prompt after sales service.

The Tandon Committee remarks: "unreliable quality and deliveries to importers abroad, with finely balanced production and sales schedules, can prove as embarrassing as non-delivery. The reasons of power, raw materials, transport and shipping, strikes and port delay; to which we can add those we do not admit, poor production planning; never optimistic acceptance of orders against an inadequate supply base: but endemic and acceptable as these factors may be to our buyers at home, they make little sense to an importer, who naturally compare us with small totally dependable countries of no comparable resource endowments, like Korea and Taiwan."[7]

Supply Problems

A serious drawback of the Indian export sector is its inability to provide continuous and smooth supply in adequate quantities in respect of several products. The problem is that "much of the exporting is the result of the residual approach rather than conscious effort of producing for export. The tendency for exporting what we produce rather than producing for export still continues to characterise the export behaviour."[8]

The Committee on Export Strategy for the 1980s has observed that the "stop-go" exports are considered abroad as causing much avoidable damage to the Indian export effort; one which can be avoided through a careful planning of supplies where possible through buffer stocks — in the case of a new product and some sacrifice by domestic consumer in an unforeseen shortage; and a permissiveness towards importers with valid contracts for fortuitous gains.[9]

Faceless Presence

Although India is an important supplier of several commodities in foreign markets, her presence in these markets is faceless in the sense that the consumers do not know that these commodities are Indian. Major export items of India like seafoods, leather manufacturers, spices etc., have in many cases, a faceless presence in foreign markets. Although these exports may undergo further processing or repacking in many cases, in several cases the Indian exports are sold in the foreign markets in the same condition as they are exported but under foreign brand name, sometimes it fetches a much higher price than the same product with an Indian name.

This is indeed a vicious circle. The poor quality image of the Indian products, many a time apparent than real, makes it difficult to sell under Indian brand names. The faceless presence, on the other hand, perpetuates the problem. In fact, most bulk importers of Indian goods want this situation to be perpetuated as this enables them to hold control over the market while the exporters, being at the mercy of the foreign traders lose bargaining power.

The failure of India to keep pace with the market dynamics has also contributed to the perpetuation of this situation. For example, the failure of India to offer spices in consumer packs and in product forms, the consumer want provided an opportunity for foreign traders to import spices in bulk and resell them in suitable forms, and thus keep the market under their control.

The faceless presence is also the result of the failure of the exporters and export promotion agencies in India to build up an image for Indian goods abroad.

Infrastructural Bottlenecks

The following observations made by the National Convention on Exports organised by the Federation of Indian Chamber of Commerce and Industry is indeed a recapitulation of the indisputably held view of the infrastructural situation in India. "Infrastructural shortages such as energy shortages, inadequate and unreliable transport and communication facilities hinder growth in exports. Power shortages and breakdowns disrupt production schedules, increase cost and adversely affect timely shipments. The continental size of the country necessitates that the inland haulage of export cargo as also its shipment at ports is done efficiently and at reasonable cost. Exports also suffer for want of efficient and economic communication facilities. Indeed, with advancements in communication and computer technologies, the very complexion of international trading has changed with more and more of cargo documentation and banking transactions getting into the electronic media. The Indian exporter, however, has to communicate through inefficient and relatively outdated telecommunication network."[10]

Improving the transportation system, including the expansion and modernisation of the port facilities, rationalisation of the charges, improving the procedural system etc. are very much essential for the development of the export sector. However, the administrative lethargy continues to plague the Indian scenario causing heavy damage to export development.

Structural Weakness

A major handicap of the Indian export sector is its structural weakness. Two of the important factors responsible for this, viz., low efficiency and productivity in resource use and poor technology have already been described. Another very important factor is the absence of a systems approach to the process of management, marketing, information, planning and decision making.

It is important to note that "India's exports do not pick up in periods of boom conditions in the world economy to the same extent as the exports of many other competitors. On the other hand, India is quick to pick up sluggishness in exports in response to sluggishness in world trade much more quickly than other exporters. This asymmetry in the response of the export activity to world market conditions is a reflection of structural weakness of the export sector as a whole."[11]

Uncertainties, Procedural Complexities and Institutional Rigidities

One of the defects of our trade policy regime has been the uncertainty about future policies, incentive schemes etc.

The procedural complexities of the Indian trade regime have been indisputably acknowledged. The government appointed the Committee on Import-Export Policies and Procedures (Alexander Committee) which in its Report (1978) made a number of recommendations for improving the regime. The Tandon Committee and the Abid Hussain Committee Reports too have suggested rationalisation and simplification of policies and procedures. Although several measures have been taken recently, still much remains to be done in this respect. There is a general feeling that not only that there are too many controls and overlapping of policies but also "the principle of Indian policy is to elaborate rules (and exceptions) to them, which are not only detailed and specific, but also subject to wide discretion."[12] These are vindicative of the structural weakness of the institutional system in India.

There have been reports of loss of exports worth hundreds of crores of rupees due to the problem of interdepartmental coordination. All these happen in a country which is said to be giving exports one of the high national priorities and which is facing serious foreign exchange problems.

Inadequacy of Trade Information System

An efficient Trade Information System is essential for success in the dynamic global market. But, "our marketing infrastructure as well as marketing techniques are neither effective nor efficient. We do not have any machinery to keep prompt track of business information overseas, as done by JETRO in Japan, KOTRA in Korea, CETDC in Hong Kong and STDB in Singapore with wide network of offices abroad. These organisations have evolved an efficient system which help them to get information pertaining to tenders and the like much before these are released officially. In India, we get these information, at times, after the expiry date. India has, no doubt, a plethora of organisations — governmental, semi-governmental as also non-governmental — engaged in this task in one way or other. Yet we do not have an easy access to market intelligence and information.[13]

The Tandon Committee has pointed out that our exporters often "miss the opportunity of participating in global tenders because of late receipt of tenders, sometimes, changes in policies and procedure in overseas countries do not reach them in time ... the information is not available on a continuing basis from any source.[13] The Task Force on Export Services constituted in June 1978 by the Government of India and the Abid Hussain Committee also drew attention to this problem. However, the situation still is not satisfactory.

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22

EXPORT PROCEDURES AND DOCUMENTS

The exporting activity involves several commercial and regulatory procedures. These procedures also involve considerable documentation requirements. Besides the documentation pertaining to the commercial aspects of the export business, there are documentation requirements of a regularly nature like excise clearance, foreign exchange regulations, etc.

The export documentation involves the preparation of the specified number of copies of the prescribed documents pertaining to the different procedures. Recently, different forms used in the export documentation have been standardised and aligned.

A detailed account of the export procedures and documentation is outside the scope of this chapter; only an outline of the important steps in exporting and the important documents are given.

Preliminaries

Some preliminary steps have to be taken before an export transaction begins.

IEC Number

Registration with Regional Licensing Authorities: Every person (whether an individual, firm or company) importing or exporting goods require an Importer-Exporter Code Number (unless specifically exempted by the DGFT). The IEC Numbers are normally allotted by the regional licensing authorities. This code number is required to be incorporated in the various export documents submitted to the authorities for purposes of export.

Membership-cum-Registration

Membership of certain bodies will help the exporters in a number of ways. There are specified Export Promotion Councils (in this chapter the term EPC also covers Commodity Boards and Export Development Authorities) for various products/product groups. Members of EPC receive different kinds of assistance and services in respect of the export business.

Exporters are advised to become members of local Chambers of Commerce, Productivity Council, or any other trade promotion organisation recogsised by the Ministry of Commerce or Industry. Membership of such bodies will help the exporters in different ways, including obtaining the certificate of origin, which is a necessary document required for export to certain countries.

Exporters will also benefit from membership of other organisations like India Trade Promotion Organisation (ITPO).

Exporters should get themselves registered with certain export promotion and regulatory bodies.

Registration with EPC/FIEO: For any benefit or concession under the Exim policy, an exporter is required to register himself with the appropriate authority and obtain a Registration-cum-membership certificate (RCMC).

An exporter may obtain RCMC from anyone EPC relating to his main line of business. However, if the export product is not covered by any EPC, the RCMC in respect thereof may be issued by the regional licensing authority concerned.

Registration with Sales Tax Authorities: For getting exemption from the sales tax on the export goods, the exporter should be registered with the Sales Tax authorities of the concerned State.

Inquiry and Offer

An inquiry is a request from a prospective importer to be informed of the terms and conditions of sale. It may contain full details of the goods required, their description, catalogue numbers or grades, sizes, weights or other distinguishing features, time and method of delivery, etc.

If the inquiry is from a person new to the exporter, it is usual to make some investigation into the financial position of the client, either by means of a banker's reference (if the bank's name is supplied by the inquirer) or by means of a trade reference, i.e., an inquiry from some firm or firms which have had business dealings with the person in question, or through inquiry agencies which specialise in acquiring and furnishing information concerning all types of traders.

As soon as the exporter receives a business inquiry from a party abroad, it should be promptly attended to. The exporter should bear in mind that the foreign buyer may have a large number of prospective suppliers in a number of countries and thus he is in a very competitive situation. Meticulous care should, therefore, be exercised in dealings with foreign customers.

It should also be remembered that the exporter may not always get a direct inquiry. In many instances, he will have to find out the prospective customers on his own initiative. Several trade journals publish trade inquiries.

Establishing an effective dialogue with the overseas buyer is very essential to clinch the issue. This should be done with meticulous care. The correspondence and communication should be elegant, clear, precise and sufficient.

The foreign buyer would be interested in knowing the details about the exporter. It is, therefore, advisable to send him the exporter's literature in the first instance and introduce himself clearly and explicitly.

When it is necessary to send samples, that should be done in accordance with the Government regulations in force.

As a starting point of the negotiations, the exporter would have to make an offer to the foreign customer. An offer is a proposal in which an exporter submits, may be in the form of a letter, his quotation and other relevant information. The offer, when accepted by the foreign buyer, becomes an order.

The offer made by the exporter is usually in the form of a proforma invoice. This is an invoice sent in advance to the buyer before the shipment is made, and usually includes details of the products to be supplied, their quantity, quality value, including freight, insurance and other charges, the method of payment, the conditions of sale, etc. Often, buyers open letters of credit on the basis of the proforma invoice. It is, therefore, necessary to take approximate freight charges on the higher side than on the lower.

Confirmation of Order

Once the negotiations are completed and the terms and conditions are acceptable to the buyer and seller, the buyer may place an order with the exporter. The exporter should immediately confirm the order by sending his acceptance. For the confirmation of the order, the proforma invoice is generally sent in triplicate to the buyer, and the buyer is asked to return two copies duly signed by him. The exporter should again send one copy to the importer with the exporter's signature to confirm the acceptance of the order. The exporter may also insist on a documentary letter of credit so that the buyer's commitment may be complete.

The confirmation of the order usually takes the form of a contract. There is no hard and fast rule for the terms that may be mentioned in an export contract. However, the contract should contain details of goods, their quantity, quality, price, period of delivery/shipment, packing and making, terms of payment, licences, insurance, documentary requirements, etc.

Export Licence

The exports of some items are banned and of some items controlled by means of licences, though many items are permitted to be exported freely. Needless to say, the exporter should make sure that the item sought to be exported is not one which falls in the banned list. If the item to be exported requires a licence, it is necessary to obtain it before finalising the contract.

Finance

If the exporter requires pre-shipment financial assistance, he should take the necessary steps to obtain it.

Production/Procurement of Goods

Once the order is confirmed, the exporter should take necessary steps to ensure the timely availability of the goods of the specifications required and execute the export order promptly. In the case of the manufacturer exporter, the production schedule should be adjusted to the export requirements. If there are resource or production constraints, the requirements of the export division may have to be given priority over production for the home market. If the exporter is not a manufacturer, he should contract with his suppliers and ensure timely availability of the goods of the buyer's specifications.

Shipping Space

As soon as the export order is confirmed, the exporter should contract the shipping companies which have sailings for the port to which goods have to be sent and book the required shipping space.

The exporter may get the necessary information about sailings from the Daily Shipping Intelligence, to which he may subscribe. Shipping companies usually have their agents, who accept the cargo on their behalf. There are, moreover, clearing and forwarding agents who will work for the exporter on a certain commission. These agents are very useful, for they have regular contacts with shipping companies and their agents, and specialise in the job. The exporter may entrust the work of booking the shipping space and despatch to clearing and forwarding agents.

On the exporter's application or on the application of the freight broker on the exporter's behalf, the shipping company issues its acceptance if the space applied for is given.

There are two kinds of acceptance, the shipping advice and the shipping order (dead freight). In the shipping advice, the shipping company is not bound to accept the cargo. It is only an intimation to the party that the goods will be accepted on the ship — they may or may not be accepted. But when a shipping order is issued, the shipping company binds itself to accept the cargo; and on its failure, it can be sued for loss or damages. The shipping order is an instruction by the shipping

company to the commanding officer of the ship that the goods from the exporter as per the details given should be received on board. The original is given to the exporter, and a copy is sent to the commanding officer of the ship.

Packing and Marking

Once the goods are ready, they are packed and marked properly.

If the buyer has given instructions about packing and marking, they should be followed accordingly. If there are no such instructions, it should be ensured that the packing and marking are of the standards recommended or specified. The Bureau of Indian Standards has prescribed packing standards for certain items. The British Standard Packing Code, published by the British Standards Institution, and the Exporters Encyclopaedia published in the USA, give detailed packing instructions. Shipping companies also give certain packing instructions, especially for highly dangerous goods.

The exporter should take meticulous care in respect of marking also. The marking should include the shipping marks of the consignee, the port of destination, measurements, the country of origin and any other matter the buyer specified. The International Cargo Handling Co-ordination Association has, for the use of exporters and carriers, made a number of recommendations for the marking of goods carried by ocean-going vessels. The International Trade Forum has set out important rules of good marking procedures which should be followed by exporters.

Quality Control and Pre-shipment Inspection

Needless to say, goods should be exported only after ensuring that they are of proper quality. If the quality of the goods exported is not satisfactory, it will affect the image of not only the exporter but of the whole nation. The exporter should, therefore, take every care to ensure the quality of exports. The government has also taken some steps in this regard. The Export (Quality Control and Inspection) Act, 1963, empowers the government to issue a notification about the commodities brought under the Compulsory Quality Control and Pre-shipment Inspection Scheme; and once a commodity is notified, it cannot be exported unless it is accompanied by a certificate of export-worthiness from the Export Inspection Council or any other agency duly authorised for this purpose.

Now specified categories of exporters can avail the self-certification scheme.

Excise Clearance

As a matter of policy, the government has granted excise duty exemption for export products. Excisable goods may be exported either under claim for rebate of excise duty or in bond. In the case of export under claim for refund of excise duty, the duty is first paid and its refund is claimed after the export has been effected. In the case of export under bond, goods are allowed to be exported without payment of duty on execution of a bond, with sufficient surety and security in the prescribed bond, and under such conditions as the Controller of Central Excise may approve, for a sum at least equivalent to the duty chargeable on the goods.

Customs Formalities

Goods may be shipped out of India only after Customs clearance has been obtained. For this purpose, the exporter (or the clearing and forwarding agent on behalf of the exporter) should present the following documents to the customs authorities.

(*i*) Shipping Bill..

(*ii*) Declaration regarding truth or statement made in the Shipping Bill.

(*iii*) Invoice.

(*iv*) GR Form.

(*v*) Export Licence (wherever required).

(*vi*) Quality Control Inspection Certificate (wherever required).

(*vii*) Original contract, wherever available or correspondence leading to contract.

(*viii*) Contract registration certificate (wherever applicable).

(ix) Letter of Credit (wherever applicable).

(*x*) Packing List.

(*xi*) AR-4 Form

(*xii*) Any other documents.

The Customs authorities scrutinise the shipping bill and other requisite documents, and if, *prima facie,* satisfied, they pass it for export, subject to a physical examination by the dock or air transit staff of the Customs. The shipping bill passed by the export department has to be presented to the cargo supervisor or the steamship company or the shed manager, who is the port official, for permission to bring in the cargo for export.

A facility is available for Customs checking of the goods at the factory. Applications for this purpose should be made to the Assistant Collector of Customs. The Customs Appraiser will go to the factory to check the consignment; and after checking it, he will seal the packages. However, the Preventive Officer on board the ship has also the right to inspect the sealed packages before they are actually loaded on the ship; but when he is satisfied about the bonafides of the party, he does not open the sealed packages nor check them again.

Exchange Control Formalities

An exporter, who has sent goods outside the country, has the obligation to satisfy the Reserve Bank of India that he has received payment from his overseas buyer. The government does not allow any exporter to export for any other consideration. The exchange control regulations require all the exporters to:

Make a declaration on the prescribed form to the Collector of Customs that foreign exchange, representing the full export value of the goods, has been or will be disposed of in the manner and within the period specified by the RBI;

Negotiate all shipping documents, including those relating to sales on consignment basis, through authorised dealers;

Receive payment by an approved method; and

Exporters are required to realise the foreign exchange proceeds of exports within the specified period. If the exporter has any genuine difficulty in obtaining, he must seek the permission of the Reserve Bank for the extension of the time limit. It is up to the exporter to prove that the delay, if any, has not been caused because of his own fault or negligence.

Exchange control regulations require an exporter to fill certain specific forms and submit them to the Customs authorities. The information sought in these includes the full value of the products that are exported and such other particulars as the names of importers and their bankers, deductions by way of commission, etc.

Insurance

The goods that are exported may be subject to certain maritime perils. The risks of such perils may be covered under marine insurance. Who should bear the cost of the insurance depends on the terms of the sale. For instance, under the CIF term, insurance is the responsibility of the exporter.

Marine insurance in India is undertaken by the four subsidiaries of the General Insurance Corporation of India (GIC): The National Insurance Company; The New India Assurance Company; The Oriental Fire and General Insurance Company; and The United India Fire and General Insurance Company.

