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MBA (International) - III Semester **Paper Code: MBIB 3002**

PAPER - XII

Management of Multinational Corporations

Objectives

- To highlight the origin and development of MNC's, and
- To highlight their problems and prospects from the point of view of both host countries and parent countries

Unit - I

International Management - Trends, challenges and opportunities; Different schools of thought of international management Different types of International business – Problems faced by MNC's – Problems posed by MNC's to host countries.

Unit - II

Growth and Development of MNCs - Role and Significance of MNCs – Pattern of Growth – Country of Origin – Different Management Styles – Strategic Issues involved.

Unit - III

Comparative Management - Importance and scope; Methods of comparative management; management styles and practices in US,Japan, China, Korea, India; Organizational design and structure of international corporations; Locus of decision making; Headquarter and subsidiary relations in international firms.

Unit - IV

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Unit - V

Indian Perspectives and Policy - Internationalization of Indian business firms and their operations abroad; International Mergers and Acquisitions. Changing government policy on entry of FIs and FIIs

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UNIT – I

Learning Objectives

After reading this unit, you should be able to

- Appreciate the need of Multinational corporations
- Know the process of overseas expansion in international companies
- Know the trends in international business
- Understand the challenges and opportunities of international management
- Provide basic ideas and insights about the international business practices
- Study traditional theories of international business

Unit Structure

Lesson 1.1 - International Management – an Introduction

Learning Objectives

After studying this lesson you should be able to:

- Appreciate the need of Multinational Corporation
- Take note of trends which will change the landscape of business
- Know the process of overseas expansion by international companies

Introduction

Globalization is the single most significant development changing business dynamics in this century. The reality of global markets and global competition is pervasive. The forces that are driving the world towards greater globalization are greater than the forces that restrain this move. With the improvements in transportation and communication technologies there is a sea change in the way the companies are run. International trade leads to international marketing, which in turn leads to growth in international business. The phenomenal growth in international business brought about number of new concepts in international management. The old theories of international trade focused upon natural resources and crude measures of factor endowments. Newer models focus upon the actual sources of competitive advantage of companies in industries. Ultimately, competitive advantage is based upon understanding what customers need and want and on knowing how to deliver these needs and wants with a competitive advantage.

The formula that guides this task is V=B/P: value = benefits divided by price. The greater the benefits and the lower the price, the greater the value. The task of global company is to deliver value to customers located in global markets. The ability of corporations of all sizes to use globally available factors of production is an important factor in international competitiveness. A single Barbie doll is made in more than ten countries-designed in the United States, with parts and clothing from Japan, Korea, Italy, and Taiwan, assembled in Mexico and sold in different countries.

Evolution of Multinational Corporation

The dynamics of international business created a great need for the evolution of Multinational corporation. The multinational corporation is a company engaged in producing and selling goods or services in more than one country. It normally consists of a parent company located in the home country and few or more foreign subsidiaries. Some MNCs have more than 100 foreign subsidiaries scattered around the world. It is the globally coordinated allocation of resources by a single centralized management that differentiates the multinational enterprise from other firms engaged in international business.

MNCs make decisions about market-entry strategy; ownership of foreign operations; and production, marketing, and financial activities with an eye to what is best for the corporation as a whole. The true multinational corporation emphasizes group performance rather than the performance of its individual parts. There are different types of multinational companies, such as;

a) **Raw-Material Seekers:** Raw-material seekers were the earliest multinationals and their aim was to exploit the raw materials that could be found overseas. The modern-day counterparts of these firms, the multinational oil and mining companies such as British Petroleum, Exxon Mobil, International Nickel, etc.,

b) **Market Seekers:** The market seeker is the archetype of the modern multinational firm that goes overseas to produce and sell in foreign markets. Examples include IBM, Toyota, Unilever, Coca-cola.

c) **Cost Minimizers:** Cost minimizers are a fairly recent category of firms doing business internationally. These firms seek out and invest in lower-cost production sites overseas (for example, Hong Kong, Malaysia, Taiwan, and India) to remain cost competitive both at home and abroad.

MNCs have to follow the changes in macroeconomic factors, environmental and social issues and business and industry developments. These factors will profoundly shape the corporate landscape in the coming years. The following section deals with these trends.

Trends Effecting Corporate World

Those who say that business success is all about execution, are wrong. The right product markets, technology and geography are critical components of long-term economic performance. Bad industries usually trump good management, however: in sectors such as banking, telecommunications and technology, almost two-thirds of the organic growth of listed Western companies can be attributed to being in the right markets and geographies. Companies that ride the currents succeed; those that swim against them usually struggle. Identifying these currents and developing strategies to navigate them are vital to corporate success. What are the currents that will make the world of 2015 a very different place to do business from the world of today? Predicting short-term changes or shocks is often a fool's errand. But forecasting long-term directional change is possible by identifying trends through an analysis of deep history rather than of the shallow past. Even the Internet took more than 30 years to become an overnight phenomenon. Let us take note of the ten trends that will change the business landscape. We have divided them under three broad categories:

a) Macroeconomic trends;
b) Social and environmental trends;
c) Business and industry trends;

a) Macroeconomic Trends

First, we have identified three macroeconomic trends that will deeply transform the underlying global economy.

New Centers of Economic Activity: Centers of economic activity will shift profoundly, not just globally, but also regionally. As a consequence of economic liberalization, technological advances, capital market developments and demographic shifts, the world has embarked on a massive realignment of economic activity. Although there will undoubtedly be shocks and setbacks, this realignment will persist. Today, Asia (excluding Japan) accounts for 13 percent of world GDP, while Western Europe accounts for more than 30 percent. Within the next 20 years the two will nearly converge. Some industries and functions—manufacturing and IT services, for example—will shift even more dramatically. The story is not simply the march to Asia. Shifts within regions are as significant as those occurring across regions. The United States will still account for the largest share of absolute economic growth in the next two decades.

Role of Public sector: Public-sector activities will balloon, making productivity gains essential. The unprecedented aging of populations across the developed world will call for new levels of efficiency and creativity from the public sector. Without clear productivity gains, the pension and health care burden will drive taxes to stifling proportions. Nor is the problem confined to the developed economies. Many emerging-market governments will have to decide what level of social services to provide to citizens who increasingly demand state-provided protections such as health care and retirement security. The adoption of proven private-sector approaches will likely become pervasive in the provision of social services in both the developed and the developing worlds.

Changing global marketplace: The consumer landscape will change and expand significantly. Almost a billion new consumers will enter the global marketplace in the next decade as economic growth in emerging markets pushes them beyond the threshold level of $5,000 in annual household income—a point when people generally begin to spend on discretionary goods. From now to 2015, the consumer's spending power in emerging economies will increase from $4 trillion to more than $9 trillion—nearly the current spending power of Western Europe. Shifts within consumer segments in developed economies will also be profound. Populations are not only aging, but of course changing in other ways too: for example, by 2015 the Hispanic population in the United States will have spending power equivalent to that of 60 percent of all Chinese consumers. And consumers, wherever they live, will increasingly have information about and access to the same products and brands.

b) Social and Environmental Trends

Next, we have identified four social and environmental trends. Although they are less predictable and their impact on the business world is less certain, they will fundamentally change how we live and work.

Communication Technology: Technological connectivity will transform the way people live and interact. The technology revolution has just been that. Yet we are at the early, not mature stage of this revolution.

Individuals, public sectors and businesses are learning how to make the best use of IT in designing processes and in developing and accessing knowledge. New developments in fields such as biotechnology, laser technology and nanotechnology are moving well beyond the realm of products and services. More transformational than technology itself is the shift in behavior that it enables. We work not just globally but also instantaneously. We are forming communities and relationships in new ways (indeed, 12 percent of US newlyweds in 2005 met online). More than two billion people now use cell phones. We send nine trillion e-mails a year. We do a billion Google searches a day, more than half in languages other than English. For perhaps the first time in history, geography is not the primary constraint on the limits of social and economic organization.

The battlefield for talent will shift: Ongoing shifts in labor and talent will be far more profound than the widely observed migration of jobs to low-wage countries. The shift to knowledge-intensive industries highlights the importance and scarcity of well-trained talent. The increasing integration of global labor markets, however is, opening up vast new talent sources. The 33 million university-educated young professionals in developing countries is more than double the number in developed ones. For many companies and governments, global labor and talent strategies will become as important as global sourcing and manufacturing strategies.

Corporate Accountability: The role and behavior of big business will come under increasingly sharp scrutiny. As businesses expand their global reach, and as the economic demands on the environment intensify, the level of societal suspicion about big business is likely to increase. The tenets of current global business ideology—for example, shareholder value, free trade, intellectual-property rights and profit repatriation—are not understood, let alone accepted, in many parts of the world. Scandals and environmental mishaps seem as inevitable as the likelihood that these incidents will be subsequently blown out of proportion, thereby fueling resentment and creating a political and regulatory backlash. This trend is not just of the past 5 years but of the past 250 years. The increasing pace and extent of global business, and the emergence of truly giant global corporations, will exacerbate the pressures over the next 10 years. Business, particularly big business, will never be loved. It can, however, be more appreciated. Business leaders need to argue and demonstrate more forcefully the intellectual, social, and economic case for business in society and the massive contributions business makes to social welfare.

Natural Resources: Demand for natural resources will grow, as will the strain on the environment. As economic growth accelerates—particularly in emerging markets—we are using natural resources at unprecedented rates. Oil demand is projected to grow by 50 percent in the next two decades, and without large new discoveries or radical innovations, supply is unlikely to keep up. We are seeing similar surges in demand across a broad range of commodities. In China, for example, demand for copper, steel and aluminum has nearly tripled in the past decade. The world's resources are increasingly constrained. Water shortages will be the key constraint to growth in many countries. And one of our scarcest natural resources—the atmosphere—will require dramatic shifts in human behavior to keep it from being depleted further. Innovation in technology, regulation and the use of resources will be central to creating a world that can both drive robust economic growth and sustain environmental demands.

c) Business and Industry Trends

Finally, we have identified a third set of trend: business and industry trends, which are driving change at the company level.

New global industry structures are emerging: In response to changing market regulation and the advent of new technologies, nontraditional business models are flourishing, often coexisting in the same market and sector space. In many industries, a barbell-like structure is appearing, with a few giants on top, a narrow middle, and then a flourish of smaller, fast-moving players on the bottom. Similarly, corporate borders are becoming blurrier as interlinked "ecosystems" of suppliers, producers and customers emerge. Even basic structural assumptions are being upended: for example, the emergence of robust private equity financing is changing corporate ownership, life cycles, and performance expectations. Winning companies, using efficiencies gained by new structural possibilities, will capitalize on these transformations.

Management will go from art to science: Bigger, more complex companies demand new tools to run and manage them. Indeed, improved technology and statistical-control tools have given rise to new management approaches that make even mega-institutions viable. Long gone is the day of the "gut instinct" management style. Today's business leaders are adopting algorithmic decision-making techniques and using highly sophisticated software to run their organizations. Scientific management is moving from a skill that creates competitive advantage to an ante that gives companies the right to play the game.

Ubiquitous access to information is changing the economics of knowledge: Knowledge is increasingly available and at the same time, increasingly specialized. The most obvious manifestation of this trend is the rise of search engines (such as Google), which make an almost infinite amount of information available instantaneously. Access to knowledge has become almost universal. Yet the transformation is much more profound than simply broad access. New models of knowledge production, access, distribution, and ownership are emerging. We are seeing the rise of open-source approaches to knowledge development as communities, not individuals, become responsible for innovations. Knowledge production itself is growing: worldwide patent applications, for example, rose from 1990 to 2004 at a rate of 20 percent annually. Companies will need to learn how to leverage this new knowledge universe—or risk drowning in a flood of too much information.

The Process of Overseas Expansion

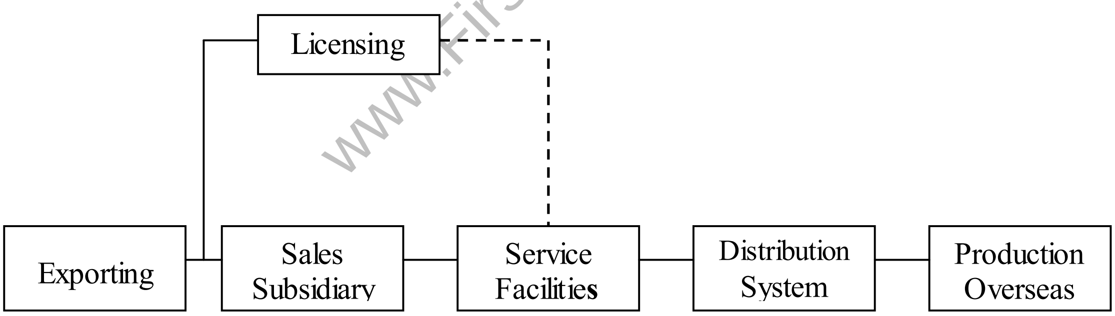
Studies of corporate expansion overseas indicate that firms become multinational by degree, with foreign direct investment being a late step in a process that begins with exports. For most companies, the *globalization* process does not occur through conscious design, at least in the early stages. It is the unplanned result of a series of corporate responses to a variety of threats and opportunities appearing at random abroad. From a broader perspective, however, the globalization of firms is the inevitable outcome of the competitive strivings of members of oligopolistic industries. Each member tries to create and to exploit monopolistic product and factor advantages internationally while simultaneously attempting to reduce the competitive threats posed by other industry members.

To meet these challenges, companies gradually increase their commitment to international business, developing strategies that are progressively more elaborate and sophisticated. The sequence normally involves exporting, setting up a foreign sales subsidiary, securing licensing agreements, and eventually establishing foreign production.

This evolutionary approach to overseas expansion is a risk-minimizing response to operating in a highly uncertain foreign environment. By internationalizing in phases, a firm can gradually move from a relatively low risk-low return, export-oriented strategy to a higher risk-higher return strategy emphasizing international production. In effect, the firm is investing in information, learning enough at each stage to significantly improve its chances for success at the next stage. Exhibit depicts the usual sequence of overseas expansion.

Exporting

Firms facing highly uncertain demand abroad will typically begin by exporting to a foreign market. The advantages of exporting are significant: Capital requirements and start-up costs are minimal, risk is low, and profits are immediate. Furthermore, this initial step provides the opportunity to learn about present and future supply and demand conditions, competition, channels of distribution, payment conventions, financial institutions, and financial techniques. Building on prior successes, companies then expand their marketing organizations abroad, switching from using export agents and other intermediaries to dealing directly with foreign agents and distributors. As increased communication with customers reduces uncertainty, the firm might set up its own sales subsidiary and new service facilities, such as a warehouse, with these marketing activities culminating in the control of its own distribution system.



Typical Foreign Expansion Sequence

Overseas Production

There is a major drawback to exporting an inability to realize the full sales potential of a product. By manufacturing abroad, a company can more easily keep abreast of market developments, adapt its products and production schedules to changing local tastes and conditions, fill orders faster, and provide more comprehensive after-sales service. Many companies also set up R & D facilities with their foreign operations; they aim to pick the best brains, wherever they are. The results help companies to keep track of competition and to design new products. For example, the Japanese subsidiary of Loctite, a U.S. maker of engineering adhesives, came up with several new applications for sealants in the electronics industry.

Setting up local production facilities also shows a greater commitment to the local market, which typically brings added sales and provides increased assurance of supply stability. Certainty of supply is particularly important for firms that produce intermediate goods for sale to other companies. A case in point is SKF, the Swedish ball bearing manufacturer.

SKF was forced to manufacture in the United States to guarantee that its product, a crucial component in military equipment, would be available when needed. The Pentagon would not permit its suppliers of military hardware to be dependent on imported ball bearings, because imports could be halted in wartime and are always subject to the vagaries of ocean shipping.

Thus, most firms selling in foreign markets eventually find themselves forced to manufacture abroad. Foreign production covers a wide spectrum of activities from repairing, packaging and finishing to processing, assembly and full manufacture. Firms typically begin with the simpler stages – for example, packaging and assembly – and progressively integrate their manufacturing activities backward – for example, production of components and subassemblies.

Because the optimal entry strategy can change over time, a firm must continually monitor and evaluate the factors that bear on the effectiveness of its current entry strategy. New information and market perceptions change the risk-return trade-off for a given entry strategy, leading to a sequence of preferred entry modes, each adapted on the basis of prior experience to sustain and strengthen the firm's market position over time.

Associated with a firm's decision to produce abroad is the question of whether to *create* its own affiliates or *acquire* going concerns. A major advantage of an acquisition is the capacity to effect a speedy transfer overseas of highly developed but underutilized parent skills, such as a novel production technology. Often the local firm also provides a ready-made marketing network. This is especially important if the parent is a late entrant to the market. Many firms have used the acquisition approach to gain knowledge about the local market or a particular technology. The disadvantage, of course, is the cost of buying an ongoing company. In general, the larger and more experienced a firm becomes the less frequently it uses acquisitions to expand overseas. Smaller and relatively less experienced firms often turn to acquisitions.

Regardless of its preferences, a firm interested in expanding overseas may not have the option of acquiring a local operation. Michelin, the French manufacturer of radical tires, set up its own facilities in the United States because its tires are built on specially designed equipment; taking over an existing operation would have been out of the question. Similarly, companies moving into developing countries often find they are forced to begin from the ground up because their line of business has no local counterpart.

Licensing

An alternative, and at times a precursor, to setting up production facilities abroad is to *license* a local firm to manufacture the company's products in return for royalties and other forms of payment. The principal advantages of licensing are the minimal investment required, faster market-entry time and fewer financial and legal risks involved. But the corresponding cash flow is also relatively low, and there may be problems in maintaining product quality standards.

The licensor may also face difficulty in controlling exports by the foreign license, particularly when, as in Japan, the host government refuses to sanction restrictive clauses on sales to foreign markets. Thus, a licensing agreement may lead to the establishment of a competitor in third-country markets, with a consequent loss of future revenues to the licensing firm.

The foreign licensee may also become such a strong competitor that the licensing firm will have difficulty entering the market when the

Notes

agreement expires, leading to a further loss of potential profits. For some firms, licensing alone is the preferred method of penetrating foreign markets. Other firms with diversified innovative product lines follow a strategy of trading technology for both equity in foreign joint ventures and royalty payments.

Challenges and Opportunities

A profound, but silent, transformation of our society is happening. Our corporate system is generating more goods and services than at any point in history, delivered through an ever-growing number of channels. Product variety is overwhelming to consumers. Propagation of cell phones, web sites and media channels increased access to more information, at greater speed and lower cost, than ever before.

However, product variety has not necessarily resulted in better consumer experiences. At the same time, competition is increasing and profit margins are shrinking to companies. Managers can no longer focus solely on costs, product and process quality, speed and efficiency. For profitable growth, managers must also strive for new sources of innovation and creativity.

Thus the paradox of the twenty-first-century economy: Consumers have more choices that yield less satisfaction. Top management has more strategic options that yield less value. Managers are under intense pressure to create value. But value creation by improving operational efficiency – through such initiatives as outsourcing, business process reengineering, and work force reduction - has natural limits in terms of morale potential.

Firms must couple such efficiencies with innovation and new business development. The following section discusses the trends, which influence business and how organizations are meeting the challenges and opportunities in resulting environment.

Summary

The remarkable growth of the global economy over the past 50 years has occurred because the balance of driving and restraining forces has shifted significantly in favor of the driving forces. It is useful to identify these forces to gain an insight into the foundations of the international economy and international markets as they exist today and as they can be expected to develop in the decade ahead.

Macroeconomic factors, environmental and social issues, business and industry developments will all profoundly shape the corporate landscape in the coming years. Traditional trade theories such as comparative advantage, absolute advantage based on factor endowment models have given way for new competitive advantage models. There is a remarkable growth in the number of MNCs in recent past. To manage these, international companies require understanding of newer concepts of international management.

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Lesson 1.2 - International Management – Trends

Introduction

As renowned management thinker the late Peter Drucker once wrote, they wish to create the future, not just predict it. This he mentioned regarding how organizations need to create their own future. It was widely accepted that major trends have to be predicted and required modifications to be made from time to time. Predicting the future is the easy part. What really matters is the ability to harness waves of change and use them to achieve high performance.

In the following section we discussed about ten crucial trends and the actions organizations need to take to create their own future. On Wall Street, they like to say that *"the trend is your friend."* Accenture a global consultancy firm recently completed a comprehensive analysis covering the most important global trends—business, social and technological—it also links those trends to specific actions organizations should be considering right now if, they wish to create the future, not just predict it. According to the analysis high performers detect the implications of trends for the distinctiveness of their capabilities, the strength of their market focus and position, and the vigor of their performance anatomy. They then take action to shape their own futures while their competitors are preoccupied with imitating the high performers' current successes. Changing business trends constantly create windows of opportunities and throws daunting challenges.

Trends

Trend 1: Permanent, Increasingly Pervasive Information Connectivity

Information technology is extending not only its horizontal reach but also its vertical reach —delving deeper into patterns of behavior or into operational information, enabling richer knowledge about companies, products and customers. Companies know more about their customers, but customers also know more about companies' products and services. As customers become increasingly comfortable shopping online, they learn how easy it is to compare market prices, inventories and even production costs. As a result, pricing and discounting have been upended, with the average retail discount in the United States rising from 10 percent to 30 percent between 1967 and 1997. Of course, companies that generally come out on top in a comparative search will welcome price transparency. Organizations have to maintain competitive advantage by counteracting pricing transparency.

Toyota Motor Corporation, for example, even provides a link from its website to the comparative pricing at www.edmunds.com, thus using pricing transparency to its advantage. But most companies will be vulnerable. One way companies are responding to the threat is by using the same IT trend to create a slew of enhanced pricing and revenue optimization capabilities, including ones for revenue management, markdown management, dynamic pricing, promotion optimization and customized pricing. Beyond this approach, however, companies must learn ways to bundle products and services to create new kinds of value in the eyes of customers, so it becomes more difficult for them to make simplistic comparisons. Companies will also find value in enabling customers to reduce information overload, helping them overcome the "decision paralysis" that can result from an overabundance of purchase information.

Increasingly sophisticated software and tools will enable companies to use analytics not only for better decision making but as a competitive weapon as well. The ability to derive real-time insight from predictive analytics can help a high performer dominate the game, or even change the game entirely. Amazon.com uses analytics to predict what products will be successful and to optimize the efficiency of its supply chain. Supply chain analytics also help companies such as Dell and Wal-Mart to reduce inventory and stock-outs. These initiatives help companies to create real-time business and market insights to change the competitive game in their favour.

Permanent information connectivity is fundamentally changing the way employees, teams and businesses communicate, collaborate and interact with one another. Organizations must be proactive about designing work tasks and flows to increase productivity and to enhance the kinds of collaboration that more frequently result in innovations. For example, investment bank Dresdner Kleinwort Wasserstein uses "wiki software," which enables workers to collaborate on Web pages, to encourage teamwork among its traders and bankers; the technology has also replaced e-mail and conference calls for tasks like pricing international bond offerings.

Trend 2: The Ascendancy of Major Emerging Economies

Competitive advantage across industries in the coming years will be determined in large part by the manner in which companies anticipate both the opportunities and the threats of four vital emerging economies: Brazil, Russia, India and especially China popularly known as BRIC countries.

One imperative need for MNCs is to prepare to compete in the Chinese industry segments that are right for their businesses. China already is one of the largest global consumer markets. The Chinese, for example, buy 16 percent of the world's refrigerators and 33 percent of the world's air conditioners. Moreover, China's large domestic market is creating strong local companies that are expanding beyond the country's borders and vying for spots as leading global players. Haier Group, for example, has in just 22 years grown into a global brand and the world's fourth-largest whitegoods maker. The key to proactive entry strategies in China and the other emerging economies is selecting the right segments, based on specific industry dynamics and then, managing risk accordingly. The Chinese marketplace is anything but monolithic; the country has more than 20 provinces and multiple languages and dialects.

