International Business Strategy.

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Chapter 12

International Business Strategy

Learning Objectives

- To understand role of Strategic Management in International Business
- To understand International Business Analysis
- To understand the mode of entry in International Business
- To understand the political and country risk in International Business

INTRODUCTION

Strategic management is the process of determining an organisation's basic vision, mission and long-term objectives. As organisations go international, this strategic process takes on added dimensions.

One of the primary reasons that MNCs—such as Toyota or Citibank—need strategic management is to keep track of increasingly diversified operations in a continuously changing international environment. This need is particularly obvious when one considers the amount of foreign direct investment (FDI) that has occurred in recent years. Recent statistics reveal that FDI has grown three times faster then trade and four times faster than world gross domestic product (GDP). These developments are resulting in a need to coordinate and inter-grade diverse operations with a unified and agreed-on focus. There are many examples of firms that are doing just this.

One is Food Motor, which has re-entered the market in Thailand and, despite a shrinking demand for automobiles there, is beginning to build a strong sales force and to garner market share. The form's strategic plan here is based on offering the right combination of price and financing to a carefully identified market segment. In particular, Ford is working to keep down the monthly payments so that customers can afford new vehicles. This is the same approach that Ford used in Mexico, where the currency crises of 1994 resulted in problems for many multinationals.

INTERNATIONAL STRATEGIC PLANNING

Many MNCs are convinced that strategic planning is critical to their success and these efforts are being conducted both at the home office and in the subsidiaries. For example, one study found that 70 per cent—of the 56 U.S. MNC subsidiaries in Asia and Latin America—had comprehensive 5 to 10 year plans. Others found that U.S., European and Japanese subsidiaries in Brazil were heavily planning-driven and that Australian manufacturing companies use planning systems that are very similar to those of U.S manufacturing firms.

Do these strategic planning efforts really pay off? To date, the evidence is mixed. Certainly, the fact—that an MNC had to coordinate and monitor its far-flung operations—must be viewed as a benefit. Similarly, the fact—that the plan helps an MNC to deal with political risk problems; competition; and currency instability—cannot be down-played.

Despite some obvious benefits, there is no definitive evidence that strategic planning—in the international arena—always results in higher profitability. Most studies—that report favorable results—were conducted at least a decade ago. Moreover, many of these findings are tempered with contingency-based recommendations. For example, one study found that when decisions were mainly at the home office, and close coordination between the subsidiary and home office was required, return on investment was negatively affected. Simply put, the home office ends up interfering with the subsidiary, and profitability suffers.

Exhibit 12.1

International Business

GSK extends its $2.6 bln offer for Human Genome:

8 Jun, 2012, 2017 hrs IST, Reuters

LONDON: GlaxoSmithKline has expanded its $2.6 billion offer to buy long-time partner Human Genome Sciences until the end of June as it fights with the U.S. biotech company's reluctant management.

The price was not unchanged at $13 a share under the longer tender, which is to expire at 5 p.m. (2100 GMT) New York time on June 29, Britain's biggest drug maker stated on Friday.

The starting tender period ran out at midnight on June 7, by when GSK had obtained less than 1 percent of Human Genome shares, which are trading at a premium to its offer.

People acquainted with the situation had previously told Reuters that GSK was set to extend its tender offer—a direct appeal to Human Genome shareholders over the heads of management–as it begins a process to replace the compare Human Genome board with the nominee of its own.

The British company has already commenced reaching out to executives in the drug industry as well as finance and governance experts who could be nominated as independent directors of the board of 12 members.

Sources declared on May 30 that GSK intended to seek approval from Human Genome shareholders to replace the board under a "consent solicitation" process, which could reach in the next few weeks. No details on the process were mentioned on Friday.

On the ground of inadequacy human Genome once again rejected GSK's bid . It has launched an auction process, inviting GSK to participate, while at the same time adopting a "poison pill" shareholder rights plan in a bid to thwart the hostile takeover attempt.

The U.S. firm has had contacts with other companies and said on Friday that the process "continues to be active and fully underway". But no counter bidder to GSK has come out and bankers say GSK has an advantage over rivals because of its partnerships around key drugs.

The two companies together sell Benlysta, a new drug for the autoimmune condition lupus, and they also collaborate on two other experimental drugs for diabetes and heart disease that could become significant sellers. GSK and Human Genome share rights to Benlysta, while GSK owns the majority of the commercial upside to the other products.

Buying Human Genome would give GSK full rights to these partnered drugs, underscoring the appetite among big drug makers for biotech products to refill their medicine chests.

But GSK may have more work to do in persuading investors that its $13-per-share bid is good enough and shares in Human Genome traded 2 percent higher at $13.50 by 1430 GMT.

That indicates investors still expect a higher price, although the stock has fallen back from a high of more than $15 hit in April, just after the unsolicited offer was declared to public.

Sources: http://m.economictimes.com/gsk-extends-its-2-6-bln-offer-for-human-genome/PDAET/articleshow/13934221.cms last accessed on 22 June 2012.

FORMULATING AND IMPLEMENTATION OF INTERNATIONAL STRATEGY

Four common approaches to formulating and implementing strategy are:

Economic Imperative

Multinational companies (MNCs) that focus on the economic imperative employ a worldwide strategy based on cost leadership, differentiation and segmentation. Many of these companies typically sell products for which a large portion of value is added in the up-stream activities of the industry's value chain. By the time the product is ready to be sold, much of its value has already been created through research and development; manufacturing.; and distribution. Some of the industries—in the group—include: automobiles; chemicals; heavy electrical systems; motorcycles; and steel. Because the product is basically homogeneous and requires no alteration to fit the needs of a specific country, management uses a worldwide strategy that is consistent on a country-to-country basis.

The strategy is also used when the product is regarded as a generic good and therefore does not have to be sold based on name, brand, or support service. A good example is the European PC market. Initially, this market was dominated by such well-known companies as IBM, Apple and Compaq. However, more recently, clone manufactures have begun to gain market share. This is because the most influential reasons—for buying a PC—have changed. A few years ago, the main reasons were brand name, service and support. Today, price has emerged as a major purchasing decision. Customers now are much more computer literate and they realise that many PCs offer identical quality performance. Therefore, it does not pay to purchase a high-priced name when a lower-priced clone will do the same things. As a result, the economic imperative dominates the strategic plans of computer manufactures.

Political Imperative

MNCs—using the political imperative approach to strategic planning—are country responsive. Their approach is designed to protect local market niches. International Management in

Action: Point/Counterpoint" demonstrates this political imperative. The products, sold by MNCs, often have a large portion of their value added in the down-stream activities of the value chain. Industries—such as insurance and consumer packaged goods—are examples of this. The success—of the product or service—generally depends heavily on marketing, sales and service. Typically, these industries use a country-centered or multi-domestic strategy.

A good example—of a country-centered strategy—is provided by Thums Up, a local drink that Coca-Cola bought from an Indian bottler in 1993. This drink was created back in the 1970s, shortly after Coca-Cola pulled up stakes and left India. In the ensuing two decades the drink, which is similar in taste to Coke, made major inroads in the Indian market. But when Coca-Cola returned and bought the company, it decided to put Thums Up on the back burner and began pushing its own soft drink. However, local buyers were not interested. They continued to buy Thums Up and Cola-Cola finally relented. Today Thums Up is the firm's biggest seller and fastest growing brand in India. The company spends much more money on this soft drink than it does on any of its other product offerings, including Coke. As one observer noted, in India the Real thing for Coca-Cola is its Thums Up brand.

Quality Imperative

A quality imperative takes inter-dependent paths: (i) changes in attitudes and a raise in expectations for service quality; and (ii) the implementation of management practices that are designed to make quality improvement an ongoing process. Commonly called total quality management, or simply TQM, the approach takes a wide number of forms including: cross training personnel to do the jobs of all members in the work group; (ii) process re-engineering designed to help identify and eliminate redundant tasks and wasteful efforts; and (iii) reward systems designed to reinforce quality performance.

Administrative Coordination

An administrative coordination approach—to formulation and implementation—is one in which the MNC makes strategic decisions based on the merits of the individual situation rather than using a pre-determined economic or political strategy. A good example is provided by Wal-Mart, which has expanded rapidly into Latin America in recent years. Many of the ideas—that worked well in the North American market—served as the basis for operations in the Southern Hemisphere. However, the company soon realised that it was doing business in a market where local tastes were different and competition was strong.

Wal-Mart is counting on its internationals to grow 25-30 per cent annually and Latin American operations are critical to this objective. For the moment, however, the company is reporting losses in Latin America, as it strives to adapt to the local markets. The firm is learning, for example, that the timely delivery of merchandise in places such as Sao Paulo, where there are continual traffic snarls and the company uses contract truckers for delivery, is often far from ideal. Another challenge is finding suppliers who can produce products to Wal-Mart's specification for easy-to-handle packaging and quality control. A third challenge is learning to adapt to the culture. For example, in Brazil, Wal-Mart has brought in stock handling equipment that does not work with standardised local pallets. It also installed a computerised book-keeping system that failed to take into account Brazil's complicated tax system.

Many large MNCs work to combine economic, political, quality and administrative approaches to strategic planning. For example, IBM relies on: (i) the economic imperative when it has strong market power (especially in less developed countries); (ii) and (iii) political and quality imperatives when the market requires a calculated response (European countries); and (iv) an administrative coordination strategy when rapid, flexible decision-making is needed to close the sale. Of the four, the first three approaches are much more common because of the firm's desire to coordinate its strategy both regionally and globally.

GLOBAL VS. REGIONAL STRATEGIES

A fundamental tension—in international strategic management—is the question of when to pursue global or regional (or local) strategies. This is commonly referred to as the globalisation vs. national responsiveness conflict. As used here, global integration is the production and distribution of products and services of a homogeneous type and quality on a worldwide basis. To a growing extent, the customers of MNCs have homogenised tastes and this has helped international consumerism. For example, throughout North America, the EU and Japan, there has been a growing acceptance of standardised yet increasingly personally customised goods such as automobiles and computers. This goal—of efficient economic performance through a globalisation and mass customisation strategy—has left MNCs open to the charge that they are overlooking the need to address national responsiveness through internet and intranet technology.

National responsiveness is the need to understand the different consumer tastes in segmented regional markets and respond to different national standards and regulations imposed by autonomous governments and agencies. For example, in designing and building cars, international manufactures now carefully tailor their offerings in the American market. Toyota's full size T100 pick-up proved much too small to attract U.S. buyers. So the firm went back to the drawing board and created a full-size Tundra pick-up that is powered by an V-8 engine and has a cabin designed to accommodate a passenger wearing a 10 gallon cowboy hat. Honda has developed its new Model X SUV with more Americanised features, including enough interior room so that travelers can eat and sleep in the vehicle. Mitsubishi has abandoned its idea—of marking a global vehicle—and has brought out its new Montero sport-utility vehicle in the U.S. market with the features that Americans want: more horse-power; more interior room; more comfort. Meanwhile, Nissan is doing what many foreign car-makers would have thought to be unthinkable just a few years ago. Today, U.S. engineers and product designers are completely responsible for the development of most Nissan vehicles sold in North America. Among other things, they are asking children—between the ages of 8 and 15, in focus-group sessions—for ideas on storage; cup holders; and other refinements that would make a full-size mini-van more attractive to them.

National responsiveness also relates to the need to adapt tools and techniques for managing the local workforce. Sometimes what works well in one country does not work in another.

GLOBAL INTEGRATION VS. NATIONAL RESPONSIVENESS MATRIX

The issue—of global integration vs. national responsiveness—can be analysed conceptually via a two dimensional matrix. The vertical axis, in the figure, measures the need for global integration; generates economies of scales (takes advantage of large size); and also capitalises on further lowering unit costs (through experience curve benefits). These economies are captured through centralising specific activities in the value-assessed chain. They also occur by reaping the benefits of increased coordination and control of geographically dispersed activities.

The horizontal axis measures the need for multinationals to respond to national responsiveness or differentiation. This suggests that MNCs must address local tastes and government regulations. The result may be a geographic dispersion of activities or a decentralisation of coordination and control for individual MNCs.

Figure 12.1 depicts four basic situations in relation to the degrees of global integration vs. national responsiveness. Quadrants 1 and 4 are the simplest cases. In quadrant 1, the need for integration is high and awareness of differentiation, low. In terms of economies of scale, this situation leads to global strategies based on price competitions.

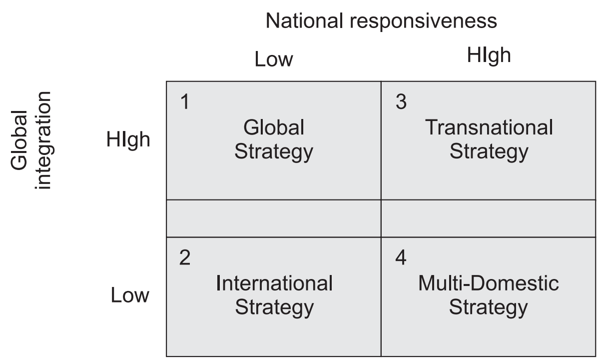

Fig. 12.1 *Global Integration Vs. National Responsiveness*

Source: *Adapted from information in Christopher A. Bartlett and Sumantra Ghoshal, Managing Across Borders : The Transnational Solution, 2nd ed. (Boston : Harvard Business School Press, 1998)*

Mergers and acquisitions often occur in this quadrant-1 environment. The opposite situation is represented by quadrant 4 where the need for differentiation is high but the concern for integration low. This quadrant is referred to as a multi-domestic strategy. In this case, niche companies adapt products to satisfy the demands of differentiation and ignore economies of scale because integration is not very important.

Quadrants 2 and 3 reflect more complex environment situations. Quadrant 2 incorporates those cases in which both the need for integration and awareness of differentiation are low. Both the potential to obtain economies of scale and the benefits of being sensitive to differentiation are of little value. Typical strategies—in quadrant 2—are characterised by increased international standardisation of products and services. This mixed approach is often referred to as an international strategy. This situation can lead to lower needs—for centralised quality control and centralised strategic decision making—while simultaneously eliminating requirements to adapt activities to individual countries.