The Export Credit Guarantee Corporation (ECGC) covers certain export risks, which are not covered by the general insurers. (For details, see the chapter on *Export Risk Insurance*).

Shipping the Goods

Goods may be exported to foreign markets by sea, air, post, land and river.

(i) Shipping by Sea

To obtain the permission of the port authorities for the movement of goods into the port, it is necessary to present the cart ticket to the gate warden/inspector/keeper at the port gate.

Sometimes, the vessels accept export cargo at the jetty and sometimes they load it in midstream. When the vessels are in midstream, the cargo has to be taken by boats for purposes of loading; this is called overside loading. In such cases, the exporter has direct touch with the ship without having to going through the Port Commissioner's formalities.

When the goods are loaded in the shed vessel, they have to be sent to the Port Commission's jetty from where they are loaded and taken care of by the man of the Port commissioner.

Several charges have to be paid to the Port commissioner before the goods are sent to the shed. These charges vary from port and are known as the Port Commissioner's charges. If the goods are sent for overside loading (midstream), only the river dues, surcharge, ad valorem or fixed toll and rent have to be paid. The exporter will, of course, have to pay for the boat charges, which will depend on the quantity of cargo and the rate of charge fixed between him and the boatman.

The exporter/forwarding agent should necessarily obtain the permission of the Preventive Officer of the Customs Department, who supervises the loading of the cargo on board the vessel. This permission, called the let ship order, is given as an endorsement on the duplicate copy of the shipping bill. The shipping company loads the cargo only after receipt of the shipping bill with the let ship order.

After the cargo is loaded, the master of the vessel issues the mate receipt, which contains information about the name of the vessel; berth; date of shipment; description of packages; marks and number; condition of the cargo at the time of its receipt on board the vessel; etc.

The exporter should then prepare at least two copies of the bill of lading and should submit them, along with the mate receipt, to the shipping company, which calculates the freight on the basis of the measurement or weight. When the exporter has paid the freight as per the calculation of the shipping company, the bill of lading, duly signed by an authorised person of the shipping company, is handed over to the exporter. The B/L gives the exporter title to the goods shipped on the vessel. The bill of lading may be a *clean* or a *claused* one. A claused B/L bears adverse endorsements, such as: *one case damaged.*

When shipment is made through Inland Container Depot (ICD), the exporter will file shipping bills at the export section of the ICD in case the cargo comprises of a full container load (FCL) and at Container Freight Station (CFS), in case the cargo comprises of less than the container load. In addition to the usual information given on the shipping bills, the exporter should mention the Port of Exit and the serial number of the containers. At the exit port, the containers will be allowed to be exported under preventive supervision on checking of the seals without any further examination (examination will only be done if the seals of the containers are found to have been tampered with or on the basis of any information, doubt, etc.)

(ii) Shipping by Air

Shipping by air has become popular for such products as commodities which are perishable and seasonal or high in cost but low in bulk. Certain advantages are associated with shipping by air. It ensures quicker delivery. This may enable the exporter to receive the payment comparatively quickly. Further, shipping by air usually involves lower packing charges, for there is less handling of the goods in transit; and the risks of pilferage and damage are reduced.

(iii) Shipping by Post

Shipping of goods may be effected by post, subject to the foreign trade and foreign exchange regulations of the country.

The export of goods by parcel post, either as gifts or for commercial purposes, is regulated in accordance with the provisions of Postal Notice No. 13, dated 3rd December 1973. The postal notice is reproduced in the Handbook of Import-Export Procedures, which is published annually by the Ministry of Commerce.

It is the responsibility of the sender to ensure that the parcel is covered by a proper export licence, where such a licence is necessary, failing which the parcel is liable to be returned. The fact that the parcel is accepted by the post office in the first instance does not in itself constitute a guarantee that the requirements of export control have been fulfilled; and when it is returned, no claim for compensation or for refund on account of postage is entertained.

(iv) Shipping by Land

The procedure for the export of excisable goods by land to countries like Afghanistan is, by and large, similar to the one laid down for export by sea. The AR-4 form is, however, different for export by land; and this is to be filled along with form AR-4A. These forms should be filled in quadruplicate instead of quintuplicate, as in the case of export by sea. The excisable goods, whether sealed or not in the exporter's factory/premises, are presented to the Frontier Customs Officer/Boarder Examiner along with forms AR-4/4A (original and duplicate). In the case of goods required to be repacked, the repacking and resealing is done under the supervision of the Frontier Customs Officer. If there is any change, the same will be recorded on the AR-4/4A forms. Having allowed the export of consignment, suitable endorsements are made on these forms, duplicates of which are returned to the exporter.

The exporter, having filled in the necessary certificate on the duplicate form, submits his claim for excise rebate to the Collector of Central Excise from whose jurisdiction the goods were despatched for export, in the manner and along with documents detailed earlier.

Negotiation of Documents

After shipping the goods, the exporter should arrange to obtain payment for the exports by negotiating the relevant documents through the bank. The set of negotiable documents usually consist of the following: Letter of credit; Commercial invoice, together with the packing slip; GR-1 form; Certificate of Origin; Marine Insurance Policy; Bill of Lading.

In accordance with foreign exchange regulations, the exporter must lodge a full set of shipping documents with the bank within prescribed period. His bank would forward the necessary documents to the buyer's bank for the collection of the amount from the importer.

Export Incentives

If the exporter is entitled to any export incentives, he should take the necessary steps to realise it (them).

EXPORT DOCUMENTS
STANDARDISED AND ALIGNED PRE-SHIPMENT DOCUMENTS

More than two dozen commercial and regulatory documents are involved in the pre-shipment stage of an export transactions. These include 16 commercial documents and 9 regulatory documents.

Commercial Documents

The commercial documents are those which, by customs of trade, are required for effecting physical transfer of goods and their title from the exporter to the importer and the realisation of export sale proceeds.

14 out of the 16 commercial documents have been standardised and aligned to one another. Shipping Order and Bill of Exchange could not be brought within the fold of the aligned documentation system because of their very different data elements and having very little in common with other commercial documents.

The commercial documents may be classified into principal documents and auxiliary documents.

Principal Export Documents

Out of the 16 commercial documents mentioned above, the exporter is required to send the following eight documents to the importer. These are known as the principal export documents:

(*i*) Commercial Invoice.
(*ii*) Packing List.
(*iii*) Bill of Lading.
(*iv*) Combined Transport Document.
(*v*) Certificate of Inspection/Quality Control (where required).
(*vi*) Insurance Certificate/Policy (in case of CIF export sales contract).
(*vii*) Certificate of Origin.
(*viii*) Bills of Exchange and Shipment Advice.

Auxiliary Documents

The remaining eight commercial documents (i.e., those other than the principal documents) are known as the auxiliary documents. They are:

(*i*) Proforma Invoice;
(*ii*) Intimation for Inspection;
(*iii*) Shipping Instructions;
(*iv*) Insurance Declaration;
(*v*) Shipping Order;
(*vi*) Mate Receipt;
(*vii*) Application for Certificate of Origin; and
(*viii*) Letter to the Bank for Collection/Negotiation of Documents.

Regulatory Documents

Regulatory pre-shipment export documents are those which have been prescribed by different Government departments/bodies in compliance of the requirements of various rules and regulations under relevant laws governing export trade such as export inspection, foreign exchange regulations, export trade control, customs etc.

On an average, there are 9 regulatory documents associated with the pre-shipment stage of an export transaction and are as follows:

(*i*) Gate Pass I/Gate Pass II — Prescribed by Central Excise Authorities.

(*ii*) AR4/AR4A Form — Prescribed by Central Excise Authorities.

(*iii*) Shipping Bill/Bill of Export — Prescribed by Central Excise Authorities.

— For Export of goods.

— For Export of duty free goods.

— For Export of dutiable goods.

— For Export of goods under claim for duty drawback.

(*iv*) Export Application/Dock Challan — Prescribed by Port Trust.

(*v*) Receipt for Payment of Port Charges.

(*vi*) Vehicle Ticket.

(*vii*) Exchange Control Declaration — Prescribed by RBI GR/PP Forms.

(*viii*) Freight Payment Certificate.

(*ix*) Insurance Premium Payment Certificate.

The different commercial and regulatory documents may be classified into documents related to goods, documents related to shipment, documents related to payment, documents related to inspection, documents related to excisable goods and documents related to foreign exchange regulations.

DOCUMENTS RELATED TO GOODS

(i) Invoice

An invoice is the seller's bill for merchandise and contains particulars of goods, such as the price per unit at a particular location, quantity, total value, packing specifications, terms of sale, identification marks of the package, bill of lading number, name and address of the importer, destination, name of the ship, etc.

Some importing countries insist that the invoice should be signed by the importing country's consul located in the exporter's country. Such invoices signed by the consul is known as *consular invoice.* The main purpose of a consular invoice is to enable the authorities of the importing country to collect accurate information about the volume, value, quality, grade, source, etc., of its imports for purpose of assessing import duties and also for statistical purposes.

There are special invoicing procedures in respect of exports to certain countries like the USA, Canada and Australia. Special customs invoices are also required for some countries, including Tanzania, Uganda, Mexico and Sudan. For many countries, there are no special invoice forms; the exporter may use his own invoice form containing the particulars required.

The special invoice forms for various countries may be obtained from any recognised Chamber of Commerce. Exporters may consult the respective Export Promotion Councils regarding the correct producers and invoice forms for different countries.

(ii) Packing Note and List

The difference between a packing note and a packing list is that the packing note refers to the particulars of the contents of an individual pack, while the packing list is a consolidated statement of the contents of a number of cases or packs.

A packing note should include the packing note number, the date of packing, the name and address of the exporter, the name and address of the importer, the order number, date, shipment per S/S, bill of lading number and date, marking numbers, case number to which the note relates, and the contents of the goods in terms of quantity and weight. Apart from the details in the packing note, a packing list should also include item-wise details.

No particular form has been prescribed for the packing note or packing list. Normally, ten copies of the packing note/list should be prepared. The first is to be sent with the shipping documents, two copies in advance to the buyer, one to the shipping agent and the remaining retained by the exporter.

(iii) Certificate of Origin

A certificate of origin, as the name indicates, is a certificate which specifies the country of the production of the goods. This certificate has also to be produced before clearance of goods and assessment of duty, for the customs law of the country may require this procedure. This certificate is a necessity where a country offers a preferential tariff to India and the former is to ensure that only goods of Indian origin benefit from such concession. A certificate of origin may be required when goods of a particular type from certain countries are banned.

A certificate of origin form may be obtained from Chambers of Commerce, Export Promotion Councils, and various trade associations which have been authorised by the Government.

CERTIFICATES RELATED TO SHIPMENT

(i) Mate Receipt

A mate receipt is a receipt issued by the Commanding Office of the ship when the cargo is loaded on the ship, and contains information about the name of the vessel, berth, date of shipment, description of packages, marks and numbers, condition of the cargo at the time of receipt on board the ship, etc.

The mate receipt is first handed over to the Port Trust authorities so that all the port dues may be paid by the exporter. After paying all the port dues, the merchant or the agent may collect the mate receipt from the Port Trust authorities. The bill of lading is prepared by the shipping agent after the mate receipt has been obtained.

(ii) Shipping Bill

The shipping bill is the main document on the basis of which the Customs' permission for export is given. The shipping bill contains particulars of the goods exported, the name of the vessel, master or agents, flag, the port at which goods are to be discharged, the country of final destination, the exporter's name and address, etc. It also contains details of the packages and the goods, such as number and description, marks and numbers, quantity details about each case, f.o.b. prices, real value as defined in the Sea Customs Act, whether Indian or foreign merchandise to be re-exported, total number of packages, their total weight and value, etc.

The following three forms of the shipping bill are available with the Customs authorities:

(*i*) *Dutiable shipping bill* for goods for which there is export duty.

(*ii*) *Free shipping bill* for goods for which there is no export duty.

(*iii*) *Drawback shipping bill* which is required for claiming the Customs drawback against goods exported.

(iii) Cart Ticket

A cart ticket, also known as a cart chit, vehicle and gate pass, is prepared by the exporter and includes details of the export cargo in terms of the shipper's name, the number of packages, the shipping bill number, the port of destination and the number of the vehicle carrying the cargo. The driver of the vehicle carrying cargo should possess the ticket, and when the vehicle is brought at the port gate, it should be presented to the gate warden/inspector/keeper along with other shipping and port documents. The gate keeper/warden/inspector, after satisfying himself that the vehicle is carrying the cargo as mentioned in the document, allows it to pass the gate.

(iv) Certificate of Measurement

Freight is charged either on the basis of weight or measurement. When it is charged on the basis of weight, the weight declared by the shipper may be accepted. However, a certificate of measurement from the Indian Chamber of Commerce or other approved organisation may be obtained by the shipper and given to the shipping company for the calculation of the necessary freight. The certificate contains the name of the vessel, port and destination, the description of goods, the quantity, length, breadth, depth, etc., of the packages.

(v) Bill of Lading

The bill of lading is a document wherein the shipping company gives its official receipts for the goods shipped in its vessel and at the same time contracts to carry them to the port of destination. It is also a document of title to the goods and, as such, is freely transferable by endorsement and delivery.

A bill of lading serves three main purposes: (*i*) As a document of title to the goods; (*ii*) As a receipt from the shipping company; and (*iii*) As a contract for the transportation of goods.

Each shipping company has its own bill of lading. The exporter prepares the bill of lading in the forms obtained from the shipping company or from the agents of the shipping company. The information contained in the bill of lading includes the date and place of shipment; the name of the consignor; the name and destination of the vessel; the description, quality and destination of the goods; the marks and numbers; the invoice number and the date of export; the gross weight and net weight; the number of packages; the amount of freight, etc.

A bill of lading acknowledging receipt of the goods apparently in good order and condition and without any qualification is termed as a *clean bill of lading;* if a bill of lading is qualified with certain adverse remarks such as, "goods insufficiently packed in accordance with Carriage of Goods by Sea Act," "one box damaged", etc., it is termed as a *claused bill of lading.*

Whenever the carrier has to use other transport facilities, such as rail, road, or another steamship company in addition to his own the consignee's centre, the carrier issues a *through* or *transshipment bill of lading*.

A bill of lading that has been held too long before it is passed on to a bank or the consignee is called *a stale bill of lading*.

When freight is paid at the time of shipment or in advance, the bill of lading is marked, *freight paid;* if the freight is not paid and is to be collected from the consignee on the arrival of the goods, the bill of lading is marked, *freight collect.*

(vi) Airway Bill

An airway bill, also called, an air consignment note, is a receipt issued by an airline for the carriage of goods. As each shipping company has its own bill of lading, each airline has its own airway bill.

DOCUMENTS RELATED TO PAYMENT

(a) Letter of Credit

A letter of credit is a document containing the guarantee of a bank to honour drafts drawn on it by an exporter, under certain conditions and up to certain amounts, provided that the beneficiary fulfils the stipulated conditions. For details of the letter of credit and the use of the letter of credit in financing foreign trade, see Annexure to the Chapter on E*xport Financing.*

(b) Bill of Exchange

The Negotiable Instruments Act, 1881, defines the bill of exchange as "an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument."

There are five important parties to a bill of exchange:

The Drawer: The drawer is the person who has issued the bill. The drawer is the creditor to whom the money is owed.

The Drawee: The drawee is the person to whom the bill is addressed or against whom the bill is drawn. In other words, the drawer is the debtor who owes money to the drawer, the creditor.

The Payee: The payee is the person to whom the bill is payable. The bill can be drawn payable to the drawee or his bank.

The Endorser: The endorser of a bill is the person who has placed his name and signature at the back of the bill signifying that he has obtained title to the bill and payment is due to him on his own account or on account of the original payee.

The Endorsee: The endorsee is the person to whom the bill is endorsed. The endorsee can obtain payment from the drawee.

There are the following important types of bill of exchange.

(*i*) *Sight Bill of Exchange:* A sight or demand B/E is one which is required to be paid by the drawee immediately on presentation of the bill.

(*ii*) *Usance Bill of Exchange:* In case of the usance or time B/E, there is maturity period called the tenor, and the payment is to be made only on the maturity of the bill.

Generally speaking, the due date of payment of the usance bill is calculated from the date of presentation or sighting of the bill by the drawee. Such a bill is called after sight usance bill. But sometimes the date of maturity is calculated from the date of drawing of the bill. Such a bill is known as *after date usance bill.*

(*iii*) *Clean Bill of Exchange:* A bill of exchange not accompanied by the relative shipping documents is known as a clean bill of exchange. In respect of the clean B/E, the documents are sent to the consignee directly, and he can take delivery of the goods on their arrival at the port of destination.

(*iv*) *Documentary Bill of Exchange:* A documentary B/E is a bill of exchange accompanied by the relative shipping documents such as the bill of lading, marine insurance policy, commercial invoice, certificate of origin, etc. The documents accompanying the bill are delivered to the importer by the bank only upon either acceptance or payment of the bill. The former is called *documents against acceptance* and the later is called *documents against payment.* It is the documentary B/E that is commonly used in foreign trade transactions.

Upon shipment of the goods, the exporter may draw a B/L on the importer or, more frequently, on bank acting for the importer. The exporter usually draws the bill payable to his own order, or to that of his bank. He then endorses the bill and sells it to, or discounts it at, his bank. In this way,

the exporter receives his money immediately upon the shipment of the goods. The bank sends the bill and the documents to its foreign branch or correspondent bank which, upon arrival, promptly notifies the importer and presents the bill to him for payment or acceptance. Until the importer has accepted the bill or made arrangements for payments, he cannot receive the bill of lading, which is his title to the goods.