Trend 3: The Accelerating Pace of Globalization

The pace of globalization and its effects have increased dramatically because of ubiquitous information connectivity. When major business functions, from production to sales, can be performed almost anywhere, it presents companies with unprecedented opportunities for both cost optimization and brand extension. Organizations have to create best-of-breed global solutions for operating businesses with the best capabilities at the lowest possible cost. Optimizing cost in a global labour market is about more than moving jobs to low-wage countries. Increasingly, it is about creating a global network in which every location is put to its best use, independent of its labour costs or even if the company sells or produces in the country.

Consider American appliance maker Whirlpool Corporation, which makes its microwave ovens in southern China and its washing machines in Germany. Despite Germany's relatively high labour costs, it has the necessary technology, as well as a trained workforce and a factory already tooled to the company's needs. If Whirlpool had focused its strategy only on labour costs, it would have missed the nuances of the global sourcing strategy by which it was ultimately able to expand its capacity at a very incremental investment.

The globalization of work and the removal of global sourcing barriers will create much more flexibility in an organization's value chain, and outsourcing models will actually become a strategic means by which to fine-tune that value chain. With the new discipline of "capability sourcing," more and more of that value chain will be outsourced.

One noteworthy example is Toshiba Corporation's hiring of logistics provider UPS to administer its customer PC repair processes. Companies will continue to more easily mix off-the-shelf and customized solutions to quickly gain new benefits from outsourcing activities, which range from application and business process outsourcing, through vertical outsourcing, to partnering to offshore owned and shared assets. Such a strategy is already in place at a number of companies, including Procter & Gamble, which has pursued outsourcing solutions in the United States and Europe for a range of corporate functions such as human resources and IT.

Enable a brand strategy that is simultaneously global and local. Yes, a brand must have global appeal. But global marketing must be accompanied by greater product and marketing differentiation, with brands adapted to local markets. For example, although McDonald's has adopted uniform brand packaging throughout the world, during 2006 the company is including nutritional value charts on the product packaging that are designed to be visually appealing to local markets. Procter & Gamble adjusts its branding strategy depending on regional perceptions.

For example, it prominently displays the company name on its packaging in Asia, but in the United States and Europe it focuses instead on its product brand names and images.

Trend 4: Rapidly Changing Demographics:

In both industrialized nations and emerging economies, a large percentage of the workforce will soon retire, resulting in the loss of critical knowledge and skills. Because of declining fertility rates in many developed nations, retiring workers are not being replaced fast enough, which raises the specter of global shortages of highly skilled labor. The situation is particularly troublesome in the public sector. Meanwhile, huge areas within both rich and poor nations are being hollowed out by the mass movement of populations to urban zones.

Organizations have to support workforce performance to raise the productivity of every employee. As the number of skilled workers declines in some industries, companies must focus on getting the most out of those who remain, on developing strength in what we call an organization's performance anatomy—the integration of elements such as leadership and strategy, people development and performance management. By taking a more comprehensive approach to talent management, companies must become effective "talent multipliers," able to increase the productivity and impact of each employee. Companies such as Yahoo are already becoming more sophisticated at developing a "talent organization"—a holistic approach to managing talent that attracts, hires, develops and retains the workers needed to achieve high performance.

Successfully managing human capital is becoming increasingly challenging in a world where more workers are temporary; where they want to carry their learning, performance history, health care records and more between employers; and where generational differences—between Gen X and Gen Y as well as with Baby Boomers—lead to misunderstanding and resentment in the workplace. Companies must therefore create new employment value propositions, which, in turn, require different people capabilities and tools.

In addition, to counteract the effects of skills shortages, companies must both retain their best workers and ensure that each worker is supported by the organization's best knowledge and experience. For a start, companies are increasingly tailoring benefits—for example, allowing employees to choose not only individualized retirement and medical plans but also more wide-ranging and important components of their jobs, such as work hours, location and vacation days. The result is increased employee satisfaction, engagement and retention. Companies are also modifying everything from leadership styles to levels of social activism to be more fully responsive to these changes. Treat employees like a "workforce of one."

In terms of supporting individual performance, role-based knowledge portals, or "performance workspaces," are now supporting specific performance needs of workers. BT Retail's performance workspace for its call center employees, for example, has increased employees' confidence in their ability to perform well by 23 percent, and also produced call handling efficiencies that generated $6 million in savings. Focus on offerings that leverage or address the effects of urban congestion. The percentage of the world's population living in cities is expected to grow to 61 percent by the year 2030, up from just 30 percent in 1950 and 48 percent in 2003. Denser urban environments create many business opportunities for those companies that can think creatively outside their existing business models. One example is the development of "small box" formats by retailers such as Wal-Mart and The Home Depot.

Another recent phenomenon is the "lifestyle center," a roofless retail center in an urban setting that features primarily upscale retail stores meant to attract higher-income shoppers. The appeal is not only the quality of the merchandise but also the experience of the "good old days," when small, downtown shopping centers provided comfort and a sense of community, as well as easy access and the ability to make quick purchases.

Public-sector entities are also responding to these demographic trends with innovative thinking of their own. Several local governments in the United States have moved to implement "congestion pricing"—higher tolls on the busiest highways or during high-traffic hours, for example. They also have begun to partner with the private sector. The state of California has been an early adopter of highway privatization, and the state of Indiana recently leased one of its major highways to a Spanish-Australian consortium for several billion dollars.

Trend 5: An Increasingly Complex and Fragile Business Environment

As business solutions and services become more elegant and complex, they also become more fragile and susceptible to business failure and security risks. With ever-larger infrastructures with more components, more things can go wrong. High mobility and extended customer reach increase the possible points of attack for those seeking to breach both information and physical security.

Security is one of the salient concerns for the 21st century, as businesses and governments look for solutions not only to protect both information and physical assets in real time but also to recover in the event of disasters. One financial services group, for example, had responded to some information security concerns during the 1991 Gulf War by developing "mirror sites" (redundant backups) for its most critical information systems. Consequently, within an hour of the 2001 terrorist attacks on the World Trade Center in New York, a mirror site in another city had already taken control of the company's mission-critical systems. Security will also become a revenue generator for companies that develop innovative products and services to protect businesses and consumers from the effects of fraud, identity theft, computer viruses and other kinds of privacy or security violations. Products or services with embedded security features will grow in importance. Secure the business and create security-based value-added offerings.

Trend 6: Shorter Time Frames for Decision Making

The increasing pace and complexity of business today means managing almost moment to moment, with an eye on both cost optimization and the quality of business performance. But many managers find themselves either unable to access the data needed to inform their decisions fast enough through their legacy IT systems, or overwhelmed by the amount of data available to them.

Recent research has clearly shown that effective enterprise performance management capabilities are critical to achieving high performance, and can increase a company's ability to create value. A Harvard Business Review study shows that companies with best-in-class performance management processes achieved nearly 3 percent higher return on assets and just over 5 percent higher returns on equity than their competitors. Imperative need is to develop the capability to comprehensively view and act on business performance in real time.

Trend 7: Shrinking Windows of Profitability

The global information network and the transparency of business operations have resulted in less opportunity for an innovative or first-mover product to maintain market dominance. The competition can more rapidly imitate or even leapfrog over products originally seen as innovative. Intellectual property rights are not protected for as long, or are violated more easily. Meanwhile, brand loyalty is declining.

Market dominance cannot be maintained without the continuous use of innovation to extend the value of existing products or to develop new ones. To increase revenue from new products, companies must develop the capability to introduce highly differentiated products in targeted markets more rapidly. Consider, for example, Apple Computer's aggressive rollout of new variants of iPod products, a strategy reminiscent of how pharmaceuticals companies extend the value of a blockbuster drug, even as it goes off patent, by rapidly releasing enhanced versions while dropping the price of older varieties. Just as important is establishing an "ideas infrastructure"—a formalized process by which ideas can be captured, analyzed and transformed into innovations. For example, Kaiser Permanente encourages more innovative attitudes, making employees feel they can effect change that will lead to improved care, member loyalty and affordability. The health care company has developed what it calls Innovation Support Teams, which are charged with focusing on innovations and are also connected to operations to assist in making the innovations a reality. Finally, bottlenecks to innovation must be removed more quickly, through a constant review of new ideas and the conscientious application of solutions to remove any barriers to such new thinking. Innovate rapidly or die is the mantra.

Trend 8: Rapidly Changing Industry and Market Boundaries

Falling trade barriers are redefining markets globally, while technology advances and other factors are blurring lines between industries like entertainment and telecommunications. Competing in evolving global markets at today's pace of innovation requires making rapid adjustments to capabilities and scale.

Companies must continue to shorten the time between a merger or acquisition and when that move begins generating value. Today, most companies' approach to inorganic growth reflects the cottage industries of the 19th century. Just as new product development and R&D have been industrialized in companies in the past 25 years, the same must now occur for M&A and related capabilities. This type of approach will no longer be reserved for companies like Cisco Systems, BP and Novartis; instead, it will extend out to all companies. Accelerate value through rapid acquisitions and divestitures.

Trend 9: A Growing Public Demand for More Corporate Transparency and Better Governance and Accountability

Calls for stricter accounting and reporting standards and more transparency are coming not just from regulators but from employees and shareholders as well. Shareholders are also now routinely pressing companies about their environmental records, hiring and firing practices, fair trade policies and charitable contributions. A number of online business practices have come under public scrutiny as well. Even companies less vulnerable to these possible actions will face an increasing need to conduct themselves in accordance with emerging national and global standards. It is better to transform the governance mindset from compliance to value creation.

High performers will increasingly be those that see governance not merely as a set of operating restrictions but also as a means to create value. Consider Brazil, Latin America's biggest economy.

In 2000, the Brazilian stock market was suffering from slow growth in new listings. Institutional investors met with Brazilian officials to help them explore how new approaches to corporate governance could stimulate the economy by raising investor confidence levels. BOVESPA, the São Paolo stock exchange, responded by creating a new listing segment, in which participating companies would have to meet more stringent standards of corporate governance.

Trend 10: An Explosion of the Life Sciences Economy

Recent discoveries, including the sequencing of the human genome, advances in information technology, and demographic trends such as aging populations throughout the industrialized world, are stimulating health spending and growth in the life sciences economy, or "bioeconomy." Driving the leading edge of the health care industry, and health care spending, in the next few years will be consumer demand for "personalized medicine." As a consequence, one of the biggest trends in life sciences is "pharmacogenomics"—treatments tailored not just to individual need or disease but also to individual genetic makeup. Drugs are already available for groups of people sharing a genetic profile.

Herceptin, for example, is a breast cancer drug designed for the approximately 25 percent of breast cancer sufferers who overproduce one particular gene. Another drug, Gleevec, is for the roughly 5,000 patients in the United States diagnosed each year with chronic myeloid leukemia, which means they have a genetic variation that causes an overproduction of white blood cells.

But it won't be simply the obvious players—pharmaceuticals companies and health care providers—that leverage opportunities of the bio-economy going forward. Implications extend to many industries, including insurance, agribusiness, food and consumer products. Each will find opportunity in the demand for better health and fitness that comes with the growing affluence of populations. Even telecommunications providers can benefit from this trend. Too far-fetched? With the advent of television programming delivered using Internet technologies—also called IPTV—telemedicine solutions will grow in importance. Such solutions would enable, for example, a physician to make an interactive virtual house call to consult directly with the homebound elderly.

The imperatives and action steps listed here can be, are daunting when taken in one dose. Yet most businesses will not feel the effects of all of these trends immediately or simultaneously. By mobilizing the appropriate executives and, most important, the best-suited program managers and change agents to address each imperative individually, companies will successfully begin the journey of evolving both their vision and their business strategy. High performers know that the future does not come all at once. With vision, but also with rigorous planning, successful companies will embody the observation of the late historian Will Durant—that the future never just happens; it is created.

Summary

Globalization affects all sizes and types of organizations. Workforce diversity requires managers to recongnize and acknowledge employee differences. Entrepreneurship is important to societies around the world and all types and sizes of organizations will need to be entrepreneurial to be successful. Managers need to recognize the realities of an e-world, whether as an e-business enhanced, e-business enabled, or total e-business organization. Successful organizations will need to be innovative and flexible, and managers will need to encourage innovation and flexibility. Managers who emphasize quality management processes are committed to continuous improvement of work activities. Managers will need to foster the development of learning organizations and cultivate a knowledge management culture. Finally, managers will have to recognize the importance of maintaining work-life balance.

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Lesson 1.3 - International Management – Emergence of Global Companies

Introduction

A Multinational Corporation (MNC) or Multinational Enterprise (MNE) or Transnational Corporation (TNC) or Multinational Organization (MNO) is a corporation /enterprise that manages production establishments or delivers services in at least two countries.

Multinational Corporations (MNC) are often divided into three broad groups:

- **Horizontally integrated multinational corporations** manage production establishments located in different countries to produce the same or similar products.
- **Vertically integrated multinational corporations** manage production establishment in certain country/countries to produce products that serve as input to its production establishments in other country/countries.
- **Diversified multinational corporations** manage production establishments located in different countries that are neither horizontally nor vertically integrated.

Very large multinationals have budgets that exceed those of many countries. Of the 100 largest economies in the world, 51 are multinational corporations. They can have a powerful influence in international relations, given their large economic influence in politicians' representative districts, as well as their extensive financial resources available for public relations and political lobbying. Multinationals have played an important role in globalization. Given their international reach and mobility, prospective countries and sometimes regions within countries, must compete with each other to have MNCs locate their facilities (and subsequent tax revenue, employment, and economic activity) within.

To compete, countries and regional political districts offer incentives to MNCs such as tax breaks, pledges of governmental assistance or improved infrastructure, or lax environmental and labour standards. This process of becoming more attractive to foreign investment can be characterized as a race to the bottom.

There is a dispute as to which was the first MNC. Some have argued that the Knights Templar, founded in 1118, became a multinational when it stumbled into banking in 1135. However, others claim that the Dutch East India Company (Dutch: Vereenigde Oostindische Compagnie) was, which first appeared in 1602. In the following section an attempt has been made to understand the composition of Global Fortune 500 companies.

Composition of Global Fortune 500 Companies

Fortune magazine every year compiles data about world's leading companies in terms of revenues, profits, biggest employers, biggest increase in revenues, Fastest -growing profits, etc. The analysis is comprehensive in nature. Table gives the top hundred companies in terms of revenues in the Fortune 500 Global List of 2006. One look at the largest corporations in the world and immediate conclusion one can jumps out is natural resources are driving the global economy as never before. Five of the top ten companies on Fortune's 2006 Global 500 are oil companies, one more than last year. Another four are automakers, whose customers pump plenty of gasoline.

Big Oil's domination is the product of a decade of industry consolidation combined with sky-high crude prices and a surge in global demand. Exxon's 2005 revenues jumped 26%, and its profits hit $36 billion - the biggest payday in the history of the Global 500. Oil companies aren't the only ones prospering; 2005 was a banner year for most Global 500 companies. It took $13.7 billion in revenue just to make this year's list - up from $12.4 billion last year. And profits for the 500 companies jumped 30%. Total revenues for the Global 500 in 2006 add up to $18.9 trillion, a third of the world's GDP. Companies of the old economy - commodities and oil - racked up the biggest gains.

The mining and crude-oil sector, which excludes major oil companies that have large refining segments, enjoyed a 77% increase in profits. Add refiners to that group, and it accounted for $2.8 trillion in combined revenue, up 27% over the previous year.

Emerging Markets Jump on

China's banking boom points to that country's fasten-your-seat-belts growth trajectory. Four new Chinese companies - China Railway Engineering, Shanghai Automotive Industry Corp., China Railway Construction, and China State Construction - made it onto the Global 500 this year, more additions than any other country, bringing China's total to 20.

Top Hundred Fortune Global 500 Companies

Rank	Company	Revenues ($ millions)	Profits ($ millions)
1	Exxon Mobil	339,938.0	36,130.0
2	Wal-Mart Stores	315,654.0	11,231.0
3	Royal Dutch Shell	306,731.0	25,311.0
4	BP	267,600.0	22,341.0
5	General Motors	192,604.0	-10,567.0
6	Chevron	189,481.0	14,099.0
7	DaimlerChrysler	186,106.3	3,536.3
8	Toyota Motor	185,805.0	12,119.6
9	Ford Motor	177,210.0	2,024.0
10	Conoco Phillips	166,683.0	13,529.0
11	General Electric	157,153.0	16,353.0
12	Total	152,360.7	15,250.0
13	ING Group	138,235.3	8,958.9
14	Citigroup	131,045.0	24,589.0
15	AXA	129,839.2	5,186.5
16	Allianz	121,406.0	5,442.4
17	Volkswagen	118,376.6	1,391.7
18	Fortis	112,351.4	4,896.3
19	Crédit Agricole	110,764.6	7,434.3
20	American Intl. Group	108,905.0	10,477.0
21	Assicurazioni Generali	101,403.8	2,384.0

22	Siemens	100,098.7	2,854.9
23	Sinopec	98,784.9	2,668.4
24	Nippon Telegraph & Telephone	94,869.3	4,404.6
25	Carrefour	94,454.5	1,784.3
26	HSBC Holdings	93,494.0	15,873.0
27	ENI	92,603.3	10,919.7
28	Aviva	92,579.4	3,211.4
29	Intl. Business Machines	91,134.0	7,934.0
30	McKesson	88,050.0	751.0
31	Honda Motor	87,510.7	5,273.2
32	State Grid	86,984.3	1,073.5
33	Hewlett-Packard	86,696.0	2,398.0
34	BNP Paribas	85,687.2	7,271.5
35	PDVSA	85,618.0	4,661.0
36	UBS	84,707.6	11,257.5
37	Bank of America Corp.	83,980.0	16,465.0
38	Hitachi	83,596.3	329.6
39	China National Petroleum	83,556.5	12,950.0
40	Pemex	83,381.7	-7,001.7
41	Nissan Motor	83,273.8	4,575.6
42	Berkshire Hathaway	81,663.0	8,528.0
43	Home Depot	81,511.0	5,838.0
44	Valero Energy	81,362.0	3,590.0
45	J.P. Morgan Chase & Co.	79,902.0	8,483.0
46	Samsung Electronics	78,716.6	7,458.8
47	Matsushita Electric Industrial	78,557.7	1,363.8
48	Deutsche Bank	76,227.6	4,385.0
49	HBOS	75,798.8	5,870.4
50	Verizon Communications	75,111.9	7,397.0
51	Cardinal Health	74,915.1	1,050.7
52	Prudential	74,744.7	1,359.5
53	Nestlé	74,658.6	6,415.5
54	Deutsche Telekom	74,061.8	6,938.5
55	Dexia Group	72,814.3	2,532.3

55	Metro	72,814.3	659.8
57	Credit Suisse	72,193.5	4,694.3
58	Royal Bank of Scotland	71,164.3	9,997.8
59	Tesco	71,127.6	2,820.8
60	Peugeot	69,915.4	1,278.6
61	U.S. Postal Service	69,907.0	1,445.0
62	Altria Group	69,148.0	10,435.0
63	Zurich Financial Services	67,186.0	3,214.0
64	E.ON	66,313.2	9,203.7
65	Sony	66,025.6	1,091.8
66	Vodafone	65,314.2	-39,092.9
67	Société Générale	64,441.9	5,524.4
68	Électricité De France	63,434.1	4,028.4
69	Nippon Life Insurance	61,158.3	1,812.5
70	Statoil	61,032.7	4,768.7
71	France Télécom	60,932.9	7,093.8
72	LG	60,574.1	587.5
73	Kroger	60,552.9	958.0
74	Munich Re Group	60,255.7	3,318.9
75	Deutsche Post	59,989.8	2,777.1
76	State Farm Insurance Cos	59,223.9	3,241.8
77	Marathon Oil	58,958.0	3,032.0
78	BMW	57,973.1	2,782.1
79	Fiat	57,833.9	1,653.9
80	Hyundai Motor	57,434.9	2,268.7
81	Procter & Gamble	56,741.0	7,257.0
82	ABN AMRO Holding	56,614.9	5,444.9
83	Royal Ahold	56,427.3	165.3
84	Repsol YPF	56,423.6	3,876.8
85	Legal & General Group	56,384.8	1,715.7
86	Petrobrás	56,324.0	10,344.0
87	Toshiba	56,028.0	690.6
88	Dell	55,908.0	3,572.0
89	Lloyds TSB Group	55,407.0	4,530.9

90	ThyssenKrupp	55,260.7	1,294.1
91	Boeing	54,848.0	2,572.0
92	AmerisourceBergen	54,589.6	264.6
93	Santander Central Hispano Group	53,848.8	7,728.9
94	BASF	53,113.3	3,736.0
95	Costco Wholesale	52,935.2	1,063.1
96	Suez	52,742.9	3,122.2
97	Target	52,620.0	2,408.0
98	Morgan Stanley	52,498.0	4,939.0
99	Robert Bosch	52,207.6	2,918.8
100	Renault	51,365.1	4,183.7

Source: www.money.cnn.com, From the July 24, 2006 issue

Note: Self-learners are advised to visit the website for complete list

Mexico added three companies: América Telecom and two that have been on the list before, Carso Global Telecom and CEMEX. Producing cement from the Persian Gulf to Central America, CEMEX acquired Britain's RMC Group last year and posted a 60% gain in profits, to just over $2 billion. And Austria joined the Global 500 for the first time with oil producer OMV hitting the list at No. 334.

Out of companies in 50-odd industries representing 32 countries, a few other shuffles warrant mention. Japan lost 11 companies, including Yamaha Motor and Central Japan Railway. Heineken Holding fell off the list, as did American companies OfficeMax, American Electric Power, and Texas Instruments.

Notable additions include U.S. homebuilder D.R. Horton and, at No. 500, Nike. And in a comeback, Apple Computer (No. 492) has returned to the Global 500 this year after a nine-year hiatus, with profits up 384%, to $1.3 billion. Whether consumer goods companies like Apple maintain their momentum this year, though, remains a question. The world's voracious appetite for energy is threatening to ignite inflation around the globe. How ironic that the very factors that helped produce outsized profits in 2005 may be the ones that squeeze growth in 2006.

Biggest Employers – Top Companies

Rank	Company	500 revenues rank	2005 Number of Employees
1	Wal-Mart Stores	2	1,800,000
2	China National Petroleum	39	1,090,232
3	State Grid	32	844,031
4	U.S. Postal Service	61	803,000
5	Sinopec	23	730,800
6	Deutsche Post	75	502,545
7	Agricultural Bank of China	377	478,895
8	UES of Russia	213	461,200
9	Siemens	22	461,000
10	McDonald's	318	447,000

Table provides information about the ten largest employers in the Fortune 500 Global list. Wal-Mart the biggest retailer in the world employs eighteen lakh people. Next biggest employer is China Petroleum, which employs more than a million people. Retailers, service organizations top the list. The particulars given here are of direct employment and indirectly these organizations are generating lot of employment.

Top Cites

Rank	City	Country	No. of Global 500 companies	Global 500 revenues ($ millions)
1	Tokyo	Japan	52	1,662,496
2	Paris	France	27	1,188,819
3	New York	U.S.	24	1,040,959
4	London	Britain	23	1,054,734
5	Beijing	China	15	520,490
6	Seoul	South Korea	9	344,894
7	Toronto	Canada	8	154,836
8	Madrid	Spain	7	232,714
8	Zürich	Switzerland	7	308,466

9	Houston	U.S.	6	326,700
9	Osaka	Japan	6	180,588
9	Munich	Germany	6	375,860
9	Atlanta	U.S.	6	202,706
10	Rome	Italy	5	210,303
10	Düsseldorf	Germany	5	225,803

Source: Fortune 500 Global, From the July 24, 2006 issue

Table presents the list of top cities in the world, which are having headquarters of most number of Fortune 500 companies. Tokyo from Japan ranks top with 52 of Global 500 companies having head offices from that city. Next place goes to Paris from France hosts 27 companies. Followed by New York and London. Which are hosting 24 and 23 companies. Majority of the cities are from G7 nations (Group of seven nations which are industrially developed). Only Beijing from emerging markets hosting 15 companies.