In quadrant 3, the needs—for integration and differentiation—are high. There is a strong need for integration in production along with higher requirements for regional differentiation in marketing. MNCs—trying to simultaneously achieve these objectives—often refer to where successful MNCs seek to operate. The problem, for many MNCs, are the cultural challenges associated with localising a global focus.

IMPLICATIONS OF FOUR BASIC STRATEGIES

MNCs can be characterised as using: an international strategy; multi-domestic strategy; a global strategy; and a transnational strategy. The appropriateness—of each-strategy—depends on pressures for cost-reduction and the local responsiveness in each country served. Firms—that pursue an international strategy—have valuable core competencies that host-country competitors do not possess and face minimal pressures for local responsiveness and cost reductions. International firms—such as McDonald's; Wal-Mart; and Microsoft—have been successful in using an international strategy. Organisations—pursuing a multi-domestic strategy—should do so when there is high pressure for local responsiveness and low pressure for reductions. Changing offerings—on a localised level—increases a firm's overall cost structure and also the likelihood that its products and services will be responsive to local needs and therefore be successful.

A global strategy is a low-cost strategy. Firms—that experience high cost pressures—should use a global strategy in an attempt to benefit from scale economies in production, distribution and marketing. By offering a standardised product worldwide, firms can leverage their experience and use aggressive pricing schemes. This strategy makes most sense where there are high cost pressures and low demand for localised product offerings. A transitional strategy should be pursued when there are high cost pressures and high demands for local responsiveness. However, a transnational strategy is very difficult to pursue effectively for cost reduction and local responsiveness put contradictory demands on a company. Another reason is that localised product offerings increase cost. Organisations—that can find appropriate synergies in global corporate function—are the ones that can leverage a transnational strategy effectively.

THE BASIC STEPS IN FORMULATING STRATEGY

The needs, benefits, approaches and pre-dispositions, of strategic planning, serve as a point of departure for the basic steps in formulating strategy. In international management, strategic planning can be broken into the following steps: (i) scanning the external environment for opportunities and threats; (ii) conducting an internal resource analysis of company strengths and weaknesses; and (iii) formulating goals in the light of external scanning and internal analysis. These steps are graphically summarized in Fig. 12.2. The following sections discuss each step in detail.

Environmental Scanning

Environmental scanning attempts to provide management with accurate forecasts of trends—that relate to external changes in geographic areas—where the firm is currently doing business or considering setting up operations. These changes relate to the economy; competition; political stability; technology; and demographic consumer data.

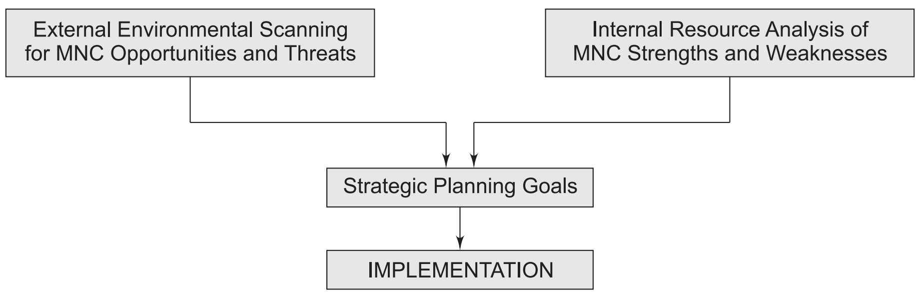

Fig.12.2 *Basic Elements of Strategic Planning for International Management*

Internal Resource Analysis

When formulating a strategy, some wait until they have completed their environmental scanning before conducing an internal analysis. Others perform these two steps simultaneously. Internal resource analysis helps the firm to evaluate its current managerial, technical, material and financial strengths and weaknesses. This assessment then is used by the MNC to determine its ability to take advantage of international market opportunities. The primary thrust—of this analysis—is to match external opportunities (gained through the environmental scan) with internal capabilities (gained through the internal resource analysis); and the environment scan) with internal capability (gained through the internal resource analysis).

An internal analysis identifies the key factors for success that will dictate how well the firm is likely to do. A key factor for success that is necessary—for a firm to compete effectively in a market niche—is KFS.

Goal Setting for Strategy Formulation

In practice, goal formulation often precedes the first two steps of environmental scanning and internal resource analysis. As used here, however, the more specific goals—for the strategic plan—come out of external scanning and internal analysis. MNCs pursue a variety of such goals; Fig. 12.3 provides a list of the most common ones. These goals typically serve as an umbrella beneath which the subsidiaries and other international groups operate.

Profitability
Level of profits Return on assets, investment, equity, sales Yearly profit growth Yearly earnings per share growth
Marketing
Total sales volume Market share-worldwide, region country Growth in market share Integration of country markets for marketing efficiency and effectiveness
Operations
Ratio of foreign to domestic production volume Economies of scale via international production integration Quality and cost control Introduction of cost-efficient production methods
Finance
Financing of foreign affiliates-retained earnings or local borrowing Taxation-minimizing tax burden globally Foreign exchange management-minimizing losses from foreign fluctuations
Human Resources
Recruitment and selection Development of managers with global orientation Management development of host-country nationals Compensation and benefits

Fig. 12.3 *Area for Formulation of MNC Goals*

Strategy Implementation

Once formulated, the strategic plan must next be implemented. Strategy implementation provides goods and services in accordance with a plan of action. Quite often, this plan will have an overall philosophy or series of guidelines that direct the process. In the case of Japanese electronic-manufacturing firms, entering the U.S. market, change has found common approach: to reduce the risk of failure, these firms are entering core business and those in which they have stronger competitive advantages over local firms first. The learning from early entry enables firms to launch further entry into area in which they have the next strongest competitive advantages. As learning accumulates, firms may overcome the disadvantages intrinsic to foreignness. Although primary learning takes place within firms through learning by doing, it may also take place through the transfer or diffusion of experience. This process is not automatic, however, and it may be enhanced by membership in a corporate network. Firms—associated with either horizontal or vertical business—are more likely to initiate entries than independent firms. By learning—from their own sequential entry experience as well as from other firms in corporate networks—firms build capabilities in foreign entry.

International management must consider three areas in strategy implementation. First, the MNC must decide where to locate operations. Second, the MNC must carry out entry- and ownership strategies. Finally, management must implement functional strategies in areas such as marketing, production and finance.

Location Considerations for Implementation

In choosing a location, today's MNC has two primary considerations: the country and the specific locale within the chosen country. Quite often, the first choice is easier than the second because there are many more alternatives from which to choose a specific locale.

- **The Country:** Traditionally, MNCs have invested in highly industrialised countries. Research reveals that annual investments have been increasing substantially. In 1993, over $325 billion was spent on mergers and acquisitions worldwide. By 1997, the annual total had jumped to $1.6 trillion although, in the last years, activity dropped somewhat to about $1.4 trillion annually. Much of this investment, especially by American MNCs, has been in Europe, Canada and Mexico.
- **Local Issues:** Once the MNC has decided upon which country to locate in, the firm must choose the specific locale. A number of factors influence this choice. Common considerations include: access to markets; proximity to competitors; availability of transportation and electric power; and desirability of the location for employees coming in from outside.

The Role of the Functional Areas in Implementation

To implement strategies, MNCs must tap the primary functional areas of marketing, production and finance. The following sections examine the roles of these functions in international strategy implementation.

- ***Marketing:*** The implementation of strategy—from a marketing perspective—must be determined on a country by country basis. What works from the standpoint of marketing in one locale, may not necessarily succeed in another. In addition, the specific steps, of a marketing approach, often are dictated by the overall strategic plan which, in turn, is based heavily on market analysis.
- ***Production:*** Although marketing usually dominates strategy implementation, the production function also plays a role.

  The production process—of exporting goods to a foreign market—traditionally has been handled through domestic operations. In recent years, however, MNCs have found that whether they are exporting or producing the goods locally in the host country, consideration—of worldwide production—is important. For example, goods may be produced in foreign countries for export to other nations. Some-times, a plant will specialise in a particular product and export it to all the MNCs. At other times, a plant will produce goods only for a specific locale such as that of Western Europe or South America. Still other facilities will produce one or more components that are shipped to a larger network of assembly plants. That last option has been widely adopted by pharmaceutical firms and automakers such as Volkswagen and Honda.

- ***Finance:*** Use of the finance is developed at the home office and carried out by the overseas affiliate or branch. Whenever a firm went international in the past, the overseas operation commonly relied on the local area for funds. The rise of global financing has ended this practice. MNCs have learned that transferring funds—from one place in the world to another, or borrowing funds in the international money markets—often is less expensive than relying on local sources. Unfortunately, there are problems in these transfers.

When dealing with the inherent risk of volatile monetary exchange rates, some MNCs have currency options that (for a price) guarantee convertibility at a specified rate. Others have developed counter trade strategies, whereby they receive products in exchange for currency. For example, PepsiCo received payment in vodka for products sold in Russia. Counter trade continues to be a popular form of international business, especially in less developed countries and those with non-convertible currencies.

SPECIALISED STRATEGIES

In addition to the basic steps in strategy formulation, the analysis of strategies may be based on the globalisation vs. national responsiveness framework and the specific processes in strategy implementation. There are some circumstances that may require specialised strategies. Strategies—(i) for developing and emerging markets; and (ii) strategies for international entrepreneurship and new ventures—have received considerable attention in recent years .

Strategies for Emerging Markets

Emerging economies have assumed an increasingly important role in the global economy and are predicted to compose more than half of global economic output by mid-century. Partly in response to this growth, MNCs are directing increasing attention to those markets. Foreign direct investment (FDI) flows into developing countries. One measure of increased integration and business activity—between developed and emerging economies—grew from $23.7 billion in 1990 to $204.8 billion in 2001. This was a nine-fold increase, helping to contribute to growth in the stock of (FDI) in developing countries from 5 per cent to 20.5 per cent of GDP In particular, big emerging markets-—Mexico, Brazil, Argentina, South Africa, Poland, Turkey, India, Indonesia, China and South Korea-—have captured the bulk of investment and business interest from MNCs and their managers.

At the same time, emerging economies pose exceptional risks due to their political and economic volatility and their relatively under-developed institutional systems. These risks show up in: corruption; failure to enforce contracts; red tape and bureaucratic costs; and general uncertainty in the legal and political environment. MNCs must adjust their strategy to respond to these risks. For example, in these risky markets, it may be wise to engage in: arm's length, or limited equity investments; or to maintain greater or limited equity investments; or to acquire greater control of operations by avoiding joint ventures or other shared ownership structures. In other circumstances, it may be wiser to collaborate with a local partner who can help buffer risks through its political connections.

First-Mover Strategies

Recent research has suggested that entry order, into developing countries, may be particularly important given the transitional nature of these markets. In particular industries and economic environments, significant economies are associated with first-mover or early-entry positioning. These include: (i) capturing learning effects important for increasing market share; (ii) achieving scale economies that accrue from opportunities for capturing that greater share; and development of alliances with the most attractive (or in some cases the only) local partner. In emerging economies—that are undergoing rapid changes such as those of privatisation and market liberalisation—there may be a narrow window of time within which these opportunities can be best exploited. In these conditions, first-mover strategies allows entrants to: (i) preempt competition; (ii) establish beach-head positions; and influence the evolving competitive environment in a manner conducive to long-tern interests and market position. One study analysed these benefits in the case of China, concluding that early entrants have reaped substantial rewards for their efforts, especially when collaborations, with governments, provided the commitment that—the deals struck in those early years of liberalisation—would not later be undone. First-mover advantages in some other transitional markets, such as Russia and Eastern Europe, are not so clear. Moreover, there may be substantial risks to premature-entry. That is, entry before the basic legal, institutional and political frameworks for doing business have been established.

Strategies for the ''base of the pyramid''

Another area—of increasing focus for MNCs—is that of the 4 to 5 billion potential customers around the world who have been mostly ignored by international business, even within emerging economies, where most MNCs target only the wealthiest consumers. Although FDI in emerging economies, where most MNCs target only the wealthiest consumers. Although FDI—in emerging economies—has grown rapidly, most has been directed at the big emerging markets—China, India and Brazil—previously mentioned. Even there, most MNC emerging market strategies have focused exclusively on the elite and emerging middle-class markets, ignoring the vast majority of people considered too poor to be viable customers. Because of this focus, MNC strategies—aimed at tailoring existing practices and products to fit the needs of emerging-market customers—have not succeeded in making products and services available to the mass markets—of the 4-5 billion people at the bottom of the economic pyramid who represent fully two-thirds of the world's population—in the developing world. Figure 12.4 shows the distribution of population and income around the world.

A group of researchers and companies have begun exploring the potentially untapped market at the base of the pyramid (BOP). They have found that incremental adaptation—of

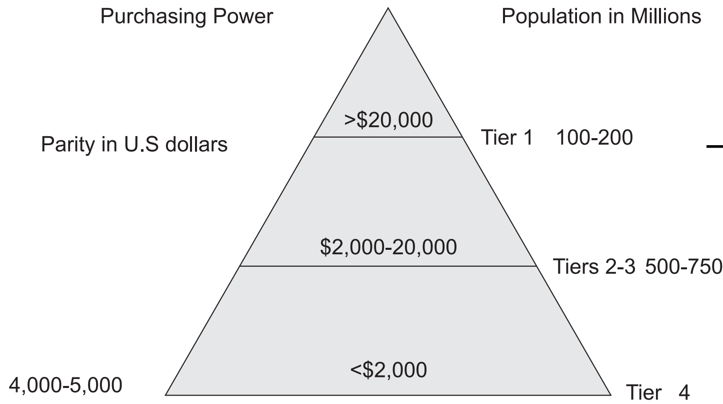

Fig. 12.4
Note Clear

Fig.12.4 *World Population and Income Pyramid*

existing technologies and products—is not effective at the BOP and that this has forced MNCs to fundamentally re-think their strategies. Companies must consider smaller-scale strategies and build relationships—with local governments, small entrepreneurs and non-profit—rather than depend on established partners such as central governments and large local companies. Building relationships—directly and at the local level—contributes to the reputation and fosters the trust necessary to overcome the lack of formal institutions such as intellectual rights and the rule of law. The BOP may also be an ideal environment for incubating new, leapfrog technologies that increase social benefit such as renewable energy and wireless telecom. This includes disruptive technologies that reduce environmental impacts. Finally, business models—forged successfully at the base of the pyramid—have the potential to travel profitably to higher-income markets because adding cost and features—to a low-cost model—may be easier than removing cost and features from high-cost models. This last finding has significant implications for the globalisation of the national responsiveness framework introduced at the beginning of the chapter and for the potential for MNCs to achieve a truly transnational strategy.