(c) Trust Receipt

If the importer is unable to take possession of the documents by making the payment on the D/P bill following the arrival of the goods, the merchandise may be made available to the importer by his bank under an arrangement whereby the importer signs a trust receipt. Under this arrangement, the importer is allowed to sell the imported goods by acting as an agent of the bank; but he retains ownership of the merchandise until the importer has made full settlement; all sums received from the sale of goods must be credited to the bank until such settlement is made.

(d) Letter of Hypothecation

A letter of hypothecation is a document signed by the customer conveying to a banker the full ownership of goods at the port of destination in respect of which he has made advances either by loan or by acceptance or negotiation of bills of exchange. This is a sort of blanket document which any banker, who accepts bills, advances money or negotiates bills and shipping documents, demands from a customer to give him recourse on the bills and control of the documents. The letter of hypothecation pledges the documents of title with the banker as security for an advance and gives the bank power to sell the goods. If necessary, to insure them and to warehouse them at the customer's expense.

(e) Bank Certificate of Payment

It is a certificate issued by the negotiating bank of the exporter, certifying that the bill covering particular consignments, has been negotiated and that the proceeds received in accordance with exchange control regulations in the approved manner.

DOCUMENTS RELATING TO INSPECTION

Certificate of Inspection

It is a certificate issued by the Export Inspection Agency, certifying that the consignment has been inspected as required under the Export (Quality Control and Inspection) Act, 1963, and satisfies the conditions relating to quality control and inspection as applicable to it, and is certified export worthy.

DOCUMENTS RELATED TO EXCISABLE GOODS

(a) G.P. Forms

A GP form is a gate pass for the removal of excisable goods from a factory or warehouse. Form GP 1 is used for the removal of excisable goods on payment of duty and Form GP 2 is used for the removal of excisable goods without payment of duty.

(b) Form C

Form C is to be used for applying for rebate of duty on the excisable goods (other than vegetable, non-essential oils and tea) exported by sea. It is to be submitted in triplicate to the Collector of Central Excises.

(c) Forms AR-4/AR-4A

These forms are meant for applying for the removal of excisable goods for export by sea/post. Form AR-4 is used for applying for excise inspection at the factory and Form AR-4A is used when goods are to be exported under a claim for rebate of excise duty or under bond.

DOCUMENTS RELATED TO FOREIGN EXCHANGE REGULATION

Foreign exchange regulations in India require the exporter to fill several forms.

There are four important types of forms namely, GR/PP, VP/COD and SOFTEX form for export of computer software obtainable from the RBI or a bank authorised to deal with the foreign exchange.

23

SOME ISSUES IN INTERNATIONAL BUSINESS

There are several important social issues in international business. This chapter considers four of them: Business ethics, social responsibility, environmental factors and labour standards.

BUSINESS ETHICS

A very complex and controversial issue is that of ethics. The varying ethical norms and social values, many a time make the international business environment very intricate and perplexing.

The term business ethics refers to the system of moral principles and rules of conduct applied to business.

That there should be business ethics means the business should be conducted according to certain self-recognised moral standards. There is, however, no unanimity of opinion regarding what constitutes business ethics. An international marketer often finds that the norms of ethics vary from country to country. What is ethically wrong or condemned in one nation may not be so in another. In this connection, Peter Drucker very appropriately remarks: There is neither a separate ethics of business, nor is one needed."[1] "For, men and women do not acquire exemption from ordinary rules of personal behaviour because of their work or job. Nor, however, do they cease to be human beings when appointed vice president, city manager, or college dean. And there have always been a number of people who cheat, steal, lie, bribe or take bribes. The problem is one of moral values and moral education of the individual, of the family or of the school."[2]

Bribery, pay-offs or kickbacks are common in business in many countries. However, the extent and intensity of it vary from country to country. In some countries, it is a common practice with government officials and other employees. The law in respect of such practices also varies among countries.

According to the regulation in some countries, while bribing is illegal within the country, bribing by the nation's firms in foreign markets to get or conduct business is not illegal because of the feeling that is inevitable in some markets. The position appears to be that "morality only exists within a culture and it is not for us to say what is moral in someone else's culture."

Several West European countries either condone bribery or look the other way – such expenses are tax deductible upto a certain amount in some countries. However, the US Foreign Corrupt Practices Act of 1977 prohibits a firm from making or authorising payments, offers, promises, or gifts for the

purpose of corruptly influencing actions by governments or their officials in order to obtain or retain orders for a company. American businessmen complain that they are severely handicapped because of this legislation when they have to compete with those who are not so regulated. In countries like France and Germany, the money paid for bribes to secure business overseas is a legitimate tax write-off.

Whatever may be the legal position regarding bribing, it is basically a question of the moral values and self-regulation. Some people, who hold that bribing politicians and top officials to get business is unethical, feel that paying the lower levels is not unfair if the papers don't move normally otherwise.

Another issue is whether it is ethical to sell products which are banned in some countries because of their harmful effects in other countries (often in developing countries). One issue is that if the government of a country permits the marketing of such a product, should a company give up the sale of the product on its own. If the harmful effects of a product outweigh the benefits, a company with sound ethics will not do business in that product even if there is no legal objection.

SOCIAL RESPONSIBILITY OF BUSINESS

Besides being ethical in business, companies, particularly the large ones, have some social responsibilities.

As the High-Powered Expert Committee on Companies and MRTP Acts (Sachar Committee) observes, "in the environment of modern economic development, the corporate sector no longer functions in isolation. If the plea of the companies that they are performing a social purpose in the development of the country is to be accepted, it can only be judged by the test of social responsiveness shown to the needs of the community by the companies. The company must behave and function as a responsible member of society, like any other individual. It cannot shun moral values, nor can it ignore actual compulsions. The real need is for some focus of accountability on the part of the management which is not limited to shareholders alone. In modern lines, the objective of business has to be the proper utilisation of resources for the benefit of others. A profit is still a necessary part of the total picture; but it is not the primary purpose. This implies that the claims of various interests will have to be balanced, not on the narrow ground of what is best for the shareholders alone but from the point of view of what is best for the community at large. The company must accept its obligation to be socially responsible and to work for the larger benefit of the community"[3].

Singhania has classified the nature of the social responsibility of business into two categories.[4]

- The manner in which a business carries out its own business activity. This involves the acceptance of the fact that business is not merely a profit-making occupation but a social function which involves certain duties, and requires that appropriate ethics are followed. For example, a business must obey all the laws, even when they are disagreeable; it should produce the maximum goods of good quality, ensure smooth supplies at competitive prices, pay taxes, shun malpractices, pay a fair wage to employees and a reasonable dividend to shareholders.
- The welfare activity that it takes upon itself as an additional function. In addition to its commercial activity, business also plays a role in promoting social welfare activity, even directly.

George Goyder, in his famous book, '*The Future of Private Enterprise: A Study in Responsibility*', mentions the following as the principal objectives of a responsible company:[5]

1. The extension, development and improvement of the company's business and the building up of its financial independence.

2. The payment of fair and regular dividends to the shareholders.
3. The payment of fair wages under the best possible conditions to the workers.
4. The reduction in the prices to be charged to consumers.

In other words, the primary objectives of a socially responsible business should be to strengthen itself with due regard to the interests of the shareholders, employees and consumers.

A responsible company has certain secondary objectives as well. The important among them are:

1. To enhance labour welfare
2. To enhance customer service and goodwill
3. To assist in developing and promoting the amenities in the locality
4. To assist in developing the industry of which the firm is a member
5. To contribute to national goals.

There is a growing recognition that the business should pay due attention to the long-term welfare of society. The marketing concept, which has gained tremendous popularity, indicates that the key to satisfying organisational goals is customer satisfaction. The societal marketing concept, which has been gaining popularity over the marketing concept, however, calls for generating customer satisfaction and long-run consumer welfare as the key to attaining a long-run profitable volume. As Philip Kotler points out, "the addition of long-run customer welfare asks the businessman to include social and ecological considerations in his product and marketing planning. He is asked to do it not only to meet his social responsibilities but also because failure to do this, may hurt his long-run interests."[6]

The enormous resources at the disposal of large business corporations enable them to carry out extensive research and development. They should also devote their R&D efforts to the social needs of the developing countries, rather than being completely guided by profit maximisation. Because of their resources position, they should also be expected to make a significant contribution to social welfare. An amount equivalent to the annual spend on entertainment by some MNCs can go a long way to improve the social welfare in some small poor economies.

The multinationals shall show as much social responsibility in the foreign countries as they do in the home country: one criticism against the MNCs is that they adopt double/multiple standards – with different norms/stands for developing countries compared to the home country or developed countries.

ENVIRONMENTAL ISSUES

Environmental issues have been engaging increasing discussion in the international business horizon. As in the case of some other social issues in the fore, the environmental issues raised are mostly those which disadvantage the developing countries, ignoring or relegating to the background several serious issues which hold the developed nations or firms from such nations guilty.

Some countries prohibit the import of goods which cause ecological damage. For example, the US has banned the import of shrimp harvested without turtle excluder devise because of its concern for the endangered sea turtles. Countries like India are affected by it.

Developing countries are affected by the relocation of polluting industries from the developed to the developing ones. Similarly, several products which are banned in the developed nations are marketed in the underdeveloped world.

The dumping of nuclear and hazardous wastes in developing countries and the shifting of polluting industries to the developing countries impose heavy social costs on them. The exploitation of the natural resources of the developing countries to satisfy the global demand also often cause ecological problems.

When the multinationals employ in the developing nations polluting technologies which are not allowed in the developed countries or do not care for the ecology as much as they do in the developed nations, it is essentially a question of ethics.

Another serious problem is that developed nations some times raise environmental issues as a trade barrier or a coercive measure rather than for genuine reasons.

The debate has intensified in recent years on the links between trade and the environment, and the role the WTO should play in promoting environment-friendly trade.[7] A central concern of those who have raised the profile of this issue in the WTO is that there are circumstances where trade and the pursuit of trade liberalisation may have harmful environmental effects. Three main arguments are forwarded as to how this might occur. First, trade can have adverse consequences on the environment when property rights in environmental resources are ill-defined or prices do not reflect scarcity. This situation results in production or consumption “externalities” and can lead to the abuse of scarce environmental resources and degradation, which is exacerbated through trade. Some of the pollution can be purely local, such as a very noisy factory. Other pollution can have global repercussions, for example, the excessive emission of greenhouse gases, the destruction of rainforests, and so on. Critics argue that trade liberalisation which encourages trade in products creating global pollution is undesirable.

The second argument linking trade and the environment is related to the first one. If some countries have low environmental standards, industry is likely to shift production of environment-intensive or highly-polluting products to such so-called pollution havens. Trade liberalisation can make the shift of “smoke-stack” industries across borders to pollution havens even more attractive. If these industries then create pollution with global adverse effects, trade liberalisation, indirectly, promote environmental degradation. Worse, trade induced competitive pressure may force countries to lower their environmental standards. The argument, in other words, is that trade liberalisation leads to a “race to the bottom” in environmental standards.

The third concern by environmentalists about the role of trade relates more to social preferences. Some practices may simply be unacceptable for certain people or societies, so they oppose trade in products which encourage such practices. These can include killing dolphins in the process of catching tuna, using leg-hold traps for catching animals for their furs, or the use of polluting production methods which have only local effects.

On the other hand, it has also been pointed out that trade liberalisation may improve the quality of the environment rather than promote degradation. First, trade stimulates economic growth, and growing prosperity is one of the key factors in societies’ demand for a cleaner environment. Growth also provides the resources to deal with environmental problems at hand — resource which poor countries often do not have. Second, trade and growth can encourage the development and dissemination of environment-friendly production techniques as the demand for cleaner products grows and trade increases the size of markets. International companies may also contribute to a cleaner environment by using the most modern and environmentally clean technology in all their operations. This is less costly than using differentiated technology based on the location of production and helps companies to maintain a good reputation. Finally, the costs of meeting environmental regulations often accounts for only a small fraction of total production costs, so that this factor is unlikely to be at the basis of relocation decisions — other factors such as labour costs and the adequacy of infrastructure are much more important.

Review of literature on the impact of trade on environment suggests that trade may not specifically add in a significant way to environmental problems, beyond those that arise through economic activity generally. But whether this is the case or not, restrictive trade policy will rarely offer an adequate solution to problems of environmental degradation. The solution lies instead in the use of appropriate environmental policies, whether they entail assigning property rights, taxing or subsidising, or applying regulatory remedies.

Box 23.1

Global Environmental Challenges

Chronic environmental degradation—today's silent emergency—threatens people worldwide and undercuts the livelihoods of at least half a billion people. Poor people themselves, having little choice, put pressure on the environment, but so does the consumption of the rich. The growing export markets for fish, shrimp, paper and many other products mean depleted stocks, less biodiversity and fewer forests. Mostly, the costs are borne by the poor—though it is the world's rich who benefit most.

Just as a country's economy can be swamped by global economic forces it has little power to control or deflect, its environment can be threatened by activities taking place beyond its borders and its control. In some low income countries, the threats may be severe enough to jeopardize further sustainable development. Climate changes, for example, could raise ocean levels, swamping the homes of millions of people in low-lying countries like Bangladesh. Governments acting alone, and even regional organisations, cannot respond effectively to this kind of environmental problem. The response must be global. Industrial countries are responsible for most of the existing global environmental problems—especially man-made greenhouse gases—but developing countries are catching up rapidly. Their capacity to contribute to future environmental damage increases as they grow.

The world has already seen one genuine environmental success story in the Montreal Protocol of 1987, which brought all countries together to address a common environmental threat. The Montreal Protocol attempts to solve the problem of chlorofluorocarbon emissions, which reduce ozone concentrations in the upper atmosphere. In the 1980s, scientists realised that allowing these emissions to continue unchecked would dangerously increase ultraviolet radiation in the higher latitudes, raising rates of skin cancer and cataracts and damaging the environment. Thanks to the Montreal Protocol and follow-on agreements, global international production of chlorofluorocarbons has fallen steeply, and global cooperation to reduce ozone depletion appears to be succeeding.

The world faces a number of other pressing environmental problems that threaten the global commons. Perhaps the best known is climate change, which is associated with increasing emissions of carbon dioxide into the atmosphere. Others include biodiversity loss, which is occurring at an alarming rate; desertification; the depletion of fish stocks; the spread of persistent organic pollutants; and threats to the ecology of Antarctica.

The ozone success story provides a model for future international agreements on global environmental issues. The scientific case for addressing the risk of environmental damage needs to be made forcefully in open and robust public debate. The world's peoples and their governments must share the belief that the costs of environmental damage are heavy enough to justify immediate action. Alternatives to current behaviour must be technically feasible and reasonably inexpensive, and all countries must be willing to participate in international accords. Sometimes, this willingness will come at a price, with high-income countries paying low-income economies to comply with an agreement and groups of signatories imposing penalties on countries that fail to meet the standards the agreement sets. Finally, the standards themselves must be flexible, because very rarely is there a "one size fits all" solution to global problems. The conditions surrounding biodiversity and climate change suggest that reaching international agreement on these issues will be more complex than it was with ozone depletion. But the international community has already begun seeking solutions. The Convention on Biological Diversity and the Framework Convention on Climate Change created at the 1992 Rio Earth Summit form a basis for moving forward. The Global Environment Facility (GEF) is a joint initiative of the United Nations Development Programme, the United Nations Environment Programme, and the World Bank. The GEF provides grants and concessional funds to cover additional costs countries incur when a development project also targets one or more of four global environmental

issues: climate change, biodiversity loss, the pollution of international waters, and depletion of the ozone layer. National governments can take a number of actions that improve domestic welfare while helping preserve the global commons. Removing fuel subsidies and improving public transportation, for example, not only are in the best interest of individual economies but also contribute to reducing global carbon dioxide emissions that affect other countries.

Courtesy: World Bank, *World Development Report, 1999/2000* and UNDP*, Human Development Report, 1999.*

LABOUR ISSUES

One of the important social issues in the developed countries in respect of business with the developing countries pertains to ill-treatment of labour and children.

Child labour used in the manufacture of exports from the developing countries is widely criticised by people in the developed countries. There is protest against this in the developing countries too. For example, it is alleged that child labour is used by the carpet industry in India and some other countries and social activists in the developed nations demand ban on the import of goods embodying child labour. Consumers are called upon to boycott such goods.

A similar issue is the *sweat labour*. The argument here is that goods are manufactured by labour working in inhuman/unhealthy working conditions not getting fair wages should be banned or boycotted. Certain important developing country exports, like garments, are alleged to be suffering from such problem.

Some multinationals are criticised for sourcing products from developing countries benefiting from the sweat labour.

According to an ILO Report, it is a regrettable feature of many export processing zones that both male and female workers are trapped in low wage and low skill jobs and labour relations and human resource development remain two of the most problematic aspects of zone functioning. The frequent absence of minimal standards and poor labour-management relations have predictable outcomes, such as high labour turnover, absenteeism, stress and fatigue, low rates of productivity, excessive wastage of materials and labour unrest which are still too common.

Another important issue is trade union rights. Absence of trade union rights in some countries provides them a cost advantage. Should the products of such countries be permitted in other countries? It may be noted that many multinationals are taking advantage of the absence of trade union rights in some countries.

While some of the criticisms are valid, it is also a fact that the developed country firms which are adversely affected by the cheap imports, blow up the issues to serve their vested interests.