How the companies stack up

Country	**No. of Fortune Global 500 companies**
US	170
Japan	70
Britain & France (tied)	38
Germany	35
China	20
Canada	14
South Korea	12
Switzerland	12
India	6

Table gives the information about number of companies and their country of origin. US lead the pack with 170 companies which originated from that country. This is about 34 per cent of the Global Fortune 500 companies. Japan is in the second place with 70 global leading companies operate from that country. Britain and France tied at the third spot. Five countries accounts more than three hundred leading companies, shows how dominant they are in the business world.

Most Profitable Global Companies

Rank	Company	2005 Profits ($ millions)
1	Exxon Mobil	36130.0
2	Royal Dutch / Shell Group	25311.0
3	Citi Group	24589.0
4	BP	22341.0
5	Bank of America Corp.	16465.0
6	General Electric	16353.0
7	HSBC Holdings	15873.0
8	Total	15250.0
9	Gazprom	14865.2
10	Chevron	14099.0

Table gives the top ten profitable companies according to the 2005 profits. Exxon is the leading company in Fortune 500 Global companies list both in revenues and profits. As mentioned earlier Exxon's 2005 revenues jumped 26% and its profits hit $36 billion. Royal Dutch/ Shell Group records profits over $25 billion. Major oil companies records highest growth in terms of profits in the 2006 list.

Top 5 in Asia

Company	2005 Revenues (($ millions)
Toyota Motors	185805
Sinopec	98784
Nippon Telegraph & Telephone	94869
Honda Motor	87510
State Grid	86984

Table presents the top five companies from Asia. Toyota Motors is the leading company form Asia. This company also features in top ten companies in the world. Asia is emerging as the fastest growing region in the world. Naturally more and more Asian companies finds place in Fortune 500 list in the coming years. China and India are having highest GDP growth rates and the countries attracting the attention of leading MNCs of the world. With liberalized business environment majority of the companies from these two countries finding place in Fortune 500 list. China with 20 and India with 6 companies (SBI got entry in 2006 Fortune's list) are becoming fast growth engines of the world.

Indian Companies in Global Fortune 500 List

Country Rank	Company	Rank	Revenues ($ millions)	City
1	IOCL	153	36537.0	New Delhi
2	Reliance Industries	342	18773.3	**Mumbai**
3	Bharat Petroleum	368	17613.8	**Mumbai**
4	Hindustan Petroleum	378	17106.4	**Mumbai**
5	Oil & Natural Gas	402	16609.2	New Delhi
6	State Bank of India	498	13755.8	**Mumbai**

Table presents the list of six Indian companies finding place in Fortune 2006 list. State Bank of India a public sector giant finds place in latest list.

Other five companies basically belong to oil and gas sectors, known as hydro carbon sector. India is one of the main oil importing country and consumption rates are increasing day by day. Except Reliance other companies in the list are from public sector. In future, one may hope that more and more Indian companies find place in Fortune 500.

Emergence of Global Companies From Rapidly Developing Economies

As we have observed from previous section that the composition of Global Fortune 500 companies is changing, more and more companies from rapidly developing economies are finding place. There are six Indian companies at present in the list.

Recently global management consultancy, the Boston Consulting Group prepared a report titled, "The New Global Challengers: How 100 top companies from rapidly developing economies are going global — and changing the world", based on observing 3,000 companies from 12 rapidly developing economies (RDEs).

The Indian 21

Sector	**Company**
Automotive	Bajaj Auto
	Tata Motors
	Mahindra & Mahindra
	TVS Motors
	Bharat Forge
IT/BPO	Infosys
	Satyam
	Tata Consultancy Services (TCS)
	Wipro
Engineering and Construction	Larsen & Toubro
Health/Pharmaceutical	Ranbaxy
	Cipla
	Dr Reddy's Laboratories
Steel and industrial goods	Hindalco
	Tata Steel
	Crompton Greaves
Other sectors	ONGC
	Reliance Industries
	Videocon
	VSNL
	Tata Tea

Source: Business Standard, 4 July 10, 2006

When the top 100 list was published in May 2006, twenty one Indian companies made it to the elite list. Asian companies formed 70 per cent of that list. And how? These companies were selected on the basis of being truly based out of developing economies. For instance, foreign JVs and RDE subsidiaries of multinational corporations were left out. Only companies with a turnover of more than $1 billion as of 2004 were considered — that's the threshold required to drive serious globalisation campaigns. If the international presence was less than 10 per cent of revenue, the companies were struck out — with exceptions. Companies which were close to hitting the 10 per cent mark and whose international business activity had grown swiftly in the recent past were considered. There was more to pass the test. International presence indicated by owned and operated subsidiaries, sales networks, manufacturing presence, R&D facilities and international investments, including M&As, were considered. Equally important were the company's access to capital for international expansion, the breadth and depth of its technologies, intellectual property portfolio, the international appeal for its existing offerings and value propositions. The chosen companies belonged to a diverse set of industries (see Table The Indian 21).As the findings below indicate, each company follows its own way, implementing a number of different strategies. But certain patterns seem to emerge which fall under six primary models of globalisation.

Model One: Taking RDE Brands Global

28 of the RDE 100 are growing internationally by taking their established home-market product lines and brands to global markets. Take the case of China's Hisense, a $3.3 billion consumer electronics group. The company is one of the largest manufacturers of television sets, air conditioners, PCs and telecom equipment. In addition to manufacturing in China, Hisense has production sites in Algeria, Hungary, Iran, Pakistan and South Africa. The company has expanded mainly through organic growth and sells 10 million television sets and 3 million air conditioners every year in more than 40 countries. International sales account for more than 15 per cent of revenue (it's the best-seller of flat-panel TV sets in France). Hisense's success formula: stylish consumer products at an affordable price and a continuous stream of innovations. Its R&D facility is located in its home-market, China, which is a huge market and a demanding one too. This gives Hisense a super scale and low-cost manufacturing base. India's automobile maker, Mahindra & Mahindra follows this model of taking its brand global. How does M&M do it can be understood from reading the Insight.

Insight.1: Mahindra's Global Rally

Does utility vehicle and tractor manufacturer, Mahindra & Mahindra's (M&M) global strategy compare with Chinese consumer electronics manufacturer, Hisense? In a sense, yes. For instance, if

Hisense took its television sets to European markets, M&M tractors rode to developed countries like the US. There was a strong rationale. India was among the top two tractor markets in the world. So the other big market, the US was the next frontier. "We went global as we felt this is one field where an Indian company can be a world leader," says V S Parthasarathy, executive vice president — international operations, farm equipment sector, Mahindra & Mahindra. There was also the fear of competition increasing on the home turf with foreign brands entering India. So M&M started looking at markets that matched their product profile (20-80 horse power engines) and markets that delivered large volumes. But markets like western Europe which uses 150 horse power engines were ruled out. Apart from the US, M&M also tapped markets like China — it has set up manufacturing facilities in China and sold 3,000 units in its first year. M&M also entered Australia last year. So how does M&M venture into foreign markets? "We are trying not only to leverage cost, but we are also trying to give value and build a brand. Doing it alone requires more financial investment, but we are using more than one model," says Parthasarathy. For instance, in the bigger markets like the US, M&M rides alone. In smaller markets like Sri Lanka or Serbia it uses distributors. In China, which requires a far greater local knowledge in terms of the market and the legal framework, M&M has a joint venture where it holds 80 per cent. For utility vehicles and pick-ups, the company has entered South Africa. The company also has a fool-proof checklist for global forays. This ranges from guidelines on prioritising global markets according to the size and attractiveness of market opportunities, to the micro issues of taking the brand abroad. For instance, "did an M&M manager establish contact with the foreign country's consulate in India? Did an M&M manager visit the Indian consulate in that country?" The company has certainly learnt from bitter lessons in the past. A key distributor in the US went bankrupt, the local partner in Greece stopped paying the company, a diamond merchant who offered to sell M&M jeeps in South Africa did not have the right intentions. Now M&M executives speak a different language. "To reduce risk you must do your homework," says Parthasarathy. The company claims to have spent about a year before starting alone in the US, nearly six-eight months researching China before they entered that market and so on. For selling its utility vehicles too, M&M plays the value game. "Our approach is to provide value for money products that meet the aspirations of the people in these countries," says Pravin N Shah, executive vice president, overseas operations, automotive sector, M&M.

According to him, this approach is more flexible and well-rounded. "In foreign markets, you need to be seen as someone who is really committed," he says. Hence, M&M set up Mahindra South Africa as a separate venture. While the current approach may require more investments, it will help in competing with global companies, believe M&M executives.

Model Two: Turning RDE Engineering Into Global Innovation

Twenty-two of the RDE 100 companies are pushing their international clout by marketing innovative technology-based solutions to leverage their strengths in engineering and research. An example is Wipro, the Indian IT services group. Wipro has expanded rapidly by providing software coding support. It was a $545 million company in 2000. By 2004, it became a $1.8 billion company. At present, Wipro is taking innovation to the next level by building extensive engineering capabilities, thus making R&D services the next battleground. The company already claims to be the world's largest third party provider of R&D services. Its 12,000 strong product engineering services (PES) group offers R&D services from product strategy to hardware design and quality consulting for clients who sell electronics-based products. Growing at 36 per cent per year for the last three years, this business group accounts for 36 per cent of Wipro's revenue.

Model Three: Assuming Global Category leadership

Only 12 companies from the list are growing by establishing themselves as specialists and global leaders in one specific, relatively narrow, product category. For instance, Hong Kong's Johnson Electric had $1.1 billion revenue in 2004 — 67 per cent of that came from outside of Asia. The company is the global market leader in small electric motors for automotive, consumer and various commercial applications. The company can produce 3 million motors every day in China alone. This is complemented with other manufacturing sites in Latin America, US, western Europe and R&D centres in Israel, Italy, Japan and the US. While putting a strong emphasis on aggressive organic growth, the company has also pursued multiple overseas acquisitions in the US of its tier-one suppliers. In parallel, the company is also using acquisitions to broaden its capability base and move into more specialised product lines such as precision piezoceramic motors (it bought Israel's Nanomotion) and digital camera motors (it acquired Japan's Nihon Mini Motor). Then Johnson has the other China advantages — superscale, high volumes and low global unit costs. In India, companies like Bharat Forge and Crompton Greaves principally follow the engineering-led innovation approach (like Wipro too), they have managed to establish strong positions in their categories. Take the example of Bharat Forge, which is the second largest forging company in the world.

Model Four: Monetising RDE Natural Resources Globally

Thirteen of the RDE 100 companies adopt this approach. They leverage their home country's natural resource advantages. Prime examples are Brazilian food processors Sadia and Perdigao, with annual revenue of $2.2 billion and $1.8 billion respectively. Half of their turnover comes from more than 100 countries. Both companies hold 30-50 per cent shares of the Brazilian market in their main product lines. Both operate along the entire value chain from farming to marketing chilled and frozen foods and high value added products like ready-to-eat meals. Both the companies' expansion models focus on growing their domestic production capacity, while investing in overseas supply chain management capabilities. Their key competitive advantage lies in abundant production resources for pork, poultry and grain which is complemented by ideal growing conditions for animal feed and by low labour costs.

Both have hatcheries that are among the most productive in the world, achieve low production costs and high yields with highest quality standards. In India, Hindalco and Tata Steel follow this model. The $2.5-billion Hindalco is Asia's largest producer of finished aluminium and alumina. It's also India's largest integrated copper producer. With India having the fifth largest reserves of bauxite in the world — reserves that could last for more than 20 years — Hindalco has an inherent competitive advantage. Similarly, in steel making, India has access to some of the richest supplies of iron ore, which gives Tata Steel a competitive edge.

Model Five: Rolling out New Business Models to Multiple Markets

These 13 companies are building regional or global portfolios in their respective businesses by rolling out business models that were pioneered in their home markets. Cemex, the $15.3-billion Mexican cement conglomerate is an example. One of the largest ready-mix concrete companies in the world, Cemex is vertically integrated and generates 79 per cent of its revenue abroad. It has built a global presence with acquisitions in America, Asia-Pacific, west Asia and Europe. The key to Cemex's success is in its rigorous approach to integrating and running acquisitions in a way that it covers every aspect of the business. Integral to this approach is a seasoned M&A and integration team that executes serial acquisitions. A number of companies which follow this model are still in the early stages of globalisation. Indian companies adopting this approach include VSNL and Reliance.

Model Six: Acquiring Natural Resources

In contrast to others, the 12 companies in this category are expanding overseas to acquire vital raw materials for their home markets. Companies in this category are active either in fossil fuels or metal and mining products. Nine of the 12 companies who follow this strategy are Chinese. A good example is Shanghai Baosteel Group Corporation, China's biggest steel maker. The company has a production capacity of 20 million tonnes of crude steel a year (half of Arcelor's capacity). But more than 98 per cent of its revenue comes from China. To secure stable supplies, Baosteel acquired a 50 per cent stake in Brazilian CVRD's Agua Limpa iron mining complex in 2001. A year later it invested in a joint venture with Hamersley Iron, an Australian subsidiary of Rio Tinto group. In India, ONGC follows this model. It has expanded globally to access oil resources and has committed investments of $4.3 billion in overseas exploration projects.

Companies from the rapidly developing economies may broadly fit into one of the six strategies. But there is a rider: while these strategies are distinct in principle, they often overlap in practice. For instance, while Tata Steel monetises natural resources of its home country, it is also rolling out business models that are perfected in its home country in its acquired businesses abroad. The RDE 100 also have some features in common. First of all they build on positions of low cost — a key competitive advantage of rapidly developing economies. Virtually all the companies are adept at learning and adapting. This is what enables them to learn the lessons of established companies. Moving forward, that might be their biggest strength

Emerging Profile

The RDE 100 companies grew at 24 per cent year-on-year from 2000-04 while the India 21 grew even faster — 30 per cent. The RDE companies also earned operating margins of 20 per cent over sales, compared to 16 per cent for US S&P 500 companies and 10 per cent for Japan's Nikkei companies. The India 21 beat the crowd again with operating margins of 25 per cent. Still, these emerging challengers have their strengths and weaknesses.

Strengths

They operate in rapidly growing markets and become quite large on their home turf before venturing abroad Working in a difficult operating environment at home creates high capabilities while going abroad. Most RDEs are key markets for MNCs. They become training grounds for competing with global incumbents. Low cost in labour, property, equipment, raw materials and capital.

Weaknesses

Low on innovation. Between 1999-2003, 100 RDE companies were granted only 3,900 US patents. Japanese companies alone got 166,000 patents in the same period. Supply chain. Added costs can wipe out manufacturing cost savings. Establishing a foothold in a new highly developed market is not very easy. Shortage of managers with international experience.

Summary

Each company's path of development is unique. Companies that decide to expand beyond their home country change. Development of a company from domestic to transnational involves lot of action. Different companies follow different route. Some companies achieve this through organic growth. That is growing on its own systematically. Some follow inorganic route by acquiring other companies or brands. Companies are not pure types: actual companies are almost always a mixture of the different stages of development. Some have moved through all of the stages in an orderly progression and others have leapfrogged to develop as global or transnational companies.

The benefits of international operations are considerable. Trade moderates inflation and improves both employment and standard of living, while providing better understanding of business process at home and abroad. For many companies, survival or the ability to diversify depends on the growth, sales and profits from abroad.

The more commitment a company makes to overseas markets in terms of personnel, sales, and resources, the more likely it will become a multinational corporation (MNC). There is a growing trend that more and more corporations from rapidly developing economies challenging the supremacy of corporations from advanced economies.

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Lesson 1.4 - International Management – Ideas and Insights

Introduction

The prime objective of this lesson is to provide basic ideas and insights of international business practices to the self-learner. What are the top trends influencing business organizations and how managers of global companies are responding to them forms the core of this lesson. We also see how companies adapting to the new situation with examples from Indian and foreign perspective.

Executives Take on the Top Business Trends

Consulting firm McKinsey conducted a global survey with executives of MNCs regarding top business trends. Executives report an accelerating pace of change in an increasingly competitive business environment, driven by knowledge and information trends and the forces of globalization. In brief the findings of the survey are as follows;

- Executives see innovation and the free flow of information as the primary drivers of ever-faster change in the business world.
- Eighty-five percent describe their own business environment as more competitive than it was five years ago, largely because of the improved capabilities of their competitors and growth in the number of low-cost competitors.
- Executives predict that future profitability will depend most on knowledge and information trends and the forces of globalization.
- Executives say that their companies are better prepared to cope with core risks in their own industries than with general threats such as a pandemic or natural disaster.

The following sub sections describe the findings of the survey in detail.

Forces Shaping the Business Environment

Executives around the world see innovation and the free flow of information as the primary drivers of an accelerating pace of change in the global business environment. At the same time, executives continue to confront familiar and powerful forces that bear the unmistakable signature of an emerging global market—plentiful, cheap and mobile capital; expanded access to talent and labor pools; and a reduction in trade barriers. The survey findings paint a picture of an increasingly competitive business world, characterized by great opportunity and risk. But while executives appear to have opportunities at the front of their minds, they may be underrating some of the equally great risks involved. The respondents cited a broad range of factors that they see as contributing most to the accelerating pace of change. Of these, innovation in products, services and business models as well as the greater ease of obtaining information and developing knowledge figure most prominently, with 41 percent of the responses.

Against the backdrop of accelerating change, 85 percent of respondents describe the business environment in which their companies operate as "more competitive" (45 percent) or "much more competitive" (40 percent) than it was five years ago. The intensity is increasing for small as well as big companies, and in all industries. Executives report notable differences, however. Judging by the responses, telecommunications is the toughest industry: more than six in ten of its representatives see it as much more competitive. At the other end of the scale is the business services industry: just over three in ten of its representatives say their industry is much more competitive, and marginally less than half view it as more competitive.

While the executives clearly agree that competitive intensity is increasing within their industries, they have differing takes on which factor contributes most to this development. Close to 25 percent single out the improved capabilities of their competitors—as measured by knowledge and talented employees, for instance—and almost as many note a growing number of low-cost competitors. Opinions about the competitive challenges differ by industry. More than one-third of heavy-industry representatives, as opposed to just one in ten in financial services, single out low-cost competitors as the most important factor. Telecom executives are almost twice as likely as respondents from other industries to be concerned about innovative market entrants. Managers in health care view regulatory changes as the most important factor behind growing competition in their industry

Trends to Watch

To a large degree, the global business landscape is shaped by macroeconomic, social and environmental, and business trends. Correctly anticipating their future impact on global business and on the profitability of individual companies can enable companies to succeed by riding the currents rather than swimming against them. Respondents rate two macroeconomic trends namely the growing number of consumers in emerging economies and the shift of economic activity between and within regions and the business trend of greater ease of obtaining information and developing knowledge will be most important for global business during the next five years. However, when assessing the impact on the profitability of their own company, they place this business trend first and rate a related social development (the increasing communication and interaction in business and social realms due to technological innovation) almost as highly as the two macroeconomic trends.

The result appears to reinforce this survey's findings about the growing role of information and knowledge in driving the pace of change and shaping the global business environment. A significant finding about another important trend—increasingly global labor and talent markets—is that it ranks somewhat higher than average in India and North America as well as in the IT and business services industries. Notably, executives expect most of the ten trends to be substantially more important to global business overall than to the profitability of individual companies. A significant exception is the application of scientific techniques and approaches to business management.

Preparing for Risk

Managing risks will be one of the keys to corporate success in a fast-moving, increasingly competitive, and global economy. Yet only three respondents in ten report that their companies have taken active steps to prepare for any one of the following scenarios that could harm virtually any company: a pandemic, a natural disaster, or increased geopolitical instability, such as terrorism. The state of preparedness is significantly higher for what appear to be core risks in individual industries. Around 70 percent of executives in health care, financial services, and telecommunications say that their company has taken active steps to prepare for major regulatory changes. More than half of the respondents in the health care industry report preparations for pandemics (for example, avian flu or SARS).

In heavy industry, 65 percent of executives say their company is prepared for significant shortages or steep increases in the price of raw materials. Generally speaking, bigger companies are better prepared than smaller companies. At companies with annual revenues of less than $1 billion, more than 20 percent of respondents report that their company has not prepared for any such risks. At companies with annual revenues of more than $1 billion, less than 5 percent were equally unprepared.

Planning Ahead

A long-term strategic-planning process can be a powerful tool for identifying growth opportunities and external risks. Asked how their strategic planning is organized, executives revealed significant differences between small and big companies. Those at companies with annual revenues of more than $1 billion have a process that takes place at more levels of the organization and has a longer time horizon.

When executives are probed about what strategic planning achieves at their companies, an interesting divergence emerges. C-level executives are more confident than their lower-ranking counterparts that the process results in concrete measures. Top executives also emphasize the effectiveness of their company's strategic planning in identifying new opportunities for growth. Others, in turn, underline its role in the annual budgeting process.

Response of Corporations

In the following sub sections we have given the responses of Indian and global organizations the way they are responding to the changes through examples.

MNC Fast Food Chains Go 'Local'

After almost a decade in our country, transnational fast food retail chains like KFC, McDonald's, Domino's, Pizza Hut and others are re-learning marketing lessons and segmenting their product portfolio to capture Indian consumers across diverse income levels and lifestyles. The strategy is an attempt by top food retailers to tone up profit margins with a multi-layered product portfolio that addresses the aspirational need of consumers willing to splurge while meeting the basic requirement at the bottom end. Retailers have intensified the localisation of products to cater to the Indian demand of 'your kind of place but our kind of food' and wooing consumers to shift from the unorganised to organised outlets. Globally too, profit worries have led to food retailers moving away from a pure volume-focused strategy.

"We have learnt that while Indian consumers like our ambience, the food has to meet their local tastes. A consumer in an urban setting is as value-seeking as a consumer in a non-urban market like Ludhiana is willing to splurge. We have therefore adopted a multi-layered marketing strategy. The attempt is to have a multi-dimensional approach of meeting the needs of a Karol Bagh shopkeeper, a Tamilian diner or a Gujarati businessman while meeting the demands of a globe traveller," said Mr.Arvind Mediratta, chief marketing officer (Indian subcontinent) of Yum! Restaurants International, which owns KFC, Pizza Hut, Taco Bell and other food chains.

Companies are learning that local needs and global brand images do not necessarily function on mutually exclusive terms. KFC has introduced a range that offers a complete meal to value-seeking Indian consumers on regular days. The company tweaks its basket to launch aspirational food products, combining it with entertainment to attract, during weekends, consumers who are willing to splurge. Pizza Hut, for instance, has beefed up its delivery model by customising offerings to replace home meals and offering international, Indian fusion and value-meal products to target various consumer requirements.

Similarly, in line with global trends, McDonald's is addressing the need to tone up profit margins by moving away from focusing only on the value-meal segment and offering products to health-conscious consumers.

The outlet today offers Indianised products like the paneer salsa wrap or a McAloo Tikki. The focus is on having a high margin portfolio, at the same time, chasing volumes with another range of products.

Company officials said it was crucial that the brand addressed various consumer needs and is not seen merely as a children's brand. Apart from offering the Happy Meal for children, the brand is changing strategies to accommodate wider consumer requirements. McDonald's low prices and taste factors have been its main attractions while KFC's unique selling proposition (USP) has been its specialty chicken fare. Food retailers say they protect the brand's global ethos by ensuring that 60% of the offerings are international while 40% is tweaked to meet local tastes.