Entrepreneurial Strategy and New Ventures

In addition to strategies that must be tailored for the particular needs and circumstances in emerging economies, another condition—that calls for specialised strategies—is the international management of entrepreneurial and new-venture firms. Most international management activities take place within the context of medium to large MNCs. Increasingly, small and medium companies, often in the form of new ventures, are getting involved in international management. This has been made possible by advancements in telecommunication and Internet technologies and by greater efficiencies and lower costs in shipping. This has allowed firms—that were previously limited to local or national markets—to access international customers. These new access channels suggest particular strategies that must be customised and tailored to the unique situations and resource limitations of small, entrepreneurial firms.

International Entrepreneurship

International entrepreneurship has been defined as a combination of innovative, proactive and risk-seeking behaviour that crosses national borders and is intended to create value in organisations. The internationalisation of the marketplace and the increasing number of entrepreneurial firms in the global economy have created new opportunities for small and new-venture firms. This international entrepreneurial activity has been observed in even the smallest and newest organisations. Indeed, one study among 57 privately held Finnish electronics firms during the mid-1990s, showed firms that internationalise, after they are in expansion, in the fields of : domestic orientation; internal domestic political ties; and domestic decision-making inertia. In contrast, firms that internationalise earlier face fewer barriers to the international environment. Thus, the earlier in its existence, that an innovative firm internationalizes, the faster it is likely to grow in both overall and in foreign markets.

However, despite this new access, there remain limitations to international entrepreneurial activities. Researchers show that deploying a technological learning advantage internationally is no simple process. They studied more than 300 private independent and corporate new ventures based in United States. Building on past research about the advantages of large, established multinational enterprises, their results—from 12 high-technology industries—show that greater diversity of national environments is associated with increased technological learning opportunities. This is true even for new ventures, whose internationalisation is usually thought to be limited. In addition, the breadth, depth and speed of technological learning—from varied international environments—is significantly enhanced by formed organisational efforts to integrate knowledge in cross-functional teams and in the formal analysis of projects. Further, research shows that venture performance (growth and return on equity) is improved by the technological learning gained from international environments.

International New Ventures and "Born-Global" Firms

Another dimension—of the growth of international entrepreneurial activities—is the increasing incidence of international new ventures, or ''born global'' firms, that engage in significant international activity after being established. Building on an empirical study of small firms in Norway and France, researchers found that more than half of the exporting firms, established there since 1990, could be classified as ''born global''. Examining the differences—between newly-established firms with high or low export involvement—revealed that a decision marker's global orientation and market conditions are important factors.

INTERNATIONAL BUSINESS ANALYSIS

International markets—compared to the domestic markets—provide a wide range of opportunities. But global business is inherently more risky than domestic business is. However, the firm prefers to go international, if the perceived benefits outweigh the anticipated risks.

Companies, going global, would like to gain from perceived benefits and minimise the risks or threats to which they are exposed. Firms, going overseas, can be both reactive and proactive to the environment.

FOREIGN MARKET ANALYSIS

International business firms have the fundamental goals of: (i) expanding market share, sales, revenue; and (ii) increase profits. Expanding markets—in overseas countries—is one of the strategies to achieve these fundamental goals. The firms have alternative foreign markets to enter. In order to achieve these goals successfully, firms have to: (i) analyse alternative foreign markets; (ii) evaluate the respective costs, benefits and risks; and (iii) select the foreign market that holds the greatest potential for entry (Table 12.1).

Table 12.1 Critical Factors in Assigning New Market Options

Topic of Appraisal	*Items to be Considered*
Product-market dimensions	How is the product market in terms of unit size and sales quantum?
Major Product-market "Differences"	What are the main difference relative to the firm's experience elsewhere in terms of customer profiles, price levels, national purchase patterns, and product technology?
	How will these differences affect the transferability of the capabilities of an organisation to the new business environment and their effectiveness?
Structural characteristics of the national product market	What links and associations exist between expected customers and established national competitors currently supplying these customers?
	What are the major link of distribution, levels of distribution separating producers from final customers , links between wholesalers, links between wholesalers and retailers, finance, role of Government)?
	What channel exist between established producers and their suppliers ?
	Do industry concentration and collusive agreement exists?
Competitor analysis	What are major competitor features (size, capacity utilisation, strengths and weaknesses, technology, supply sources, preferential market arrangements, and relations with the government)? What is competitor performance in terms of market share, sales growth, and profit margins?
Potential Target	What are the features of major product-market segments?
Market	Which segments are potential targets upon entry?
	What changes have come out in total size of product market (Short-medium and long-term)?
Relevant trends (historic and projected)	What changes have made in competitor performance (market share, sales and profits)? What is the nature of competition (e.g. National or International)? What changes have occurred in the structure of market?

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Explanation of change	Why are some firms gaining and other losing ?
	Are foreign firms already operating in India gaining or losing?
	Is there some general diagnosis of observed change, for example, product life cycle, change in overall business activity, and shift in nature of demand?
	What is the future outlook ?
Success Factor	What are the significant factors behind success in this business environment, the pressure points that can shift market share from one firm to another?
	How are these different from those we have experienced in other countries?
	How do these success factors relate to our firms?
Strategic Options	What element come out from the above analysis that point to possible strategies for this country?
	What additional information is needed to identify our options more precisely?

Source: Multinational Corporate Strategy : Planning of world markets by James Leoutiades, Lexington Books, 1985

Analyse Alternative Foreign Markets

The firm has to analyse alternative foreign markets by taking the following factors into consideration:

- Current and potential size of the alternative markets;
- Level of competition the firm will face in each of these alternative markets;
- Legal and political environments;
- Socio-cultural environment;
- Size of the population of the country/market;
- GDP of the country and per capita GDP;
- Urban areas/rural areas; and
- Purchasing power.

The concentration of the population in urban areas—with high purchasing power—provides marketing opportunities for consumer durables like: automobiles; washing machines; refrigerators; vaccum cleaning machines etc.

Contrary to this, the spread of the population in rural areas—with low purchasing power—provides marketing opportunities for low-cost consumer goods, farm equipment etc.

Companies—producing high quality and high priced goods—find richer markets—like Taiwan, rather than People's Republic of China—due to high per capita income. In contrast, companies—producing low quality and low priced goods—find poorer markets like China and India quite attractive.

Companies have to collect relevant data specific to the product. For example, a tire manufacturing company, seeking to export tires, should collect data about: transportation;

infrastructure; alternative modes of transportation; petrol prices; increase in vehicle ownership; and production of vehicles in prospective foreign markets. Sometimes, companies use proxy data. For example, Whirlpool used the data of other household appliances while deciding to introduce dishwashers in the South Korean Market.

Companies should also use data regarding prospects for growth of the market. Based on such data, Procter & Gamble and Unilever entered central and eastern European countries immediately after the collapse of communism in these countries. These firms established production facilities, distribution channels etc. in these countries to get first-mover advantages.

Level of Competition

Companies must consider both present and likely future levels of competition while selecting foreign markets. The company should consider:

- Number and size of existing firms in the market;
- Relative strengths and weaknesses of existing firms;
- Product, price and distribution strategies of these companies; and
- Actual market conditions.

For example, Honda could offer superior quality cars at low cost during 1970s owing to manufacture of poor quality cars by General Motors, Ford and Chrysler in the USA. However, Japanese cars could successfully enter the U.S. market due to their cost, convenience and product design. At present, the level of competition is less for the telecommunication industry in most of the liberalised economies.

Legal and Political Environment

Companies—planning to enter global markets—should know the trade policies; and the general, legal and political environment of the foreign markets. Companies may establish manufacturing facilities in foreign countries rather than exporting owing to high tariffs and restrictions in foreign countries.

In order to avoid high tariffs, General Motors, Ford, Audi and Mercedes-Benz have established manufacturing facilities, i.e. auto factories in Brazil. They also export from Brazil to other nearby countries.

Another factor is that some of the countries impose the legal condition that foreign companies can enter the country only by operating as a joint-venture with a local company. For example, Eritrea—a newly-born African country-—imposed this condition.

If we see tax policies of various countries, some countries impose high tax rates in the case of foreign companies, while others provide incentives.

France offered economic incentives to Toyota. Hence, Toyota located its $668 million assembly plant in Northern France. This plant provided employment to 2000 persons. The state of Alabama, USA provided incentives worth of $253 million to Mercedes-Benz and the latter established its factory in Tuscaloosa.

Companies should assess the legal and political environment carefully. Russia's political factors create risk while the economic factors provide tremendous opportunities. To take an example, Mars entered the market carefully through low-cost facilities. This company sells $300 million worth candy bars a year in Russia. Mars products have become a symbol of so-called '' Snickerization'' of the Russian Economy.

Socio-cultural Influences

Companies must also consider socio-cultural factors carefully while deciding to go abroad. For example, Americans are more interested in the function of a product rather than its design and as such they are willing to pay more for new technology than for interesting appearance.

Companies often focus their initial internationalisation efforts in countries culturally similar to their domestic markets in order to minimise socio-cultural risks.

Assessing Costs, Benefits and Risks

The next step—in entering foreign markets—is assessment costs; benefits; and risks associated with carrying out business in a particular country.

Costs

Companies have to consider direct and opportunity costs. Direct costs are those which the company incurs in entering and setting-up operations in the global market. Opportunity costs are the profits that the company would have earned by entering the alternative market.

Benefits

Benefits are the opportunities that the company gets by entering a foreign market. Table 12.2 lists Proactive reasons for International Business. The benefits include:

- High sales, profits;
- Lower acquisition and manufacturing costs;
- Foreclosing of markets to competitors;
- Competitive advantage;
- Access to new technology;
- Cheap labour and other resources in the country; and
- Opportunity to achieve synergy.

Risks

The risks—in entering new foreign markets—include:

- Exchange rate fluctuations;
- Operating complexity;
- Direct financial losses due to misassessment of market potential; and
- Government seizure of property. For example, in 2001, Zimbabwe nationalised the property of foreign firms.

Table 12.2 Proactive reasons for International Business

Advantage/Opportunity	*Explanation of Action*
Additional resources	Various inputs, including natural resources, technologies, skilled personnel and materials may be received more readily outside the home country.
Lower costs	Different costs, including labour materials, transport, and financing may be lower outside the home country.
Incentives	Different incentives may be a available from the host government to encourage foreign investment in specific locations.
New, expanded markets	Different markets may be available outside the home country; excess resources, including management, skills, machinery, and money can be utilized in foreign locations.
Exploitation of firm specific strengths	Brands technologies names are specific that can provide opportunities in foreign locations.
Taxes	Differing corporate tax and rates tax systems in different locations provide opportunities for companies to maximize their after-tax worldwide profits.
Economies of Scale	National markets may be very small to help efficient production, while sales from several, markets/countries allow for larger-scale production.
Synergy	Operations in more than one national environment provide opportunities to combine benefits from one location with another which is impossible without both of them.
Power and prestige	The image of being international may enhance a company's power and reputation and improve its domestic sales and relations with various stakeholder groups.
Safety to home market through offense in competitor's home	A strong blow in a competitor's market can put pressure on the competitor that results in a pull from foreign activities to protect itself a home.

Source: Mark Mendenhall, Betty Punnett and David Ricks, *Global Management* Blackwell publishers, 1995, p. 224.

Table 12.3 Reactive Reasons for Expanding Business Internationally

Outside Occurrence	*Explanation of Reaction*
Trade Business	Control trade practices, can make exports to foreign markets less attractive, local operations in foreign locations, thus become more attractive.
International Customers	If a company's customer base becomes international and the company wants to continue to serve it, local operations in foreign locations may be essential.
International Competition	If there is international organisation's competitors and the organisation wants to remain competitive, foreign operations may be necessary.
Regulations	Rules & regulations and restrictions imposed by the home government may be possible to avoid these by establishing foreign operations.
Chance	Unexpected incident can prompt an organisation to come forward for enter foreign locations.

Source: Ibid., p. 222

Having discussed the analysis—of new market environment, costs, benefits and risks—we now proceed to discuss the different modes of entry.

Companies—desiring to enter foreign markets—face the dilemma of deciding upon which method of entry to choose for a given overseas location. Companies can reduce the dilemma by analysing the decision factors.

DECISION FACTORS

After deciding to go to foreign markets, companies have to decide the mode of entry. This dilemma can be solved to some extent by considering the following factors:

- Ownership Advantages;
- Location Advantages; and
- Interntionalisation Advantages.

Ownership Advantages

Ownership advantages are benefits designed by a company by owing resources. These benefits provide competitive advantage to the company over its competitors. These advantages are both tangible and intangible.

Toronto based Inco. Ltd.—of rich, nickel-bearing ores—allowed the company to dominate the production of both primary nickel and nickel-based metal alloys. Similarly, Tata Iron and Steel Company (TISCO) Ltd., owned its iron ore-and coal mines. This ownership grants the advantage of low producer to the company.

Location Advantages

Certain locational factors grant benefit to the company when manufacturing facilities are located in the host-rather than in the home country. These locational factors include:

- Customer Need, Preferences and Tastes;
- Logistic Requirements;
- Cheap Land Acquisition Cost;
- Cheap Labour;
- Political Stability;
- Low-cost Raw Materials; and
- Climatic Conditions.