According to the WTO,[8] the debate on the interaction between trade and labour standards is in many ways similar to the debate on trade and environmental standards. A concern expressed in some industrial countries is that excessively low standards in certain countries will impose downward pressure on standards, or give the low-standard countries an unwarranted competitive advantage. Developing countries, on the other hand, fear that this argument may be used as a surrogate form of protection. As with environmental standards, the WTO was not designed to set labour standards. This was made clear in the Singapore Ministerial Declaration of December 1996, which also acknowledged the competence of the International Labour Organisation (ILO) in the matter of labour standards. Specifically, the Singapore Ministerial Declaration concluded that: (*i*) members are committed to the observance of internationally recognised core labour standards, (*ii*) these standards should be addressed in the ILO, whose work the members support, (*iii*) standards are promoted by growth and development, fostered through trade liberalisation; and (*iv*) members reject the use of labour standards for protectionist purposes, and agree that the comparative advantage of countries must in no way be put into question. Members of the ILO recently agreed on a "Declaration of Fundamental Principles

and Rights at Work", in which ILO Members agreed to increase the scrutiny of adherence to core labour rights and reiterated the commitment in the Singapore Declaration not to use labour standards for protectionist purposes.

The WTO points out that the debate on labour standards distinguishes between so-called basic labour rights and less commonly accepted standards. Basic labour rights are part of the ILO Conventions on human rights and labour standards and include the prohibition of forced labour, the freedom of association, the right to organise and bargain collectively, the elimination of child labour exploitation and the non-discrimination in employment. Other less common accepted standards include minimum wages, limits on the hours worked and occupational safety and health standards. The following discussion focuses only on the basic standards.

The arguments of those favouring inclusion of basic labour standards in the WTO framework are very similar to those in the trade and environment debate. Trade could have adverse consequences on labour rights if individual countries disregard labour standards. Trade, it is argued, increases the demand for products produced with labour that does not enjoy adequate labour standards, and thereby encourages such practices. If poor working conditions are the main reasons for a country's competitiveness, then international competition will induce companies to relocate to countries with weak, non-existent or unenforced labour standards. Countries with higher labour standards may be forced to relax their own standards in a "race to the bottom". Value judgements also play a role, when people argue that they are not willing to accept exchange of products which have been produced under morally unacceptable conditions. If trade has such adverse consequences on labour standards, critics argue, labour standards should become an integral part of the WTO framework.

On the other hand, a number of arguments suggest that trade can contribute to more stringent labour standards and their enforcement. Trade promotes economic growth, which in turn increases people's demand for better working conditions. Growth and prosperity also provide the means to finance improvements in labour standards, and to send children to school instead of factories. International companies are reluctant to provide inhuman working conditions or to use child labour for the fear of their reputation and boycotts. Finally, the production of exportable products today increasingly requires people with some skills, and safe and clean working conditions.

The WTO also points out that empirical studies do not provide support for the claim that trade undermines labour standards; most evidence suggests a positive link between trade and labour standards, mainly through trade's positive effect on income.

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7. The information in the following paragraphs of this section is adopted from WTO, *Annual Report*, 1998.
8. The information in the following paragraphs of this section is adopted from WTO, *Annual Report*, 1998.

ANNEXURES

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Import Substitution

Import substitution may be defined as the substitution of domestic source of supply for foreign source of supply.

It is clear from this definition that import substitution implies:

(1) development or creation of new source of supply or productive capacity if there is no domestic supply;

(2) expansion of the domestic production/supply if the domestic supply is insufficient; and

(3) protection of domestic industries from foreign competition if competitive disadvantage of the industries, especially the infant ones, is encouraging the foreign source of supply.

Import substitution is one of the important planks of the commercial economic policy of the developing countries. The foreign exchange scarcity created by the import-export gap prompt these countries to emphasise on the import substitution in a bid to reduce the import requirements and thereby to narrow down or remove the trade deficit.

Import substitution assumed importance in the Indian economic development policy since the Second Five Year Plan. The large-scale imports necessitated by the development requirements of the nation gave rise to what may be called a *development disequilibrium* in the balance of payments. Export promotion and import substitution are the two important measures to narrow down and ultimately to wipe out the balance of payments deficit.

Industries and other sectors with potential for import substitution have been given high importance in our development programmes. At the beginning of the planning era, India was relying very heavily on the foreign sources of supply for her requirements of capital goods and a number of basic and other important inputs. In the last five decades, considerable import substitution has taken place in many important areas like capital goods, cement, organic chemicals, pharmaceuticals, dye stuffs etc. Today, imports account for only less than 10 per cent of the total supply in many vital sectors.

However, the manner in which the policy of import substitution has been carried forward has been subject to criticism from certain corners. For instance, S.V.S. Raghavan opines[1] that "in the Indian context, the emphasis on import substitution has often run counter to the objective of technology development." To substantiate his view, the following "aspect of a policy of emphasising import substitution — rather than technology development" has been cited.

(*i*) It had led to a multiplicity of collaboration for the same basic product, however simple it may have been. For example, there were some 20 foreign collaborations one time in the country for water meters and 25 for electric hoists/cranes.

(*ii*) It has led to repeated renewal of the same collaboration usually without any updating of technology. It is estimated that 80 per cent of the collaborations effected to date have been renewed 2 to 5 times; 20 per cent have been renewed 6 times and more.

(*iii*) Proposals for up-dating technology were evalauted as if the complete production envisaged was substitution of imports.

(*iv*) The claims of import substitution were often exaggerated or other manipulations hidden (*e.g.,* the role of many MNCs in importing bulk drugs at inflated prices).

1. S.V.S. Raghavan, "Public Enterprises and Transfer of Technology," in *Issue in Public Enterprise Development, op.cit.,* p. 101.

Export Promotion Councils

One of the organisational arrangements made for export promotion is the establishment of Export Promotion Councils (EPCs). An EPC is responsible for the promotion of a particular group of products, projects and services. For some commodities, instead of the EPC, there are other organisations for export promotion, viz., Export Development Authorities and Commodity Boards.

The EPC are non-profit organisations registered under the Companies Act or the Societies Registration Act, as the case may be. They are supported by financial assistance from the Central Government.

The main role of the EPCs is to project India's image abroad as a reliable supplier of high quality goods and services. In particular, the EPCs shall encourage and monitor the observance of international standards and specifications by exporters. The EPCs shall keep abreast of the trends and opportunities in international markets for goods and services and assist their members in taking advantage of such opportunities in order to expand and diversify exports.

The major functions of the EPCs are as follows:

(*a*) To provide commercially useful information and assistance to their members in developing and increasing their exports;

(*b*) To offer professional advice to their members in areas such as technology upgradation, quality and design improvement, standards and specifications, product development, innovation, etc.;

(*c*) To organise visits of delegations of its members abroad to explore overseas market opportunities; and

(*d*) To organise participation in trade fairs, exhibitions and buyer-seller meets in India and abroad.

(*e*) To promote interaction between the exporting community and the Government both at the Central and State levels.

(*f*) To build a statistical base and provide data on the exports and imports of the country, exports and imports of their members, as well as other relevant international trade data.

Any exporter/importer may apply to become a member of an EPC and such application shall be considered and disposed of within one month thereof in accordance with the rules and regulations of the EPC. On being admitted to membership, the applicant shall be granted forthwith a Registration-cum-Membership Certificate (RCMC).

It has been made clear by the Exim Policy that the support given to the EPCs by the Government, monetary or otherwise, would depend upon:

(*a*) effective discharge of functions assigned to them;

(*b*) democratisation of the membership of the EPCs;

(*c*) democratic elections of office bearers of the EPCs being held regularly; and

(*d*) timely audit of the accounts of the EPCs.

For certain products, instead of EPC, there is a Commodity Board (e.g., Coffee Board, Coir Board, Spices Board or Export Development Authority, Marine Products Export Development Authority (MPEDA) and Agricultural and Processed Food Products Export Development Authority (APEDA) whose functions include, besides export promotion, development of the production of the commodity and certain regulatory measures.

LIST OF EXPORT PROMOTION COUNCILS

(*i*) Engineering Export Promotion Council (EEPC), Kolkata.
(*ii*) Overseas Construction Council of India (OCCI), Mumbai.
(*iii*) Electronics and Computer Software Export Promotion Council, New Delhi.
(*iv*) Plastics and Linoleums Export Promotion Council (PLEXICIL), Mumbai.
(*v*) Basic Chemicals, Pharmaceuticals and Cosmetics, Export Promotion Council (CHEMEXCIL), Mumbai.
(*vi*) Chemicals and Allied Products Export Promotion Council (CAPEXCIL), Kolkata.
(*vii*) Gems and Jewellery Export Promotion Council (GJEPC), Mumbai.
(*viii*) Council for Leather Exports (CLE), Chennai.
(*ix*) Sports Goods Export Promotion Council (SGEPC), New Delhi.
(*x*) Cashew Export Promotion Council, Kochi.
(*xi*) Shellac Export Promotion Council, Kolkata.
(*xii*) Apparel Export Promotion Council (AEPC), New Delhi.
(*xiii*) Synthetic and Rayon Textiles Export Promotion Council, Mumbai.
(*xiv*) Indian Silk Export Promotion Council, Mumbai.
(*xv*) Carpet Export Promotion Council, New Delhi.
(*xvi*) Export Promotion Council for Handicrafts, New Delhi.
(*xvii*) Wool and Woollens, Export Promotion Council, New Delhi.
(*xviii*) Cotton Textiles Export Promotion Council (TEXPROCIL), Mumbai.
(*xix*) Handloom Export Promotion Council (HEPC), Chennai.

GSP

The *Generalised System of Preferences* (GSP) is a scheme designed by the UNCTAD to encourage exports of developing countries to developed countries. Under this scheme, developed countries grant duty concession on imports of specified manufactures and semi-manufactures from developing countries.

It was a resolution adopted at the UNCTAD-II, held in 1968 in New Delhi, that led to the introduction of the GSP, which is the result of the realisation that temporary advantages in the form of generalised arrangements for special tariff treatment for developing countries in the market of developed countries may assist developing countries to increase their export earnings and so contribute to an acceleration in the areas of their economic growth.

The EEC countries and a number of other countries, such as the USA, Japan, Norway, New Zealand, Finland, Sweden, Hungary, Switzerland, Australia, Canada, Australia, Bulgaria and Poland have introduced the GSP.

The GSP facility is available only to developing countries; it is subject to certain stringent limitations and is applicable only for a period of 10 years from its institution by the preference-granting countries.

The preferential rates of duty allowed on the import of manufactures and semi- manufactures and processed agricultural products differ in schemes of different developed countries because each country has developed its own GSP, keeping in view its local production base and certain other factors. Each scheme has a safeguard clause or an escape clause to protect the sensitive sectors in its economy.

A particular item is qualified for GSP benefits only if the following conditions are satisfied:

(*i*) The product must be included in the GSP list;

(*ii*) The country exporting the item should be declared under the GSP as a beneficiary country;

(*iii*) The value-added requirements/process criteria must be complied with;

(*iv*) The product must be imported into the GSP donor country from a GSP beneficiary country;

(*v*) The exporter must send to his buyer/importer a certificate of origin in form "A", duly filled in and duly signed by him, and then certified by a designated Government authority;

(*vi*) If the import of the GSP item in question is subject to a quota/ceiling, the quota/ceiling of the import from the GSP beneficiary countries has so far not been exhausted in EEC countries. However, in the USA, US imports of articles from India must not have exceeded US$ 33.442 million and must not have accounted for 50 per cent of the total US imports of the article in the previous year (known as competitive need clause).

GSTP

Expansion of trade among the developing countries is viewed as an important aspect of economic cooperation among developing countries (ECDC). It is felt that trade preferences can help achieve expansion of South-South trade.

Although the UNCTAD gave its sanction to a scheme of trade preferences as far back as 1968, it was not until 1979 that the Group of 77 drew up an action plan for collective self-reliance. It took three more years for the Group to formally adopt a programme of Global System of Trade Preferences (GSTP).

The Group of 77 ministerial conference held in New Delhi in July 1985, resolved to complete the first round of negotiations on GSTP by May 1, 1987. The agreement reached at the Conference included across the board tariff preference margin of 10 per cent, the removal of reduction of non-tariff barriers, selection of specific sectors and products where trade preferences could be extended and trade creating production sharing and marketing arrangements.

The inordinate delay in formulating and implementing a meaningful scheme of GSTP is an indicator of a lack of unity of purpose and will among the developing countries. Curiously, the Generalised System of Preferences (GSP), designed by the major industrialised countries to give tariff concessions in favour of developing countries to facilitate easier access for the latter's exports to the former, particularly of manufactures and semi-manufactures, came into being much faster than the GSTP. Indeed, the "problem of trade preferences among developing countries is a complex one. These countries form an extremely heterogeneous lot one with great diversities in levels of development and industrialisation, foreign trade regimes and not the least of all, approaches to development." Further, however effective the GSTP may be, it... can only be one of the many instruments for promoting South-South financial and monetary cooperation, new payment arrangements and joint debentures in production and marketing. On most of these issues, the developing countries have made little progress in the past decade. Unless they display a unity of purpose and sense of urgency backed by strong political will, South-South trade will continue to remain on a weak wicket.

The agreement on GSTP adopted at the Ministerial meeting of the developing countries of the Group of 77 held in Belgrade in April 1988 annexed a list of tariff concessions exchange amongst 48 participating countries of G77 in the first round of negotiations. India exchanged tariff concessions with 14 countries. The tariff concessions exchanged in the first round were only modest in terms of trade and product coverage. But the significant achievement lies in the conclusion of the Agreement which provided a framework for exchange of trade concessions among developing countries and for promoting trade and economic cooperation among themselves.

Devaluation

Devaluation, an official reduction in the value of the domestic currency in terms of foreign currencies, or exchange rate adjustments, is a common thing. For example, between 1985-87 the US engineered a 50 per cent fall in the external value of dollar through the Group of Seven. Many of India's other trade partners have also made substantial exchange rate adjustments over the past few years. Over the period end December 1980 to end December 1989, China depreciated the currency by 68 per cent and Indonesia by 65 per cent while India depreciated by only 54 per cent against the US dollar, whereas increase in consumer prices in China and Indonesia were lower (at 100 per cent and 111 per cent respectively) against India's 114 per cent over the same period.

Devaluation is resorted to help correct the balance of payments disequilibrium by increasing exports and decreasing imports. To illustrate, let us take the example of the devaluation of Indian rupee in 1966. Just before the devaluation of the Rupee with effect from 6-6-1966, the exchange rate was $ 1 = ₹ 4.76. The devaluation of the Rupee by 36.5 per cent changed the exchange rate to $ 1 = ₹ 7.50. Before devaluation, the price of an imported commodity which cost $ 1 abroad ₹ 4.76 (assuming costless free trade). But after devaluation, the same commodity which cost $ 1 abroad would cost ₹ 7.50 when imported because of the change in the exchange rate. Thus, devaluation makes foreign goods costlier in terms of domestic currency and this is supposed to discourage imports. On the other hand, devaluation makes exports (from the country that has devalued the currency) cheaper in foreign markets. Taking the above example, before devaluation, a commodity which cost ₹ 4.76 in India was sold abroad at $ 1 (assuming costless free trade), but after devaluation the landed cost abroad of the same commodity was only $ 0.64. This comparative cheapness of the Indian goods in the foreign markets was expected to stimulate demand for Indian exports.

It may appear that devaluation can help solve the problem of trade deficit by stimulating exports and curtailing imports. But in actual practice, the effect of devaluation depends on a number of intricate and, often, interdependent factors Depending on these factors, the net effect of devaluation may be favourable or unfavourable. If factors are, by and large unfavourable, exports may not increase sufficiently enough to improve the trade position or the high cost of imports and certain other developments resulting from devaluation may cause inflation and nullify the initial effect of devaluation on export prices.

A basic assumption related to devaluation is that the demand for the country's exports and imports is price elastic, i.e., a fall in exports prices will substantially increase the demand for exports and an increase in the prices of imports will significantly reduce imports. However, these things need not necessarily happen.

The demand for many exports of the developing countries, like the primary commodities, is regarded as relatively price inelastic, that is, a fall in the price will not significantly increase the demand. On the other hand, the demand for many of the imports of the developing countries, like essential consumer goods, capital goods, technology etc. is also relatively price inelastic, i.e., an increase in the import prices will not considerably reduce the imports.

It should be noted that devaluation may lead to a fall in the unit value of exports and hence the total earnings will increase only if the quantum of exports increases more than the rate of fall in the unit value of exports following the devaluation. If the quantum of exports does not increase at least to the extent of the rate of fall in the unit value of exports following the devaluation. If the quantum of exports does not increase at least to the extent of the rate of fall in the unit value of exports, there will be a fall in the total export earnings. However, as trade balace is a function of

both exports and imports, we have to consider the effect of devaluation on both exports and imports. In other words, devaluation will improve a country's trade balance only if the sum of elasticities of demand for exports and of its demand for imports is greater than one. This is described in economies as the *Marshall-Lerner condition*.

If the demand for imports is inelastic, not only that devaluation will not reduce the import bill but also will lead to price rise in the domestic economy because of the increased cost of the imported consumer goods, capital goods, intermediate goods, raw materials, etc. This increase in domestic prices will soon wipe off the price advantage in respect of exports brought about by devaluation. If the exports have import content, as is true in many cases, the problem is further accentuated. Thus, the whole situation could again deteriorate to make the trade balance very adverse.

Even if there is good demand for a country's exports, exportable surplus is an important determinant of export earnings. Given the level of domestic absorption, exportable surplus depends on the level of domestic output which is affected by such factors as supply of inputs like raw materials and power, climatic conditions which affect agricultural production etc. While adverse factors will reduce the exportable surplus of some commodities, short supply will necessitate larger imports of some other commodities.

An important condition necessary for the success of devaluation is that other countries should not retaliate or should not take measures which discourage our exports to them. For example, if an importing country enhances import duties, the prices of our exports in that country would increase. This will defeat our objective of increasing exports by reducing prices by devaluation and in the absence of sufficient increase in the quantum of exports we might end up with a lower export earning due to the fall in the unit value of exports. Further, competitors may react by depreciating their currencies.