Godrej Consumer buys Rapidol's South Africa unit:

Godrej Consumer Products has entered into an agreement for the acquisition of the South African hair color business of the UK-based Rapidol, as well as its subsidiary Rapidol international which had as combined turnover of 52 million South African Rand (₹ 33 crore), for an undisclosed amount. The company proposes to facilitate the acquisition through a 100 per cent cash deal, subject to regulatory approvals. Acquisition gives company entry into large ethnic hair colour markets

Godrej Consumer Products, in a release to the Bombay Stock Exchange, stated that the acquisition gives the company an entry into a large ethnic hair color market through a profit making company. The South African deal will not only augment its top line and bottom line, which in turn will enhance stakeholder value, but also provides the company an opportunity to acquire the Inecto and Sofelene trademarks that would allow the company much larger territorial rights over the brand equities and the combined entity will be in a position to create value at a faster pace. It will also provide a springboard for the introduction of the company's products in South Africa and other African countries, the company said in the release.

Rapidol South Africa owns Inecto that is an internationally known brand, which enjoys a reputation of being a safe and affordable hair colourant with consumers across South Africa and the African continent. Inecto is distributed across Angola, Zambia, Mozambique, Tanzania, The

Democratic Republic of Congo, Swaziland, Ghana, Gabon, Botswana, Namibia, Lesotho, Zimbabwe, Mauritius, Seychelles and Madagascar mainly through the cash and carry route. Additionally, Godrej also proposes to introduce some of its products such as hair colors, FairGlow and Evita, viewed to enjoy a significant potential, in the African market. The company proposes to drive further value from the transaction by leveraging its high-quality low-cost manufacturing skills to considerably improve the South African offering.

Adi Godrej, chairman and managing director said; "This transaction is consistent with our endeavour to build a strong personal and household care business both in India and across the globe, especially in Hair Colors. Rapidol South Africa is a profit making company that manufactures and markets premium hair colourants in the African market." Godrej added that the brands would widen its portfolio of hair colourant and hair care offerings and give the company access to the large and growing African market. "We also propose to introduce some of our own products there, via Rapidol's established distribution network.

This is our second international acquisition in less than a year and reflects our aggressive growth focus. We will continue to pursue value enhancing inorganic and organic growth opportunities both in India and overseas," he said. The South African acquisition comes on the back of Godrej Consumer's acquisition of UK-based Keyline Brands in October 2005, which was the first international acquisition by Godrej Consumer. Currently, the group is also looking at expanding its presence to other countries in the East particularly China.

In India, it's a Brand New Way

What do you do when you are a leading MNC and want to tap into the Indian consumer market? Look at how the second best global brands have executed their India strategy.

While global market leaders have proven to be flat-footed and bookish, brands like Reebok, LG, Hyundai and Lee have stolen a march over their arch-rivals by burning the book and thinking on their feet. "Most MNC companies are run by a global manual, but those succeeded in India have shredded this manual and taken the 'when in India, go local' approach and developed on local consumer insight to chart their strategy," reasons marketing consultant Harish Bijoor, CEO, Harish Bijoor Consults. Consider Lee. When it entered India in 1995, there was a very nascent market for branded apparel, much less premium jeans wear. Premium brands like Levi's chose to play it safe by using the multi-brand outlet route, but Lee chose to go it alone and set up exclusive showrooms. According to market watchers, Levi's suffered from a brand perception problem because it was clubbed with non-premium brands.

Further, Arvind Brands, which owns the licence for Lee in India, decided to retain ownership of operations for Lee. According to Chakor Jain, head (business development, Lee), Arvind Brands, "Exclusive showrooms and owning the operations added to our costs. However, it also added to the overall customer experience, which we considered most important."

When Reebok came to India in 1995, it forged alliances with health clubs and fitness centres to create brand awareness. When the retail market matured, Reebok changed focus. Says Subhinder Sing Prem, MD, Reebok India, "On the retail front, we went about opening up new markets beginning with metros and large cities, we swiftly moved into tier II and III towns."

To further establish its brand, Reebok signed up Indian cricketers, while Nike continued showing its international advertisements in Indian media. Today, Reebok has a exclusive retail presence through 400 plus outlets, second only to Bata, while Nike lags behind. LG's is the proverbial 'third time lucky' story. After two failed joint ventures, it made a re-entry into the Indian market in 1998 all by itself. The other chaebols were on their way here, too, while Phillips and Sony were already well-established. LG began with a rapid national roll-out, mass customisation and products adapted specifically for Indian markets. It also kept its dealers happy with a wide portfolio and allowed them to cut sweet deals.

"Our success in India can be attributed to our ability to focus on empowering people, profit-driven market presence and being an open organisation, with just about all employees having access to the company's finances," says LG India's MD, KR Kim. Today, with over ₹ 7,500 crore in sales, LG leads in almost all the categories in consumer durables. When Hyundai, with a name prone to mis-pronounciation and virtually no global heritage, entered India in 1998, it signed up Shah Rukh Khan to educate the consumers about the brand. Behind the scenes, the company resorted to extensive market studies and technical camps before coming up with its first offering, Santro, a hatchback with tall boy design. And it had chosen its market well, starting with the small car. To date, Hyundai has stayed true to its strategy and played by the conventional Indian market rules tailored to suit its specific targets.

Farex to Acquire a New Taste

An ₹ 250-crore brand a few years back, Farex has now slipped to less than ₹ 10 crore. So a few eyebrows were raised when Wockhardt announced its acquisition of the baby food brand last week. But Wockhardt says it has a few plans up its sleeve to reposition the brand in a big way. That includes changing its look and flavour. The in-house spraydry milk processing technology will come in handy for Wockhardt in adding a dash of fresh milk's taste in bland Farex. It may even launch Farex in different flavours to tingle the baby palate.

This will be done to regain the lost market shares. Market research showed that babies do not like the taste of the 50-year old infant nutrition product, and seem to prefer Nestle's Cerelac, which is the leader in this segment. For Farex, Wockhardt will be its third owner. The brand had changed hands twice earlier – first, when the original owner, Glaxo, sold it to the ketchup major Heinz India almost a decade ago. Subsequently, the brand moved from Heinz to Dumex India, which was acquired by the UK-based Royal Numico in 2004. Wockhardt had last week announced the acquisition of this brand along with another medical nutritional brand Protinex in a deal, which involves takeover of Dumex India, a company owned by the UK-based Royal Numico.

Besides the two heritage brands with over 50 years of brand equity, Wockhardt inherits a strong sales and marketing organisation with 235 personnel with this deal. The acquisition follows Royal Numico's decision to exit India and focus on China and other markets. Royal Numico move to exit India comes less than a year after it acquired Farex from Heinz and at a time when the company was setting up a ₹ 100-crore plus modern manufacturing facility for nutritional supplement products. Under the agreement, Royal Numico will also offer technical know-how to Wockhardt for the manufacture of specialised sugar-free infant food products currently marketed in India and internationally, under its brand names Dulac and Dupro. These brands are fast gaining acceptance in the Indian market.

Future Beholds A Global Corp

Infosys Technologies, as it rings In Its 25th Anniversary this year is uniquely positioned to take the Global Delivery Model it has perfected, to the next level. INFOSYS CEO Nandan Nilekani is rather fond of saying "the model of the future is yet to emerge," with reference to IT services companies. Implicit in the statement is the assumption, more rather the belief, that if Infosys were to play its cards right, it will have a better shot at defining the new global standard than anybody else, local or global. Nobody can accuse Infosys or its iconic founders of thinking small. The logic being that it takes the same amount of energy and time to think big as small!

Infosys, as it rings in its 25th anniversary, is uniquely positioned to take the model it has almost perfected, to the next level. It is given that IT services as they were historically delivered by companies like EDS, CSC, IBM Global Services, is history. All of them, IBM being the most aggressive, have embraced the virtues of offshoring and of the global delivery model. In the meantime Indian IT services like Infosys who led the offshoring charge and brought about a paradigm shift in the industry are building the front ends in the US and other western markets and beefing up their consulting arms.

Infosys is betting that going from top to bottom as the big American companies are doing (from a high-cost platform with expensive consultants to a low cost platform), will prove to be more disruptive for the balance sheets of those companies than the reverse will be for Infosys and ilk. That is go from a solid low cost model and build the costlier high end in the US and Europe. Some might quibble with this theory, arguing that it is easier to set up people factories in India and other low-cost destinations than to build a strong brand and front end in the Western world. Infosys, of course, isn't buying the 'toughness' of this argument. The 'model of the future,' that Infosys wants to script to a large extent depends on it emerging as a true global corporation. To its chairman and talisman, NR Narayana Murthy, Infosys will be truly global when it will be able to walk into the top campuses in the world and get the best talent from there to work for it.

Infosys, as he points out, is already truly global in terms of its customers. As over 90% of its revenues flow in from overseas, it follows that its clients are outside of India. It now needs to get global in terms of employees, and geographical presence. As K Dinesh, a co-founder of Infosys says: "Our biggest challenge will be to be a truly global company. Today, we are still very India centric though we have 38 nationalities working with us. We need to be present in all the continents and not just US and Europe."

While the company has local nationals on its sales team, it is now planning to set up HR hubs overseas and increase the number of foreign nationals even in the delivery function. As Infosys crosses the quarter century mark and aims for true blue MNC status, another issue it needs to confront is, 'Who, after the founders?'

This is not an immediate concern as Nilekani at 51 has another seven years to retirement. But with the rest of the promoters being in Nilekani's age bracket, it is essential for the company to groom the next tier, who at the moment aren't visible, publicly at least. Also, one might argue that the first 25 years were the easy ones. The absolute ignorance about the IT sector meant that Infosys grew to its current size is attracting very little attention from the political establishment. But increasingly as its ambitious growth targets and need to house its thousands of employees run smack into political forces who are inimical to parting with land in boom towns like Bangalore, Infosys' ability to tread the fine line will become critical.

Welspun Wraps up UK's Christy

Welspun India today announced that acquisition of 85 per cent stake in CHT Holdings, the promoters of UK's leading towel brand Christy, for an enterprise value of ₹ 132.6 crore. The acquisition is in line with the company's strategy of emerging as one of the largest global home textile company by 2008. B K Goenka, vice-chairman and managing director of Welspun India, said the company had paid ₹ 100 crore towards the acquisition. The company mobilised ₹ 40 crore from internal resources and took a loan of ₹ 60 crore from Bank of India. Standard Chartered Bank advised Welspun on the deal.

Following the announcement of the acquisition, the share price of Welspun closed at ₹ 87.70 on the BSE, 12.51 per cent higher over its previous ₹ 77.95. The balance 15 per cent stake will continue to be with CHT management. Welspun will acquire the stake after three years. Both the parties shall be able to exercise a put / call option after April 1, 2009. Rajesh Mandawewala, joint MD of Welspun has been appointed as chairman of Christy. Founded in 1851, Christy is the world's oldest towel maker and enjoys 75 per cent share of the UK market with an annual turnover of pound 35 million (nearly ₹ 284 crore). It invented the first loom to mechanically weave and the sole supplier to Wimbledon Championship tennis towel. It supplies to retailers such as Mark and Spencer's and John Lewis in UK.

Goenka, said, "We want to benefit from Christy's product technology. Christy also complements our recent initiatives to develop a more robust model providing global consumers including the UK and US with contemporary products for the home." The acquisition is expected to give Welspun an access to UK and European markets and extend the Christy brand to domestic consumers through Welspun retail. Welspun is expected to cross the $1 billion mark at the end of the current financial year. Welspun said it would realign its US distribution network with Christy's own network. Joel Rosenblatt, CEO of Christy, said the company expected to post a turnover of nearly ₹ 338 crore next year. Welspun is the largest terry towel producer in Asia and fourth largest in the world.

Outsourcing is passe, companies now bet on Co – sourcing:

New methods of outsourcing are today redefining the way of working. One such way is co-sourcing which is an investment relationship marked by shared objectives, shared risks and shared rewards between two companies, one of which is a service provider. Specifically, the service provider would have to help restructure the company and be willing to make new investments, while driving out costs from the co-sourcing company's existing ways working.

According to a joint case study by Accenture and Thomas Cook, the cosourcing agreement between Accenture and Thomas Cook, UK and Ireland has helped Thomas Cook to improve operations and reduce costs. The study notes that due to the alliance, Thomas Cook has been able to save £140 million ($243.72 million) in 16 months.

The more recent expansion of services at Accenture's delivery centre capabilities has resulted in an additional 30% savings. The study notes that under a 10-year arrangement, Accenture transitioned approximately 60% of the shared services workload, including functional areas such as application management, accounting operations, payroll help desk and training administration, to its delivery centre in Bangalore.

The remaining shared services resources focused on more strategic activities, including IT operations, reporting and payroll processing. The term was able to migrate the majority of the work in six months, and completed the transition in 11 months with all transition goals met on time and on budget.

Accenture had initially collaborated with Thomas Cook UK and Ireland to share a 10-year co-sourcing arrangement. The main component of this agreement was a cost-effective shared services centre co-located in Peterborough, United Kingdom. Accenture and Thomas Cook designed the shared services centre to be a multi-process centre covering all the services under one roof.

According to Carl Dawson, Thomas Cook UK and Ireland's IT director, "We knew that co-sourcing would enable us to create a single administrative focus, with a single set of information systems under the management of experts.

In addition, the arrangement would free Thomas Cook UK from non-strategic functions, allowing it to propel its business forward." To support the shared services model, Accenture transferred nearly 400 Thomas Cook employees to Accenture. Accenture also collaborated with Thomas Cook to develop a single, integrated SAP platform for the entire business. Given the cost savings and other benefits, co-sourcing can well be the new model for outsourcing allowing both parties to retain stake.

Summary

In future we will see the emergence of economic domains, which have no regard to borders. The world is reorganising itself around economic domains. Celebrated futurist John Naisbitt spoke about globalisation long before anyone did in the 1980s. He predicted the rise of China and Asia in 1996, much before the now famous Goldman Sach's BRIC report. In his latest book Mind Set he has given eleven mindsets which may help global business managers to have better perspective of global trends. He mentioned that the compulsion to be right is the enemy of creativity and growth. Organizations should not worry about wrong decisions. They should learn from their mistakes. The success as well as failure stories have to be documented and should be shared among different divisions, entities, subsidiaries, etc., One of the key mindsets is that you get results not by solving problems but by seeking opportunities. Problem solvers are necessarily dealing with yesterday. Most of the business organizations are responding proactively to the changes in the international business environment and reaping rich benefits.

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Lesson 1.5 - International Management – Schools of Thought

Introduction

International business activity is not new. The transfer of goods and services across national borders has been taking place for thousands of years. Since the end of World War II, however, international business has undergone a revolution. Contemporary business is characterized by growing globalization. Globalization refers to the process of internationalization, typical of open economies. There are different theories which explain how and why MNCs come up, in what direction they are moving or when they will take a definite form, etc., Let us discuss briefly these theories in the following sections.

International Trade Theories

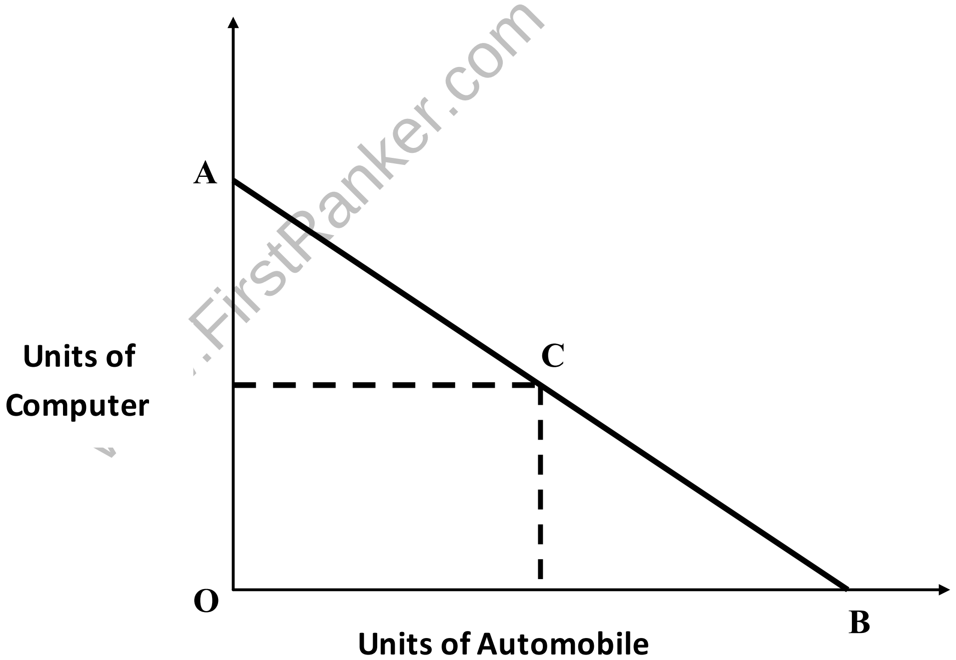
Whenever a buyer and seller come together, each expects to gain something from the other. The same expectation applies to nations that trade with each other. It is virtually impossible for a country to be completely self-sufficient without incurring undue costs. Therefore, trade becomes a necessary activity, though in some cases trade does not always work to the advantage of the nations involved. Virtually all governments feel political pressure when they experience trade deficits. Too much emphasis is often placed on the negative effects of trade, even though it is questionable whether such perceived disadvantages are real or imaginary. The benefits of trade, in contrast, are not often stressed, nor are well communicated to workers and consumers.

Why do nations trade? A nation trades because it expects to gain something from its trading partner. One may ask whether trade is like a zero-sum game, in the sense that one must lost so that another will gain. The answer is no, because though one does not mind gaining benefits at someone else's expense, no one wants to engage in a transaction that includes a high risk of loss. For trade to take place, both nations must anticipate gain from it. In other worlds, trade is a positive sum game.

In order to explain how gain is derived from trade, it is necessary to examine a country's production possibility curve. How absolute and relative advantages affect trade options are based on the trading partners' production possibility curves.

Production Possibility Curve

Without trade, a nation would have to produce all commodities by itself in order to satisfy all its needs. Exhibit shows a hypothetical example of a country with a decision concerning the production of two products, computers and automobiles. This graph shows the number of units of computer or automobile the country is able to produce. The production possibility curve shows the maximum number of units made when computers and automobiles are produced in various combinations, since one product can be substituted for the other within the limit of available resources. The country may elect to specialize or put all its resources into making either computers (point A) or automobiles (point B). At point C, product specialization has not been chosen, and thus a specific number of each of the two products will be produced.



Production Possibility Curve: Constant Opportunity Cost

Because each country has a unique set of resources, each country possesses its own unique production possibility curve. This curve, when analyzed, provides an explanation of the logic behind international trade.

Regardless of whether the opportunity cost is constant or variable, a country must determine the proper mix of any two products and must decide whether it wants to specialize in one of the two. Specialization will likely occur if specialization allows the country to improve its prosperity by trading with another nation. The principles of absolute advantage and relative advantage explain how the production possibility curve enables a country to determine what to export and what to import.

Mercantilism

According to the philosophy of mercantilism prevalent in the sixteenth and seventeenth centuries, nations should create and accumulate wealth through trade, by maximizing net export surplus (exports minus imports). Accordingly trade and commerce was deemed more important than manufacturing and production. Several trading companies such as East India Company and Dutch India Company started exploring and exploiting colonies like India in search of raw materials and market for the finished goods of mother countries like England and Holland. Thus, the then MNCs in the crudest form confined only to trading initially and eventually tried to build an empire in the form of which capitalism spread.

This theory emphasizes the responsibility of the state to protect and promote national wealth by encouraging exports and limiting imports. Since wealth is limited, trade between nations is a zero-sum game, so one country can only benefit at the expense of another. Mercantilism was advocated by a number of English, French and German writers, many of whom were merchants. Leading Mercantilists included Gerald Malynes (1586-1641), Thomas Mun (1571-1623) and John Locke (1632-1704). Mercantilists welcomed government involvement in economic matters as a means of stimulating the creation of wealth, and favored such policies as high-import tariffs, prohibition of bullion exports, and exchange control.

Absolute Advantage Theory

This model comes under classical economic model suggests the use of the principles and policies of *laissez faire* to get the best out of a development process. Extension of this philosophy from domestic to international transactions implies that 'free-trade' is better than 'restricted trade' which is better than 'no-trade'. The wealth of nations can grow only through free-trade between countries based on the principle of 'Absolute Cost Advantage' or Comparative Cost Advantage'. Either way, free trade will generate 'gains from trade'. As a corollary, countries should encourage not only foreign trade, but also foreign investment.

Absolute advantage theory of Scottish economist Adam Smith (1723-1790) was an international trade history theory that asserted individuals or nations trade because they have superior productivity in particular industries. Nations should produce and export goods for which they possess an absolute advantage and import others which other nations possess an absolute advantage for. A country has an absolute advantage economically over another when it can produce something more cheaply. Governments may attempt to counter absolute advantage by erecting trade barriers, allowing young, uncompetitive, industries enough time to become established. Adam Smith's absolute advantage theory was superseded by the comparative advantage approach.

Comparative Advantage

The theory of comparative advantage explains why it can be beneficial for two to trade, even though one of them may be able to produce every kind of item more cheaply than the other. What matters is not the absolute cost of production, but rather the ratio between how easily the two countries can produce different kinds of things. The concept is highly important in modern international trade theory.

Comparative advantage was first described by Robert Torrens in1815 in an essay on the corn trade. He concluded that it was to England's advantage to trade various goods with Poland in return for corn, even though it might be possible to produce that corn more cheaply in England than Poland. However, the theory is usually attributed to David Ricardo, who explained it in greater detail in his 1817 book *The Principles of Political Economy and Taxation* in an example involving England and Portugal. In Portugal it is possible to produce both wine and cloth with less work than it takes in England. However, the relative costs of producing those two goods are different in the two countries. In England it is very hard to produce wine, and only moderately difficult to produce cloth. In Portugal both are easy to produce. Therefore, while it is cheaper to produce cloth in Portugal than England, it is cheaper still for Portugal to produce excess wine, and trade that for English cloth. Conversely, England benefits from this trade because its cost for producing cloth has not changed but it can now get wine at closer to the cost of cloth.

In simple words David Ricardo showed that a nation might properly import goods it could make itself with a lower expenditure of labour as long as its relative efficiency in making other exportable goods was greater. He suggested that specialization, based on absolute cost advantage, would not be possible because of the immobility of both capital and labour. However, the assumption of this theory were questioned by many.

Critical Analysis of Ricardo's Theory

Ricardo's principle relies on a variety of implicit assumptions that are debatable, such as that there is no (or a low) cost for transportation, and that the advantages of increased production outweigh externalities such as environmental contamination or social inequities. Opponents of free trade often point out that globalized communications and transportation unavailable in Ricardo's time invalidate the assumption of capital immobility and cause capital to gravitate toward absolute advantage. Another concern is that comparative advantage only works when competition is absolutely perfect. It has also been argued that comparative advantage may reduce economic diversity to risky levels. Advice to diversify one's portfolio is allegedly generally applicable to economies also. Some would dissent, however, and say that globalization has decreased transportation costs and despite the increased movement of capital, differences in capacities of production are still wide, in fact, usually the opponents of globalization also claim that the gap is widening. As to perfect competition, supporters of the theory claim that this could be achieved through universal free trade, which although has not been achieved to date should be an active goal of state leaders.