If the company has locational advantages, it can enter foreign markets through direct investment. If the location of manufacturing facilities in the home country is more advantageous than it is in the host country, the company enters foreign markets through exporting.

Siam Cement, one of the world's lowest-cost producers, used to export—from its modern Thailand factories—to Vietnam, Cambodia and Laotia.

However, civil wars, corruption, political instability and discouraging Government policies make the companies not want to devote resources significantly in the host country. High tariffs discourage export and favour production in the host country.

Mc Donalds built a factory in Cairo, Egypt, in 1996, due to its frustration in dealing with Egyptian rules. Bureaucrats, in Egypt required the company to obtain more than a dozen signatures each time imported hamburger burns into Egypt.

Culture, of the country, provides locational advantages. Turkey provides locational advantages to MNCs to serve Central Asian and Caucasus republics of former USSR. Siemens, Chase Manhattan and Good Year established their regional offices in Istanbul to export to the entire Eurasian region. Shared religious, cultural and linguistic ties have made Turkey a gateway to the Muslim and Turkic-speaking populations of the Caucasus and Central Asian Republic. Hundreds of MNCs have established regional headquarters in Istanbul-Turkey's commercial capital.

International Advantages

Internationalisation results in the benefits that a company gets by manufacturing goods, or rendering services in the host country by itself than through contract arrangements with companies in the country.

Sometimes the cost of negotiating, monitoring and enforcing an agreement with the host country's company would be difficult and costly. In such cases, the company enters international markets through direct investment. Otherwise, if the company thinks that transaction costs are low and the local companies, in the host country, can produce efficiently without jeopardizing its interests, the company can enter foreign markets through contract manufacturing, franchising, or licensing.

Toyota enters foreign markets through direct investment and joint-ventures as the local companies—in foreign countries—cannot product as efficiently as Toyota.

Companies—with low cash reserves—normally prefer the licensing mode over foreign direct investment (FDI). Merck entered Israel by issuing to Teva Pharmaceutical, an Israel company, in order to save the expenses of establishing in Israel. In contrast, cash rich firms may prefer FDI. Firms enter through FDI in order to take advantage of economies of scale and synergies between their domestic and international operations.

However, software companies prefer the licensing and franchising mode as they have to respond quickly to market needs. Examples include: Microsoft and Compaq.

Thus, different firms select different modes on the nature of the industry; the company's abilities; and the conditions in the country.

MODE OF ENTRY IN INTERNATIONAL MARKET

Now, we shift our discussion to the different modes of entry to foreign markets. Figure 12.5 presents the different models of entry in international business

EXPORTING
- Indirect Exports
- Direct Exports
- Intra-corporate Transfers

LICENSING
- International Licensing

FRANCHISING
- International Franchising

SPECIAL MODES
- Contract Manufacturing
- Business Process Outsourcing
- Management Contracts
- Turnkey Projects

FOREIGN DIRECT INVESTMENT WITHOUT ALLIANCES

Green Field Strategy

FOREIGN DIRECT INVESTMENT WITH ALLIANCES
- Merger and Acquisitions
- Joint Ventures

The first one in the modes of entry is exporting.

Fig. 12.5 *Different Modes of Entry to International Business*

Exporting

Exporting is the simplest and most widely-used mode of entering foreign markets.

The advantages of exporting include:

- **Need for Limited Finance:** If the company selects a company in the host country to distribute, the company can enter the international market with no or less financial resources. Alternatively, if the company chooses to distribute on its own, it needs to invest financial resources, but this amount would be quite less compared to what would be necessary under modes;
- **Less Risk:** Exporting involves less risk as the company understands the culture, customer and the market of the country gradually. The company can enter the host country on a full-scale, if the product is accepted by the host country's market. A British company selected this mode to export jams to Japan; and
- **Motivation for Exporting:** Motivations—for exporting—are proactive and reactive. Proactive motivations are opportunities available in the host country. San Antonia's Pace, Inc.—producing Tex-Mex food products—exported its products to Mexico as Mexicans relished the taste of its products.

Reactive motivations are taken by the company to export the product to a foreign country due to the decline in demand in the home country (Table 12.3).

Toto Ltd., of Japan started exporting its products—i.e., Porcelain bathroom fixtures to China—when the Japanese economy began slowing down in the 1990s.

Forms of Exporting

Forms of exporting include: indirect exporting; direct exporting; and intra-corporate transfers:

- **Indirect Exporting:** Indirect exporting is of products—either in their original-or in their modified form—to foreign country through another domestic company. Various publishers in India—including Himalaya Publishing House—sell their books to various exporters in India which, in turn, export these books to various foreign countries.
- **Direct Exporting:** Direct exporting is selling the product, in a foreign country, directly through its distribution arrangements or through a host country's company. Baskin Robbins initially exported its ice-cream to Russia in 1990 and later opened 74 outlets with Russian partners. Finally, in 1995, it established its ice-cream plant in Moscow.
- **Intra-corporate Transfers:** Intra-corporate transfers involve the selling of products by a company to its affiliated company in the host country (another country). Selling of products—by Hindustan Lever in India to Unilever in the USA—provides a case in point. This transaction is treated as exports in India and imports in the USA.
- **Factors to be considered:** The company, while exporting, should consider the following factors:
  - Government factors like: export policies; import policies; export financing; foreign exchange etc.;
  - Marketing factors like: image, distributions networks, responsiveness to the customer, customer awareness and customer preferences;
  - Logistical considerations like: physical distribution costs, ware housing costs, packaging, transporting, inventory carrying costs etc.;
  - Distribution issues like: distribution networks and networks of the host country's companies. Japanese companies—like Sony, Minolta and Hitachi—rely on the distribution networks of their subsidiaries in the host country.
- **Export Intermediaries:** Export intermediaries perform a variety of functions and enable small companies to export their goods to foreign countries. Their functions include: handling transportation; documentation; taking ownership of foreign-bound goods; and assuming total responsibility for exporting and financing. Types of export intermediaries include:
  - **Export Management:** Companies act as export department of the exporting firm (its client). These companies act as commission agents for exports or they take title to the goods;
  - **Co-operative Society:** Domestic companies desire to export goods from a co-operative society, which undertakes the exporting operations of its members;
  - **International Trading Company:** This company is engaged in directly exporting and importing. It buys goods from domestic companies and exports. Therefore, companies can export goods by selling them to the international trading company;

- ◦ **Manufacturers' Agents:** They work on a commission basis. They solicit domestic orders for foreign manufacturers;
- ◦ **Manufacturers' Export Agents:** These agents also work on a commission basis. They sell domestic manufacturers' products in the foreign markets and act as their foreign sales department;
- ◦ **Export and Import Brokers:** These brokers bridge the gap between exporters and importers and bring these two together; and
- **Freight Forwarders:** Freight forwarders help domestic manufacturers in exporting their goods by performing various functions like: physical transportation of goods; arranging customs documents; and arranging transportation services.

LICENSING

International Licensing

In this mode of entry, the domestic manufacturer leases the right to use its intellectual property, i.e., technology; work methods; patents; copy rights; brand names; trade marks etc.—to a manufacturer in a foreign country. A manufacturer—in the domestic country—is called a licensor; and the manufacturer—in the foreign country—is called the licensee.

Licensing is a popular method of entering foreign markets. The cost—of entering foreign markets through this mode—is fairly high. The domestic company need not invest any capital as it has already developed intellectual property. As such, the domestic company earns revenue without additional investment. Hence, most companies prefer this mode of foreign entry.

The domestic company can choose any international location and can enjoy the advantages without incurring any obligations and responsibilities of ownership, managerial investment etc. Kirin Brewery, Japan's largest beer producer, entered Canada by granting license to Charles Wells Brewery.

Exhibit 12.1

Pfizer Scraps Insulin Deal with Biocon

Pfizer cited other priorities in its biosimilar program for the split, which immediately ends a relationship that stood to earn Biocon hundreds of millions of dollars in royalties. Shares of Biocon fell 6.3 percent.

"The development is definitely negative for Biocon's insulin sales as it will have to look for new partners," said analyst Bino Pathiparampil of Mumbai brokerage IIFL.

Pfizer's move shows how the drugmaker has been narrowing its focus, said MKM Partners analyst Jon LeCroy. For example, Pfizer is looking at selling or spinning off its animal health and nutrition businesses.

"They realize they can't do everything," LeCroy said. "They're not a diabetes company. Other than to be playing in biosimilars, it didn't make a lot of sense for their core business anyway."

Pfizer spokeswoman Joan Campion said the company was focusing on other programs in the growing market of biosimilars, which are low-cost versions of biotechnology medicines. It is developing biosimilars for oncology, pain and rare diseases, but none are yet being tested in humans, she said.

"Pfizer continues to be devoted to developing a broad portfolio of biosimilars medicines," Diem Nguyen, Pfizer's general manager for biosimilars, said in a statement.

Biocon will retain payments already received from Pfizer, Kiran Mazumdar Shaw, the Indian company's chairman, told Reuters after the announcement of the split on Tuesday.

"(We) will receive additional amounts as settlement from escrow," she said, without mentioning details.

Pfizer made upfront payments of $200 million to Biocon, which was eligible to receive additional development and regulatory milestone payments of up to $150 million, as well as royalties.

"We are tweaking down our estimates for Biocon for the fiscal year 2013 after this news, for sure," said analyst Siddhant Khandekar of ICICI Direct in Mumbai. "We expect a 1.5 to 2 rupees hit on their earnings per share, from 20.4 rupees down to around 18.4 rupees."

Deutsche Bank cut its target price for Biocon shares by 9 percent to 215 rupees after Pfizer's exit, citing increased risk for the Indian drugmaker.

Sources: http://in.reuters.com/article/2012/03/13/pfizer-biocon-idINDEE82C01K20120313 last accessed on 21 June 2012.

BASIC ISSUES IN INTERNATIONAL LICENSING

Companies should consider various factors in deciding negotiations. Each international licensing is unique and has to be decided separately. However, there are certain common factors which affect most international licenses. They are: specifying the agreement's boundaries; determining the royalty; determining rights, privileges and constraints; defining dispute resolution methods; and specifying the duration of the contract. Now, we shall discuss these factors in detail:

- **Boundaries of the Agreements:** The companies should clearly define the boundaries of agreements. They determine which rights and privileges are being conveyed in the agreement;
- Pepsi-Cola granted licence to Heineken of Netherlands with exclusive rights of producing and selling Pepsi-Cola in the Netherlands. Under this agreement, the boundaries are: (i) Heineken should export Pepsi-Cola to any other country; (ii) Pepsi supplies concentrated cola syrup and Heineken adds carbonate water to produce beverages; and (iii) Pepsi can grant license to other companies in Netherlands to produce other products like potato chips;
- **Determination of Royalty:** The most important factor—in deciding the licence—is the amount of royalty. It is needless to mention that the licensor expects high rates of royalty which the licensee would be unwilling to pay. However, both parties negotiate for a fair royalty, for both sides, in order to implement the contract more successfully;
- **Determining Rights, Privileges and Constraints:** Another important factor, in granting licence, is determining clearly and specifically the rights, privilege and constraints. For example, if the Indian licenses of Aiwa TV use interior inputs—in order to reduce prices and boost up sales and profits—the image of the Japanese licensor would be damaged;

- Another constraint is that licensees may under-report the volume of sales in order to reduce the royalty payment to the licensor. Therefore, the licensing agreement clearly and specifically should indicate the rights, privileges etc. of both parties and thereby reduce the freedom of the licensee to plant hurdles in the implementation of the agreement.
- **Dispute Settlement Mechanism:** The licensee and licensor should clearly mention the mechanism to settle the disputes that are bound to crop up. This is because, settlement of disputes in courts is costly, time consuming and hinders business interests; and
- **Agreement Duration:** The two parties of the agreement specify the duration of the agreement. Licensing cannot be a short-term strategy. Hence, the duration of the licensing should not be a short-term measure. It would always be appropriate to have long duration of licensing. Tokyo Disneyland demanded a 100-year licensing agreement with the Walt Disney Company.

Before, we switch over to the next mode, we shall discuss the advantages and disadvantages of licensing (Table 12.4).

Table 12.4 Advantage and Disadvantages of Licensing

Advantages	*Disadvantages*
• Licensing mode carries relatively low investment on the part of licensor.	• Licensing agreements reduce the market opportunities for both the licensor and licensee. Pepsi-cola can not enter Netherlands and Heineken can not sell Coca-cola.
• Licensing mode carries low financial risk to licensor.	• Both the parties have the responsibilities to maintain the product quality and promoting the product. Therefore, one party can affect the other through their improper acts.
• Licensor can investigate the foreign market without much efforts on his part.	• Costly and tedious litigation may crop up and hurt both the parties and market.
• Licensee gets the benefits with less investment on research and development.	• There is scope for misunderstanding between the parties despite the effectiveness of the agreement. The best example is Oleg Cassini and Jovan.
• Licensee escapes himself from the risk of product failure.	• There is a problem of leakage of the trade secrets of the licensor.
	• The licensee may develop his reputation.
	• The liensee may sell the product outside the agreed territory and after the expiry of the contract.

FRANCHISING

Now, we shall discuss the next mode of going abroad, i.e. international franchising.

International Franchising

Franchising is a form of licensing. The franchisor can exercise more control, over the franchised, than the licensor can. International franchising is growing at a fast rate.

Under franchising, an independent organisation—called the franchisee—operates the business under the name of another company called the franchisor. Under this agreement, the franchisee pays a fee to the franchisor. Services to the franchisee include:

- Trademarks;
- Operating Systems;
- Product Reputations;
- Continuous Support Systems like: advertising, employee training, reservation services, quality assurance programmes etc.

Basic Issues in Franchising

The franchisor has been successful in his home country. McDonalds was successful in the USA due to the popular menu and fast and efficient services;

- The factors—for the success of McDonalds—were later transferred to other countries;
- The franchisor may have the required experience in franchising in the home country before going for international franchising; and
- Foreign investors should come forward for introducing the product on franchising basis.