There are, thus, a host of factors which determine the success of devaluation in improving the foreign trade balance.* Against this background, let us have a look at the factors which tend to limit the success of devaluation in India.

Devaluation will stir up domestic prices because we are very import dependent. Many of our vital imports, being essential items, are price inelastic in demand. Petroleum oil and lubricants (POL) account for a large share of our total import bill. In the event of a devaluation, the increase in the price of imported oil will have cascading effect on domestic prices. Chemicals are also important imports and their imports will not be considerably affected by price. We spent a considerable amount on import of capital goods. There are also a number of indispensable consumer goods, raw materials and intermediate goods imports. The demand for many foreign goods which satisfy 'conspicuous' consumption is relatively price inelastic.

Thus, devaluation is unlikely to achieve considerable import savings. On the other hand, it will raise domestic prices because of the high cost of capital goods, oil, raw materials, intermediate goods, etc. It may also encourage smuggling. Devaluation will increase the output prices of industries using imported inputs. This point is clearly demonstrated by the increase in the prices of automobiles manufactured with Japanese collaboration following the appreciation of the yen. A devaluation of the rupee will have similar effect on the output prices of industries using imported inputs.

Many Indian exports embody imported inputs. Therefore, devaluation will have direct effect on export prices, apart from the effect of general increase in prices in the economy. Therefore, the initial price advantage of exports imparted by devaluation will soon vanish and will usher in a further high cost domestic economy.

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* For a detailed theoretical exposition of the effects of devaluation, see the author's book *International Economics* (Tata McGraw-Hill, New Delhi).

Agro-based products account for a significant share of our total exports. Adverse weather and climatic conditions may affect their exportable surplus and necessitate increased import of certain agricultural based products. This unfortunate situation occurred in the year following the devaluation of 1966. Even if there will be good foreign demand for certain industrial products, our ability to generate sufficient exportable surplus is constrained by inadequacy of the productive apparatus and other supply bottlenecks.

Rupee Devaluation of July 1991

Having discussed the conditions necessary for the success of devaluation and the possible limitations and problems of devaluation in general, let us now consider the devaluation of the Rupee in July 1991 which was one of the trade promotion measures taken in the context of persistent balance of payments deficit and the consequent foreign exchange crisis.

While many criticise the government for not having effected the devaluation in one stroke, C. Rangarajan, former Governor of the Reserve Bank of India and a member of the Planning Commission, justifies the adjustment made in two stages. Basically, the first adjustment enabled to test the waters. After the second adjustment, it was made clear that there would be no further change. He also points out that 18-20 per cent devaluation was completely appropriate under the circumstances.[2]

Rangarajan also answers the questions: why such a large exchange rate adjustment over a short span of time? Couldn't we continue to make small changes in exchange rate as we had been doing? The answer lies in the role of expectations. In certain circumstances' it is better to make a significant adjustment and dampen anticipations so as to attract remittances and capital inflows. Even in these days of fluctuating exchange rates, many countries have affected large, discrete devaluations in the recent past.[3]

The July 1991 devaluation should not be viewed in isolation. It should be seen as an important item of a package of measures introduced to reform the trade regime which is linked to the general economic policy reform introduced in the country. The evaluation of the devaluation should be made in this context.

Other important measures in the trade promotion package include abolition of the Cash Compensatory Support (CCS) and modification of the REP scheme.

The abolition of export subsidy, namely, CCS was a much needed measure for two important reasons. Firstly, it was an important contributor to the surging fiscal deficit in India. If the CCS were not abolished, in 1991-92 it would have amounted to an estimated ₹ 3,000 crore or more.

Secondly, the CCS, being an export subsidy, was strongly opposed by forums like GATT and retaliated by importing countries. Further, looking at the CCS which the Indian exporters were enjoying, importers of Indian goods often tried to bargain down the prices.

In addition to the above reasons, the administrative problems like the delays in dispersing the CCS, fixation of appropriate CCS rates etc. called for its replacement by a better alternative.

The devaluation and the modified Rep scheme, which is now called the Exim scrip, more than compensate the exporters for the loss of the CCS while solving the problems created by the CCS to the nation and exporters. Further, all exporters benefit out of the new regime. More particularly, export with least import intensity benefit the most.

In the preceding section, we have seen that the success of devaluation in increasing exports depends on a number of factors. One of these factors is the elasticity of demand for exports. According

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2. E. Rangarajan, "Devaluation: Causes and Consequences," *The Economic Times,* August 5, 1991.
3. *Ibid.*

to an econometric estimation, the elasticity of exports with respect to the real effective exchange rate (REER) is 0.66, i.e., for a one percentage point depreciation of the REER, export volume would increase by 0.66 of one per cent. Exports of manufactured goods are even more price-sensitive.[4] It needs to be cautioned that the quantitative estimates may not reflect the exact picture as they are not able to incorporate several relevant factors influencing the exports. These estimates, however are indicative. Further, the change in the composition of India's exports makes the situation in the 1990s different from what it was at the time of the devaluation in the 1966.

The composition of India's exports have undergone significant changes since the mid 1960s and manufactured exports today constitute 70 per cent of total exports.

It should, however, be noted that exports of several commodities continue to suffer because of supply constraints for which devaluation is no solution. There is no alternative to increases in their supply. The industrial policy liberalisations including the policy towards foreign capital and technology provide a much better environment for supply expansion when compared to the situation at the time of the 1966 Rupee devaluation.

It has been reported that export of certain commodities have been boosted following the increased export profitability due to devaluation and modification of the Rep scheme. Further, export of certain commodities which was not profitable earlier, has become profitable consequent to devaluation.

Although devaluation makes imports costlier, imports of essential items cannot be contained unless the domestic production increases to bridge th demand-supply gap. Thus, on the import side also, devaluation is no alternative to increase in domestic production.

Devaluation can encourage import substitution. Several such cases have been reported. For example, in the two-wheeler industry where there is fierce competition among producers, one company has reduced its imported capital goods to half by substituting them with local machine tools. The difference between the original planned imports of capital goods and what is now proposed runs to tens of crores of rupees in the case of this particular project. Another company had planned the import of a major piece of equipment costing about a million dollars. By the time, the company got CG licence, the rupee costs had gone up to such a level that the company decided to fabricate the equipment itself. It has done so successfully and is now thinking in terms of exporting it. Such examples of import substitution arising from the exchange rate policy could be multiplied.[5]

It has been pointed out that despite notions to the contrary our imports are also sensitive to relative changes in price changes. A recent study shows that the price elasticities are greater than one for manufactured goods and machinery and transport equipment, which amounted to an estimated 50 per cent of total imports in 1989-90. This does not mean that consumer demand for other imports is not responsive to prices. In many cases, higher import prices are not passed through to consumers because of a proportion of our imports such as defence imports and bulk imports are insulated from price factors. Consequently, the impact of the changes in the value of the currency is not fully reflected in imports.[6]

Devaluation, obviously, increases prices of imported goods and products with import content. The increase in the price of several imported items like petroleum products will affect the general price level. It has been reported that devaluation will increase the cost of various multilateral and bilateral aided power projects by about ₹ 30,000 crore and as a result against the ongoing ₹ 2.5 to 3 crore per mega watt cost for thermal projects, the effect of the depreciation of the rupee will push the per watt cost to over ₹ 3.5 crore.[7]

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4. *Ibid.*
5. A.V. Rajwade, "Devaluation: Was it Really Necessary?" *The Economic Times,* 20 July, 1991.
6. C. Rangarajan, *op. cit.*
7. "Devaluation will make power projects ₹ 30,000 crores costlier," *The Economic Times,* 11 July, 1991.

Unless the government takes effective measures to contain inflation, the favourable price effects of devaluation on exports will be soon wiped out, particularly in respect of products with import content.

An important question in this context is, can the government control the prices? The answer is 'Yes', if appropriate measures are taken. Apart from the general measures of price control, there are certain specific measures that could be taken to prevent a price rise due to devaluation. Devaluation does not increase the foreign exchange cost of imports. Hence, the government can hold the price of essential items like petroleum products. But the tragedy is that to increase the revenue flow to the exchequer the government increases the administered prices. The imported price of items like capital goods can be prevented from rising due to devaluation if the government lowers the tariff wall. But here also revenue considerations often override other considerations.

If the government does not hold the price line by these and other measures, the benefits of devaluation will be short-lived.

Further, to improve the export performance considerably, we should move ahead from international trading to international marketing.

CASES

INDEX TO CASES

Case No.	*Title of the Case*	*Area/Dimensions*
1.	Cultural Barrier or Catalyst?	Social and global environments
2.	The Costs of Delay	Political and government environment
3.	Natural Thrust	Social and global environments
4.	Different for Gamble	Social and global environments
5.	Outsourcing	Outsourcing
6.	Channel Selection and Product Modification	Market entry, channel selection and product modification
7.	Towel Manufacturing Co.	SWOT analysis, domestic and foreign environments
8.	Sind Steel Works Ltd.	Product life cycle, strategic planning
9.	Fine Home Furnishings Ltd.	Labour problems, problems of small firms
10.	The McDonald's Way	Market entry/globalisation strategies; socio-cultural and economic environment of business; business ethics

Case 1

CULTURAL BARRIER OR CATALYST?

Cultural barriers is one of the most talked about in international business problems. It is, however, very interesting to note that cross-border transmission of culture is very rampant. Many politicians, sociologists and others are highly critical of the invasion of the Western culture in the developing countries. The export of American culture is interpreted as a means to spread American imperialism. The Coca Cola culture or the corn flakes culture or the pop culture, the term which has come to be very broadly used to include, besides the pop music and associated thing, the Western products and styles such as foreign jeans, cola drinks, fast foods, Hollywood movies and like the youth, particularly, are crazy about, has fast spread to the developed and developing countries.

The emergence of culture as economic goods that can be traded — crafts, music, films, TV programmes, software, books, tourism etc. — has contributed very substantially to the globalisation of culture.

A UNESCO study shows that world trade in goods with cultural content—printed matter, literature, music, visual arts, cinema and photographic, radio and television equipment — has grown tremendously. For the United States, the largest single export industry is not aircraft, computers or automobiles — it is entertainment, in films and television programmes. Hollywood films grossed more than $30 billion worldwide in 1997, and in 1998 a single movie, *Titanic,* grossed more than $1.8 billion.

As the *Human Development Report 1999* points out, the vehicles for this trade in cultural goods are the new technologies. Satellite communications technology from the mid-1980s gave rise to a powerful new medium with a global reach and to such global media networks as CNN. The development of the Internet is also spreading culture around the world, over an expanded telecommunications infrastructure of fiber optics and parabolic antennas.

The Report referred to above points out that the global market for cultural products is becoming concentrated, driving out small and local industries. At the core of the entertainment industry — film, music and television — there is a growing dominance of US products, and many countries are seeing their local industries wither. Although India makes the most films each year, Hollywood reaches every market, getting more than 50 per cent of its revenues from overseas, up from just 30 per cent in 1980. It claimed 70 per cent of the film market in Europe in 1996, up from 56 per cent in 1987— and 83 per cent in Latin America and 50 per cent in Japan. By contrast, foreign films rarely make it big in the United States, taking less than three per cent of the market there.

QUESTIONS

1. In the light of the above account, evaluate the view that culture is a highly difficult barrier to international business.
2. What are the implications of the spread of pop culture for business?
3. What could be the reasons for the adoption, particularly by the youth, of the pop culture?
4. Can pop culture encourage achievement motivation?
5. Discuss the impact of pop culture on the domestic business? What strategies they should adopt to fight the adverse impact of the pop culture on their business?
6. Discuss the social implications of the pop culture.

Case 2

THE COSTS OF DELAY

The public sector Indian Oil Corporation (IOC), the major oil refining and marketing company which was also the canalising agency for oil imports and the only Indian company in the Fortune 500, in terms of sales, planned to make a foray into the foreign market by acquiring a substantial stake in the Balal Oil field in Iran of the Premier Oil. The project was estimated to have recoverable oil reserves of about 11 million tonnes and IOC was supposed to get nearly four million tonnes.

When IOC started talking to the Iranian company for the acquisition in October 1998, oil prices were at rock bottom ($11 per barrel) and most refining companies were closing shop due to falling margins. Indeed, a number of good oil properties in the Middle East were up for sale. Using this opportunity, several developing countries "made a killing by acquiring oil equities abroad."

IOC needed Government's permission to invest abroad. Application by Indian company for investing abroad is to be scrutinised by a special committee represented by the Reserve Bank of India and the finance and commerce ministries. By the time, the government gave the clearance for the acquisition in December 1999 (i.e., more than a year after the application was made), the prices had bounced back to $24 per barrel. And the Elf of France had virtually took away the deal from under IOC's nose by acquiring the Premier Oil.

The RBI, which gave IOC the approval for $15 million investment, took more than a year for clearing the deal because the structure for such investments were not in place, it was reported.

QUESTIONS

1. Discuss internal, domestic and global environments of business revealed by this case.
2. Discuss whether it is the domestic or global environment that hinders the globalisation of Indian business.
3. Even if Elf had not acquired Premier Oil, what would have been the impact of the delay in the clearance on IOC?
4. What would have been the significance of the foreign acquisition to IOC?
5. What are the lessons of this case?

Case 3

NATURAL THRUST

Balsara Hygiene Products Ltd., which had some fairly successful household hygiene products introduced in 1978 a toothpaste, *Promise*, with clove oil (which has been traditionally regarded in India as an effective deterrent to tooth decay and tooth ache) as a unique selling proposition. By 1986, Promise captured a market share of 16 per cent and became the second largest selling toothpaste brand in India. There was, however, an erosion of its market share later because of the fighting back of the multinationals. Hindustan Lever's *Close-Up* gel appealed to the consumers, particularly to the teens and young, very well and toppled Promise from the second position.

Supported by the Export Import Bank of India's Export Marketing Finance (EMF) programme and development assistance, Balsara entered the Malaysian market with Promise and another brand of toothpaste, *Miswak*.

The emphasis on the clove oil ingredient of the Promise evoked good response in Malaysia too. There was good response to Miswak also in the Muslim dominated Malaysia. Its promotion highlighted the fact that Miswak (Latin name: Salvadora Persica) was a plant that had been used for centuries as a tooth cleaning twig. It had references in Koran. Quoting from *Faizal-E-Miswak*, it was pointed out that prophet Mohammed used "miswak before sleeping at night and after awakening." The religious appeal in the promotion was reinforced by the findings of scientists all over the world, including Arabic ones, of the antibacterial property of clove and its ability to prevent tooth decay and gums.

Market intelligence revealed that there was a growing preference in the advanced countries for nature based products. Balsara tied up with Auromere Imports Inc. (AII), Los Angeles. An agency established by American followers of Aurobindo, an Indian philosopher saint. Eight months of intensive R&D enabled Balsara to develop a tooth paste containing 24 herbal ingredients that would satisfy the required parameters. *Auromere* was voted as the No.1 toothpaste in North Eastern USA, in a US Health magazine survey in 1991.

The product line was extended by introducing several variants of Auromere. A saccharine free toothpaste was introduced. It was found that mint and menthol were taboo for users of homeopathic medicines. So, a product free of such mints was developed. Auromere Fresh Mint for the young and Auromere Cina Mint containing a combination of cinnamon and peppermint were also introduced. When the company realised that Auromere was not doing well in Germany because of the foaming agent used in the product, it introduced a chemical free variant of the product.

QUESTIONS

1. Explain the environmental factors which Balsara used to its advantage.
2. What is the strength of AII to market ayurvedic toothpaste in USA?

Case 4

DIFFERENT FOR GAMBLE

Procter and Gamble (P&G), a global consumer products giant, "stormed the Japanese market with American products, American managers, American sales methods and strategies. The result was disastrous until the company learnt how to adapt products and marketing style to Japanese culture. P&G which entered the Japanese market in 1973 lost money until 1987, but by 1991 it became its second largest foreign market."

P&G, acclaimed as "the world's most admired marketing machine" entered India, which has been considered as one of the largest emerging markets, in 1985. It entered the Indian detergent marketing in the early nineties with the *Ariel* brand through P&G India (in which it had a 51 per cent holding which was raised to 65 per cent in January 1993, the remaining 35 per cent being held by the public). P&G established P&G Home products, a 100 per cent subsidiary later (1993) and the Ariel was transferred to it. Besides soaps and detergents, P&G had or introduced later product portfolios like shampoos (Pantene), medical products (Vikas range, Clearasil and Mediker) and personal products (Whisper feminine hygiene products, Pampers diapers and Old Spice range of men's toiletries).

The Indian detergents and personal care products market was dominated by Hindustan Lever Ltd. (HLL). In some segments of the personal care products market, the multinational Johnson & Johnson has had a strong presence. Tata group's Tomco, which had been in the red for some time, was sold to Hindustan Lever Ltd. (HLL). HLL, a subsidiary of P&G's global competitor, has been in India for about a century. The take-over of Tomco by HLL further increased its market dominance. In the low priced detergents segment, Nirma has established a very strong presence.

Over the period of about one-and-a-half decades since its entry in India, P&G invested several thousand crores. However, dissatisfied with its performance in India, it decided to restructure its operations, which in several respects meant a shrinking of activities – the manpower was drastically cut, and thousands of stockists were terminated. P&G, however holds that, it will continue to invest in India. According to Gary Cofer, the country manager, "it takes time to build a business category or brand in India. It is possibly an even more demanding geography than others".[1]

China, on the other hand, with business worth several times than in India in less than 12 years, has emerged as a highly promising market for P&G. When the Chinese market was opened up, P&G was one of the first MNCs to enter. Prior to the liberalisation, Chinese consumers had to content with shoddy products manufactured by government companies. Per capita income of China is substantially higher than India's and the Chinese economy was growing faster than the Indian. Further, the success of the single child concept in China means higher disposable income.