Heckscher-Ohlin Trade Theory (1919)

First developed by Eli Heckscher (1879-1952) and later developed by fellow Swedish economist Bertil Ohlin (1899-1979) in 1933, Heckscher-Ohlin trade theory is a theory to explain the existence and pattern of international trade based on a comparative cost advantage between countries producing different goods. Heckscher and Ohlin state that this advantage exists because of the relative resource endowments of the countries trading. Heckscher-Ohlin identified the source of comparative advantage not just in labour costs but in total 'factor-endowments' in different countries. A labour-abundant country will specialize in the production of labour-intensive goods; a capital-abundant country will specialize in the production of capital-intensive goods. Accordingly, there will be trade between countries depending on their respective factor-endowments. A labour-abundant country will export labour-intensive goods, but import capital-intensive goods. However, the Russian-born American economist Wassily Leontief (1906-1999) in 1954 examined US foreign trade and found that US exports were more labor intensive and imports were more capital intensive (the Leontief paradox). Whereas we believe US is capital-abundant rather than labour-abundant.

This generalization is based on the tacit assumption of factor immobility, identical production functions, perfect competition, zero information costs, absence of external economies of production, scale and norms of market efficiency-all these conditions being obtained with the trading partners. On this basis countries will enter international trade until it 'equalizes factor prices between countries' (Samuelson). The major weakness of this model lies in the unrealistic nature of the underlying assumptions. In particular, in today's world, factors like labour, capital and technology are mobile among the countries. Therefore, empirical findings on flows of foreign capital, foreign technology, foreign goods and services, foreign brand names across countries often negate the proposition of this model.

Trade Theories – Conclusion

Trade theories, in spite of their usefulness, simply explain what nations should do rather than describe what nations actually do. The desired trade pattern based on those theories related to comparative advantage and factor endowment often deviates significantly from the actual trade practice. It is thus necessary to modify the theories to account for the divergence caused by extraneous variables. Industrial nations' high-income levels for instance may foster a preference for high-quality products that least developed countries (LDCs) may be unable to supply. Furthermore, trade restrictions, a norm rather than an exception, heavily influence the extent and direction of trade, and any investigation is not complete without taking tariffs, quotas, and other trade barriers into consideration. Perhaps the most serious problem with classical trade theories is their failure to incorporate marketing activities into the analysis. It is inappropriate to assume that consumers' tastes are homogeneous across national markets and that such tastes can be largely satisfied by commodities that are homogeneous. Marketing activities such as distribution and promotion add more value to a product, the success of the product is often determined by the planning and execution of such activities.

In theory, the more different two countries are, the more they stand to gain by trading with each other. There is no reason why a country should want to trade with another that is a mirror image of itself. However, a look at world trade casts some doubt on the validity of classical trade theories. Developed countries trade more among themselves than with developing countries.

Alternative Models

This section outlines a brief view of alternative models, which also influence the major international business decisions.

Theory of International Product Life Cycle

Long-term patterns of international trade are influenced by product innovation and subsequent diffusion. A country that produces technically superior goods will sell these first to its domestic market, then to other technically advanced countries. In time, developing countries will import and later manufacture these goods, by which stage the original innovator will have produced new products.

The international product life cycle (IPLC) theory, developed by Vernon and others economists to explain trade in a context of comparative advantage, describes the diffusion of an innovation across national boundaries. The life cycle begins when a developed country, having a new product to satisfy consumer needs, wants to exploit its technological breakthrough by selling abroad. Other advanced nations soon start up their own production facilities, and before long LDC's do the same.

Efficiency / comparative advantage shifts from developed countries to developing nations. Finally, advanced nations, no longer cost-effective, import products from their former customers. The moral of this process could be that an advanced nation becomes a victim of its own creation.

The international product life cycle can be defined as market life span stages the product goes through in international markets sequentially, simultaneously or asynchronously. The sequential stages are introduction, growth, maturity, decline and extinction in the international markets. When a product is positioned in different international markets at the same time and is going through similar life cycle stages, the cycle process is simultaneous. The life cycle stages are asynchronous when the product is in different stages in different international markets at the same time. The life cycle stage in which a product can be positioned is influenced by macro variables indigenous to country markets.

Stanton and others cite examples of this phenomenon. Steel-belted auto radial tires had reached the saturation level in Western Europe when they were being discovered by the U.S. market. Thus it was in the maturity stage in Western Europe and introductory stage in the United States.

Technological Gap Theory

Technological gap theory proposes that changes in international trade are dictated by the relative technological sophistication of countries. Some nations, such as the US or Japan, have a competitive trade advantage because of their ability to innovate. Over time, other countries will bridge a particular gap although the really innovative will have opened others.

Diamond Model – Competitive Advantage of Nations

The Diamond model of Michael Porter for the Competitive Advantage of Nations offers a model that can help understand the competitive position of a nation in global competition. This model can also be used for other major geographic regions.

Traditionally, economic theory mentions the following factors for comparative advantage for regions or countries:

A. Land

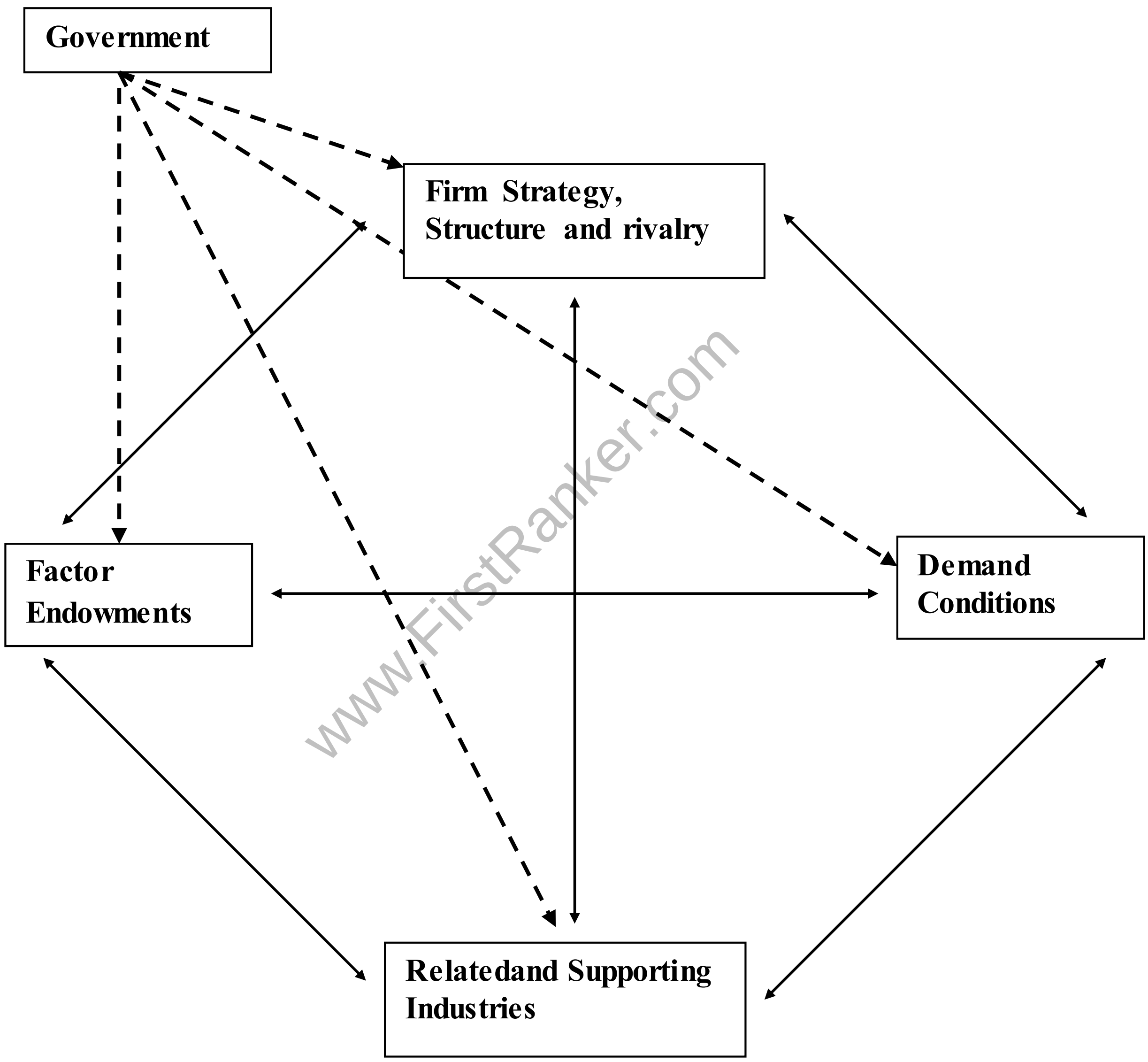
B. Location

C. Natural resources (minerals, energy)

D. Labor, and

E. Local population size.

Because these factor endowments can hardly be influenced, this fits in a rather passive (inherited) view towards national economic opportunity.



Porter's Diamond Model for Competitive Advantage of Nations:

Porter says sustained industrial growth has hardly ever been built on above mentioned basic inherited factors. Abundance of such factors may actually undermine competitive advantage! He introduced a concept of "clusters," or groups of interconnected firms, suppliers, related industries, and institutions that arise in particular locations.

As a rule Competitive Advantage of nations has been the outcome of 4 interlinked advanced factors and activities in and between companies in these clusters. These can be influenced in a pro-active way by government. These interlinked advanced factors for Competitive Advantage for countries or regions in Porters Diamond framework are:

1. **Firm Strategy, Structure and Rivalry** (The world is dominated by dynamic conditions, and it is direct competition that impels firms to work for increases in productivity and innovation)
2. **Demand Conditions** (The more demanding the customers in an economy, the greater the pressure facing firms to constantly improve their competitiveness via innovative products, through high quality, etc)
3. **Related Supporting Industries** (Spatial proximity of upstream or downstream industries facilitates the exchange of information and promotes a continuous exchange of ideas and innovations)
4. **Factor Conditions** (Contrary to conventional wisdom, Porter argues that the "key" factors of production (or specialized factors) are created, not inherited. Specialized factors of production are skilled labour, capital and infrastructure. "Non-key" factors or general use factors, such as unskilled labor and raw materials, can be obtained by any company and, hence, do not generate sustained competitive advantage. However, specialized factors involve heavy, sustained investment. They are more difficult to duplicate. This leads to a competitive advantage, because if other firms cannot easily duplicate these factors, they are valuable).

The role of government in Porter's Diamond Model is "acting as a catalyst and challenger; it is to encourage - or even push - companies to raise their aspirations and move to higher levels of competitive performance". They must encourage companies to raise their performance, stimulate early demand for advanced products, focus on specialized factor creation and to stimulate local rivalry by limiting direct cooperation and enforcing anti-trust regulations.

Porter introduced this model in his book: The Competitive Advantage of Nations, after having done research in ten leading trading nations. The book was the first theory of competitiveness based on the causes of the productivity with which companies compete instead of traditional comparative advantages such as natural resources and pools of labour.

Competitive Models of International Business

The following section deals with models of contemporary nature and very useful for strategy formulation of MNCs.

Core Competency

The concept of core competencies was developed in the management field. C.K.Prahalad and Gary Hamel introduced the concept in a 1990 Harvard Business Review article. They wrote that a core competency is "an area of specialized expertise that is the result of harmonizing complex streams of technology and work activity." As an example they gave Honda's expertise in engines. Honda was able to exploit this core competency to develop a variety of quality products from lawn mowers and snow blowers to trucks and automobiles. To take an example from the automotive industry, it has been claimed that Volvo's core competence is safety. A company's core competency are things that a firm can do well and that meet the following three conditions;

1. It provides customer benefits,
2. It is hard for competitors to imitate, and
3. it can be leveraged widely to many products and markets.

A core competency can take various forms, including technical / subject matter know how, a reliable process, and/or close relationships with customers and suppliers. It may also include product development or culture such as employee dedication. Modern business theories suggest that most activities that are not part of a company's core competency should be outsourced. If a core competency yields a long term advantage to the company, it is said to be a sustainable competitive advantage.

Ever since this concept is introduced in the 1990's many researchers have tried to highlight and further illuminate the meaning of core competence. According to Leonard-Barton, D. "Capabilities are considered core if they differentiate a company strategically". On the other hand Galunic and Rodan (1998) argue that "a core competence differentiates not only between firms but also inside a firm it differentiates amongst several competencies. In other words, a core competency guides a firm recombining its competencies in response to demands from the environment".

It is important to distinguish between individual competencies or capabilities and core competencies. Individual capabilities stand-alone and are generally considered in isolation. Gallon, Stillman, and Coates (1995) made it explicit that core competencies are more than the traits of individuals. They defined core competencies as "aggregates of capabilities, where synergy is created that has sustainable value and broad applicability." That synergy needs to be sustained in the face of potential competition and, as in the case of engines, must not be specific to one product or market. So according to this definition, core competencies are harmonized, intentional constructions. Coyne, Hall, and Clifford (1997) proposed that "a core competence is a combination of complementary skills and knowledge bases embedded in a group or team that results in the ability to execute one or more critical processes to a world class standard." Two ideas are especially important here. The skills or knowledge must be complementary, and taken together they should make it possible to provide a superior product."

For example, Black and Decker's core technological competency is in 200 to 600 W electric motors. All of their products are modifications of this basic technology (with the exception of their work benches, flash lights, battery charging systems, toaster ovens, and coffee percolators). They produce products for three markets;

1. **The home workshop market** - In the home workshop market, small electric motors are used to produce drills, circular saws, sanders, routers, rotary tools, polishers, and drivers.

2. **The home cleaning and maintenance market** - In the home cleaning and maintenance market, small electric motors are used to produce dust busters, etc.
3. **Kitchen appliance market**. In the kitchen appliance market, small electric motors are used to produce can openers, food processors, blenders, bread makers, and fans.

Sustainable Competitive Advantage

Sustainable competitive advantage (SCA) A company that is more profitable than its rivals is exploiting some form of competitive advantage. The benchmark for profitability is the company's cost of capital. To consistently make profits in excess of its cost of capital - economic rent - the company must possess some form of sustainable competitive advantage (SCA) to derive firm specific distinctive strategic positioning.

A firm possesses a SCA when it has value creating processes and positions that cannot be duplicated or imitated by other firms that lead to the production of above normal rents. A SCA is different from a competitive advantage (CA) in that it provides a long-term advantage that is not easily replicated. However, these above normal rents can attract new entrants who drive down economic rents. A CA is a position a firm attains that lead to above normal rents or a superior financial performance. The processes and positions that engender such a position (CA) is not necessarily non-duplicable or inimitable. It is possible for some companies to, temporarily, make profits above the cost of capital without sustainable competitive advantage.

A key difference between CA and SCA is that the processes and positions a firm may hold are non-duplicable and inimitable when a firm possesses a SCA. Hence a sustainable competitive advantage is one that can be maintained for a significant amount of time even in the presence of competition. This brings us to the question what is a significant amount of time". A CA becomes SCA when all duplication and imitation efforts have ceased and the rival firms have not been able to create the same value that the said firm is creating.

In marketing and strategic management, sustainable competitive advantage is an advantage that one firm has relative to competing firms.

The source of the advantage can be something the company does that is distinctive and difficult to replicate, also known as a core competency. It can also simply be a result of the industry's cost structure, for example the large fixed costs that tend to create natural monopolies in utility industries.

For example P&G' ability to derive superior consumer insights and implement them in managing its brand portfolio. It can also be an asset such as a brand, e.g. Coca Cola or a patent, such as Viagra.

Value Chain

The Value chain was described and popularized by Michael Porter in his 1985 best-seller, Competitive Advantage: Creating and Sustaining Superior Performance. The value chain categorizes the generic value-adding activities of an organization. The "primary activities" include: inbound logistics, operations (production), outbound logistics, sales and marketing, and service (maintenance). The "support activities" include: administrative infrastructure management, human resources management, R&D, and procurement. The costs and value drivers are identified for each value activity. The value chain framework quickly made its way to the forefront of management thought as a powerful analysis tool for strategic planning. Its ultimate goal is to maximize value creation while minimizing costs.

The concept has been extended beyond individual organizations. It can apply to whole supply chains and distributions networks. The delivery of a mix of products and services to the end customer will mobilize different economic factors, each managing its own value chain. The industry wide synchronized interactions of those local value chains create an extended value chain, sometimes global in extent. Porter terms this larger interconnected system of value chains the "value system." A value system includes the value chains of a firm's supplier (and their suppliers all the way back), the firm itself, the firm distribution channels, and the firm's buyers (and presumably extended to the buyers of their products, and so on). Capturing the value generated along the chain is the new approach taken by many management strategists.

For example, a manufacturer might require its part suppliers to be located nearby its assembly plant to minimize the cost of transportation. By exploiting the upstream and downstream information flowing along the value chain, the firms may try to bypass the intermediaries creating new business models, or in other ways create improvements in its value system.

Different Types of International Business

Companies intending to undertake international business must determine the type of presence they desire to maintain in every market where they would like to operate. One major choice concerns the technique of market entry. The following are the four levels of business activities carried out by the companies:

- **Domestic Business:** A domestic business is the one that acquires its resources and sells its products in a single country
- **International Business:** An international business refers to profit-related activities conducted across national boundaries. It is based in one country but acquires its resources or revenues from other countries. It may import resources from other countries or sell products to customers abroad or transfer funds to subsidiaries abroad.
- **Multinational Business:** A multinational business has a worldwide market for purchase of raw materials, raising of funds, manufacturing its products and selling the same. Companies that perform multinational business are known as multinational corporations.
- **Global Business:** When the business goes international to the maximum extent, it is referred to as global business. It cuts across national boundaries and is not confined to a single country.

One of the critical decisions in international business is the mode of entering into the foreign market. At one extreme, a company may decide to produce the product domestically and export it to the foreign market. In this case the company need not make any investment overseas. On the other extreme, the company may establish manufacturing facilities in the foreign country to sell the product there. This strategy requires foreign investment by the company. In between these two extremes, there are several options each of which demand different level of foreign investment.

Different types of international business

Branches

An international business firm may open branches in different countries. These branches work under the direction and control of the head office. The headquarters lay down policy guidelines to be followed by the branches. Every branch follows the laws and regulations of the country in which it is located. Multinationals find it easiest to operate through branches.

Exporting

Many manufacturing firms begin their global business as exporters and only later switch to another mode for serving a foreign market. Exporting represents the least commitment on the part of the firm entering a foreign market. Exporting to a foreign market is a strategy many companies follow for atleast some of their markets. Since many countries do not offer a large enough opportunity to justify local production, exporting allows a company to centrally manufacturing its products for several markets and therefore to obtain economies of scale. Normally, company exports the same product which is being marketed in the home market. This process of export taken place two different forms viz., direct export and indirect export.

Advantages

- It avoids the often-substantial costs of establishing manufacturing operations in the host country.
- Exporting may help a firm achieve experience curve and location economies. By manufacturing the product in a centralized location and exporting it to other national markets, the firm may realize substantial scale economies from its global sales volume.
- In case the export house works on commission basis, there is incentive for the export house to expand sales.
- Manufacturer can overcome the problems of direct exporting such as investment of resources in collecting marketing intelligence for getting up of export department etc., and can receive instant foreign market knowledge.
- In view of the fact that the export house will be effecting consolidated shipments, there is a possibility of reduction in unit freight.
- The reputation of export house will enable the manufacturer to get better representation for his products abroad. In case the export house is selling complementary products, sales might increase.

Disadvantages

- Exporting from the firm's home base may not be appropriate if there are lower-cost locations for manufacturing the product abroad. Thus particularly for firms pursuing global or transnational strategies.
- Drawback to the exporting is that high transport cost can make exporting uneconomical, particularly for bulk products.
- Tariff barriers can make exporting uneconomical. Similarly, the threat of tariff barriers by the host country government can make it very risky.
- There is also possibility of both the manufacturing and the export house lacking personal involvement in the export business since either party may drop the other at any moment.

- Under this arrangement, there is a possibility of the manufacturer continually depending on the export house and not developing export expertise himself.

Franchising

In this form, a multinational corporation grants firm in foreign countries the right (franchise) to use its trade marks, brand names, patents, technology, etc., The firms getting the right or license operate as per the terms and conditions of the franchise agreement. They pay a periodical royalty or license fees to the multinational corporation. In case the firm holding franchise violate the terms of the agreement, the license may be cancelled. This system is popular for products which enjoy good demand in host countries.

Advantages

- Franchisor can enter global markets with low investment and low risks
- Franchisor can get the information regarding the markets, culture, customs and environment of the host country.
- Franchisor learns more lessons from the experience of the franchisees, which he could not experience from the home country's market.
- Franchisee can early start a business with low risk as he selects an established and proven product and operating system.
- Franchisee gets the benefits of R&D with low cost.
- Franchisee escapes from the risk of product failure.

Disadvantages

- International franchising may be more complicated than domestic franchising.
- It is difficult to control the international franchisee.
- Franchising agents reduce the market opportunities for both the franchisor and franchisee.
- Both the parties have the responsibilities to maintain product quality and product promotion.

- There is scope for misunderstanding between the parties
- There is a problem of leakage of trade secrets

Licensing

Under a licensing agreement, a company (the licensor) grants rights to intangible property to another company (the licensee) for a specified period; in exchange, the licensee ordinarily pay a royalty to the licensor. The rights may be exclusive (monopoly within a given territory) or non exclusive. Licensing agreements are most common on the use of patents, trademarks, copy rights and unpatented technology. The licensor does not have to risk placing tangible assets, such as plant and equipment, abroad. The licensee may find that the cost of the arrangement is less than if it developed the intangible property on its own. It permits foreign company to use industrial property (i.e., patents, trademarks, and copyrights), technical know-how and skills (eg. Feasibility studies, manuals, technical advice etc.,) architectural and engineering design, or any combination of these in a foreign market. Essentially, a licensor allows a foreign company to manufacture a product for sale in the licensee's country and sometimes in other specified markets.

Advantages

- Licensing offers a small business many advantages, such as rapid entry into foreign markets and virtually no capital requirements to establish manufacturing operations.
- Returns are usually realized more quickly than for manufacturing ventures
- Licensing mode carries relatively low investment on the part of licensor
- Licensing mode carries low financial risk to the licensor
- Licensor can investigate the foreign market without much effort on his part
- Licensee gets the benefits with less investment on research and development
- Licensee escapes himself from the risk of product failure.

Disadvantages

- Control may be lost over manufacturing and marketing
- The licensee may become a competitor if too much knowledge and know-how is transferred. Care should be taken to protect trademarks and intellectual property.
- Licensing agreements reduce the market opportunities for both the licensor and licensee.
- There is scope for misunderstanding between the parties despite the effectiveness of the agreement.
- There is a problem of leakage of the trade secrets of the licensor
- Quality control may be difficult to achieve.

Turnkey Projects

Firms that specialize in the design, construction, and start up of turnkey plants are common in some industries. In a turnkey project, the contractor agrees to handle every detail of the project for a foreign client, including the training of operating personnel. At completion of the contract, the foreign client is handled the "Key" to a plant that is ready for full operation.

This is means of exporting process technology to other countries. Turnkey projects are most common in the chemical, pharmaceutical, petroleum refining, and metal refining industries, all of which use complex expensive production technologies.

Advantages

- The opportunity to sell both components and other intangible assets
- Host governments patronage which ensures that payments are made promptly and may also lead to mutually beneficial relationship in other areas and
- For the host nation, the opportunity to build industrial complexes and train local personnel

Disadvantages

- Lack of client control and participation
- High overall cost than traditional approach
- Limited flexibility to incorporate change
- A firm that enters into a turnkey project with a foreign enterprise may inadvertently create competitors.

Contract Manufacturing

Under contract manufacturing, a company arranges to have its products manufactured by an independent local company on a contractual basis. A company doing international business enters into contract with a local firm in the foreign country to manufacture the product, while retaining the responsibility of marketing. The local manufacturer produces and supplies the product to the international company, while international company hires the production capacity of the local firm without establishing its own plant and thus circumvents barriers on import of its products. This strategy is practicable only when there is a foreign producer with the necessary manufacturing capacity and ability to maintain quality. The local producer firm gives virtually no commitment beyond the placement of orders.