Franchising

Agreement

The franchising agreement should contain the following important items:

- Franchisee has to pay a fixed amount and royalty based on the sales to the franchisor;
- Franchisee should agree to adhere to franchisor's requirements like: appearance, financial reporting, operating procedures, customer service etc.;
- Franchisor helps the franchisee in establishing manufacturing facilities, service facilities, expertise, advertising, corporate image etc.; and
- Franchisor allows the franchisee some degree of flexibility in order to meet local tastes and preferences. McDonalds restaurants, in Germany, sell beer also; and McDonalds restaurants, in France, sell wine.

Franchising is more popular in the USA. Fast food companies—like McDonalds; Dairy Queen; Domino's; Pizza Hut; and KFC—have franchised restaurants worldwide. NIIT has franchised computer training centres throughout India.

Hotels like Hilton and Marriott; rental cars like Hertz and Avis also have international franchisees.

Like every mode, franchising also has advantages and disadvantages. We now enumerate the advantages and disadvantages of franchising.

SPECIAL MODES

Some companies can not make long-term investments, or long-term contacts to enter foreign markets. Therefore they may use specialised strategies.

- These specialised strategies include:
- Contract Manufacturing;
- Management Contract; and
- Turn-key Projects.

Table 10.5 Advantages and Disadvantages of Franchising

Advantages	*Disadvantages*
• Franchisor can enter global markets with low investment and low risks.	• International franchising may be more complicated than domestic franchising. McDonalds taught the Russian farmers the methods of growing potatoes to meet its standards.
• Franchisor can get the information regarding the markets, culture, customs and environment of the host country.	• It is difficult to control the international franchisee. As one of the French investors did not maintain the stores as per the standards, McDonald did revoke the franchise.
• Franchisor learns more lessons from the experiences of the franchisees, which he could not experience from the home country's market. McDonalds benefited from the worldwide learning phenomenon. McDonalds is convinced to open a restaurant in inner-city office building in Japan.This location has become a more successful one. Based on this lesson, McDonalds opened its restaurants in downtown locations in various countries.	• Franchising agents reduce the market opportunities for both the franchisor and the franchisee.
• Franchisee can also start a business with low risk as he selects an established and proven product and operating system.	• Both the parties have the responsibilities to maintain product quality and product promotion.
• Franchisee gets the benefits of R & D with low cost.	• There is scope for misunderstanding between the parties.
• Franchise escapes from the risk of product failure.	• There is a problem of leakage of trade secrets.

Exhibit 12.2

Absolute Projects (India) Ltd.

"APIL," a Limited organisation having Pan India operation today, was registered in February 2005. Absolute Projects (India) Ltd. has its registered office at Darya Ganj, New Delhi. Also having a factory outlet at Roorkee (Uttarakhand) where it sells power transmission , distribution equipment and machinery. It is a well reputed and recognized brand with Type Tests & Accreditation Certificate from CPRI, NABL and ERDA. APIL has inspecting agencies such as *RITES, ERDA, BUREAU VARITAS, NTPC, PGCIL* which are coming regularly for inspection on its panel. Sourcing of raw materials & equipments is done from approved vendors of our clients namely PGCIL & NTPC.

APIL executes projects on turnkey basis for transmission lines & distribution sub-stations upto 400 / 220 KV for prestigious clients like NTPC, Power Grid, Tata Power, Honeywell Automation India Ltd., HPCL, BSES, UPL, NDPL, WBSEB, Reliance Energy, Ajmer Vidyut Vitran Nigam Ltd. -AVVNL, Pashimanchal Vidyut Vitran Nigam Ltd. – PVVNL, to name a few. Absolute Projects also dares to go beyond the above prestigious clients & serve emerging entrepreneurs working in the area of power distribution. APIL has introduced High Voltage Distribution System (HVDS) concept first time in New Delhi in association with NDPL.

APIL vision is "To be one of Leading EPC contracting companies with a strong manufacturing & financial base and emerge a best organisation to work for." The vision dares to go beyond the obvious & wants to become a national fame in itself.

APIL would achieve the above vision through adopting mission critical business processes such as achieving execution excellence in engineering, developing reliable supply chain and by providing quality products & services to its customer. Absolute Projects also believes in promoting responsible parenthood as its Corporate Social Responsibility to enrich quality of life for lower segment of the society.

APIL has also adopted Quality Policy that emphasizes "To provide quality service to its customers that meet or exceed their expectations." Absolute Projects nourishes core values such as Ownership, Unity, Respect for individual, and Workmanship & Cost consciousness among its Human Resource Management.

Contract Manufacturing

Some companies outsource their part of, or entire production and concentrate on marketing operations. This practice is called contract manufacturing or outsourcing.

Nike has contracted with a number of factories in south-east Asia to produce athletic footware and it concentrates on marketing. Bata has also contracted—with a number of cobblers in India—to produce footware and concentrate on marketing. Mega-Toys—a Los Angeles based company—contracts with Chinese plants to produce toys and Mega Toys.

The advantages and disadvantages of contract manufacturing include:

Table 12.6 Advantage and Disadvantages of Contract Manufacturing

Advantages	*Disadvantages*
• International business can focus on the value chain where it is of specific competence.	• Host country's companies may take up the marketing activities also, hindering the interest of the international company.
• It reduces the cost of production as the country's companies with relative cost advantage produce at low cost.	• Host country's companies may not strictly follow the production problems, design problem and other surprises.
• Small and medium industrial units in the host country can also develop as most of the production activities take in these units.	• The poor working countries in the host country's companies affect the company's image. For example, Nike has suffered a string of blows to its public image because of reports of unsafe and harsh working conditions in Vietnamese factories chumming out Nike foorware.
• The international company gets the locational advantages generated by the host country's production.	

The next strategy is management contract. Now, we shall discuss this strategy.

Strategy in Action

Global Pharmaceutical Contract Manufacturing Market to Reach US$40.7 Billion

In spite of the fact that there was tough times faced by companies in the pharmaceutical contract manufacturing industry during the recession, overall market maintained a positive growth posting only a moderate slowdown in growth. However, a drop in entrepreneurship capital funding due to the recession has compelled many pharmaceutical and biotechnology companies to cut down on expenses, affecting the fortunes of contract manufacturers worldwide. As a result, several projects were kept on hold and new project to be started were delayed, cascading the impact of the pharmaceutical industry as well as outsourcing industry .

Global pharma industry has been facing drastic changes such as increasing competition in generic markets, declining research and development (R&D) productivity, shrinking average patent life, and mounting governmental pressure to decrease drug prices. Further, the drug development process is known to extend over a period ranging from 8 to 15 years, and the cost of bringing out a single new molecule into the market is more than US$800 million. With limited new blockbuster drugs, the decisive factors for growth and sustainability are faster new drug development and cost containment. When the drug gets regulatory approval, pharma companies will require large quantities of product supplies for marketing and distribution. Given the considerable timeliness of drug development, it is not only difficult to project a company's manufacturing needs but also challenging to procure extensive capital requirements. As such, PCM outsourcing emerged to bail out pharma companies from these manufacturing uncertainties. Initially, it gained popularity in the US and Western Europe. Over the years, PCM outsourcing shifted its base to low-cost nations.

Now-a-days, manufacturing capacity constraints are only one of the reasons for outsourcing. Pharmaceutical manufacturing entails sophisticated technology (cGMP synthesis and scale up, impurity profiling, lyophilization) and strict regulatory compliance (good manufacturing practices -GMP). Outsourcing such activities to Contract Manufacturing Organizations (CMOs) enables a pharma company to expedite its R&D, and thus realize the potential revenues. Moreover, CMOs are increasingly offering a wide range of value-added services, which make PCMO an indispensable opportunity to pharma companies.

The US represents the largest regional market for Pharmaceutical Contract Manufacturing worldwide, as stated by the new market research report on Pharmaceutical Contract Manufacturing. Europe trails behind the US. However, future growth in the market is expected to otiginate from developing regions, such as Asia-Pacific. Japanese market for Pharmaceutical Contract Manufacturing alone is projected to register a compounded annual growth rate of 12.8% during the analysis period. Segment-wise, solid dosage forms represents the largest segment. The market for liquid dosage forms is projected to record a compounded annual growth rate of close to 6.0% during the period of analysis.

Dominant players profiled in the report include Althea Technologies, Catalent Pharma Solutions, Dishman Pharmaceuticals and Chemicals Ltd, HAUPT Pharma AG, Jubilant Life Sciences Limited, Kemwell Pvt. Ltd, Next Pharma, Nipro Corp., Patheon Inc., Royal DSM N.V., among others.

The research report titled "Pharmaceutical Contract Manufacturing: A Global Strategic Business Report" announced by Global Industry Analysts Inc., provides a comprehensive review of the pharmaceutical contract manufacturing markets, impact of the recession on the market, current market trends, key growth drivers, recent industry activity, and profiles of major/niche global as well as regional market participants. The report provides annual sales estimates and projections for pharmaceutical contract manufacturing market for the years 2007 through 2015 for the following geographic markets—US, Canada, Japan, Europe, Asia-Pacific, and Rest of World. Key product segments analyzed include Injectables (Injections, Vials & Intravenous Solutions), Solid Dosage Forms (Tablets & Capsules) and Liquid Dosage Forms (Syrups & Suspensions). Also, a seven-year (2000-2006) historic analysis for additional perspective is also provided.

Sources: http://www.pharmamanufacturing.com/industrynews/2011/004.html last accessed on 22 June 2012.

Business Process Outsourcing (BPO)

Business process outsourcing is the long-term contracting out—of non-core business processes—to an outside provider to help achieve increased shareholder value. Some forms of BPO may include turning-over functions such as: pay-roll; accounting; billing; or even real estate management to a third party. Business processes may well depend on IT, but they are separate function from core IT operations such as: data center activities; or network management.

Availability of qualified skill pool, and faster adoption defined business processes, leads to higher productivity gains without compromising on quality.

- ***To enable executives to concentrate on strategy:*** An important aspect—of business process outsourcing—is its ability to free corporate executives from some of their day-to-day process management responsibilities and enable them to concentrate on strategic issues. Traditionally, executives spend 80 per cent of their time managing details and only 20 per cent on strategy. Once a process is successfully outsourced, the ratio can be reversed. Executives get more control over the most valuable resource i.e., time. Time to explore new revenue streams; to accelerate other projects; and to focus on their customers;
- ***To improve processes and save money:*** Companies—that outsource business processes—are often able to re-engineer those processes and capture new efficiencies. Then they can re-allocate resources to other important projects and leverage their investment in technology. For example, processes—that are handled in a shared production environment for multiple companies—save everyone money. In most cases, high-calibre subject-matter exports are brought in to design and manage these processes, bringing with them best practices; innovation; and years of experience;
- ***Increase organisational capacities:*** With this expertise, often comes increased capability. In addition to doing things more efficiently, organisations can expand to deliver new products and services to customers. Then there are the factors of scalability and scope. Companies—that want to grow internationally—must continuously invest in infrastructure and find talent around the world. Many outsourcing providers are already established globally and can help make the growth process run smoothly.

In order to meet the growing international demand—for lucrative, customer-interaction centers—many organisations, worldwide, are outsourcing these service from locations like India. India has inherent strengths, which have made it a major success as an outsourcing destination.

Scope

A booming IT industry, with IT strengths recognised all over the world.

Language: The largest English speaking population after the USA.

- **Manpower**
  - **A vast workforce**—of educated, English speaking, tech-savvy personnel—is a boon in a high-growth industry faced with shortage of skilled workers;

  - **Cost-effective Manpower:** In a call interaction center operation, manpower typically accounts for 55 to 60 per cent of the cost. In India, the manpower cost is approximately one-tenth of what it is overseas. Per agent cost—in the USA—is approximately $40,000 while in India it is only $5,000;
  - **Technical Support:** India graduates about 100,000 engineers each year. These can be used in call centers—for troubleshooting/technical support—as the salaries are dramatically lower than those in Europe or the U.S.
- **Government Policy**
  - The Government of India has recognised the potential of IT-enabled services and has taken positive steps by providing numerous incentives;
  - IT is one of the Government of India's top five priorities;
  - The National IT Task Force submitted its 108-point action plan to promote IT in the country. The Government of India has approved the plan and is in the process of implementing it;
  - A separate Ministry of Information Technology was set up to expedite swift approval and implementation of IT projects and to streamline the regulatory process;
  - Information Technology Act 2000: The Information Technology Bill—that was passed in the Indian Parliament in May 2000—has now been notified as the IT Act 2000. The IT Bill brings e-commerce within the purview of law and accords stringent punishments to cyber criminals. With this, India joins a select band of 12 nations that have cyber laws.
- **Regulatory Enablers**
  - 100 per cent foreign ownership is permitted in IT Enabled Services, unlike other sectors where foreign ownership is restricted;
  - Software Technology Parks (STPs) established;
  - To provide ready to plug infrastructure and telecom facilities;
  - Single window clearance for all regulatory compliance issues.
- **Infrastructure Enablers**
  - Basic, Cellular, Paging and Internet Services privatised;
  - Domestic leased circuit tariff reduced by 80 per cent in the last one year;
  - International Internet Gateway privatised-likely reduction in tariff.

  As India emerges, as a global outsourcing hub, the industry is likely to explode at exponential rates—from 23,000 people and $10 million per year in 1998 to over a million people; and revenues in excess of $20 billion by 2008. Pivotal segments are going to be: back office operations; medical transcriptions; insurance claims processing; customer interaction centers; and content development. Current trends suggest that the country is well on the course for achieving the above target.

MANAGEMENT CONTRACTS

Companies—with low level technology and managerial expertise—may seek the assistance of a foreign company. Then foreign company may agree to provide technical assistance and managerial expertise. This agreement—between these two companies—is called the management contract.

A management contract is an agreement, between two companies, whereby one company provides managerial assistance, expertise and specialised services to the second company—for a certain agreed period—in return for monetary compensation. Table 12.7 lists some advantages and disadvantages of the contract. Monetary compensation may be in the form of:

- A flat fee; or
- Percentage over sales; and
- Performance bonus based on profitability, sales growth, production or quality measures.