Further, it is also pointed out that for a global company like P&G, understanding Chinese culture was far easier since the expat Chinese in the US was not very different from those back home whereas most Indian expats tended to adapt far more to the cultural nuances of the immigrant country.[2]

One of P&G's big bets in India was the compact technology premium detergent brand *Ariel.* After an initial show, Ariel, however, failed to generate enough sales – consumers seem to have gone by the per kilo cost than the cost per wash propagated by the promotion. To start with, P&G had to import the expensive state-of-the-art ingredients, which attracted heavy customs duties. The company estimated that it would cost ₹ 60 per kilo for Ariel compared to ₹ 27 for Surf and ₹ 8 for Nirma Because of the Rupee devaluation of the early 1990s, the test market price of ₹ 35 for 500 gms was soon ₹ 41 by the time the product was launched. HLL fought Ariel back with premium variants of Surf like Surf Excel.

It is pointed out that, "in hindsight, even P&G managers privately admit that bringing in the latest compact technology was a big blunder. In the eighties, P&G had taken a huge beating in one of its most profitable markets, Japan, at the hands of local company Kao. Knowing the Japanese consumer's fondness for small things, Kao weaved magic with its new-found compact technology. For a company that prided itself on technology, the drubbing in Japan was particularly painful. It was, therefore, decided that compacts would now be the lead brand for the entire Asia-Pacific region. When P&G launched Ariel in India, it hoped that the Indian consumer would devise the appropriate benchmarks to evaluate Ariel. As compacts promised economy of use, P&G hoped that consumers would buy into the low-cost-per-wash story. But selling that story through advertising was particularly difficult, especially since Indian consumers believed that the washing wasn't over unless the bar had been used for scrubbing. Even though Ariel was targeted at consumers with high disposable income, who represented half the urban population, consumers simply baulked at the outlay.

Thereafter, one thing led to another. Ariel's strategy of introducing variants was a smart move to flank Lever at every price point by cleverly using the brand's halo effect. And by supporting the brand in mass media and retaining the share of voice. By 1996, it had become clear that Ariel's equity as a high-performance detergent had begun to take a beating. Its equity as a top-of-the-line detergent was getting eroded…Nowhere in P&G's history had a concept like Super Soaker been used to gain volumes…It was decided that Super Soaker would no longer be supported, nor would Ariel bar be supported in media."[3]

QUESTIONS

1. Discuss the reasons for the initial failure of P&G in Japan.
2. Where did P&G go wrong (if it did) in the evaluation of the Indian market and its strategy?
3. Discuss the reasons for the differences in the performance of P&G in India and China.

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2. *Ibid.*
3. *Ibid.*

Case 5

OUTSOURCING

Mahindra & Mahindra (M&M) is a major player in the tractor and certain segments of the automobile market in India. After an impressive growth for a few years, the tractor market in India has been stagnating during 1998-99 to 2000-01.

M&M has been selling its tractors and utility vehicles in foreign markets including USA. Some of the components for its products have been sourced from abroad.

M&M has a 100 per cent subsidiary in USA, Mahindra USA, with a strong network of 100 dealers.

Mahindra has a five-per cent market share in the US market in the 28-30 horse power (HP) range.

As a part of the strategy aimed at building a global supply chain, Mahindra USA has signed a memorandum of understanding (MoU) with the Korean tractor major Tong Yang, a part of the $2 billion Tong Yang Moolsam group, according to which Mahindra will source high horse power (mostly 25-40 hp range) and sell them around the world under the M&M brand name. To start with, the premium range of tractors will be sold in the US.

M&M's current tractor range is more utility-oriented and lacks the aesthetic appeal that Tong Yang's tractors have, a must for a strong presence in the US market.

QUESTIONS

1. What are the advantages and disadvantages of global sourcing?
2. How will the foreign market expansion help M&M?
3. How does the strategic alliance with Tong Yang benefit M&M?
4. What are the possible risks of the alliance? How can they be overcome/minimised?

Case 6

CHANNEL SELECTION AND PRODUCT MODIFICATION

The Brindavan Incenses is a tiny unit located in Mysore, manufacturing and selling agarbathies. It is owned and managed by Mr. Devappa, who has had only high school education. Through lot of experiments, Devappa had developed a blend of incense that has been widely liked.

During the last four years of existence of the Brindavan Incenses, the two brands of agarbathi, *Bhagya* and *Sowbhagya*, have earned a very good reputation. Initially, it introduced just one brand, *Bhagya. Bhagya* clicked well in the market. Though the product was regarded as very good, the price of 'Bhagya' was a bit lower than that of the popular branch of established manufactures. By selling at lower price, Devappa hoped to generate more sales. Use of cheaper packaging and lower overheads enabled him to sell at lower but sufficiently remunerative price. Labelling was done in Kannada and English. The Brindavan Incenses have not had any aggressive marketing programme. At the beginning, free samples were supplied to some households in residential localities. Slides were also exhibited in certain cinema threatres. The dealers were offered attractive terms. Initially, the product was sold only in and around Mysore city. Encouraged by its success in Mysore, sale of *Bhagya* was extended to all over Karnataka and the consumer response was favourable.

On the advice of Mr. Shyam, a close friend of Mr. Devappa and who was doing his MBA course, the Brindavan Incenses introduced a premium brand, *Sowbhagya.* The ingredients and quality of the new brand were not significantly different from that of *Bhagya*. Instead of the rectangular package of *Bhagya*, a tubular package was used for *Sowbhagya.* The new brand also got good market acceptance.

Devappa was thinking of expanding his market to outside Karnataka also. There was no problem to get additional workers to roll agarbathies; nor was there any problem of input availability. The problem was organisational. The Brindavan Incenses was managed all alone by Mr. Devappa. The distribution to dealers was done by agents who worked on commission basis.

As a birthday presentation, Devappa sent hundred packets each of *Bhagya* and *Sowbhagya* to his good friend Nazeer working in Saudi Arabia. Two months later, Devappa received a letter from Nazeer. The letter contained the following information of particular importance to Devappa's business. Nazeer distributed most of the agarbathies among his friends. His friends liked the products very well. Some of them ranked *Bhagya* and *Sowbhagya* as good as the best brands available. Some even considered them as better than leading brands. Some of the foreigners found it difficult to pronounce and remember the words *Bhagya* and *Sowbhagya*.

Nazeer suggested that Devappa could think of entering the foreign markets. Devappa knew that a few agarbathi manufacturer who had started in a small way grew well in the domestic and foreign markets. Devappa became enthusiastic about selling his products in the foreign markets. He was wondering how he could carry out this idea. He decided to consult Mr. Shyam who has completed his M.I.B. programme. From Devappa's discussion with him, Shyam conceived that Devappa would like to have his advice on the following:

1. The International marketing channel suitable for the Brindavan Incenses.
2. Product modifications, including brand, packaging and labelling, for the overseas markets.

Case 7

TOWEL MANUFACTURING COMPANY*

Background and SWOT Analysis

The Towel Manufacturing Company (TMC) was founded in 1972 in Karachi, Pakistan. The majority of its shares are owned by the family of Mr Khalil, its managing director. This family also owns one of Pakistan's leading fabric manufacturing concerns.

TMC has grown consistently over the years to become Pakistan's largest manufacturer of towels for export. It employs a staff of about 400, the larger proportion of whom are engaged in the production of white terry towels carrying the brand name Ocean Breeze. Its leading export market, with a share of 90 per cent of its total sales, is the United States. A number of European countries make up its other markets. TMC enjoys a reputation as a supplier of quality towels.

The company is facing increasing competition from smaller towel manufacturers with more modest overheads. Demand is growing for dyed towels. Mr Khalil is aware that some competitors are producing dyed towels to meet this demand. He is likewise aware that the United States is close to passing legislation that would reduce imports of towels from Pakistan.

TMC produces solely for export. Management is not only fully committed to exporting but also has a decade of export experience behind it.

TMC has a current profit margin of 5 per cent on bleached towels. A margin of 15 per cent can be expected if it decides to produce unicoloured dyed towels. However, in order to do this, it would have to invest rupees 7.5 million on dyeing equipment.

This investment is needed to safeguard the company's reputation for quality. The managing director feels that subcontracting will not result in products of consistent quality. The current Ocean Breeze line is dependable, durable and is priced competitively.

TMC has plenty of factory space and access to labour and technical assistance. This will enable it to produce coloured towels soon after the installation of dyeing equipment. Its concentration on production for export is another advantage, it has over similar companies in the country. Its links with the country's leading fabric producer, enables it to obtain bulk supplies at lower prices; imported raw materials are also made available to it at favourable prices.

A recapitulation of the company's weaknesses follows:

- A number of small Pakistani companies have been operating with smaller overheads and have eaten into TMC's market share.

  Unlike a number of smaller companies, TMC does not produce solid-coloured towels and is thus unable to meet the demand for this product line. This is making it vulnerable to competition from the newer (and smaller) producers of towels in Pakistan.
- The profit margin (5%) on its current product line, white towels, is very low.
- The United States, its main market, is considering imposing an additional quota on imports from Pakistan. Such quotas severely limit the company's future potential in its main market. Its heavy dependence on this market will also put the company in a precarious position if the market declines for any reason.
- It will lose favour with United States importers if it cannot supply dyed towels to complement its current product line.

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* Case reproduced from ITC, *Export Marketing Strategies and Plans: A Case-book for Trainers*, Geneva, ITC, 1992.

TMC has started experimenting with European markets. In the Commonwealth of Independent States (CIS), profit margins are 5 per cent for white towels and 10% for the dyed (unicoloured) ones. Barter has in the past been the preferred method of payment in the area now covered by CIS. This and TMC's limited marketing experience in the area are a disadvantage. As regards Western Europe, TMC's total lack of marketing experience in the region is a major weakness.

Strategic Options

TMC has several attractive options which Mr. Khalil can evaluate.

- It can reduce its dependence on the United States by developing market in Asia and Europe. Its first product offer to these markets should be its white terry towel.
- It can establish a joint venture with a company in a country that is no subject to quotas or tariff barriers in the United States.
- It can implement a strategy of product adaptation and line extension. By offering white, solid-colour and dyed designed towels, it will be much more competitive. It will also benefit from the higher profit margins that can be gained from dyed towels.

No matter what strategy is selected, TMC's ultimate goal is increased profits and growth.

Recommended Strategy

A combined strategy for market development and for product adaption should be adopted as these are obviously the areas where TMC requires the most help.

Product adaptation and development. As far as this aspect is concerned, TMC has several alternatives.

First, it could continue to produce only its white Ocean Breeze towels. This is a safe approach as it limits itself to where the company's experience lies: there will be no need for expensive product redesigns or modifications; existing inventories will require no readjustment: there will be no necessity for expensive additions to plant and machinery; and prices can therefore be maintained at a reasonably low level. The disadvantages are as follows: TMC may be limiting potential market access; it may become increasingly difficult for the company to find agents or distributors willing to handle its single line of products; selling prices may have to be cut because the product is not quite what is demanded; and it may become even more difficult to compete effectively with other exporters.

Second, TMC could produce solid-coloured dyed towels in addition to its traditional line of white towels. This will enable the company to meet the demand and thus compete with suppliers to, both its current and potential markets. It will benefit from both the larger profit margins obtainable from the sale of dyed towels and from expanded trade. The new product line may enable the company to obtain the business of distribution chains, larger retailers such as Sears & Roebuck and Montgomery Wards and other distributors.

The problems associated with this strategy are as follows: It will require a huge investment in new machinery (rupees 7.5 million); the company will run the risk of producing towels in colours that no one wants; the additional costs of producing coloured towels may drive TMC's prices up to a level unattractive to its markets; the new products may not meet the standards of the middlemen and thus damage TMC's reputation for quality.

A third option for TMC is to produce single-coloured towels with designs. The advantages and disadvantages of this option are similar to those of solid-coloured towels. An additional disadvantage is that to produce this type of towel the yarn will have to be dyed first; this will tend to reduce the towel's absorptive capacity. This may not appeal to consumers in the United States, who in a recent survey ranked absorbency as their second most important criterion for choosing a towel.

Market Development

Again, TMC has several options as far as this aspect is concerned.

First, it can keep its markets as they are now, with the United States absorbing 95 per cent of its exports and the Commonwealth of Independent States 5 per cent. The advantages in regard to the United States in particular include concentration on the wealthiest and largest market for towels in the world; being better able to cater to its best customer; being able to remain with a market in which it has the most experience and with which it is most at ease; and being able to plan all long-term projects with one market in mind. The disadvantages include the following: limiting TMC's potential to one major market; lack of alternative markets during periods of economic downturn in the United States; finally — and this is perhaps the biggest disadvantage of this strategy — quotas (both current and future) on imports of Pakistani towels into the United States will both limit sales and raise the prices of the limited quantities that can be imported.

A second alternative is for TMC to pull back from the United States and to concentrate on other markets such as the Commonwealth of Independent States and Western Europe. The advantages include having other markets to turn to in periods of recession in one or the other market; providing TMC with more hands-on experience in international marketing; and greatly increasing TMC's potential customer and sales base. Among the disadvantages are the following: the possibility of over-extending TMC's resources; the possibility of making the company more vulnerable to small companies specialising in specific countries; TMC's inexperience in dealing with markets other than the United States; and its lack of ability to research potential in a large number of countries. While the initial market analysis and preliminary screening can be carried out on the basis of secondary data, the analysis of TMC's market potential will require primary data, which is expensive to obtain and which requires research specialists. A third alternative is for TMC to find ways around quotas in the United States while developing other markets. This has advantages and disadvantages similar to those of the second alternative. An added disadvantage is the consequence of failure to circumvent United States quotas.

Export Marketing Plan

While Mr. Khalil has decided not to give up the United States market, he is also of the view that it would be unsound to remain dependent on only market.

The rationale for retaining the United States as a major market is obvious. First, much of TMC's experience is with this market. Second, the United States is the world's largest and wealthiest market for towels. Third, TMC's towels are exactly what American consumers want in terms of quality, price and material (terry). Finally, TMC has established an excellent reputation for its Ocean Breeze brand over the years.

The quotas and heavy duties and tariffs imposed on Pakistani products are the greatest disadvantages of this market. To circumvent them, TMC could do one of the two things. The first is to use the traditional methods of entry which have enabled the company to sell 95% of its goods to this market. In order to widen access through these methods, TMC should carefully go through United States' regulations and identify new opportunities to obtain lower tariffs and duties and higher quotas.

The second is to find a more basic way of going round these barriers. TMC could set up a small branch factory in Bangladesh, where the towels can be cut and stitched before shipment to the United States. Towels from this country are subject to less restrictive tariff barriers. Or, TMC could form a joint venture with a firm in Bangladesh or any other country entitled to better trade conditions.

Although the United States is and will be a key market for TMC, the company should for a number of reasons not remain too dependent on one market. In the immediate future, TMC should

start pursuing trade opportunities in the Commonwealth of Independent States and Western Europe. The former is a good second market for a number of reasons. First, TMC has some trade experience there, although not enough to gain a foothold. Second, this experience has shown that TMC can obtain a 5% profit margin on bleached towels and 10% on dyed towels. Finally, no tariffs, duties or quotas are likely to be imposed if TMC moves at a reasonable pace.

One major problem of dealing with CIS countries is their tradition of barter trade. Currently, TMC does not have a barter specialist. TMC could either train its employees in the intricacies of barter and countertrade, or hire a specialist to carry out these transactions.

TMC's short-term goals are to increase its sales in the Commonwealth of Independent States to 20% in the next three years. Once this is accomplished, a slow and methodic penetration of Western European markets should begin. This pace is essential to ensuring that no trade barriers are imposed on towels. The goal for the next 10 years is for Western Europe to account for 25% of sales, CIS 30% and the United States 45%. This will insulate TMC from the effects of an economic slowdown in one of its markets. It will also provide safety from the dangers arising from increasing protectionist pressures in the United States.

As regards to its product offer, TMC has decided not to produce designed dyed towels. The financial and other requirements for processing such towels are much larger than those for dyed towels. Also, the market for designed towels is not big. A recent survey in the United States showed that only 17% of towel users preferred towels with designs. This, in addition to the fact that a designed towel is less absorbent and hence less appealing to TMC consumers, would make production of designed towels unprofitable for TMC in the immediate future.

While the equipment for producing unicoloured towels costs rupees 7.5 million, market returns would make the investment worthwhile. It has been conservatively estimated that TMC will sell rupees 33 million worth of these towels within five years, at a profit margin of 15%.

To penetrate the market for unicoloured towels, TMC must carry out certain steps. First, it must obtain information on future fashion trends in the United States and eventually in CIS and Western Europe. To do this, it could undertake primary research to see what colours will be "in" in the future. Alternatively, it could rely on its importers to obtain this information from their retail contacts; these should have a good idea of what consumers are looking for. Or, TMC could subscribe to a number of magazines to ascertain future trends through secondary data.

Second, it could seek to become a supplier for a major retail chain in the United States. While it may be initially costly to make the right contacts, the financial rewards of supplying these chains are substantial. This is within the realm of the possible, as towels of the type produced by TMC are the mainstay of these retailers.

TMC should move now to diversify both its product line and its markets. If not, its future may be bleak.

QUESTIONS

1. Analyse the strengths and weaknesses of TMC.
2. Analyse the domestic and foreign environments of TMC's business.
3. Evaluate the recommended strategy.

Case 8

SIND STEEL WORKS LTD.*

Mr. Mohammed Din looked painfully disturbed at today's Pakistan's Times business section. In one of the leading articles his worries had come to fruition: "Steel Importers to be Levied 110 Per Cent Import Duty", read the headline. In the small print, it was announced that even the re-export of imported steel products was not going to be exempted. It was a clear design to protect the newly established steel mill which had been financed with national funds. The talk of the town was that the Government's worry was not being able to meet interest and principal payments of the international loan on time. This had led them to the protective legislation as rated in today's newspaper. His immediate concern was how he could compete in the national and international markets with his steel prices now having to be raised by 110 per cent.