Advantages

- The company does not have to commit resources for setting up production facilities abroad
- It frees the company from the risks of investing in foreign countries
- If ideal production capacity is readily available in the foreign country, it enables the marketer to get started immediately
- The cost of the product obtained by contract manufacturing is lower than if it were manufactured by the international firm.
- Contract manufacturing is a less risky way to start with. If the business does not pick up sufficiently, dropping it is easy; but if the company had established its own production facilities, the exit would be difficult.

Disadvantages

- The parent company has to forego the manufacturing profit to the local firm
- It is always not easy to locate a local party with the necessary capabilities to manufacture the product upto the requirements of the parent firm.
- The local party gains experience in marketing, and in course of time may pose a threat to the parent company.
- On many occasions, local firms face difficulties in maintaining the quality of the product upto the standards required by the parent firm.

Joint Venture

In this system, a multinational corporation establishes a company in a foreign country in partnership with a local firm for manufacturing or marketing some product. The multinational and foreign firm shares the ownership and control of the business. Generally international organizations provides the technical know-how and managerial expertise whereas day to day management is left to the local partner. For example Maruti Udyog, the Government of India and Suzuki of Japan have jointly supplied the capital and sharing profits.

Advantages

- The resources of foreign and local firms are pooled together to complement each other.
- Joint venture are preferable when the multinational lacks necessary resources to expand its international operations or wants to enter overseas markets where wholly owned subsidiaries prohibited.
- The multinational can make use of the management skills and market position of the local partner.
- The multinational need not exercise complete control on the venture.
- The privileges and influence of local authorities and special tax benefits of host country can be utilized.

- Risk involved due to economic and political circumstances of the host country is reduced.

Disadvantages

- The partner of joint venture faces the problem of conflicts over policy matters. A multinational may not be able to carry out specific manufacturing and marketing policies on a worldwide basis due to joint ownership and control.
- Disputes between the partners may arise on management styles, profit sharing and expansion of the joint venture.

Strategic Alliance

A more recent phenomenon is the development of a range of strategic alliance. Alliances are different from traditional joint ventures in which two partners contribute a fixed amount of resources and the venture develops on its own. In an alliance, two firms pool their resources directly in a collaboration that goes beyond the limits of a joint venture. Although a new entity may be formed, it is not a requirement. Sometimes, the alliance is supported by some equity acquisition of one or both the partners. In an alliance, partners bring a particular skill or resource, usually one that is complementary to each other. By joining forces, both are expected to profit from each other's experience. Typically, alliance involves either distribution access or technology transfers or production technology, with each partner contributing a different aspect to the venture. This strategy seeks to enhance the long term competitive advantage of the firm by forming alliance with its competitor, instead of competing with each other.

Advantages

- To produce or sell abroad, a company must incur certain fixed costs. At a small volume of business, it may be cheaper for it to contract the work to a specialist rather than handle it internally.
- Company may seek to improve its performance by concentrating on those activities that best fit its competencies and by depending on other firms to supply it with products, services, or support activities for which it has lesser competency.

- Some times in the market to avoid counter competition companies may band together, so that they do not have to compete with one another.
- There is potential cost savings and supply assurances from vertical integration. However, companies may lack the competence or resources needed to own and manage the full value-chain of activities.
- This helps to gain advantage over cultural, political, competitive and economic differences among countries create barriers for companies that want to operate abroad.
- It helps to overcome the governmental constraints. Many countries limit foreign ownership
- By operating in a variety of countries a company can smooth its sales and earnings because business cycles occur at different times within different countries. Collaborative arrangements offer a faster initial means of entering multiple markets.
- Minimize exposure in risky environments.

Disadvantages

- If the company selects wrong alliance it leads to adverse effect on business.
- Partners in an alliance may possess resources and capabilities of high quality and of considerable value but fail to make them available to alliances partners.
- Once a strategic alliance has been formed, partners may make investments that have value only in the context of that alliance and in no other activities.
- Access to information some time leads to reveal business secrets.
- Distribution of earnings make serious of problems between alliance partners
- Changing circumstances may also affect the viability of a strategic alliance. The economic conditions that motivated the co-operatives arrangement may no longer exist, or technological advances may render the alliance obsolete.

Merger and Acquisition (M&A)

Merger and Acquisitions (M&A) have been very important market entry strategy as well as expansion strategy in international business. A number of Indian companies have used this entry strategy. In the case of a merger, the international business firm absorbs one or more enterprises abroad by purchasing assets and taking over liabilities of those enterprises on payment of an agreed amount. Similarly, the international business firm may also take over the management of an existing company aboard by taking the controlling stake the equity of that company at a predetermined price. This is called acquisition. M&A as an entry strategy provides instant access to markets and distribution network. As one of the most difficult areas in international marketing and distribution, this is often a very important consideration for M&A.

Advantages

- The main objective of M&A is to obtain access to new technology or a patent right.
- M&A also has the advantage of reducing the competition between the companies.
- Merger may allow greater investment in R&D. this is because the new firm will have more profit. This can lead to a better quality of goods for consumers.
- Greater efficiency is possible due to elimination of redundancies.
- M&A can help the company to deal with international competition

Disadvantages

- M&A may also give rise to some problems which arise mostly because of the deficiencies of the evaluation of the case for acquisition. Sometimes the cost of acquisition may be unrealistically high.
- When an enterprise is taken over, all its problems are also acquired with it. The success of the enterprise will naturally depend on the success in solving the problems.
- Many companies on sale are poor performers having outdated technology and low morale employees

- The location, equipments and layout factors cannot be changed and hence may be problematic.

Wholly-Owned Subsidiary

An international business firm may establish wholly owned subsidiaries in foreign countries. In case of partly owned subsidiaries people in the host country also own shares. The multinational controls the board of directors of the subsidiary company and the subsidiary follows the policies laid down by the parent company. For any firm the most expensive method of market entry is likely to be the development of its own foreign subsidiary, as this requires the greatest commitment in terms of management time and resources. Subsidiaries are considered to be more profitable than franchising. A multinational can expand its business operations through subsidiaries all over the world.

Advantages

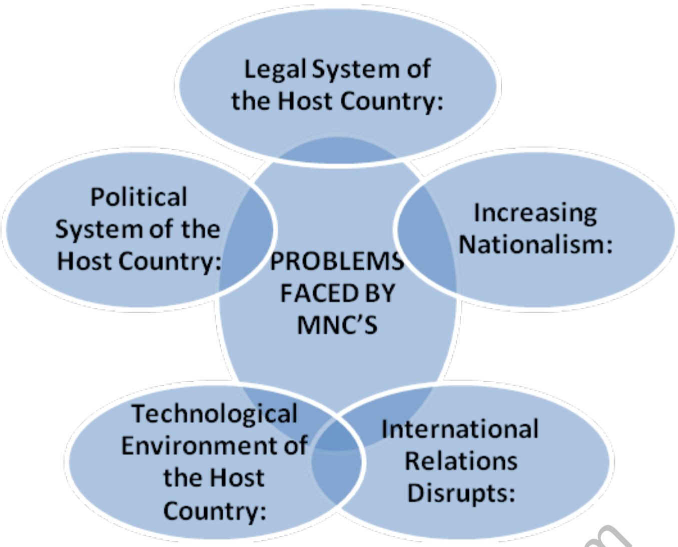
- No risk of losing technical competence to a competitor thus gaining a competitive edge.
- It provides tight control over operations
- It provides the ability to realize learning curve and location economies.
- Protection of technology can be well executed
- It provides ability to engage in global strategic coordination
- It provides ability to realize location and experience economics

Disadvantages

- Company bears full cost and risk
- An effective supervision and direction is needed which increases rigidity
- It faces several hurdles in the forms of regulation and taxation in foreign countries
- Having re-decision information gathering and research evaluation
- Wholly owned subsidiaries have high political risk.

Problems Faced by MNC'S

The benefits of international business are only potential in nature. They largely depend upon the environment, government action and actual behavior of the MNCs. They operate in multiple environments of economic, political, legal, socio-cultural and technical dimensions and try to cope up with a number of challenges and risks. They face the following challenges while operating in foreign environments.



Increasing Nationalism

There is growing awareness amongst people of developing countries to buy national goods rather than those produced by MNCs. The MNCs are, thus, facing tough competition from the national products.

International Relations

It is difficult for MNC's to operate in a nation where there is disharmony between the two governments, howsoever favorable the business opportunities may be.

Technological Environment of the Host Country

The level of technological development varies amongst countries. Introduction of advanced technology in a developing nation may not be easily accepted by the host country's government. This may require the concerned MNCs to change its technologies setup or to discontinue its operations in that country.

Political System of the Host Country

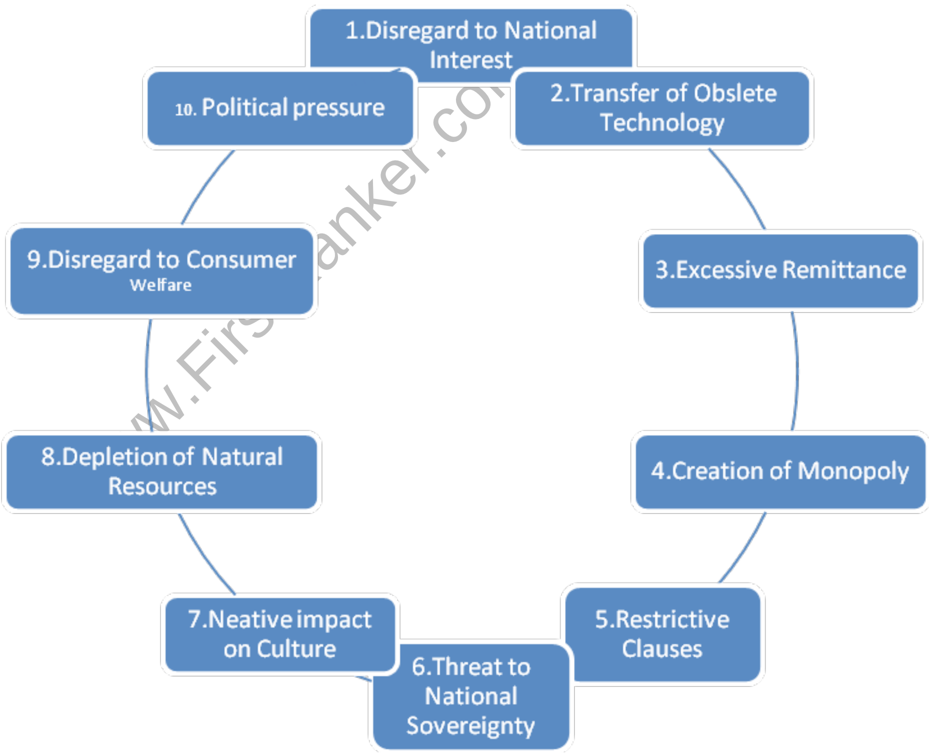
Political stability, attitude of the opposition groups, government's policy towards encouraging foreign capital are some of the political factors that affect the working of MNCs in the area of international operations.

Legal System of the Host Country

Legal framework of a country with respect to laws such as taxation, currency exchange, tariffs and quotas etc., also challenge the MNCs operations abroad.

Problem Posed by Mnc's to Host Countries

The Host countries face the following problems with MNCs



Disregard of National Interest

International business firms invest in most profitable sectors, e.g. consumer goods disregarding the national interest and priorities of host countries. They do very little for underdeveloped strategic sectors and backward regions. Due to their capital intensive technology and profit-mindedness', they create relatively few jobs and fail to solve the chronic problems, e.g., unemployment and poverty of host nations.

Obsolete Technology

International business firms often transfer outdated technology to their collaborators in host countries. In many cases technology transferred was unsuitable causing waste of scarce capital. Repetitive imports of similar technology led to excessive royalty payments without adding to technical knowledge in host countries. Sometimes, machinery available locally was imported or it remained idle for want of repairs and maintenance facilities. MNCs have failed to develop local skills and talents. MNCs use capital intensive technology which may reduce jobs.

Excessive Remittance

International business firms squeeze out maximum payment from their subsidiaries/ affiliates and collaborators in the form of royalty, technical fee, dividend, etc., By repatriating profits, MNCs put severe pressures on the foreign exchange reserves and balance of payments of host countries.

Creation of Monopoly

MNCs join hands with big business houses and give rise to monopoly and concentration of economic power in host countries. They kill indigenous enterprises through strategic advantages like patents, superior technology, etc., for example Pearl soft drinks and Kwality Ice Cream Co. had to sell themselves to foreign MNCs in India. MNCs pose a threat to small scale industries.

Restrictive Clauses

Due to their strong bargaining power, international business firms introduce restrictive clauses in collaboration agreements, e.g. technology cannot be passed to third parties, pricing of products will be by the MNCs, exports from host country will be restricted and managerial posts will be filled by the parent company. MNCs do not transfer R&D, training and other facilities to host countries.

Threat to National Sovereignty

MNCs pose a danger to the independence of host countries. These corporations tend to interfere in the political affairs of host nations. Some MNCs like ITI are accused of overthrowing government in countries such as Chile.

Negative Impact on Culture

MNCs tend to vitiate the cultural heritage of local people and propagate their own culture to sell their products. For instance, MNCs have encouraged the consumption of synthetic food, soft drinks, etc., in India.

Depletion of Natural Resources

MNCs cause rapid depletion of some of the non-renewable natural resources in host countries.

Disregard to Consumer Welfare

Their main objective of coming to India is to exploit the big market available here. Most of them are in FMCG selling fast food (junk food) with no nutritive value e.g. Pepsi and Coca-cola selling soft drinks and snacks, Nestle, McDonald.

Political Pressures

Because of their size, financial and technical power, MNCs have been able to create political pressures in the developing host countries. They interfere with the decision-making processes of the host-country's government. The governments of many countries, therefore, restrict the activities of MNCs operating in their economies.

Summary

The ability of corporations of all sizes to use globally available factors of production is a far bigger factor in international competitiveness than broad macroeconomic differences among countries. Based in part on the development of modern communications and transportation technologies, the rise of the multinational corporation was unanticipated by the classical theory of international trade as first developed by Adam Smith and David Ricardo. In present day world differences among corporations are becoming more important than the aggregate differences among countries. Furthermore, the increasing capacity of even small companies to operate in a global perspective makes the old analytical framework even more obsolete. In this present day integrated world, the best model for organizations is Creating and Sustaining Superior Performance.

Self Assessment Questions

1. Define Multinational Corporation. Explain the need for emergence of MNCs.
2. What are the major trends that are changing the landscape of business?
3. Explain the normal process of overseas expansion of a business organization.
4. "Organizations at least have to follow trends if not create them" Comment.
5. Explain various trends that may affect business organizations worldwide.
6. Discuss the challenges and opportunities that are existed for the global business organizations. Define Multi National Corporation and explain major types of MNCs.
7. Highlight the importance of MNCs in world of business. Describe the composition of MNCs, which featured in Fortune 500 Global list.
8. How companies from Rapidly Developing Economies challenging the supremacy of companies from developed economies?
9. Pick an Indian Corporation with which you are familiar and analyze the reasons why it might be motivated to expand its internationalism.

10. Describe briefly the findings of McKinsey Global survey of executives on top business trends.

11. Give two example of how Indian companies are approaching the internationalization of their businesses.

12. Explain with examples how global companies are localizing their business strategies to suit Indian market conditions.

13. What are the important traditional theories of international Trade? Explain them briefly.

14. Explain the relevance of 'International Product Life Cycle' model in the context of present day international business environment.

15. Describe Porter's Diamond Model for Competitive Advantage of Nations.

16. Explain various Competitive Models of International Business.

17. Explain the concept and feature of Multinational Corporation with suitable example.

18. Critically examine the role of multinational in India

19. Explain the evils of Multinational Corporations (MNCs)

20. MNCs are mixed blessings to the developing economics – Comment.

21. Distinguish between Indian transnational corporations and foreign transnational corporations.

22. What are the factors to consider in exporting?

23. What are the reason companies go for licensing?

24. Define franchising. Explain its advantages and disadvantages

25. What is turnkey contracts? Explain its suitability.

26 Write characteristics of joint venture business and compare joint venture business with strategic alliance.

27. Write short notes on: (i). Criticisms against Multinational in India
(ii). Foreign Transnational Corporations
(iii). Indian Transnational Corporations

CASE STUDY

Nestle is one of the oldest of all multinational business. The company was founded in Switzerland in 1866 by Heinrich Nestle, who established Nestle' to distribute "Milk Food", a type of infant food he had invented that was made from powdered milk, baked food and sugar. From its very early days, the company looked to other countries for growth opportunities, establishing its first foreign officers in London in 1868. In 1905, the company merged with the Anglo Swiss Condensed Milk, thereby broadening the company's product line to include both condensed milk and infant formulas. Forced by Switzerland's small size to Look outside its borders for growth opportunities Nestle' established condensed milk and infant food processing plants in the United States and Great Britan in the late 19^{th} Century and in Australia, South America, Africa and Asia in the first three decades of the 20^{th} Century.

In 1929, Nestle' moved into the chocolate business when is acquired a Swiss chocolate maker. This was followed in 1938 by the development of Nestle's most revolutionary product, Nescafe, the World's first soluble coffee drink. After World War II Nestle' continued to expand into other areas of the food business, primarily through a series of acquisitions that included Maggi (1947), Cross and Blackwell (1960), Findus (1962), Libby's (1970), Stouffer's (1973), Carnation (1985), Rowntree (1988) and Perrier (1992).

By the late 1990's Nestle' has 500 factories in 76 countries and sold its products in a staggering 193 nations – almost every country in the world. In 1998, the company generated sales of close to SWF 72' billion ($51 billion), only 1 percent of which occurred in its home country. Similarly only 3 percent of its 2,10,000 employees were located in Switzerland. Nestle' was the World's biggest maker of Infant formula, powdered milk, chocolates, instant coffee, soups, and mineral waters. It was number two in ice cream, breakfast cereals, and pet food. Roughly 38 percent of its food sales were made in Europe, 32 percent of its food sales were made in Europe, 32 percent in the America and 20 percent in Africa and Asia.

Questions

(a) How will you categorise the growth and development of Nestle's over the years? Why?

(b) Was Nestle' as a multi product firm able to break through the East Asian countries for a sound market performance? How?

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UNIT - II

Learning Objectives

After reading this unit, you should be able to

- Understand the growth and development of MNcs
- Acquainted with different Management styles
- Understand different Strategic issues in MNCs

Unit Structure

Lesson 2.1 - Growth and Development of MNCs

Lesson 2.2 - Different Management Styles

Lesson 2.3 - Strategic Issues

Lesson 2.1 - Growth and Development of MNCS

Introduction

Multinational corporations are spreading their wings globally. Their growth is unprecedented. The causes for their growth are diverse. They bring benefits to nation States and their potentials to harm them are also very high. They also face problems created by nation states. All these and more are presented in this lesson.

Growth of Multinational Corporations

Multinational Corporations have been growing in number, volume, geographical spread and so on. Though, and generally MNC consists of a parent company located in the home country and at least five or six subsidiaries with a high degree of strategic alliance among the units there are MNCs which have over 150 foreign subsidiaries as well. The MNCs had a global sales in excess of 24.8 trillion which is larger than the value of global trade in 2005. About a third of world output is contributed by the MNCs.

About 100 million people are in direct employment with the MNCs, representing 10% of world employment in non-agricultural employment. The number of MNCs was at around 47000 in 2005 with over 2 lakh foreign subsidiaries. The top most 100 MNCs, excluding those in banking and finance, held 6.8 trillion in 2005, of which 40% were located outside their home country.

With liberalisation of economic policy being earnestly followed by most countries of the world, there has been enormous increase in the geographical spread of MNCs.

The popularity of MNCs can be known from the fact that most of them receive 50% or more of their revenues and profits. Some of them are: IBM, Gillette, Colgate-Palmolive, Philips, Xerox, Hewlett-Packard, Coca-

Cola and so on. It is said that coco-cola earns more money by selling soda in Japan than it does in USA. Exxon a American base MNC, had about 56% of its assets, 74% of its sales and 97% of its profits abroad.

In India of the top 500 companies by market value, about 225 were MNCs during 2004-05. 60 of the MNCs came in the top 50. Notable MNCs present in India include the lever, the ITC, the Nestle, the Ponds, the Glaxo, the smithkline-beecham etc. These MNCs brands are almost house-hold names in India. Thus MNCs have been growing in stature and spread all over.

Reasons for Growth of Mncs

There are several factors that underlie the growth of MNCs. These include, increasing factor mobility, opening up of command economies, growth urge, and opportunities for growth, the Bretton woods system, market capturing, raw-material availability, low-cost of production possibilities, profit orientation and management culture.

Factor Mobility

First factor mobility is the most important of all factors that has contributed to the growths of MNCs. During the time of the great economists like Adam Smith and David Ricardo, Cross-border movement of goods only on the basis of comparative cost principle was envisaged. Cross-border movement of factors of production was not envisaged. Now capital, technology, labour and even management just move from anywhere to anywhere. Perhaps international understanding and economic corporation have paved the way for world-wide flow of factors of production.

Technical collaborations, overseas job market expansion and overseas management consultancy are all on the increase. MNCs play a vital role in this factor mobility contributing to their growth. As a result of the factor mobility, instead of goods being traded across national borders, production plants are set up in the identified markets themselves by the MNCs.

Economic Reforms

Second, the economic reforms undertaken in most of the developing and under developed economies are another cause for the growth of MNCs. Governments of most of these countries having become vexed with the regressed performance of their public sector and their bureaucracy and consequent waste of precious resources resulting in poor gross domestic product growth fuelling poverty and unemployment, in order to take their economies on to the growth path have started embarking on a programme of economic reforms.

Globalisation as a part of such reforms process, has opened their economies to international players on an equal footing with domestic operators. Ever since the reforms process has been introduced in India, for instance, many MNCs have started opening up their shops in the country. Pepsi, Coco-Cola etc., have set their foot in India.

Existing multinations have enhanced their stake in the country and some are putting up 100% subsidiaries. For instance P&G is putting up P&G Home Products Private Limited to make detergents, Gillette is putting up Wilkinson India Private Limited to channelise investments into other companies, H.P. is putting up H.P. India to develop and export software and GEC is putting GEC India Limited to oversee the group s expanding Indian operations. 100% ownership will enable the parent company to retain proprietary control over technologies and products. Beside backward integration to gain economies and shed diseconomies of scale is possible.

Opening Up of Command Economies

Third, opening up of command economies is a factor behind, recent growth in MNCs. China, Russia, etc. are no longer command economies. Socialism and Communism have given way to capitalism in their very place of origin and growth. The communist countries have opened up their economies to competition. Since 1985, Russia introduced restructuring measures. The collapse of political structure has hampered the transition to market economy resulting in economic disruption. Privatisation is being acceleratingly followed in Russia. A logical extension of this privatisation programme is the entry of MNCs into these lands.

China is sporting excellently in opening up its economy, as is borne out by foreign investment statistics. The Chinese reforms process has been introduced in top-down orderly fashion. Of late, foreign investment rose significantly and many MNCs have put up their plants in China. Some have hastened to have their plants there, as they did not want to lag behind potential competitors.

Growth Urge

Fourth, MNCs generally have the growth impetus with them. They always look upon growth opportunities anywhere in the globe and try to seize them. Strategic alliance, joint ventures, wholly owned subsdiaries, mergers on acquisition, franchising etc. are the diverse strategies they adopt to expand their operation globally.

The motives for such expansion are securing supplies of materials, energy and scarce raw materials, development of technology or brand recognition leading to global demand met through overseas investment and availability o f cheap er factors overseas and using the same by geographically spreading the operations.