Table 12.7 Advantage and Disadvantages of Management Contracts

Advantages	*Disadvantages*
• Foreign company gets additional income without any additional investment, risks and obligations.	• Sometimes the companies allows the companies in the host country even to use their trade marks and brand name. The host country's companies spoil the brand name, if they do not keep up the quality of product service.
• Hilton Hotels provided these service to other hotels without additional investment and earned additional income.	• The host country's companies may leak the secrets of technology.
• This arrangement and additional income allows the company to enhance its image with the investors and mobilise the funds for expansion.	
• Management control helps the companies to enter other business areas in the host country.	
• The companies can act as dealers for the business of the host country's business in the home country. Italy's ENI (Ente Nazionale Idrocarburi) used its knowledge of European energy industry to help the Algerian national oil firm. Later the Algerian national firm requested the ENI to increase their business in European petroleum market. Under a management contract, ENI constructed	

Management contracts are mostly due to governmental interventions. The Government of the Kingdom of Saudi Arabia nationalised Armco and requested the former owners to manage the company. Exxon, and other former owners of Armco, accepted the offer. Delta, Air France and KLM often provide technical and managerial assistance to the small airlines companies owned by the Governments.

TURN-KEY PROJECT

Indonesian Government, during 1974, invited global tender constructions of a sugar factory in the country. Indonesian Government received the tenders from the companies of the USA, the UK, France, Germany and Japan. One Japanese company quoted the highest price.

Indonesian Government studied the quotations of this Japanese company. This quotation includes: development of the fields for growing sugarcane; development of seedlings; construction of sugar factory roads; communication; power; water; connecting the factory; training the local people; development of distribution channels in Indonesia; production of by-products and their markets; and plans for the export of surplus sugar. It also made a provision for: the transfer of the factory along with the total package to the Indonesian Government; and follow-up of activities after they are transferred to the Indonesian Government.

Indonesian Government was very much satisfied with the total package and invited the Japanese company to implement the project. The Japanese company and the Indonesian Government entered an agreement for implementation of this project for a price. This project is called '' Turn-key Project.''

A turn-key project is a contract under which a firm agrees to fully design, construct and equip a manufacturing/business/service facility and turn the project over to the purchaser when it is ready for operation for a remuneration. The forms of remuneration include:

- A fixed price (firm plans to implement the project below this price);
- Payment on cost plus basis (i.e., total cost incurred plus profit).

This form of pricing allows the company to shift the risk of inflation/enhanced costs to the purchaser.

International turn-key projects include: nuclear power plants; airports; oil refinery; national highways; railway lines etc. Hence they are large and multi-year projects. International companies—involved in such projects—include: Bechtel; Brown and Root; Hyundai Group; Kennengen; Friedrich Krupp Gmb H.etc.

The recent approach to turn-key is Build, Operate and Transfer (B-O-T). The company builds the manufacturing/services facility; operates it for some time; and then transfers it to the host country's Government. In this approach, the contractor will not be paid the remuneration. Government of Gabon and the Electricity Supply Board International of Ireland and Campaginc Generals des Eaux of France agreed to establish electricity supply and water in Gabon for twenty-five years and than transfer the ownership of these projects to the Government of Gabon.

So far, we have discussed the various indirect methods of entering foreign market. Now, we shall discuss the direct method, i.e., Foreign Direct Investment.

FOREIGN DIRECT INVESTMENT WITHOUT ALLIANCE

Some companies enter foreign markets through exporting, licensing, franchising etc They acquire knowledge and awareness of foreign markets; culture of the country; customer preferences; political situation of the country etc., and then establish manufacturing facilities by ownership in the foreign countries. Baskin-Robbins, in Russia, followed this strategy. In contrast, some other companies enter the foreign market through ownership and control of assets in host countries.

Companies—which enter the international markets through foreign direct investment (FDI)—invest their money and establish manufacturing and marketing facilities through ownership and control,

Foreign firms need to control operations when:

- It has subsidiaries to achieve strategic synergies;
- The technology manufacturing expertise, intellectual property rights should be exploited maximally.

The U.S. companies transferred their managerial expertise and technological skill to the subsidiaries operating in the U.K. and hence these subsidiaries have become successful competitors to the U.K. companies.

Now we analyse the advantages and disadvantages of FDI (Table 12.8).

Table12.8 Advantages and Disadvantage of FDI

Advantages	*Disadvantages*
• Mostly, the customers of the host country prefer the products in their like—Be American, Buy American, be Indian, buy Indian. In such cases FDI helps the company to gain market this mode rather than other modes.	• FDI helps the company to gain market this mode rather than other modes.
• Purchase managers of most of the companies prefer to buy local production in order to ensure certainty of supply, faster services, quality dependability and better communication with the supplier.	• FDI also exposes the company to the exchange-rate fluctuations.
• The company can product based on the local environment and changing preferences of the customers.	• Some contries discourage the entry of foreign companies through FDI in order to protect the domestic industry.
	• Changing Government polities of the host country may create uncertainties to the company.
	• Host country Government, sometimes, ban the acquisition of local companies by foreign companies, impose restrictions on repatriation of dividends and capital. India has allowed 100% convertibility.

Now, we shift our discussion to the different methods of FDI.

The mode of FDI—without alliances—is the Greenfield strategy.

The Greenfield Strategy

The term Greenfield refers to staring at a virginal green site and then building on it. Thus, Greenfield is the starting of the operations of a company from scratch in a foreign market. The company conducts the market survey; selects the location; buys or leases land; creates new facilities; erects machinery; remits or transfers human resources; and starts the operations and market activities. This strategy is followed by Fuji in locating its manufacturing facilities in South Carolina; by Mercedes-Benz in locating automobile assembly plant in Alabama; and by Nissan in locating its factory in Sunderland, England.

This management faced the problems in building Disneyland in Paris.

These problems include:

- Problems in dealing with French construction contractors;
- Communication difficulties with painters;
- Local contractors demanded $ 150 million extra at the time of opening and threatened the opening;
- Local employees resisted the firm's attempt to impose its U.S. work values.

The next one is the FDI with strategic alliances.

Now, we discuss the advantages and disadvantages of the Greenfield strategy (Table 12.9).

Table 12.9 Advantages and Disadvantages of the Greenfield Strategy

Advantages	*Disadvantages*
• The company selects the best location from all viewpoints.	• This strategy results in a linger gestation period as the successful implementation takes time and patience.
• The company can avail incentives, rebates and concession offered by the host governments including local governments.	• Some companies may not get the land in the location of its choice.
• The company can have latest models of the buildings, machinery and equipment technology.	• The company has to follows the rules and regulations imposed by the country's Government in case of construction of the factory buildings.
• The company can also have its own policies and styles of human resources management.	• Host country's Government may impose conditions that the company should recruit local people and train them, if necessary, to meet the company's requirements.
• The company can have its gestation period to understand and adjust to the new culture of the host country. Thus, it can avoid the cultural shock.	

FOREIGN DIRECT INVESTMENT WITH STRATEGIC ALLIANCE

Innovations, creations, productivity, growth, expansions and diversifications, in the recent years, are mostly accomplished by the strategic alliances adopted by various companies like mergers, acquisitions and joint-ventures.

Strategic alliance is a co-operative and collaborative approach to achieve large goals. Strategic alliance takes different forms like: licensing; franchising; contract manufacturing; joint ventures etc. Alliance is a strategy to explore a new market, which the companies individually can not do. For example, Xerox of the USA and Fuji of Japan, collaborated to explore new markets in Europe and the pacific rim.

Two companies joined hands to align their distinctive and different strengths. Dunlop and Pirelli—the two tyre-making corporations—joined together in order to synergise the strength and marketing capabilities of Dunlop; and R&D capabilities of Pirelli.

Role and Logic of Alliance

- Alliances play a vital role in today's market conditions and environment. Many complicated issues are solved through alliances. AT & T joined hands with Apple; IBM; and Sun Micro-Systems so that all their products would work with AT & T's new video conferencing system. Alliances would help to develop the technologies. AT & T; IBM; Motorola; and Loral have joined hands to develop an advanced computer chip manufacturing technology;
- These alliances play a vital role in providing the parities each other's strengths. The Ford and Mazda alignment has provided technological knowledge to Ford and marketing knowledge to Mazda. Alliances are pivotal to providing competitive advantage. The alliance—between Ford and Volkswagon AG—made the joint-venture "Autolatina" dominate the car market in Brazil and Argentina;
- There are several ways to argue for strategic alliance. Only one company has been able to develop products historically due to the limited addition to the existing products in the process of development of products on the small-scale. Products were developed within industry boundaries. The explosion of technology made it possible, necessary and relevant to develop new products through two or more industries. This process proves the logic of having an alliance;
- A number of industries provided inputs for the development of high density television. Similarly, IBM; Apple; and Motorola joined their unique technological capabilities to meet the challenges of technological revolution;
- The product life cycles—of most of the companies—is increasingly becoming shorter. Companies invest in product development and insure loss when the product becomes obsolete. Hence, companies collaborate with each other for product development and share the outlay;
- It is gigantic task to hit a multinational company or get a market share from global competitors. Hence, companies collaborate with each other to acquire the strength to compete with a multinational company. Fujistu's computer searched alliance to hit IBM;
- Multinational companies, in recent years, are forced to meet local customer needs. Hence, these companies are forced to enter local markets, only through joint-ventures, with local companies. These local companies are familiar with: customer needs,

preferences and customer behaviour, availability of the various inputs in the local area, marketing intermediaries and their network in the local area etc.; and

- Thus, multinational corporations are expected to balance the product standardisation companies, which produce products with local inputs, based on the taste and preference of the local customer.

Building Competitive Coalition

Competitive advantage is any feature, of a business firm, that enables it to earn a high return on investment despite counter-pressure from competitors. Synergy is derived from size and diversification. A large firm gets the advantages of large operations; and less cost of doing business per unit. Diversified firms can use portfolio planning to get synergistic advantage by allocating resources according to market shares and scope for development.

Further, the firm gets market entry through risk sharing and learning potential. Each collaborating company will achieve more competency, than ever before, to enter a new market or industry alone. The alliance—between Pepsi and Thormas J.Lipton—created a favourable brand image regarding Pepsi Cola and the ready-to-drink tea of Thomas J. Lipton Co. Similarly, Siemens and Motorola established a joint venture, in 1995, to produce 64-megabyte and 256-megabyte DRAM computer chips. Motorola termed with Siemens, in part, to help finance the new $1.5 billion factory the partners had agreed to build; Siemens sought to benefit from Motorola's manufacturing expertise and to improve its access to the U.S. market, which typically accounts for 40 per cent of worldwide market for DRAM memory chips.

Gaining Market Access Alliance

- Similarly, today's customers do not prefer standard products. Hence, companies produce products based on the taste and preference of local customers. Local companies are more familiar—with the taste and preferences of the customers—than foreign companies are. Therefore, foreign companies gain market access via alliances;
- Building a brand image—in the minds of customers in the local markets—is mostly possible through existing local brands. .Coca-cola entered the Indian market, a second time, through acquisitions strategy. Same is the case with Whirlpool and Kelvinator.

The modes—of foreign direct investment through alliance—are:

- Mergers and acquisitions; and
- Joint ventures

Mergers and Acquisitions

Domestic companies enter international business through mergers and acquisitions. A domestic company selects a foreign company and merges itself with the foreign company in order to enter international business.

Alternatively, the domestic company may purchase the foreign company and acquire its ownership and control.

Domestic business selects this mode of entering international business as it provides immediate access to international manufacturing facilities and marketing networks. Otherwise, the domestic company faces serious problems in gaining access to international markets. For, example, Coca-Cola entered Indian market instantly by acquiring Parle and its bottling units. In addition, the domestic company—through this strategy of mergers and acquisition—may also get access to new technology or a patent right (Table 12.10).

It would be very difficult to appraise the cases of acquisitions and mergers even though they provide easy and instant entry to global business. . Sometimes it would be cheaper—for a domestic company—to have a green field strategy. Sometimes mergers and acquisitions also result in purchasing the problems of a foreign company.

Companies adopt this strategy just as a means of entering foreign markets. Procter and Gamble entered Mexican tissue products, in 1997, by purchasing Loreto Y. Pena Pobre's manufacturing and marketing systems.

Arcelor share as against his original offer to pay 35.37 Euros per share. Mittal's biggest bargain, other than the merger, is believed to be the removal of current Arcelor CEO and his bete noir Guy Dolle.

In what is considered to be the biggest gamble of his life, Mittal conceded the Arcelor board's demand—for greater professionalism and better corporate governance—by agreeing to a majority representation, by Arcelor, on the board of the merged entity. Even though he will own 45 per cent equity.

In a whole range of other concessions, Mittal is believed to have agreed to be co-chairman of Arcelor Mittal alongside Arcelor's current chairman Joseph Kinesch. Despite his majority ownership, Mittal has agreed to—Arcelor Mittal—the new name of the merged entity, rather than the Mittal Arcelor that he would have preferred.

Table 12.10 Advantages and Disadvantages of Acquisition Strategy

Advantages	*Disadvantages*
• The company immediately gets the ownership and control over the acquired firm's factories, employees, technology, brand names and distribution networks.	• Acquiring a firm in a foreign country is a complex task involving bankers, lawyers, regulations, mergers and acquisition specialists from the two courtiers.
• The company can formulate international strategy and generate more revenues.	• This strategy adds no capacity to the industry.
• If the industry already reached the stage of optimum capacity level or overcapacity level in the host country, then this strategy helps the economy of the host country.	• Sometimes host countries imposed restrictions on acquisition of local companies by the foreign companies.
	• Labour problems of the host country's company are also transferred to the acquired company.

Joint Ventures

Two or more firms join togather and create a new business entity that is legally separate and distinct from its parent bodies. Joint ventures are established as corporations and owned by the funding. Joint ventures are established as corporations—entered into a joint venture with Beijing Automotive Works called Beijing Jeep—to enter Chinese market by producing jeeps and other vehicles. Joint ventures involve shared ownership. Joint ventures are common in international business. Various environmental factors—like social, technological, economic and political—encourage the formation of joint ventures (Table 12.11). Joint ventures provide required strengths in terms of required capital, latest technology, human talent etc.