Company Background

Sind Steel Works was in the business of producing steel products for the construction industry. Its product line included rods for the re-enforcement of cement walls; angles for the support of floors and steel poles for the structure of a building. Its business was divided into 60 per cent national and 40 per cent international accounts. Its exports were going mainly to the South East Asian region, though lately it had picked up some African business from Botswana and Swaziland. Its comparative advantage in the marketplace was basically its low prices. The company was able to quote 30 per cent to 40 per cent lower than its main competitor. The difference was that the company was in a position to process used, rather than original steel.

Mr. Din's principal competitors in the local market were those using original steel supplied to them by the new steel mill. The new plant was producing a very fine product which was the result of the technology of injecting a high percentage of oxygen into the melt ore and of continuous casting into ingots.

His company purchased, in contrast, the raw materials from his ship-breaking business. In fact, his involvement in the ship-breaking business had been a form of backward vertical integration. His firm used to buy and process new steel like everybody else in Pakistan. It was through a business with the Republic of Korea that he learned about the ship-breaking business. He learned that, through a network of brokers and the international business press, he could be informed about steel ships which were up for auction in the international marketplace. The excess supply of ocean carrying capacity of the early 1980s had accelerated the supply of obsolete ships far beyond the world's demand, which had persuaded him also to move into the ship-breaking business.

The ships were offered for sale through competitive bidding and represented a mix of super tankers of recent design but which had become ecologically unsound due to hull breakage in severe weather, when millions of gallons of oil were spilled in the oceans. Also more traditional ships were offered for sale, which just "had run out of steam", due to old age. Before Mr. Din could make a decision whether or not to bid, he would visit the location of the ship and inspect the hull to assure himself of the quantity and quality of recoverable cast steel. When he won a bid, the ship 'would be chartered out to be sailed for her last voyage to a beach near Karachi, which he had leased from the Government. His crew would slice the hull into pieces with an oxy-acetylene cutter, after which a truck would transport the steel sheets to his factory furnances for remelting and casting into construction rods, angles and poles.

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* Reproduced from *Selected Asian Cases of Small And Medium-Scale Enterprises In Export Marketing* brought out by ITC, Geneva, 1989.

The Government's decision to impose a 110 per cent tariff on all imported steel, used and new, might well finish off his ship-breaking business. He now had to decide how to remain in the steel construction business on a competitive footing.

The Situation

Mr. Din's principal source of profit originated from his ship-breaking business, representing a very attractive source of raw materials for his furnaces and sometimes he wondered in which business he really was in. Besides, the recycling of the ships' steel through his factory's furnaces, his ship-breaking business had led him into a multitude of other profitable businesses such as the supply of used instruments, furnishings, lumber, copper and brass.

The critical factor was the age of his factory. Without the cheap supplies of used steel, he could not dream of being price competitive with other national suppliers. His plant was badly due for refurbishing and updating of its antiquated technology. The expensive local supply of new steel from the new factory would wipe out his price-competitiveness. Besides, his ability to subsidise his steel construction business, with profits from ship-breaking and *vice versa*, depending on which industry was in a recession, would also come to a halt.

Alternatives

He had to do some major strategic thinking. Would he remain in the steel construction business or get out? Being forced from now on to buy new steel from the local steel mill would change his cost structure to being the most rather than the least expensive supplier. Would his old customers stay with him?

Refurbishing his present factory with modern equipment was another alternnative. It probably would be the least costly solution. One drawback was his fear of not getting a permit to expand his plant due to his location near the city centre.

Moving his ship-breaking business to another country and setting up a smelting plant in the same country represented another alternative. It would finish his business in Pakistan but would allow him to concentrate much more on export business. Bangladesh was a country he was familiar with and where he might be able to break into the local market as well.

At a local seminar, he had learned about the declining steel manufacturing business in the USA and in the EEC due to its declining competitiveness in the world market. Particularly, the EEC countries had to subsidise their steel factories heavily. The European Coal and Steel Board had been authorised to close down various steel manufacturing plants over the next few years in order to reduce the capacity within the EEC market.

One supporting article mentioned that complete factories were available in the EEC at a cost equivalent to removing the plant from its premises and outside Europe. A wild thought crept into his mind. Would it be possible to apply his ship-breaking experience to the breaking up of an EEC steel factory presently serving the steel needs of its construction industry. It would involve breaking, packing, and shipping a complete factory from one of the EEC countries.

He thought about the possibility of using his own ship-breaking crew and perhaps hiring some European engineers to assist him in reassembling the plant, in Pakistan. Perhaps, he could even buy his last ship in an EEC country to be broken in Pakistan and put the entire factory with his crew on her while steaming back home. The factory would be a "down-steam" link in the steel industry of Pakistan and would allow him to take advantage of a much more competitive cost structure than with his existing facilities. He suddenly remembered that the lecturer at the seminar had called the "factory transplant" *the international product life cycle.*

QUESTIONS

1. What is the meaning of the international production life cycle (IPLC)? How could it effect your domestic and export business?
2. What are the causes of this cycle? Is it restricted to industrialised countries?
3. What are the advantages and disadvantages of the IPLC for an export-oriented company?
4. Can you relate Mr. Din's idea of his ship-breaking business to another country, to the IPLC?
5. What is the relationship between the IPLC and countries which have moved into high technology industries?
6. Do you see a relationship between, the IPLC and strategic planning for Mr. Din's business?
7. Could a steel factory transplant from an EEC country to Pakistan benefit that EEC country by exporting its products back to the EEC?
8. Could an expired patent in one country allow one to continue to benefit from it in another country?

Case 9

FINE HOME FURNISHING CO.*

Mr. Roberto Gonzales, Managing Director of Fine Home Furnishings, Manila, faced problems in quality control in the production of home furnishings for export markets. This problem was compounded by unexpected fluctuations in demand. He thought of establishing an export unit with a separate staff, but the type of home furnishing exported by the company had a fluctuating demand pattern not justifying such an investment.

Company Background

Fine Home Furnishings Company (FHFC) was one of the largest exporters of fashionable home furnishings in the Philippines. The company's product mix included pillow cases, bedspreads, curtains, sofa and chair covers, and wall coverings. The products were being sold under the company 's own brand name! ("Chic") in the local market but under private labels in the United States and EEC. The company had an annual production capacity in 1987 of 10 million pesos. Fine Home Furnishings employed a full-time workforce of 200. The company participated regularly in trade fairs and had built up a good image for their products at home and abroad.

Specific Interest Areas

The company was experiencing a variety of labour problems, but the most immediate problem facing the director was how to maintain high quality standards in its export business.

The quality control issue was complicated by the absence of many cutting, stitching and finishing details not required by the domestic buyer, but insisted upon by the foreign buyer. Further, the close relationship abroad, between the demand for home furnishings and the economic climate in the construction industry had made the demand pattern for home furnishings very cyclical. Seasonality of export demand was another factor due to the tendency by the consumers to spend more on home furnishings in the fall and winter seasons rather than in the spring and summer.

The above factors caused spurts of accelerated activity, leading to many labour management disputes due to a much higher rejection rate for lose products geared for export markets. The presence of a piece rate pay system led to a considerable drop in morale among workers with a higher than normal rate of absenteeism when export business was in process.

Mr. Gonzales realised that he had a number of alternative solutions to choose from. He could consider dividing the workforce into two groups; one exclusively for export business to which one could "graduate" from the domestic workforce when certain performance standards had been met.

He considered eliminating the piece rate pay system for the export business workers in favour of a weekly salary system. He also thought of maintaining one labour force exclusively for the export business and channel all domestic business to subcontractors.

Another alternative was to substitute more sophisticated machinery for labour. He had read of auto-controlled cutting, sewing and stitching machinery equipped with electric eyes and other electronic sensors. The last solution would allow him to reduce his labour force, increase the rate of output and maintain similar high quality for both the domestic and foreign markets. The required investment, however, would be considerable.

The last idea which had been put into his mind this morning by his secretary was that all workers could produce high quality standards. She said that the problem was psychological, caused

* Reproduced from *Selected Asian Cases of Small And Medium-Scale Enterprises In Export Marketing* brought out by ITC, Geneva, 1989.

by switching on and off the higher quality standards only required for exports. Only one standard should be made the norm, both for domestic and foreign demand, i.e., the export standard.

Specific Issues/Problems

Mr. Gonzales was anxious to make a decision. Various constraints made the selection of one clear solution difficult:

1. It was a practice in the Philippines to hire workers for up to six months as "trainees" after which social security and other cost/benefits had to be paid.

2. Producing under the private label of a foreign buyer caused considerable pressure on the profit margin. The only way to make a profit was by squeezing labour costs, as most of the materials were imported at high cost from China (Taiwan Province) or were provided by the foreign buyer.

3. Labour unions were becoming increasingly militant, demanding more job security for their members along with higher pay.

QUESTIONS

1. What are the principal and secondary problems faced by Mr. Gonzales?
2. Why is the business of home furnishings a cyclical and a seasonal business? How can Mr. Gonzales solve the "cause" of the problem?
3. Is cash-flow a problem in the home furnishing business and would the lack of it affect the company's ability to pay higher salaries and wages?
4. Consider each alternative proposed by Mr. Gonzales to solve his labour problem. Do you feel that other alternative solutions have not been mentioned? What probability of success would you assign to each alternative?
5. Are Mr. Gonzales' problems generic to all exporters in developing countries?

Case 10

THE MCDONALD'S WAY

McDonald's, considered a symbol of globalisation, is a target of attack by protagonist of anti-globalisation. The global fast food major which prides itself of the 'McDonald's way' — its business philosophy - is often accused of unethical and unfair practices and social irresponsibility. This case can be used to teach a variety of subjects like Business Environment (particularly Global Business Environment), Globalisation Strategies, International Marketing, Business Ethics and CSR, Corporate Governance etc.

McDonald's Today

The McDonald's Corporation, also known as *Mickey D's* (in the US and Canada), *Macky D's* (in the UK), *McDo* (in France and Quebec), *Maccer's* (in Ireland), *Maccas* (in New Zealand and Australia) or *de Mac* (in the Netherlands), is the world's largest chain of fast-food restaurants, (also known as Quick Service Restaurants or QSR). McDonald's predominantly sells hamburgers, various types of chicken sandwiches and products, French fries, soft drinks, breakfasts, and desserts.

In 2012, the McDonald's system had more than 33,000 restaurants (up from 20,884 at the end of 1996) in about 120 countries and territories around the world, serving nearly 68 million customer daily and employing about 17 lakh people. Of the total of 31,666 restaurants, 13,774 were in USA, 1391 in Canada, 6406 in Europe and 7822 in Asia-Pacific, Middle East and Africa.

About 80% of McDonald's restaurants worldwide are owned and operated by independent local men and women.

In May 2012, McDonald's had 235 restaurants in India (up from 34 at the end of 2001).

Brief History

The origin of the business of McDonald's goes back to 1940 when a restaurant was opened by siblings Dick and Mac McDonald in San Bernardino, California. The *Speedee Service* system introduced by them in 1948 marked the establishment of the principles of the modern fast food restaurant. The fast service has been one of the important contributors to the rapid growth of McDonald's business.

In 1954, Ray Kroc, 52-year-old, an exclusive distributor for *Multimixer* milkshake machines, amazed by the sight of rapidly moving line of customers buying bags of hamburgers and French fries at McDonald's restaurant, stumbled upon the idea of franchising when the McDonald brothers explained to him that they didn't have the personal desire to oversee the expansion of their business across the nation. Kroc became the exclusive franchising agent for the entire country by forming a franchising company on March 2, 1955 under the name of McDonald's System Inc. This was the start of McDonald's as it is known today. Kroc opened his first restaurant in Des Plaines, Illinois (the 9th Mc Donald's restaurant overall) on April 15, 1955.

As per the agreement between Kroc and McDonald brothers, Kroc got the right to sell McDonald's franchises. Besides the $950 at which a franchise was sold, there was also a royalty of 1.9 per cent on sales (with Kroc and the McDonald brothers receiving 1.5 per cent and 0.4 per cent respectively). Kroc later purchased the McDonald brothers' equity in the company and led its worldwide expansion.

In 1957, *quality*, *service*, *cleanliness* and *value* (QSC & V) were established as the company motto. By 1959, the number of McDonald's restaurants reached 100 and in 1961 the Hamburger University opened was in EllkGrove, near Chicago, for training its franchisees and others. In 1965,

the corporation went public and the first McDonald's restaurants outside of the USA were opened in 1967 (in Canada and Puerto Rico). In 1968, the 1000th restaurant was opened and the *Big Mac* was introduced. The US economic boom of 1950s and 60s and the increasing automobile ownership provided a very favourable environment for the growth of McDonald's and throughout the 1960s and 70s the chain grew incredibly and quickly.

In 1973, McDonald's first opened for breakfast with the creation of the Egg McMuffin and by 1987 one-fourth of breakfasts eaten outside the home in the United States came from McDonald's.

The 1970s witnessed an intensification of competition in the fast foods business, culminating in the *Burger Wars* of the early 1980s. In order to cater to changing consumer preferences, McDonald's introduced Chicken *Mc Nuggets* in 1983 and by the end of the year McDonalds's was the second largest retailer of chicken in the world. However, due to a series of difficulties including failed marketing strategies and new sandwiches that flopped, growth in the US slowed during 1990s. However, the rapid growth of the overseas business more than made good the slowdown in domestic business.

By 1972, a new McDonald's restaurant was opening every day. The global foray continued more vigorously and in 1989 McDonald's was listed on the Frankfurt, Munich, Paris and Tokyo stock exchanges. In 1990, McDonald's was opened in Moscow and in 1992 it entered China. Between 1991 and 1998, the number of McDonald's restaurants abroad increased about three-fold (from about 3,600 to more than 11,000), largely in Japan, Canada, Germany, Great Britain, Australia and France. The total number of countries with McDonald's nearly doubled from 59 in 1991 to 114 in 1998. In 1993, McDonald's first expanded into the Middle East and opened in Tel Aviv, Israel. In 1994, restaurants were opened in several Arab countries bringing the total number to over 15,000 in 79 countries on six continents. By 1997, McDonald's was opening about 2000 restaurants a year (more than five restaurants, on an average, every day). This trend was fostered by the liberalisation, growth of entrepreneurship and the socio-economic changes across the world. The growth in the number of restaurants slowed down recently; the growth tapering off after a fast phase of growth is common.

In 1996, India became the 95th market entered by McDonald's.

McDonaldisation

The fast expansion of McDonald's globally, influencing the lifestyles and attitudes across the world, has led to the emergence of the usage *McDonaldisation*. Terms such as *Cocacolonization* and *McDonaldisation* are often used to refer to the impact of the Western culture on the people of the other countries through globalisation. It is often alleged that the invasion of the developing countries by pop culture, cola culture, burger/pizza culture etc. have been changing the outlook, attitudes, values and lifestyles (including consumption habits) of people of developing countries to the detriment of their economies and culture. The exportation of these Western products, including music and dance, to other countries have great impact, good or bad, on the youth, particularly, around the world. The term McDonaldisation was originally used by sociologist Geotge Ritzer in his book *The McDonaldisation of Society* (1995) wherein he described it as the process by which a society takes on the characteristics of a fast food restaurant. McDonaldisation is a reconceptualisation of rationalisation, or moving from traditional to rational modes of thought and scientific management. Ritzer has highlighted four primary components of McDonaldisation: *Efficiency* — the optimal method for accomplishing a task; *Calculability* — objective should be quantifiable (i.e., sales) rather than subjective (i.e., taste); *Predictability* - standardised and uniform services; *Control* — standardised and uniform employees, replacement of human by non-human technologies. Ritzer has summarised the process of McDonaldisation as the way in which "the principles of the fast food restaurant are coming to dominate more and more sectors of American society as well as of the rest of the world."

McDonaldisation has both negative and positive impact on culture and business, *albeit* their balance is a subject of heated debate. In a number of countries, McDonald's have become a symbol for the desire to embrace Western cultural norms. As McDonald's is closely identified with United States culture and lifestyle, its international business expansion has been termed part of *Americanisation* and American *cultural imperialism* and as a consequence McDonald's is one of the targets of anti-globalisation and political anti-American protesters worldwide.

However, McDonald's has been credited with increasing the standard of service in markets that it enters. It is pointed out that in a number of countries the adherences to consistently high standards of cleanliness and hygiene and courteous service of employees have oriented consumers towards demanding the same of other restaurants and institutions. McDonald's business processes and Management present very important principles and practices for other firms to learn from.

McDonald's became popular around the world also due to the convenience the fast food offers. For example, a 2002 survey revealed that on average a white-collar employee in China preferred Kentucky Fried Chicken (KFC), hamburger or pizza to carrying a lunch packet from home. Fast food was found to be a preferred choice of children and students who were getting more pocket money (to buy lunch). Fast food was regarded convenient while traveling or on shopping.

McDonald's has also been instrumental in changing local customs. For example, Watson points out that by popularising the idea of a quick restaurant meal, McDonald's led to the easing or elimination of various taboos, such as eating while walking in Japan (*Golden Arches East*, Stanford University Press, 1998, edited by James L. Watson).

4. The McDonald's System

McDonald has been using different market entry/operating modes for its global expansion. In 2012, nearly 80 per cent of the total number of restaurants were franchised ones. In India, McDonald's restaurants are joint ventures between McDonald's Corporation and two Indian entrepreneurs.