MNCs have technology and competitive edge. With these they easily establish brand image. Global spread is very simple for them unless nation, states are vociferously against the entry of MNCs. Liberalisation and reforms process adopted in the third world nations have opened out vast growth opportunities for MNCs. However, the essential element is the urge of MNCs to seek out, undertake, and integrate manufacturing, marketing, R&D and finance opportunities on a global scale rather than on domestic level.

Bretton Woods System

Fifth, the Bretton woods organs-the World Bank and International Monetary Fund and their subsidiaries like the International Development Association, International Finance Corporation, Multilateral Investment Guaratnee Agency and other multilateral bodies generally insist on borrowing countries to open their economies and going for competitive bidding. This paves the way for the growth of MNCs.

Market Potential

Sixth, there are MNCs who always have an eye on foreign markets. IBM, Valvo Unilever etc., come in this category. Originally American firms bought plant and equipment in Western Europe. Later, Western Europe firms opened shops in USA. In the last part of the 20th Century, Japanese acquired firms in Europe and the America. Now, there is camping of MNCs in the emerging world markets like India, China, and Mexico etc. Perceived restrictions on imports led to MNCs opening up factories in foreign lands.

India and China have great attraction as market for most MNCs at present. There is a classic difference between US and Japanese MNCs in market capturing. US MNCs look at the up-end of the market, while Japanese MNCs look at the unattended low-end. Low-end market has lot of growth potential and this gives scale economies. With accumulated resource, wide market, and proven process technology, Japanese MNCs are a threat to the US MNCs.

Raw Material Availability

Seventh, initially most MNCs were spreading their wings globally just to tap raw-materials available elsewhere for supporting production at the patent plant. British, French and Dutch East India Companies are classic examples of MNCs of the raw-material seeking type. Now instead of tapping raw-materials, the MNCs set up plants where factor markets are favourable. Because their search for growth is never inward but always outwards. That is their culture.

Low Cost Production Possibilities

Eighth, MNCs are now driven by cost-minimisation drives. They set up plants at places where low-cost production possibilities are great. Taiwan, Hongkong and Finland are preferred by MNCs for setting up electronic industrial units for there is cost efficiency. India, being a cheap labour country, MNCs have started flooding into India. IBM, Ford outsource production of parts to low-wage countries such as Mexico by establishing assembly plants and R&D Centres in Europe and Japan.

Risk-Minimising

Ninth, MNCs have long back realized the need for risk-minimising. Threats from their oligopolitic competitors are always there. Further, country-risk is always there. Meeting both the risks is facilitated by geographical spread. By being close to market, better orientation to market is possible and that monopolistic product differentiation is easily facilitated. Geographical spread is risk-minimising strategy and there is growth. Japanese Competition affects the American Auto Industry. So, American Auto firms go out to the third world in search of strategic alliance partnership.

Profit Orientation

Tenth, MNCs are interested in profits. and MNCs are generally highly profitable. Profit booking facilitates growth, diversification, modernization and R&D competitiveness. Actually MNCs book profits by being flexible, adaptable and quick. In today's head-on competition, the most important factor for growth is speed. Ability to design, develop and distribute products / services in short span of time holds the key to success.

Management Culture

Eleventh, growth of MNCs is very much influenced by their management culture. MNCs generally adopt to local conditions and the relationship between parent and subsidiaries is that of coordinated federation. Decisions on investment financing and market are localized. But Japanese MNCs do centralize decisions. The East-West difference is thus found. But the underlying similarity is the basis for action. Corporate strategic planning is an essential package o f MNCs management practice whereby the MNCs scan and plan for enhanced integration and co-ordination of their global activities.

Microsoft Corporation allows its European subsidiaries to develop local strategies to meet local market needs. This type of autonomous adoption to fast changing local business environment has been the main reason for the spread of MNCs. The autonomy enjoyed by subsidiaries is not to turn into dysfunctional anarchy, for the behaviour of individual managers is well shaped through shared vision of identification and binding commitment to the global strategy of the MNCs. Hence the growth of MNCs.

Development in Communication Technology

Twelfth and fin ally the growth of MNCs is partially attributed to development in communication and transportation techno log y. The advent of information technology has helped MNCs to sp read their wings far and wide. Internet, e-mail, Fax and other communication tools are used by MNCs to do their business from the place of its origin to the place of doing transaction.

Development of MNCs

The development and spread of the MNCs through direct foreign investment is a more recent phenomenon. The earliest MNCs were mainly European firms, setting up manufacturing facilities in their colonies to extract primary resources for con version into finished products back at home. Institution s such as the International Monetary Fund, the World Bank, World Trade Organisation and the World Court provided a stable world wide environment in which MNCs could conduct their business.

Due to the advent of globalization, the arrival of MNCs have become unavoidable. In term of its ability to move knowledge, people, capital, goods and services and technology across borders, the process of globalization led by MNCs had gone far beyond the reach of any national sovereign Government or Multinational Agreement. To borrow a phrase from an expert on multinational business, Raymond, the MNC had reached a level of maturity and influence world wide whereby it could keep 'sovereignity at bay'.

Role and Significance of MNCs

It is observed that MNCs have their branches or subsdiaries not only in developing countries or third world countries in Asia, Africa and Latin America but also in developed countries in Europe, Australia and Newzealand.

The MNCs in developing countries generally operate in the following fields: various plantations, in mine extracting and refining crude oil, pharmaceuticals, fertilizers, manufacture of various consumer goods and of capital goods, electronic & telecommunication goods both for domestic consumption and for exports. The MNCs are also functioning in various services such as banking, insurance, shipping and tourism etc.

The MNCs have been playing a very significant role in the economic development of many countries some of which are stated below:

- The MNCs have a strong financial base and through direct investment in developing and under developed countries, have been contributing to their economic development. As the rate of domestic savings in most underdeveloped countries is low, the MNCs help these countries to push the rate of investment which is the vital aspect of development strategy.
- The developing countries are not in a position to undertake risks which are great in industries like mining, oil exploration etc. Because of their strong financial base, MNCs can successfully undertake business risks which are inherent in the initial stages of industrialisation of developing countries.
- MNCs are in a position to develop and provide infrastructural facilities like means of transport and communication, power, technical institutes. These are all essential for rapid economic development of less developed countries.
- MNCs help development of modern skills in developing and underdeveloped countries such as entrepreneurial, managerial and organisational capabilities and various other skills necessary for modernization of economies which they generally lack.
- Research and Development are the very foundations of economic development and progress. They require huge investment initially and there is no guarantee about the success of various experiments conducted for quite some time. The R&D by the MNCs often result in discovering new products or new uses of existing natural resources contributing to their economic development.

- The MNCs transfer modern technologies to developing and underdeveloped countries. Among various inputs, technology is the most important for increasing efficiency, productivity and consequent rapid economic development of these countries.

- The MNCs adopt aggressive marketing and advertising strategy and thus help capture foreign markets into which goods and services from underdeveloped countries may enter and thus help acquire foreign currencies needed for developmental imports.

- The MNCs help further utilization of natural and human resources of third world countries, help to raise level of employment and income and thus bring about rise in standard of living of people in these countries.

- When MNCs enter other underdeveloped countries, the latter are exposed to modern techniques and values which help bring about social and psychological transformation which is absolutely essential for rapid economic development of less developed countries.

Pattern of Growth of Mncs and Country of Origin

As you know already, a multinational enterprise in any business that has productive activities in two or more countries. Since the 1960s, there have been two notable trends in the demographics of the MNCs.

(i) The risk of non-U.S. multi nations particularly Japanese Multinations and

(ii) The growth of mini multi nationals.

Non U.S. Multinationals

In the 1960s, multinational business activity was dominated by large U.S. multinational corporations with U.S. firms accounting for about two-thirds of foreign direct investment during 1960s, one would expect non MNCs to be U.S. enterprises. According to the sources from the Economics of the MNC, 1973, 48.5 percent of the world s 260 largest multinationals were U.S. firms. The second largest source country was the U.K. with 18.8 percent of the largest MNCs. Japan accounted for only 3.5 percent of the world's largest MNCs at the time.

By 2000, however things had shifted significantly. U.S. firms accounted for 26 percent of the world's 100 largest MNCs, followed by Japan with 17 percent. France was third with 13 percent. The globalization of the world economy together with Japan rise to the top rank of economic powers has resulted in a relative decline in the dominance of U.S. firm in the global market place.

According to United Nations data, the ranks of the world's largest 100 multinationals are still dominated by firms from developed economies. However, for the first time three firms from developing economies entered in the UN s list of the 100 largest MNCs. They were Hutchison of Hong Kong, China which ranked 48 in terms of Foreign assets, Petroleos de Venezuela of Venezuela which ranked, and Cemex of Mexico which came in at 100.

However, if we look at smaller the firms, it is evident that there has been growth in the number of MNCs from developed economies. At starting of 2000, the largest 50 MNCs from developing economies had foreign sales of $ 103 billion out of total sales of $ 453 billion and employed over more than 4,50,000 people outside of their home country. Looking to the future, we can reasonably expect growth of new MNCs from the world's developing nations.

The Size of Mini-Multinations

Another trend in multinational business has been the growth of medium sized and small multinationals. When people think of multinational business, they tend to think of firms such as General Motors, Ford, Fuji, Kodak, Matsushita, Procter & Gamble, Sony and Unilever-large, complex multinational corporations with operations that span the globe. Although it is certainly true that most international trade and investment is still conducted by large firms, it is also true that many medium sized and small business are becoming increasingly involved in multinational trade and investment.

Summary

This lesson sets the scene for understanding the growth and development of MNCs. The reasons for the growth of MNCs are clearly discussed in detail. The role and significance of MNCs are also highlighted. We have also explained the changing nature of MNCs which have been demographically divided into Non US MNCs and Mini-MNCs. Multinational business is conducted not just by large firms but also by medium sized and small enterprises.

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Lesson 2.2 - Different Management Styles

Introduction

Although some people treat the terms managership and leadership as similar, two should be distinguished. As a matter of fact, there can be leaders of completely, unorganized groups, but there can be managers, only where organized structures create roles. Separating leadership from manager ship has analytical advantages. It permits leadership to be singled out for study without the encumbrance of qualifications relating to the more general issue of managership.

Leadership is an important aspect of managing. As this lesson will highlight, the ability to lead effectively is one of the keys to being an effective manager, also, undertaking the other essentials of managing doing the entire managerial job has an important tearing on ensuring that a manager will be an effective leader. Multinational Corporation Managers must exercise all the functions of their role in order to combine human and material resources to achieve objectives. The key to doing this is the existence of a clear role and a degree of discretion or authority to support manager's actions.

Management Styles

There are several theories on management styles. This part focuses on

(1) Management style based on the use of authority

(2) Likert's four systems of managing

(3) The managerial grid and

(4) Managers involving a variety of styles, ranging from a maximum to a minimum use of power and influence.

Styles Based on Use of Authority

Earlier management analysts classified styles based on how authority was being used. Managers were seen as applying three basic styles.

The Autocratic style which commands and expects compliance, is dogmatic and positive, and leads by ability to withhold or give rewards and punishment.

The democratic or participative style is one where the manager consults with subordinates on proposed actions and decisions and encourages participation from them. This type of manager ranges from the person who does not take action without subordinates concurrence to the one who makes decisions but consults with subordinates before doing so.

The free rein management style is a style where manager uses his power very little, giving subordinates a high degree of independence in their operations. Such managers depend largely on subordinates to set their own goals and the means of achieving them and they see their role as one of aiding the operations of followers by furnishing them with information and acting primarily as a contact with the group s external environment.

There are variations within this simple classification of management styles. Some autocracies are seen as benevolent autocrats. Although they listen considerably to their follower’s opinions before making a decision, the decision is their own. They may be willing to hear and consider subordinate’s ideas and concerns, but when a decision is to be made, they may be more autocratic than benevolent.

A variation of the participative manager is the person who is supportive. In this category, they may look upon their task as not only consulting with followers and carefully considering their opinions but also doing all they can support subordinates in accomplishing their duties.

The use of any management style will depend on the situation. A manager may be highly autocratic in an emergency; one can hardly imagine a fire chief holding a long meeting with the view to consider the best way of fighting a fire. Managers may also be autocratic when they alone have the answers to certain questions.

A manager may gain considerable knowledge and a better commitment on the part of persons involved by consulting with subordinates. Further, a manager dealing with a group of research scientists may give them free rein in developing their inquiries and experiments. But the same manager might be quite autocratic in enforcing a rule stipulating that employees should wear protective covering when they are handling certain potentially dangerous chemicals.

Likerts Four Systems of Management

Professor Likert and his associates at the University of Michigan have studied the patterns and styles of managers for three decades. In the course of this research, Likert has developed certain ideas and approaches to understanding managerial behaviour. He sees an effective manager as strongly oriented to subordinates, relying on communication to keep all parties working as a unit. All members of the group, including the manager adopt a supportive attitude in which they share in one an other s common needs, values, goals, aspirations and expectations. Since, it appeals to human motivations, Likert views this approach as the most effective way to lead a group.

As guidelines for research and for the classification of his concepts, Likert has suggested four systems of management.

System 1 management is described as exploitive authoritative; its managers are highly autocratic, have little trust in subordinates, motivate people through fear and punishment and only occasional rewards, engage in downward communication and limit decision making to the top.

System 2 management is called benevolent authoritative; its managers have a patronizing confidence and trust in subordinates, motivate with rewards and some fear and punishment, permit some upward communication, solicit some ideas and opinions from subordinates, and allow some delegation of decision making but with close policy control.

System 3 management is referred to as consultative. Managers in this system have substantial but not complete confidence and trust in subordinates, usually try to make use of subordinates ideas and opinions, use rewards for inspiration with occasional punishment and some participations, engage in communication flow both down and up, make broad policy and general decisions to be made at lower levels, and act consultatively in other ways.

System 4 Likert saw this management as the most participative of all and referred to it as participative group. Under this system, managers have complete trust and confidence in subordinates in all matters; they always get ideas and opinions from subordinates and constructively use them. They also give economic rewards on the basis of group participations and involvement in such areas as setting goals and appraising progress toward goals. They engage in much communication down and up with peers, encourage decision making throughout the organization and operate among themselves and with their subordinates as a group.

In general Likert found that those managers who applied the System 4 approach to their operations had greatest success as leaders in the multinational corporations. Moreover, he noted that departments and companies managed by the System 4 approach were most effective in setting goals and achieving them and were generally more productive. He ascribed this success mainly to the degree of participation and the extent to which the practice of supporting subordinates was maintained.

The Managerial Grid

A well known approach to defining management styles is the managerial grid, developed some years ago by Robert Blake and Jane Mouton. Building on precious research that showed the importance of a managers having concern both for production and for people, Blake and Mouton devised a clever device to dramatise this concern. This grid, shown in figure, has been used throughout the world as a means of training managers and of identifying various combinations of management styles.

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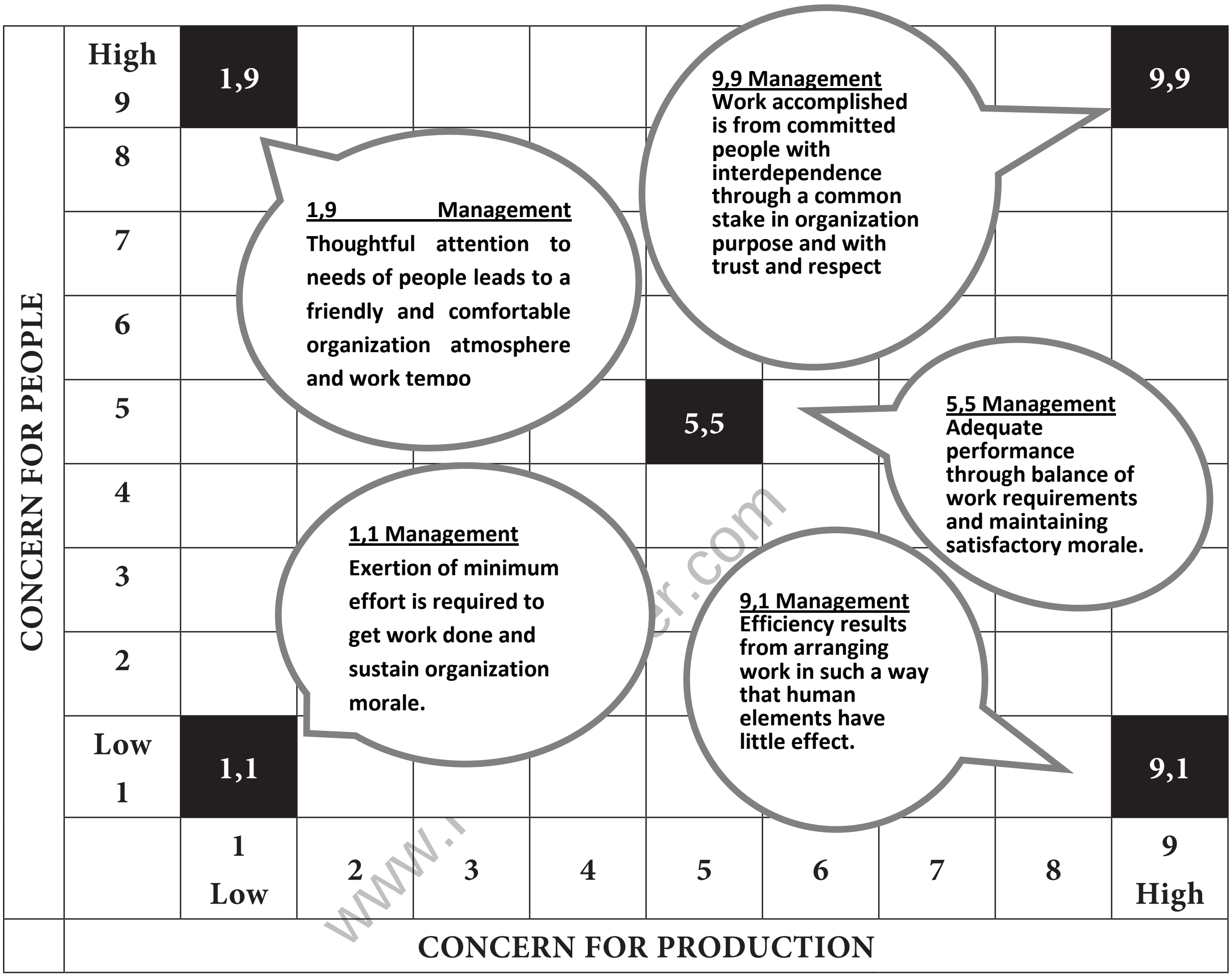
The Grid Dimensions

The grid has two dimensions: concern for people and concern for production. As Blake and Mouton have emphasised, the phrase concern for is meant to convey how managers are concerned about production or how they are concerned about people and not such things as 'how much' production they are concerned about getting out of a group.

Managerial Grid



Adopted from R.R. Blake and J.S. Mouton, The managerial Grid

Concern for Production includes the attitudes of a supervisor toward a wide variety of things, such as the quality of policy decisions, procedures and processes, creativeness of research, quality of staff services, work efficiency and volume of output. Concern for people is likewise interpreted in a broad way. It includes such elements as degree of personal commitment toward goal achiev ement, maintenance of the self-esteem of workers, provision of good working conditions and maintenance of satisfying interpersonal relations.

The Four Extreme Styles

Blake an d Mouton recognise four extremes of style. Under 1,1 style (referred to as impoverished management) managers concern themselves very little with either people or production and have minimum involvement in their jobs; to all intents and purposes, they have abandoned their jobs and only mark time or act as messengers communicating information from superiors to subordinates.

At the other extreme are the 9,9 managers, who display in their actions the highest possible dedication both to people and to production. They are the real team managers who are able to mesh the production needs of the enterprise with the needs of individuals.

Another style is 1,9 management (called country club management) in which managers have little or no concern for production but are concerned only for people. They promote an environment in which every one is relaxed, friendly and happy and no one is concerned about putting forth co-ordinated effort to accomplish enterprise goals.

At another extreme are the 9,1 managers (sometimes referred as autocratic task managers), who are concerned only with developing an efficient operation, who have little or no concern for people and who are quite autocratic in their style of leadership.

By using these four extremes as points of reference, every managerial technique, approach or style can be placed somewhere on the grid. Clearly 5,5 managers have medium concern for production and for people. They obtain adequate but not outstanding, morale and production. They do not set goals too high, and they are likely to have a rather benevolently autocratic attitude toward people.

The managerial grid is a useful device for identifying and classifying managerial styles but it does not tell us why a manager falls into one part or another of the grid. To determine the reason, one has to look at underlying causes, such as the personality characteristics of the managers or the followers, the ability and training of manages, the enterprise environment and other situational factors that influence how managers and followers act.

Management as a Continuum

The adaptation of management styles to different contingencies has been well characterised by Robert and H. Schemidt, developers of the Management Continuum concept. Under this concept, management as involving a variety of styles, ranging from one that is highly boss-centered to one that is highly subordinate - centered. The styles vary with the degree of freedom a manager grants to subordinates. Thus, instead of suggesting a choice between the two styles of management authoritarian or democratic this approach offers a range of styles, with no suggestion that one is always right and another is always wrong.

This continuum theory recognises that which style of management is appropriate depends on the manager, the followers and the situation. To Robert and Schmidt, the most important elements that may influence a manager's style can be seen along a continuum as

(1) The forces operating in the manager's personality, including his value system, confidence in sub ordinates, inclination towards management styles and feelings of security in uncertain situations;

(2) The forces in subordinates (such as their willingness to assume responsibility, their knowledge and experience and their tolerance for ambiguity) that will affect the manager's behaviour; and

(3) The forces in the situation, such as organisation values and traditions, the effectiveness of subordinates working as a unit, the nature of a problem and the feasibility of safely delegating the authority to handle it and the pressure of time.

In reviewing their continuum model in 1993, Robert and Schmidt placed much importance on the concept in such a way that it represent to influence on the style imposed by both the organisational environment and the social environment. This was done to emphasise the open-system of management styles and the various impacts of the organisational environment and of the social environment outside an enterprise. In their 1993 review, they put increased stress on the interdependency of management style and environmental forces such as labour unions, greater pressures for social responsibility, the civil rights movement and the ecology and consumer movements that challenge the rights of managers to make decisions or handle their subordinates without considering interests outside the organisation.

Fiedler's Contingency Approach to Management

Although their approach to management is primarily one of analyzing management style, Fiedler and his associates at the University of Illinois have suggested a contingency theory of management. The theory holds that people become managers / leaders not only because of the attributes of their personalities but also because of various situational factors and the interactions between managers and group members.

Critical Dimensions of the Management Situation

On the basis of his studies, Fiedler described three critical dimensions of the management situation that help determine what style of management will be most effective;

(1) **Position Power:** This is the degree to which the power of a position, as distinguished fromother sources of power such as personality or expertise enables a leader to get group members to comply with directions; in the case of manages, this is the power arising from organisational authority.

(2) **Task Structure:** With this dimension, Fiedler had in mind the extent to which tasks can be clearly spelled out and people held responsible for them. If tasks are clear, the quality of performance can be more easily controlled and employees can be held more definitely responsible for performance.

(3) **Manager Employee Relations:** Fiedler regarded this dimension as the most important from a manager's point of view, since position power and task structure may be largely under the control of an enterprise. It has to do with the extent to which group members like and trust a manager and are willing to abide by the regulations formulated by him.

To approach his study, Fiedler set forth two major styles of management. One of these is primarily task- oriented and the other is oriented toward achieving good interpersonal relations and attaining a position of personal prominence.

In reviewing Fiedler's research one finds that there is nothing automatic or good in either the task-oriented or the people satisfaction oriented style. Management effectiveness depends upon the various elements in the group environment.