Joint ventures involve local companies. This act improves the local image in the host country and also satisfies governmental requirements regarding joint ventures. In fact, support of the host country's Government is essential for the success of the joint venture.

Massey-Ferguson entered into a 51 per cent joint venture, in Turkey, to produce tractors. It planned to produce 50,000 engines per year and called the Government to provide facilities for an additional production of 30,000 tractors a year. Massey-Feguson failed to understand the economic and political factors pivotal to a successful operation. The venture was terminated as the Government of Turkey did not provide support to the company.

Exhibit 12.3

Dr Reddy's–China

In China, operation of Dr. Reddy's is done through its joint venture (JV) with Rotam Group of Canada. The joint venture is widely known as Kunshan Rotam Reddy Pharmaceutical Co., Ltd. (KRRP).

KRRP was established in year 2000 complying with China laws, situated in Kunshan Economic & Technological Development Zone (KETD), which is a state-level investor-friendly development zone with abundant infrastructure facilities and scientific talents.

All Dr Reddy's Active Pharmaceutical Ingredient (API) products and Finished Dosage (FD) plants (tablet, capsule, cream, and imported repacking tablet) have gained GMP certificates from SFDA. KRRP is equipped with an in-house research institute specializing in new product development and a team of highly-qualified personnel is actively developing new products in the focus therapeutic areas of Central Nervous System (CNS), Gastroenterology, Cardiology, Endocrinology, Dermatology, Rheumatology, and so on. It has robust product pipeline and a host of products are at different stages of registration. Dr Reddy's is seeking best from better, continuously advancing technology level, and enhancing efficiency of operations as well as improving quality standards in all operation.

KRRP has been able to establish a strong presence in CNS, Dermatology, Gastroenterology and Endocrinology segments with its brands. Across China market, KRRP is ranked No. 1 in promotion of Anti gout product and No. 3 in promotion of one of the CNS product. KRRP has a well-established distribution network covering almost all parts of China and products of KRRP are available in several hospitals and pharmacies of that country.

Sources: http://www.drreddys.com/china, last accessed on 21 June 2012.

Table 12.11 Advantages and Disadvantages of a Joint Venture

Advantages	*Disadvantages*
• Joint ventures provide large scale capital funds.	• Joint ventures are also potential for conflicts. They result in disputes between or among parties due to varied interests. For example, the interest of a host country's company in developing countries would be to get the technology from its partner while the interest of a partner of an advanced country would be to get the expertise of marketing from the host country's organisation.
• Joint ventures are suitable for major projects.	• The partners delay the decision-making once a dispute arises. Then the operations become unresponsive and inefficient.
• Joint ventures spread the risk between or among partners.	• Decision-making is normally slowed down in joint ventures due to the involvement of number of parties.
• Different parties to the joint venture, different kinds of skills like technical skills, technology, human skills, expertise, marketing skills or marketing networks.	• Possibility of collapse of a joint venture is more due to entry of competitors, changes in the business environment in the two countries, changes in the partners' strengths etc.
• Joint ventures make large projects and turn key projects feasible and possible.	• Life cycle of a joint venture is hindered by many causes of collapse.
• Joint ventures provide synergy due to combined efforts of varied parties.	

Life Cycle of Joint Venture

The first stage—of the life cycle life of a joint venture—is the exploratory stage. During this stage the prospective partners start making:

- Alliance Collaborations;
- Project Studies;
- Feasibility Studies.

  After making alliances, the growth phase of the joint venture takes place. If the interests of the parties vary at this stage, they will lead to a collapse of the joint ventures in this phase itself. If the partners work together, this phase leads to stability of the joint ventures. Even in the stability stage, the joint venture may collapse. If not, the changed interests, of the parties, force them to re-negotiate their interests and shares. If the re-negotiation is not successful, the joint venture may collapse. The reasons for collapse include:

- Entry of New Competitors;
- Changes in Business Environment;
- Changes in Partner Strengths;

- Today's Partners may become tomorrow's Competitors;
- Changes in Partners' interests.

Partners in the Joint Ventures

Different types of partners join ventures. They include:

- **Host Country's Governments:** Host country's governments normally act as local partners in joint ventures. These are most effective in developing and socialistic countries.

This type of joint venture is called the public-private venture:

- **Public-Private venture:** Public-private joint ventures involve a partnership between a government and a private company. This type of joint venture depends on the following circumstances:
    - When the priority of the government—for development—matches the competence of a private company. Government of lvory coast formed a joint venture with Ranger Oil Limited of Canada and Gulf Canada to explore and develop prospective oil fields in the country;
    - When a country allows entry of foreign companies only through joint ventures with the government; and
    - Firms enter centrally controlled economies—like China and Sweden—only through joint ventures with the government. For example, Alcatel's joint ventures—with the Ministry of Posts and Telecommunications—in Shanghai Bell, China.
- **Private Partners:** Many companies would like to have joint venture with private companies. Local, private companies provide: marketing knowledge, cultural know-how, information regarding financial companies, creditors, employee work culture, trade unions etc. Active partners participate in ownership and management. Silent partners provide local acceptance and local knowledge.
- **Joint Venture Between Multinational Companies:** These joint ventures are quite common. Joint ventures are formed with the special skills of the two multinational companies.

How to Make Joint Ventures Successful

It is indicated that joint ventures mostly fail due to potential problems and cultural variations.

Harrigan suggests the following measures to make joint ventures successful:

- Do not accept a joint venture agreement too-quickly, weigh the pros and cons;
- Get to know a partner by initially doing a limited project together. If it is successful, bigger projects become more feasible;
- Small companies are vulnerable to having their expertise lost to larger joint venture partners; small companies must structure such deals with great care and guard against potential losses;

- Companies—with similar cultures and relatively equal financial resources—work best together. This must be kept in mind when looking for an appropriate partner;
- Protect the company's core business through legal means such as those of unassailable patents; if this is not possible, do not let the partner learn your methods;
- The joint enterprise must fit the corporate strategy of both parents. If this is not the case, there will inevitably be conflicts;
- Keep the mission of the joint enterprise small and well-defined; ensure that it does not compete with the parent companies;
- Give the joint enterprise the autonomy to function on its own set-up mechanisms to monitor its results. This should be distinct from both parent organisations;
- Learn from the joint enterprise and use this in the parent organisation; and
- Limit the frame of the joint enterprise and review its progress frequently.

Table 12.12 Comparison of Different Modes of Entry

Mode	*Primary-Advantages*	*Primary-Disadvantages*
Exporting	Relatively low financial exposure Permit gradual market entry Acquire knowledge local market Avoid restrictions on foreign investment.	Vulnerable to tariffs and NTBs Logistical complexities Potential conflicts with distributors.
Licensing	Low financial risks Low-cost way to assess market potential Avoid tariffs, NTBs, restrictions on foreign investment Licensee provides knowledge of local markets. Low financial risks	Limits market opportunities/ profits Dependency on licensee Potential confects with licensee May be creating future competitor.
Franchising	Low-cost way to assess market potential Avoid tariffs, NTBs, restrictions on foreign investment Maintain more control than licensing Maintain more control than with licensing Franchisee provides knowledge of local market. Low financial risks	Limit market opportunities/profits Dependence on franchisee Potential conflicts with franchisee. May be creating future competitor.
Contract Manufacturing	Minimize resources devoted to manufacturing Focus firm's resources on other elements of the value chain.	Reduce control (may affect quality, delivery schedules, etc) Reduced learning potential Potential public relations problems may need to monitor working conditions, etc.

Contd...

Contd...

Management Contracts	Focus firm's resources on its areas of expertise Minimal financial exposure.	Potential returns limited by contract May unintentionally transfer proprietary knowledge and techniques to contract.
Turnkey Projects	Focus firm's resources on its area of expertise Avoid all long-term operational risks.	Bear financial risk (cost overruns, etc.) Bear construction risks (delays, problems with suppliers, etc)
Foreign investment	High profit potential Maintain control over operations Acquire knowledge of local market Avoid tariffs and NIBs.	High financial and managerial investments. High exposure to political risk. Vulnerable to restrictions on foreign investment. Greater managerial complexity.

So far, we have discussed comprehensive strategic alliances like acquisitions and joint ventures. The alliances can also be functional. Now, we will discuss functional alliances.

- **Production Alliances:** Two or more companies share common manufacturing facilities in production function alliance. Companies may use the existing manufacturing facilities owned by any one of them. In the Toyota and General Motors joint ventures, they used the General Motors' assembly plant in California. Alternatively, partners build new manufacturing facilities;
- **Marketing Alliances:** Two or more companies share marketing services expertise and facilities. Mallinckrodt, a St. Louis Pharmaceutical, established marketing alliances with India's Cadila Pharmaceuticals Limited. Each company markets the other's medical, pharmaceutical and laboratory products in its home country;
- **Financial Alliances:** Companies join together to reduce the financial risks associated with the project. Partners contribute finances jointly, in varying shares, in order to share the profit and reduce the risks;
- **Research and Development Alliances:** Fast changing technology; high cost of research; and development and the need to be ahead of the change force companies to form alliances in the research and development areas. Siemens, Motorola, IBM and Toshiba joined together in designing a one-gigabyte DRAM semiconductor chip, which they had hoped would be ready by 2001.

MANAGING CONFLICT SITUATIONS

Alliances aim at co-operating and collaborating with other partners to achieve a common goal. But initial common goals result in conflicts at a later stage. Hence, the partners of the alliance should manage conflict successfully in order to maintain the alliances. Methods of managing conflict situations include:

- **Compatibility:** The company should select a partner with which it can work effectively and can trust. Strategic alliance—like the matrimonial alliance—is unlikely to succeed without mutual trust. Alliance—between General Electric Corporation, a U.K. company and the Siemens of Germany—failed due to incompatibility of management styles;
- **Nature of Potential Partner's Products/services:** Companies—with complementary but not competitive products or services—can have alliances. Otherwise the alliance will fail. Pepsi and Lipton collaborated on complementary products; and
- **The Relative Safeness of the Alliance:** Partners should assess the potential—for the success or failure of the alliance—based on the previous agreements of companies and undertake the alliance cautiously.

BREAK-UP OF ALLIANCE

Alliances or coalitions may not always result in success. They may end-up in heavy losses to all partners. Now, we will discuss the reasons for the break-up of coalitions:

- **Incompatibility of Partners:** As indicated earlier, incompatibility—in management styles, financial position, culture and business interests—can result in a break-up of the coalition. AT & T and Olivetti of Italy announced an alliance but it failed before the agreement was reached. Another example is General Electric of the U.K. and Siemens of Germany;
- **Access to Information:** The partners, of the alliance, should provide the necessary information to the other party. But partners—at the stage of implementation of the alliance—fail to provide access to information to partners. This leads to break-up of coalition. Alliance between Ford and Mazda—on the design of the new Ford Escort—was almost stalled when Mazda officials refused to let the officials of Ford visit their Research Laboratory;
- **Distribution of Income:** Normally, partners agree on the distribution of profits. But conflicts develop over the distribution of income;
- **Changes in Business Environment:** The changes in business environmental factors—like political, economic, technological changes—make the alliance obsolete. This again results in a break-up of the coalition;
- **Acquiring the Strengths of the Partner:** The companies, over the period of alliance, acquire the strengths of the partner, turn their weakness into strengths and then divorce the partners. Mostly foreign companies enter the market through alliance. They then acquire the marketing know-how from the local partner. After becoming strong in marketing skills, the foreign company breaks the coalition up. A similar case can also happen when the local acquires technical know-how from the foreign partner; and
- **Legal Factor:** Sometimes legal factors become hurdles for the continuation of the alliance. Sometimes the changed law, in the host country, creates hurdles and results in a break-up of the alliance.

Exhibit 12.4

Blade Wars: Gillette Wins Latest Round in Multi-Blade Razor Patent Litigation

Gillette owns U.S. Patent No. 6,212,777 for wet-shave safety razors with multiple blades. Gillette sued Energizer in the United States District Court for the District of Massachusetts alleging Energizer's QUATTRO®, a four-bladed wet-shave safety razor, infringed claims of the patent. The district court denied Gillette's motion for a preliminary injunction because it found that the claims covered only a three-bladed razor. On appeal, CAFC vacated the district court's decision and remanded for further proceeding.

The '777 patent claims a disposable safety razor with a group of blades, each blade placed in a particular geometric position relative to the other blades. Claim 1 describes a progressive blade exposure as follows:

A safety razor blade unit comprising a guard, a cap, and a group of first, second, and third blades with parallel sharpened edges located between the guard and cap.

In fixing the meaning and the scope of claim 1, the CAFC attempted to place the claim language in its proper technological and temporal context. The Court reasoned that the inventors' statutorily-required written patent description itself, including the claims, the specification and the prosecution history, is the primary source of the meaning of disputed claim language.

Using this standard, CAFC determined that the language "comprising . . . a group of first, second, and third blades" can encompass the four-bladed Energizer razors. To begin, CAFC noted that the claim uses "open" claim terms "comprising" and "group of" in addition to other language to encompass subject matter beyond a razor with only three blades. Moreover, although the specification focused on blade units with three blades, the patent also disclosed a plurality of blades showing that the '777 patent covers razors with more than three blades. The CAFC further explained that it may be that a four-bladed razor may be less preferred embodiment, but noted that a patentee typically claims broadly enough to cover less preferred embodiments as well as more preferred embodiments, precisely to block competitors from marketing less than optimal versions of the invention claimed.

Further, CAFC also noted that the specification provided further support for interpreting claim 1 to encompass razors with more than three blades. The first sentence of the written description teaches that the invention relates to razors having a plurality of blades. Moreover, the prosecution of patents related to the '777 patent also supports reading claim 1 as an open claim. Gillette endorsed an open interpretation of "comprising" when it argued to the European Patent Office (EPO) that a virtually identical claim in Gillette's European counterpart to the '777 patent would not exclude an arrangement with four or more blades. Accordingly, the CAFC concluded that the district court erred in limiting the claims of the '777 patent to encompass razors with three blades because no statement in the '777 patent excludes a four-bladed razor.