The normal strategy of McDonald's is to enter foreign markets through company operated restaurants or joint ventures. It may move to the franchise mode only after it has built up significant customer base. For example, McDonald's began franchising in China only in 2003, more than a decade after its entry in that market. The franchise rout has not yet opened in India. A 2003 study by the Federation of Indian Chamber of Commerce and Industry (FICCI) suggested McDonald's franchising strategy in China (in which prospective franchisees start by operating company-owned units, gain hands-on experience before finally setting up shop as franchisees) as a model for the food and beverages franchising units in India.

In India, McDonald's operates through two 50:50 joint ventures, run by Indians. Hardcastle Restaurants Private Limited owns and manages McDonald's restaurants in the West and those in the North are owned and managed by Connaught Plaza Restaurants Private Limited.

In franchising, McDonald's Corporation's business model is slightly different from that of most other fast food chains. In addition to the ordinary franchise fees, supplies, and percentage of sales, McDonald's also collects rent, partially linked to sales. As a condition of the franchise agreement, the corporation owns the properties on which most McDonald's franchises are located. The corporation often insisted that the franchisees paid from their non-borrowed personal resources. Besides the financial strength, the company evaluates a potential franchisee on such criteria as business acumen, leadership skills, entrepreneurship qualities, the willingness to involve herself/ himself full-time with the restaurant, track record of success in business, a willingness to undergo McDonald's all-inclusive training programme etc. McDonald's extends supportive services to its franchisees in areas such as operations, training, purchasing, marketing etc.

There are different types of McDonald's restaurants. Most standalone restaurants offer both counter service and drive-through service, with indoor and sometimes outdoor seatings. In 1975, McDonald's pioneered its Drive-Thru window; Drive-Thru sales eventually accounted for more than half of McDonald's system-wide sales. Drive-Thru, Auto-Mac, Pay and Drive, or McDrive as it is known in different countries, often has separate stations for placing, paying for, and picking up orders, though the latter two steps are frequently combined. Locations in high-density city neighbourhoods often omit drive-through service. There are also a few locations, mostly in downtown districts, that offer Walk-Thru service in place of Drive-Thru. Specially themed restaurants also exist, such as the Solid Gold McDonald's, a 1950s rock-and-roll themed restaurant. In Victoria, British Columbia, there is also a McDonald's with a 24-carat gold chandelier and similar light fixtures.

Some McDonald's in suburban areas and certain cities feature large indoor or outdoor playgrounds called McDonald's PlayPlace (if indoors) or Playland (outdoors). The first PlayPlace with the familiar crawl-tube design with ball pits and slides was introduced in 1987 in the USA, with many more being constructed soon after. Some PlayPlace playgrounds have been renovated into R Gym areas (in-restaurant play area that features interactive game zones designed for children aged 4 to 12. Equipped with stationary bicycles attached to video games, dance pads, basketball hoops, monkey bars, an obstacle course, and other games which emphasise physical activity.

In 2006, McDonald's introduced its Forever Young brand by redesigning all of their restaurants, the first major redesign since the 1970s. The new restaurants feature areas such as: The *linger* zone that offers armchairs, sofas, and Wi-Fi connections, a concept introduced by Starbucks. The *grab and go* zone that features tall counters with bar stools for customers who eat alone; Plasma TVs offer them news and weather reports. The *flexible* zone, targeted toward families, which has booths featuring fabric cushions with colourful patterns and flexible seating. Different music will be targeted to each zone.

5. McDonald's Philosophy

According to the corporation, the secret behind McDonald's phenomenal success is the philosophy enunciated by the founder Ray Kroc that "we take the burger business more seriously than anyone else."

The set of principles and core values, described by the corporation as the *McDonald's Way*, are:

- Quality, Service, Cleanliness and Value — It is an unflinching McDonald's ideology that its customers must always get quality products, served quickly and with a smile, in a clean and pleasant environment; and all at a fair price.
- The corporation is committed to exceeding the customers' expectations in every restaurant every time.
- McDonald's has a passion and a responsibility for enhancing and protecting the McDonald's brand.
- The corporation believes in a collaborative management approach, employing a mutually respectful business philosophy,
- It will seize every opportunity to innovate and lead the industry on behalf of its customers

6. Localisation

Even as the corporation is committed to consistency and uniformity – the trademark of McDonald's anywhere in the world – be it in areas like the quality of the food or the attention to service, McDonald's

modifies its product mix and operations to fit the cultural environment of the market. This may involve deleting certain items or developing new products for the particular market. For example, it deleted beef and pork products from the Indian menu and has developed a special menu with vegetarian selections to suit Indian tastes and preferences. McDonald's has reformulated some of its products using spices favoured by Indians. Among these are McVeggie burger, McAloo Tikki burger, Veg. Pizza, McPuff and Chicken McGrill burger. It has also developed special sauces for the Indian market. Even the soft serves and McShakes are egg-less. McDonald's has also added Chatpatey (spicy) Potato Wedges and the Wrap to their menu in 2002. The selection of meats McDonald's uses varies with the culture of the host country.

The company affirms that all the vegetarian products offered in India are 100 per cent vegetarian. Even its mayonnaise is specially developed for Indian consumers and hence does not contain any egg. McDonald's has also changed its operations to address the special requirements of a vegetarian menu. Vegetable products are prepared separately, using dedicated equipment and utensils. McDonald's had, in fact, spent considerable amount of time to understand Indian culture.

McDonald's adaptation strategy is also influenced by the nature of competition. For example, in China, when Kentucky Fried Chicken (KFC), the market leader (KFC entered China in 1987 — 5 years ahead of McDonald's), dished out rice porridge and chicken rolls customised to suit the Chinese palate, McDonald's followed suit with spiced chicken wings (or 'McWings' as they are known). Similarly, while KFC decorated its outlets with Chinese kites and paper shapes, Mac outlet used the Chinese characters 'Mai Dang Lao', to phonetically approximate the word 'McDonald's'.

7. Sourcing and Supply Chain Management

Local sourcing (i.e., from the same country where the restaurant is located) is a strategy very assiduously followed by McDonald's to serve its business purpose and to build local goodwill by benefiting farmers and entrepreneurs. For example, McDonald's India purchases more than 96 per cent of its products and supplies domestically. The restaurants are constructed using local architects, contractors, labour and maximum local content in materials.

The corporation very carefully selects the suppliers to ensure that the quality and delivery standards are satisfied. Suppliers must adherence to national regulations on food, health and hygiene while continuously maintaining McDonald's recognised standards. The suppliers are supported with arrangements for provision of international technology to make sure that local supplies matched its standards. For instance, China has been one of the world's largest potato producers, but the produce has been typically short and stubby. McDonald's scouted around for Chinese farmers who could produce crop as per its specifications. The company spent close to a decade working alongside Chinese farmers improving their produce. To improve its supply networks in China, McDonald's roped in the services of its suppliers from the highly efficient North American system. Similarly, even prior to its entry into India, McDonald's had worked with local suppliers and farmers to source its requirements. The company spent 6 years and around ₹ 450 crore to set up the food supply chain even before opening its first restaurant in the country. This also involved setting up a cold chain, an integral part of the supply chain, which is necessary to maintain the integrity of food products and retain their freshness and nutritional value. McDonald's restaurants store products to be used on a daily basis, within a temperature range of –18°C to 4°C. About half of its food products need to be stored under these conditions before they are used. The establishment of the cold chain involved the transfer of state-of-the-art food processing technology by McDonald's and its international suppliers to pioneering Indian entrepreneurs, who have now become an integral part of the cold chain. The supply chain of McDonalds involves several domestic and international firms which supply its material requirements and rend's different vital services.

Further, as the required quality potato was not available in India, McDonald's and its supplier partner, McCain Foods Pvt. Ltd. (a French company), began to work closely with farmers in Gujarat and Maharashtra to develop process-grade potato varieties. Leaders in agronomy, technology and innovation partnered with McDonald's to work with farmers in Gujarat to interact with agronomists and field assistants to demonstrate the best practices – right from better agronomy techniques like irrigation system, sowing seed treatments, planting methods, fertiliser application programmes and better storage methods for the produce. In addition to this, the farmers also benefit through incremental monetary gains as they sell directly to McDonald's supplier instead of commission agents.

As the ingredients move from farms to processing plants to the restaurant, McDonald's Quality Inspection Programme (QIP) carries out quality checks at over 20 different points in the cold chain system. Setting up of the cold chain has also enabled the corporation to cut down on operational wastage. Hazard Analysis at Critical Control Points (HACCP) is a systematic approach to food safety that emphasises prevention of illness or presence of microbiological data within its suppliers' facilities and restaurants rather than its detection through inspection. Based on HACCP guidelines, control points and critical control points for all McDonald's major food processing plants and restaurants in India have been identified. The HACCP verification is done at least twice in a year and certified.

8. Backlashes

Despite the wide publicity given by McDonalds's for its business principles and philosophy, care for the labour and suppliers, consumer and societal welfare, it has been often accused of being guilty on the above scores. McDonald's global ubiquity has made it a target of criticism from different sections across the world: from farmers to students and from consumers to opponents of global cultural hegemony. Allegations include damaging people's health with junk food, exploiting labour and children, employing unethical promotion strategies and tactics, using toys made in sweat shops for promotion etc. Several books, articles and films have been produced to expose the unethical practices and deleterious impacts of McDonald's. It also has had to face a number of law suits and complaints before advertising regulatory bodies.

Investigative journalist Eric Schlosser in his book *Fast Food Nation: The Dark Side of the All-American Meal* (2001), which examines the local and global influence of the United States fast food industry, argues that the fast food industry wields powerful economic — and therefore political — influence on American culture and exploits that influence to increase profits at the expense of public health and of the social conditions of its workers.

McDonald's, being the leading fast food business chain, had to bear the major brunt of criticisms against the adverse effects of these products. Major allegations include the heavy contribution of fast food to the epidemic of obesity in American society, and failing to provide nutritional information about its food for its customers. Similarly, the increased obesity in China and Japan are linked with the arrival of fast food. This could be true of other countries where the fast food culture is spreading. Even sexual dysfunction is attributed to regular consumption of such food.

McDonald's lost credibility when investigations proved that it repeatedly failed to take the corrective measures it promised. It also had to pay damages/penalty/ compensation on account of these. Although McDonald's announced in September 2002 that it would be voluntarily reducing the *trans fat* content of its cooking oil by February 2003, it was not changed. (Trans fat is the common name for a type of unsaturated fat with trans isomer fatty acid(s). Unlike other dietary fats, trans fats are neither required nor beneficial for health. Eating trans fats increases the risk of coronary heart diseases). For the settlement of the ensuing lawsuits, in which the plaintiffs claimed that McDonald's failed to inform the public that the oil was not changed, McDonald's was required to donate $7 million to

the American Heart Association for public education about the risks of consuming trans fat. Besides, the company was asked to spend up to $1.5 million on publishing notices to ensure that the public knows the status of its trans fat initiative. If the cost of publishing the notices was less than $1.5 million, the difference would be donated to the American Heart Association.

For decades, McDonald's cooked its French fries in a mixture of about 7 per cent cottonseed oil and 93 per cent beef tallow. The mix gave the fries their unique flavour — and more saturated beef fat per ounce than a McDonald's hamburger.

In 1990, news reports informed the public that McDonald's, Wendy's and Burger King were switching to all-vegetable oil to cook their fries to reduce the saturated fat content (bad for the heart), which, in McDonald's case, went from 42 grams to 23 grams for a two-ounce serving of fries. Previously, the fries were cooked with beef tallow. McDonald's biscuits also contained beef flavouring along with animal flavoring. However, McDonald's encountered a problem — the veggie-oil cooked fries didn't taste like their popular tallow-cooked fries. It was solved by including a beef flavouring at the time of preprocessing for distribution (not while being cooked in the restaurant). But because of the hype over the switch to vegetable oil for frying, vegetarians assumed — and McDonald's did not try to dissuade — that the fries were now vegetarian. A Seattle lawyer, Harish Bharti, a vegetarian Hindu, who examined McDonald's French fries felt that the company deceived the public about beef flavourings in their "vegetarian fries." Bharti sued McDonald's in 2001 and that grew into a lawsuit involving a number of lawyers and organisations. Ultimately, Hindus, Sikhs, Jews, Muslims, vegetarians and vegans joined the fray — the Jews because the beef flavouring was not 'kosher' and the Muslims because it wasn't 'halal'. In March, 2002, when the lawsuit was close to being settled, McDonald's agreed to issue a formal apology, better disclosure of ingredients, creation of an advisory board and payment of $10,000,000 to organisations which promote vegetarianism and issues related to the fries. The apology reads, in part as follows: "McDonald's sincerely apologizes to Hindus, vegetarians and others for failing to provide the kind of information they needed to make informed dietary decisions at our US restaurants. We acknowledge that, upon our switch to vegetable oil in the early 1990s for the purpose of reducing cholesterol, mistakes were made in communicating to the public and customers about the ingredients in our French fries and hash browns. Those mistakes included instances in which French fries and hash browns sold at US restaurants were improperly identified as vegetarian." It was part of the settlement that the full apology be printed in *Veggie Life*, *India Tribune* and *Hinduism Today*. Bharti wrote at the time, "I am proud of obtaining the apology (with admission of wrongdoing), the enhanced disclosure from McDonald's and the advisory board. This means a lot to my clients and me, because this is very valuable for the consumer interest in the long run. In the last 100 years, this is the first giant corporation to apologize, admit wrongdoing and also pay millions of dollars."

Following a documentary film *Supersize Me* (2004) that highlighted the heavy contribution McDonald's food to the epidemic of obesity and the failure to provide nutritional information about its food for its customers, McDonald's stated it was phasing out its *Supersize* meal option and would begin offering several healthier menu items. However, while the healthier menu items have appeared, the *Supersize* meal option continued to be available at some locations. The company also began a practice of putting nutritional information for all menu items in light grey small print on the reverse of their tray liners and later started phasing in nutritional labelling in clear black print on the actual packaging of its food items.

Eric Schlosser's book reveals that McDonald's is the largest private operator of playgrounds in the US as well as the single largest purchaser of beef, pork, potatoes, and apples. The fast food indstry too has been regarded responsible for the poor conditions of the farm labour and labour in the supplier industries and harmful farming practices. For example, meat packing industry is dominated

by casual, easily exploited immigrant labour and that levels of injury here are among the highest of any occupation in the United States. The animal farming and meat processing sectors are characterised by several hazardous practices which are responsible for the spread of bovine spongiform encephalopathy (BSE), commonly known as mad cow disease, as well as introducing into the food supply harmful bacteria.

McDonald's has been subject to scathing criticisms in respect of its promotion strategies and practices which are considered unethical and misleading. Ironically, the company, which took (or threatened to take) legal action in many cases involving trade mark disputes and the like, had to face lawsuits for plagiaralism. The company has threatened many food businesses with legal action unless they drop the Mc or Mac from their trading name. It even sued a Scottish café owner called *McDonald*, even though the business in question dated back over a century.

In 2003, the UK Advertising Standards Authority (ASA) found McDonald's guilty of breach of the codes of practice in describing, in print ad, how its French fries were prepared: "After selecting certain potatoes, we peel them, slice them, fry them and that's it." It was indeed a misleading ad because in actual practice the product was sliced, pre-fried, sometimes had dextrose added, was then frozen, shipped, and re-fried and then had salt added. (ASA is an independent body set up by the advertising industry to police the rules laid down in the advertising codes. The strength of the self-regulatory system lies in both the independence of the ASA and the support and commitment of the advertising industry, through the Committee of Advertising Practice (CAP), to the standards of the codes, protecting consumers and creating a level playing field for advertisers.)

McDonald's promotion strategy to woo the children is one of the most criticised. Schlosser points out that McDonald's child-targeted marketing was influenced by the marketing tactics of The Walt Disney Company, which inspired the creation of advertising icons such as Ronald McDonald and his sidekicks. The children-oriented promotion strategy was aimed at not only attracting children, but their parents and grandparents as well. More importantly, the tactic would instill brand loyalty that would persist through adulthood via nostalgic associations to McDonald's. Schlosser also discusses the tactic's ills: the exploitation of children's naïveté and trusting nature. The marketing strategies of the corporations also included infiltrating schools through sponsorship and *quid pro quo*.

McDonald's has had to face the wrath of public opinion and legal action for its attitude towards labour and, in particular, for employment of child labour. It is interesting to note that *McJob* has become a buzzword for low-paid, unskilled work with few prospects or benefits and little security. McDonald's, however, has presented data to disputes the argument that its restaurant jobs have no prospects.

McDonald's has had to defend itself in several cases involving workers' rights. In 2001, the company was fined £12,400 by British magistrates for illegally employing and over-working child labour in one of its London restaurants. This is thought to be one of the largest fines imposed on a company for breaking laws relating to child working conditions. In April 2007, it has pleaded guilty to five charges of employing children under the age of 15 at an Australian outlet and was fined AU$ 8,000.

In several cases, McDonald's has responded to the changing reality, like endeavouring to introduce menu with nutritional importance, introduction of informative labelling etc. When environmentally damaging packaging and waste produced by the company's restaurants became a public concern, it started a joint project with Friends of the Earth to eliminate the use of polystyrene containers (only in the United States) and to reduce the amount of waste produced.

QUESTIONS

1. Discuss the business environment of the global firm McDonald's Corporation.
2. Make a SWOT analysis of McDonald's Corporation *vis-à-vis* global business environment
3. Explain the significance of global business to McDonald's.
4. Compare the advantages and disadvantages of the different market entry and operating modes.
5. Discuss the impact and implications of *publics* with special reference to McDonald's.
6. Examine the significance of cultural environment to business.
7. Where did McDonald's go wrong in respect of the problems mentioned in the case?
8. Comment on the business ethics and corporate social responsibility of McDonald's.
9. Evaluate the corporate governance of McDonald's.
10. Discuss how relevant is the *societal marketing concept* for McDonald's. Suggest a socially friendly corporate strategy for McDonald's.