In dissent, Judge argued that claim 1 should not be construed as permitting a group with more than three blades simply because claim 1 contains the open transition term "comprising" in its preamble. Judge Archer concluded that a three-bladed razor is not merely a preferred embodiment of the invention, but is the invention itself, and that the inventors did not regard a blade unit with four blades arranged in the described geometry as their invention.

Sources: *http://patentlaw.typepad.com/patent/2005/05/blade_wars_gill.htm*. last accessed on 22 June 2012.

Exhibit 12.5

Apple Filing Could Delay Kodak Patent Sale

Apple on Thursday asked a federal judge to move a lawsuit against it by Eastman Kodak Company to a new court, which could derail the photography pioneer's plan to quickly sell a large patent portfolio through the process.

Kodak had sued Apple on Monday, seeking to stop the largest US company by market value from claiming ownership of 10 patents, including for technology that helps camera owners preview photographs on LCD screens.

These patents are part of a "digital-capture" portfolio of more than 700 patents for devices such as digital cameras, smartphones and tablets.

This portfolio has generated more than $3 billion of revenue since 2001. Kodak is trying to sell it fast, and remain in compliance with a $950 million bankruptcy loan.

But in a filing with the US District Court in Manhattan, Apple said the dispute should be reviewed by a jury in a federal district court, not as Kodak wishes by a judge in a federal bankruptcy court, where there are no juries.

Apple also said that while it is "amenable to a reasonably-expedited proceeding," it should be in district court, because a bankruptcy judge lacks the power and expertise to get involved.

"Kodak wants the bankruptcy court to rule on its claims in a matter of weeks based on a self-imposed, artificially-accelerated sale process," Apple said. "No law or policy permits giving Apple's intellectual property rights such short shrift."

Chris Veronda, a Kodak spokesman, did not immediately respond to a request for comment. A lawyer for Kodak declined immediate comment.

Privately held FlashPoint Technology, which Apple spun off in 1996, has also claimed ownership of the 10 disputed patents, and is also a defendant in the bankruptcy case.

Kodak owns about 10,700 patents overall and has hired Lazard to help market its digital-capture and digital-imaging patent portfolio, which together include more than 1,100 patents.

Last week, Kodak said it expected to auction the patents in early August, with a winning bidder announced by August 13. Kodak is based in Rochester, New York. It filed for protection on January 19. Apple is based in Cupertino, California.

The case is Apple Inc v Eastman Kodak Co, US District Court, Southern District of New York, No. 12-04881. Kodak's lawsuit is Eastman Kodak Co v. Apple Inc et al, US Bankruptcy Court, Southern District of New York, No. 12-ap-01720. The bankruptcy case is In re: Eastman Kodak Co et al, U.S. Bankruptcy Court, Southern District of New York, No. 12-10202.

Sources: http://timesofindia.indiatimes.com/tech/news/hardware/Apple-filing-could-delay-Kodak-patent-sale/articlesho. last accessed on 22 June 2012.

POLITICAL AND COUNTRY RISK IN INTERNATIONAL BUSINESS

Political actions, or political risks have a negative impact on a firm's value to shareholders. The process of establishing a cause-and-effect relationship—between political factors and business income—is said to be political risk analysis. Political risk is not confined to developing countries alone. It exists even in highly industrialised economies. War and anti-globalisation movements affect the value of all firms in the country. Micro-political risks—like the regulation of certain industries—adversely affect the value of firms within those industries.

The availability—of quality man-power level of infrastructure development and the FDI policy of a country—has a positive impact on the operational decisions of companies. Besides, political stability and government attitude—towards globalisation—have an impact on the investment of companies. Countries—with fewer regulations controlling foreign currency flows; more liberalised entry and exit policies; and more efficient redressal machinery—are preferred destinations for investments.

NATURE OF POLITICAL RISK

Political risk analysis calls for an understanding of the composition of political parties in a country.

Profits vs. Non-convertibility of Currency

Countries—with no foreign trade—can afford to enforce complete non-convertibility. It is difficult to think of any such completely closed economy today. Countries—like the U.K. and the U.S.—have full convertibility of their currencies. This means that U.S. citizens are allowed to make capital investment abroad and foreign nationals are allowed to buy assets in the U.S. Countries, like India, have partly convertible currencies. Export and import of goods and services are permitted; capital account transactions—involving purchase of assets Indians aboard—is not permitted; and foreign nationals can purchase assets in India by complying with government and RBI regulations which change time to time.

Nationalisation and Compensation

Nationalisation is the process of transfer of ownership of firm(s) from private hands to the government. Governments undertake nationalisation for security reasons, or to protect the interests of the country's citizens. For example, the Indian defence industry is nationalised for security reasons. Competition—as a result of the growth of private sector banks; the entry of foreign banks in India; and the disinvestment of government equity in public sector banks—has benefited customers to a considerable extent.

Political Violence Within the Country

Domestic political violence covers acts of violence by certain people in a country to indicate their opposition to the political, economic, or social effects of MNC presence in the country. Outlet in Bangalore was vandalised to protest against companies setting up shop in India.

Terrorist Attacks

The most significant example—of a terrorist attack in recent times—was the one at the World Trade Country, New York, on 11 September 2001. Banks and financial institutions—in the commercial district of New York—were badly hit by the human loss and the damage to telecommunications facilities and power lines. Other industries—badly affected by the fallout of '9/11'—were the airlines and tourism. The repercussions were also felt on manufacturing industries and services.

Country Risk

Country risk combines economic conditions, government political conditions and security factors. The challenge—of country risk analysis—is in the aggregation of risk factors. Country risk includes the following factors:

- ***Economic conditions:*** Factors—like interest rates; inflation; GDP; exchange rate; fiscal deficit; and savings and consumption patterns—are key indicators of the state position of the economy. Low inflation economies typically attract more investment since the cost of operation is less. Revenue deficits and lack of conscious effort by the government will have a negative impact on the country's credibility. Besides there are other factors like: infrastructure; population growth etc.

- ***Financial environment legal procedures and government policies:*** Selection of machinery—for the destination for investment—is an important factor. An efficient and unbiased legal system attracts more foreign capital. More stringent disclosure norms—for companies; banks; non-banking financial intermediaries; and capital market participants like: stock-brokers and under-writers—push up investor confidence.
- ***Annual budget of government:*** The government's borrowing program—related to the following year—is an indication of the market for debt instruments in that country. Budget allocations—to various industries—also indicate the level of public support for those industries. A higher budget allocation—for infrastructure development—is a positive indicator since it increases activity in allied industries and generates employment.
- ***Violation of terms of contract:*** Violation of terms of contract; favoritism towards domestic companies or one or a few foreign partners; and the absence of an efficient redressal system are all potential sources of risk.

MANAGING POLITICAL AND COUNTRY RISK

The importance of political risk analysis—for multinational companies—is not restricted to the initial investment decision. It continues as long as the company has interests in the country. Publications—of political analysts; international rating agencies; and the views of employees of foreign subsidiaries—are some of the sources of information for the company on political risk. Political risk analysis involves macro-and micro analyses. Macro analysis with: political stability; the composition of the ruling party; and the strength of domestic industrialists. Micro analysis deals with the impact of government policies and political changes on the business of the firm and the industry in which it operates.

Instruments of Trade Policy

The purpose—of a trade policy—is to maintain a favourable balance of payments position; to conserve foreign exchange; and to protect the domestic industry through the regulation of imports and exports.

Tariffs

A tariff is a levied on imports. A tariff is an ugly way of making imports expensive. Specific and compound duties are charged on goods imported. Ad valorem duties are based on the value of goods. An example—of an ad valorem duty in India—is the import duty of 105 per cent on the import of old cars. Though the government and domestic producers benefit by the imposition of duties, such duties are anti-consumer. A specific duty is a flat tax that is imposed regardless of the value of the imported goods. A compound duty is a combination of both ad valorem and specific duties. By imposing duties and making imports dearer, the government may promote inefficient utilisation of resources.

Subsidies

Subsidy is a financial aid. Subsidies are provided to domestic producers to make their products globally competitive. Benefits accrue to the government in terms of increased foreign exchange earnings and the subsequent tax revenues. However, subsidies are provided for, in the first place, from tax revenue. Whether or not subsidies are beneficial to the economy, depends on the benefits to the economy against costs to tax payers.

Non-tariff Barriers (NTB)

Governments may restrict the entry of foreign firms by putting in place restrictions based on the quantity and not on the value of the goods imported/exported. These are known as non-tariff barriers.

Voluntary Export Restraint (VER)

Voluntary Export Restraints (VER) are quotas imposed on exports at the request of the importing country. This helps the importing country reduce the outflow of foreign exchange and protect its domestic industry. One such voluntary restraint is the Multi Fibre Arrangement (MFA).

Quantitative Restrictions

Quotas are the most popular form of NTB. Here the restriction is in terms of the total number of items of a particular import or export that can be traded. An import quota states the maximum quantity of a particular import that can be brought in .The aim—of the restriction—is to protect the interests of domestic producers or to conserve foreign exchange. Export quotas are meant to protect the economy from the excessive exports of specified goods.

Administered Protection

Administered protection covers government regulatory actions in the nature of health and product standards and customs procedures. While the need for health and safety standards can not be debated, the misuse of these measures—to restrict trade—has to be addressed.

Licensing

Under a regime of licensing, importers and exporters are required to obtain licenses from the authorities. In compliance with WTO requirements, India has recently moved almost 1000 items—including processed food products; milk products; and certain cereals—from the restricted license category to the Open General License (OGL) list. By 2005, India is to remove all import restrictions.

SUMMARY

- The work place of any corporate seat is product of the culture of the society. It may not have positive consequences.
- Human resource policies have to address national differences in culture. The selected organisational structure should reconcile the conflicting elements arising out of geographic and product-line heterogeneity.
- MNCs may be defined as companies that operate in more than one country as opposed to purely domestic firms, which have no operations abroad. MNCs generally have active direct investment (FDI) in foreign countries and own or control value-added activities in several countries.
- After internationalisation, or organisations operation they face business problems such as: excessive transportation costs; government restrictions; differences in taste; and poor production conditions. Product attributes that depend on cultural and economic conditions have important implications for the marketing strategy of multinationals.
- A company's distributions strategy, in a country, is affected by the type of distribution system prevalent. Cultural barriers and the image of the country of origin determine the communication strategy of the firm. Managing human resources in an international context—is also more complex than in a domestic set up.
- Supply Chain Management and global logistics are emerging as a strategic tool to help companies focus on core competencies and achieve cost efficiency.
- Logistics management involves managing the flow of goods—from the supplier to manufacturing facilities—across the world. It is related to distribution of finished goods.
- The integration of world capital market has opened-up new scope for funding and managers have developed innovative financial instruments. Various financial and technological innovations have helped managers build risk management systems suited to their needs. The level of complexity associated with the political environment—increases to a considerable extent when interests—of the company's home country and host country—do not coincide. Firms have to operate in this complex environment in order to reap the benefits of the global market.
- Different strategies of foreign direct investment are: Greenfield strategy; acquisition strategy; and joint venture.
- A firm might face political risks in the form of: no convertibility of currency; restrictions on repatriation of violence; or damage caused by terrorist attacks. Risk is implied if there is a breach of contract by the host government.
- The arrangement between a group of countries in a particular geographic area—to minimise and gradually remove ride barriers to facilitate free flow of goods and services—is called regional economic integration.

- Trade policies of different countries influence the international business environment. Instruments of trade policy include: tariffs; subsidies and non-tariff barriers; quantitative restrictions; and voluntary export restraints and licensing.

KEY CONCEPTS

- **Globalisation** implies opening-up the economy for the rest of the globe by liberalising rules and regulations.
- **International market analysis:** alternative foreign markets; legal and political environments; and socio-cultural environments.
- **Strategic alliance** is a co-operative and collaborative approach to achieve larger goals.
- **Centrally administered economies** allow foreign companies to enter their markets through alliances.
- **Different methods of entering foreign markets** are: exporting; licensing; franchising; FDI; management contracts; turn-key projects, etc.
- **International franchising** covers trademarks; operating systems; product reputations; and continuous support systems.
- **Turn-key project** is a contract under which a firm agrees to fully design a contract and equip a manufacturing/business/service facility and turn the project over to the purchases when it is ready for operation for a remuneration.
- **Life cycle stages of joint venture—**include: alliances; project collaborations; and feasibility studies.
- **Functional alliances** include: production alliances; marketing alliances; financial alliances; and research and development alliances.
- **Capitalists in the alliances** should be managed through compatibility and the relative safety of the alliance. However, sometimes alliance may break-up.

Short Answer-type Questions

1. What is globalisation? Explain the factors responsible for globalising the Indian economy.
2. Explain the steps towards a globalisation.
3. Explain International Franchising and what are the basic issues in International Franchising?
4. What are the four common approaches to formulating and implementing strategy?
5. What are the Strategies for the ''Base of the Pyramid''?
6. What is International licensing?
7. What is contract manufacturing?

8. What is green field strategy, explain with Indian example?
9. What is Foreign Direct Investment without Alliance?
10. What are the advantages and disadvantages of Licensing?

Discussion Questions

1. What is FDI? What are the advantages and disadvantages of FDI?
2. What is Joint-Venture? What are the advantage, dis-advantage and life cycle of joint-venture?
3. How to make joint venture more successful in the organisation?
4. What is merger and acquisition? What are the advantages and disadvantages of acquisition?
5. Why do firms enter international markets? How do different environmental factors enable the domestic firm to become global?
6. What is exporting? How do firms enter international markets through the exporting strategy?
7. What is international licensing? What are the advantages and disadvantages of international licensing?
8. What is international franchising? Explain the issues involved in franchising and the franchising agreement.
9. How does contract manufacturing differ from management contracts?
10. What is a Turn-key project? Explain the advantages and disadvantages of a Turn-key project.

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