The Path Goal Approach to Management Effectiveness

The path goal approach suggests that the main function of the manager /leader is to clarify and set goals with subordinates, help them find the best path for achieving the goals and remove obstacles. This approach, rather than suggesting that there is one best way to lead, it suggests that appropriate style depends on the situation. Ambiguous and uncertain situations can be frustrating for subordinates, and a more task oriented style may be called for. In other words, when subordinates are confused, then the manager may tell them what to do and show them a clear path to goals.

Summary

Management is the art of getting things done by others perhaps using different styles to achieve desired goals. There are various approaches to this study, ranging from the trait to the contingency approach. One such approach focuses on three styles: the autocratic, the democratic and the free rein. Likert identified four systems of management, ranging from system 1 (exploitative authoritative) through system 4 (participative group) which he considers the most effective system.

The managerial grid identified two dimensions: concern for production and concern for people. On these basis, four extreme styles are identified and a middle of the road style is recommended for practice. Management can also be viewed as a continuum. At one extreme, the manager has a gr eat deal of freedom while subordinates have very little. At the other extreme, the manager has very little freedom where as subordinates have a great deal.

Fiedler's contingency approach takes into account the position of power of the manager, the structure of the task and the relations between the manager and the employees. The conclusion is that there is no best management style and that managers can be successful if placed in appropriate situations. The path-goal approach to management suggests that the most effective managers help subordinates achieve enterprise and personal goals.

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Lesson 2.3 - Strategic Issues

Introduction

In the last lesson, we have seen the different management styles being followed by managers of various multinational corporations. In this lesson, we propose to discuss the different strategies that multinationals pursue when competing globally. Consider the merits and demerits of these strategies, explain the various factors that affect a firm's choice of strategy and look at the tactis multinational adopt when competing in the international arena.

Nature of Multinational Strategic Management

Strategic management is concerned with the process of formulating, implementing and evaluating strategies to achieve a firm's objectives. In concept, strategic management process in a multinational corporation is similar to that in any other form of organisation, the main complicating factors being the numerous country an d regional environments it has to analyse and understand before considering the various strategic options.

More time and effort are required to identify and evaluate external trends and events in MNCs Geographic distances, cultural and national differences and variations in business practices, often make communication between home offices and overseas operations difficult. Strategy implementation can be more difficult because different cultures have different norms, values and work this.

Strategic management is critical to multinational business. An MNC needs to keep track of its increasingly diversified operations in a continuously changing multinational environment. This need is particularly obvious when one considers the amount of foreign direct investment that has taken place in recent years. Foreign direct investment has outgrown trade across the globe and this development necessitates the need to coordinate and integrate diverse operations with an effective strategy.

For example, take the case of Ford 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 increase market share. The firm s strategic plan is based on offering the right contribution of price and financing to a carefully identified market segment. In particular, Ford is working to bring down the monthly payment so that customers can afford a new vehicle. This is the same strategy that Ford used in Mexico, where the currency crisis of 1994, resulted in serious problems for many multinationals.

An MNC is able to increase its profitability in ways often not available ton a domestic firm. For example, a global firm is able to:

- Earn a greater return from its distinctive skills and core competencies.
- Realise location of economies by dispensing operations to those locations where they can be performed most efficiently.
- Realise greater economies of scale, which reduces the cost of production.
- Acquire and or/develop widely known brands.

However, the MNC s ability to increase its profitability by exploiting the four strategies stated above depends on how well its formulates it production, marketing and finance strategies and implements them in differing national environments.

Acquiring and/or Developing Brands

Nestle, a multinational food company has been highly successful in its global operations. It has adopted several strategies to achieve the success. Through aggressive acquisitions it has expanded its sales with new, high margin, and sophisticated products.

Another company Mittal Steels which is using the strategy of acquiring number of companies in Europe and other regions. The final strategy being used here is that the company has given local managers substantial autonomy.

Reaping the Benefits of Large Scale Production

Multinational corporations reap the benefits of large scale production thereby reducing the production costs and fixing competitive selling price. One firm that has exploited the strategy of mass production is in India by name Hero Cycles. Mass production has led to the organisation to fix low selling price and increase the market share in the cycle segment. This Hero Honda has entered into many European and African markets and successfully doing its business profitably.

Realising Location Economies

As we are aware, that countries differ on a wide range of dimensions such as economic, political, legal, cultural and that these differences can either increase or decrease the costs of doing business, location of production units play an important role in optimising the profit levels. Advantages of location economic help a firm lower its cost of production and differentiate its product from those of competitions. For example General Motors did precisely the same thing. Design of its pontiac car was done in Germany, key components were manufactured in Japan, Singapore and Taiwan, assembly was performed in South Korea, and the advertising strategy was formulated in Great Britain. Each of these countries was best suited to perform a particular value creation activity.

Core Competencies

The term core competence refers to skills within the firm that competitors cannot easily initiate. The skills may exist in production, finance, R&D, marketing, but they are the bedrock of the firms competitive advantage. For example, Toyota has a core competence in the production of cars; Mc Donald s has a core competence in managing fast food operations and P&G has core competence in developing and marketing consumer products.

Multinational Strategic Management Process

Strategic management process involves formulation of strategies, their implementation and evaluation and control of the consequences. Specifically multinational strategic management involves four major steps namely:

- Scanning of global environment
- Formulation of strategies
- Implementation of strategies and
- Evaluation and control

Environmental Scanning

Environmental scanning provides management with accurate forecasts of trends that relate to external changes in geographic areas where the firm is currently doing business. An MNC is interested in three areas of macro environment.

First, the MNC will begin by conducting a forecast of macro economic and industry performance dealing with factors such as markets for specific products per capita income of the population and availability of labour and raw materials.

A second common forecast will predict likely trends in exchange rates, exchange controls, balance of payments and rates of inflation.

A third in the forecast of the company is potential market share in a particular geographic area as well as that of the competitors.

Several MNCs have profited from careful environmental scanning. For example, Alcatel of France after a careful analysis of macro environment, made a series of acquisitions and alliances and now is the world's largest telephone equipment company. Along with the scanning of external environment, MNC conducts a study of internal resource position which helps the firm evaluate its current managerial, technical, financial and material strengths and weaknesses. This strategy is used by the firm to determine its ability to take advantage of multinational market opportunities.

Strategy Formulation

Before describing how strategies are formulated by an MNC, it is useful to understand that the firm has four major strategy options:

- World Wide Integration
- National Responsiveness
- Regional Responsiveness and
- Multifocal Approach

World Wide Integration: A worldwide integration strategy is aimed at developing relatively standardized products with global appeal, as well as rationalising operations throughout the world. Rationalisation means exploiting the comparative advantage of costs which nations possess.

Worldwide integration is based on the notion that there are a number of products that can be used around the globe with alteration of specifications. Coca-cola which is sold in more than 165 countries, is a classic example of a global product requiring only limited alterations of formula. Not all products and situations lend themselves to such cross-country integration.

National Responsiveness: A national responsiveness strategy allows subsidiaries to have substantial latitude in adapting products and services to suit the particular needs and political realities of the countries in which they operate. Subsidiaries operate almost as if they were stand alone companies, although they retain many of the substantial benefits of being affiliated with an MNC, such as shared financial risks and access to global R&D resources.

Regional Responsiveness: This strategy allows regional offices to have substantial freedom to co-ordinate the activities of local subsidiaries and adapt products and services to suit the particular needs and political realities of the regions in which they operate. Regional offices are able to obtain some economies of scale and make adjustments to suit regional tastes, yet still retain many of the benefits of being affiliated with a multinational company. For example, Thomson Consumer Electronics of France established four factories in Europe that assemble specific types of TV sets for the European market.

Multifocal Emphasis: A multifocal strategy is aimed at achieving the advantages of world wide integration wherever possible, while still attempting to be responsive to national needs. Thus, the strategy encompasses both world wide integration and national responsiveness. Firms with multifocal strategies are difficult to manage as they need to be concerned with two dimensions simultaneously.

Goal Setting for Strategy Formulation

Whatever may be the focus, strategy formulation should be preceded by goal setting. MNCs pursue a variety of goals. These goals typically serve as an umbrella beneath which the subsdiaries operate.

Profitability and marketing usually dominate the strategic plans of today s MNCs. Profitability is of a very high significance because MNCs generally need higher profitability from their overseas operations than they expect from domestic activities. The reason is obvious. Setting up overseas operations involves greater risk and effort. Further, a firm that has done well domestically with a product or service usually has done so because the competition is less severe. Firms, with such an advantage often find additional lucrative opportunities beyond their borders.

Moreover, the more successful a firm is domestically, the more difficult it is to increase market share without strong competitive response. Multinational markets, however, offer an ideal alternative to the desire for increased growth and profitability.

Another reason why profitability and marketing top the list of goals is that these tend to be more externally environmentally responsive, whereas production, finance and personnel areas tend to be more internally controlled. Thus, for strategic planning, profitability and marketing goals are given higher importance and deserve closer attention.

Once the strategic goals are set, the MNC will develop specific operational goals and controls, usually through a two-way process at the subsidiary or affiliate level. For example, the MNC headquarters may require periodic financial reports, an d require that all client contracts be cleared through the house office. These guidelines are designed to ensure that the overseas group s activities support the goals in the strategic plan and that all units operate in a co-ordinated effort.

Strategic Implementation

The strategy formulated needs to be implemented. Strategy implementation is the process of attaining goals by using the organisational structure to execute the strategy formulated.

Three issues deserve serious consideration for strategy implementation.

- Location.
- Ownership decisions and
- Functional area implementation.

Location: An MNC must decide the location of its subsidiary. Core consideration in choosing a country is the size of its market. MNCs have traditionally invested in the rich countries. Another consideration in choosing a country is the extent of Government control. Earlier, MNCs refused to do business in eastern European countries and to some extent even in India. The recent liberalization of economy in India and shift towards free market in the republics of the former Soviet Union and other European nations, however encouraged MNCs to change their perception and they are now making moves in this largely untapped part of the global market.

Location is important for an MNC for a number of reasons. Facilities in a host country contribute to the competitive edge to the MNC. Location is also important because host country citizens prefer locally produced products. Imported goods may be subject to tariff restrictions. Besides, an MNC may already be doing so much business in a country that the local Government will insist that it set up local operations and begin producing more of its goods internally.

Ownership: Ownership of multinational operations has become an important issue in recent years. There are a number of forms of ownership in international operations. The most common ownership patterns are joint ventures, alliances, mergers and acquisitions and new facilities. Depending on the region of the world, some patterns are more popular than others. For example in China joint ventures are more popular while in Australia alliances are widely used. However, the most widely recognized strategies are wholly owned subsdiaries acquired through mergers and acquisitions, licensing agreements, franchising and basic export and import operations.

Functional Strategies: Functional strategies are used to coordinate operations and to examine that the strategies are implemented effectively. While the specific functions in MNCs vary, they typically fall into five major areas namely marketing, manufacturing, finance, technology and human resources.

Evaluation and Control

The final phase in multinational strategic management is evaluation and control. Evaluation involves an examination of the MNCs performance for the purpose of determining:

i. How well the organisation has done and
ii. What corrective actions should be taken in light of this performance.

Strategy evaluation includes two basic activities:

a) Assessing the actual results and comparing them with the expected ones
b) Taking corrective actions to ensure that performance conforms the plans.

Strategy evaluation is essential to ensure that stated objectives are being achieved. It is also important because MNCs face dynamic environments in which forces change quickly and dramatically. Today's success is not guaranteed for tomorrow. An organisation should never be lulled into complacency with success.

Quantitative criteria such as financial ratios, may also be employed to evaluate the performance of the firm. Some key financial ratios that are particularly useful as criteria for evaluation include Return on investment, Return on equity, Profit margin, Debt to equity, Earnings per share and Sales and Assets growth.

Summary

In this lesson we have seen multinational strategic management issues in general and more particularly strategic management process. We have also analysed multinational environment scanning.

Further, we have analysed how strategies are formulated and its four major strategy options such as world- wide integration, national and regional responsiveness and multifocal approach. We have also analysed the implementation part of the strategy and the involvement of three issues namely location, ownership, decisions and functional areas of implementation. Finally evaluation and control of multinational strategic management are also discussed in detail.

Self Assessment Questions

1. Explain the factors behind the growth of MNCs.
2. Write a short note on the development of MNCs.
3. The study of multinational business is fine if you are going to work in a large MNC, but it has no relevance for individuals who are going to work in small firms. Evaluate this statement.
4. What is strategic management? How is it important for an MNC?
5. Describe the Multinational Strategic Management Process?
6. Explain how MNCs formulate their strategies?
7. How is environmental scanning useful to multinational business?
8. Explain Lickert s four systems of management?
9. Write a note on Managerical Grid ?
10. Explain contingency approach to management style?
11. Discuss management styles based on use of authority?

CASE STUDY

Many experts like Friedman believe that if businesses were to survive, they must be relived of in appropriate social responsibilities and allowed to get back to basics: Making Money. A business's primary responsibility is to maximize profits. A company's contribution to the general welfare should be the efficient production of goods and services. Social problems should be left to concerned individuals and Government agencies.

Questions

(a) Whether the opinion of Friedman is correct ?

(b) If yes, substantiate your answer suitably.

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UNIT – III

Learning Objectives

After reading this unit, you should be able to

- Understand the importance and scope of comparative management
- Analyze the management styles and practices in different countries
- Acquaint with various forms of International organization structure
- Understand the locus of decision making
- Understand the Headquarters and subsidiary relationship and control

Unit Structure

Lesson 3.1 - Comparative Management

Lesson 3.2 - Management Styles and Practices in Different Countries

Lesson 3.3 - Organization Design and Structure of International Corporation

Lesson 3.4 - Locus of Decision Making

Lesson 3.5 - Headquarters and Subsidiary Relationships

Lesson 3.1 - Comparative Management

Today's and tomorrow's managers confront increasingly complex organizations, accelerated technological change, and a demanding business environment. Internationalization and globalization of the markets and an ever increasing exchange with foreign cultures have become reality in everyday business today. Nearly all small and medium-sized companies are increasingly exporting to foreign countries or are part of a global supply chain. How does the enterprise deal with highly competitive and open market economies which directly affect the bottom lines of organizations? How to prepare a responsible manager? What business rules apply in different countries? Immediate relevance to current business issues and the lasting benefit to corporations are the guidelines in designing multinational corporations management programme.

In a fast changing global business environment Multinational Companies are preparing a comprehensive approach which will work effectively at various environmental conditions. The basic idea of this approach is to study the multiplicity of business environments and management principles adopted by the companies to administer the situation. Based on the experiences at different countries firms are proficient to identify the cause and effect relationships by which they can prepare a strategy for meeting different environmental requirements which is called as comparative management.

Comparative management is defined as the study and analysis of management in different environments and the reasons that enterprises show different results in various countries. Management is an important element in economic growth and in the improvement of productivity.

The art and the skill of comparative management require manager understanding of the Political, Economic, Social, Technological and Ecological context in which enterprises operate. Managers must make a judgment call about what works where and why.

Importance of Comparative Management

The increase in the number of multinational companies that invest directly in foreign countries has given rise to a relatively new management field known as comparative management. Comparative management is identifying, measuring, and interpreting similarities and differences among managers' behavior, techniques, and practices in various countries.

Multinational companies have opened plants in foreign countries for several reasons: to gain a share in a foreign market to take advantage of economies of scale, to capitalize on savings gained through fluctuations in the foreign exchange market, to avoid trade restrictions, and to take advantages of low-cost government loans that encourage foreign investment. Difficulties arise from the different environments, beliefs, government influences, social customs, and forces in the foreign country. Comparative management approach has become essential to solve the problems faced by a company operating in a foreign environment. Following are the major points for captivating comparative management.

1. **Versatile:** There are several reasons to understand management in an international context. First, as an increasing number of managers go abroad for overseas assignments, they are faced with the problems of motivating and communicating with the foreign work force. Understanding and being responsive to local conditions help managers to achieve personnel and organizational goals. Second, awareness of potential conflict between the multinational company and the host country makes for a mutually beneficial relationships. For example; the multinational might hire a higher percentage of nationals for managerial positions or permit more local autonomy as a way of smoothing labor relations. Third, getting to know how the managers in foreign countries perform their tasks expedites continued trade and cooperation. Fourth, observing how different cultures solve similar problems provides the multinational with innovative problem-solving techniques, which lead to improved management. Finally, the ability to see worthwhile differences and to observe how to act in varying situations is made available.

2. **Convergence:** There is a divergence of opinion with respect to this concept. A German manager of a U.S. plant suggests: "We are

finding out that the way of the future is one world – one market place." The plethora of goods such as watches, cars, musical instruments, office copiers, and the electronic products supplied by multinationals suggests that a common set of managerial beliefs is becoming more relevant. As countries share more common external problems, their different management and organizational system results to a convergence or adoption of various traditional management systems.

On the other hand, there are those who argue that environmental factors will continue to dominate management of a foreign plant. It is interesting to note, however, that successful Japanese and Europeans approaches to management have been adopted in several of their U.S. plants.

3. **Semantic difficulties:** Misunderstandings about the different ways cultures interpret certain words or concepts can lead to major inefficiencies. For example, the word 'leader' has a different meaning in Australia than in the United States. Even the word 'manager' does not have a uniform meaning throughout the world. And words like status, security, and esteem mean different things in different countries. In some countries, the meaning and the measurement of what it means are both in a single word. Further, a number of managerial terms originated in the United Status and have been adopted unchanged in the foreign languages, but the common meaning of the word in the foreign country has grown to mean something quite different from the original U.S. term. Additionally, every culture has some idiomatic expressions that convey no meaning at all when translated into another language.

Scope of Comparative Management

Globalisation of business complicated the management of international companies at various levels. Striving to be a truly global company is a relatively new quest. A few early explorers steered uncharted courses during the first half of the 20th century. But most companies recognized the opportunities presented by an increasingly global marketplace only in the past two decades. So it's not surprising that the number of global companies remains extremely small.

Besides the newness and, of course, the difficulty of this quest, there is one other important reason. So few global companies exist today. Not many executives/managers possess the qualities needed to lead their companies around the world. The practice of comparative management increases the scope for the managers to learn in a versatile environment. The following are the scope of comparative management in management of multinational companies.

1. Think Globally, Act Locally

Companies working through comparative management get the opportunity of finding the best management approach. Players in this new environment will have a fast response capability, will be comfortable with cross-cultural influences, and will be entrepreneurial and flexible. Global managers will require a working knowledge of international relationships and foreign affairs, including global financial markets and exchange-rate movements. These expanded business management skills will need to be coupled with global responsibilities to take advantage of manufacturing rationalization, "mass customization" of products, and low-cost, global sourcing. The global mind-set required by these new economic and competitive realities will be needed at all levels in the firm. Managers with this global perspective will need to strike a balance between national responsiveness and exploitation of global economies of scale. This is the vaunted ability to "think globally, but act locally."

2. Forming of Transnational Corporations

Managing change in the unstable environment is an unending challenge. Constantly fine-tuning the balance between global and local pressures under changing competitive conditions will contribute to the need for frequent reorganization of resources, human networks, technology, and marketing and distribution systems. The shortening of product life cycles, driven by technological change in the products and how they are manufactured and delivered, contributes to the acceleration of change. As difficult as these constant changes are to manage, the overall transition to global operations represents a formidable challenge in itself. Existing international operations, often marked by standardization of products and uniformity of procedures, may be a barrier to effective globalization. For example, a long history of mass-producing standard products may make it especially difficult to invest in and effectively operate flexible factories, one way that firms may offer differentiated products to different markets on a global scale.

For a successful transition to global operations, it is also important that country managers are in agreement with the strategy. If poorly implemented, the move to globalisation can pit headquarters managers against country or field managers. There is a tendency for autonomous units in a firm to protect their own turf. If global strategy is perceived as a move toward a centralization of responsibility, a local manager's role may become less strategic. Subsidiary managers who joined a company because of its commitment to local autonomy and adapting products to local environments may become disenchanted or even leave the organization. In terms of organization structure, effective global managers will need the skills to manage the transition from independence/dependence to interdependence, from control to coordination and cooperation, and from symmetry to differentiation.

3. Ability to Manage Cultural Diversity

Global aptitude encompasses several different qualities. First, of course, is foreign experience. But probably equally important is sensitivity to other cultures. As one starts to function internationally, an understanding of culture and its impact on behavior, particularly management behavior and practices, becomes essential. Very often, people experience difficulties when they have to work in another culture because peoples' world views and mental programs are different in different cultures. Culture has been called "the collective programming of the mind which distinguishes one human group from another." As a result of having different mental programs, people often see situations differently and has different approaches and solutions to problems. Each tends to believe that his or her way is the right way and makes the most sense. The result can be frustration, conflict, and an inability to successfully carry out strategy or plans. Understanding has two parts: cultural awareness or how another person's culture affects his or her behavior; and self-awareness or understanding how our own culture affects our behavior. It is not sufficient to understand how others differ, if we do not understand how we also differ.

The first imperative for effectively managing cultural diversity is cultural sensitivity. The marketers of Coca-Cola, the world's most recognized brand, attribute their success to the ability of their people to hold and to understand the following perspectives simultaneously: Their corporate culture, the culture of their brand, and the culture of the people to whom they market the brand. Sometimes cultural sensitivity leads to marketing one's products to a particular market segment across cultural boundaries, basically finding common subcultures within otherwise diverse cultures. In a classic study of international marketing practices of several bed linen companies headquartered in the United Kingdom, findings stressed the ability to develop a high level of cultural awareness in order to:

1. Know the culture and understand consumption pattern.
2. Obtain high product acceptance in light of the fact that culturally rooted differences have a significant impact on a product's success in a global market.
3. Recognize universal themes by segmenting according to similarities instead of geographical differences.

Lack of cultural awareness can be devastating to organizations competing globally. An organization not managed according to values felt by its members is likely to experience conflict. Hidden values and beliefs must be recognized and understood in order to manage effectively. Global managers must have the ability to recognize that cultural differences operate internally and externally. It is important to understand the influence of the home office's own cultural filters when dealing with foreign affiliates and to accept that the home office way of doing things will not be appropriate in all instances.

In today's global environment, a firm's home culture must no longer dominate the entire organization's culture. Instilling such an attitude, a global mind-set, is not as simple as sending a memo announcing the change. Attitudes are notoriously resistant to change. There are four distinct attitude clusters that are useful in thinking about, and characterizing, corporate worldviews or mind-sets: ethnocentric, polycentric, regiocentric, and geocentric. These attitudes may be reflected in a firm's structure; authority and decision-making processes; selection, development, evaluation, control, and reward systems; information flows; and geographical identification.

4. Design Flexible Organizations

Companies worldwide are facing unprecedented challenges in handling uncertainty, and thus in managing their organization structure too. Given the complexities of the global economy and its attendant demands on managers, it is unlikely that any single organizational form will be adequate to the tasks. Global managers will surely need significantly increased creativity in organizational design, but limited organizational capability may represent the most critical constraint in responding to the new strategic demands.

An individual manager cannot be expected to develop and use all the diverse skills required for successful global management. It is essential then that the organization support global managers. Global managers will, therefore, be called on to design and operate the very organizations that will help them to be more effective.

The best managers are already creating borderless organizations where the ability to learn, to be responsive, and to be efficient occurs within the firm's administrative heritage. This suggests that a wide range of people in such firms must demonstrate the capacity for strategic thinking and action, assisted by open communication of plans, decentralization of strategic tasks, early opportunities for development of top management capabilities, and control systems measuring performance across many dimensions. These new organizations will have multiple centers of influence and managers will move between jobs at these centers. This lateral movement between centers and jobs will be common and will displace hierarchy and promotion "up the ladder."

To ensure that the potential cultural diversity in such situations is taken advantage of, managers will need the ability to create an alignment of authority and responsibility between home office and field offices that moves decision making as close as possible to the customer. Balance is required though and, as noted earlier, the ability to coordinate manufacturing interdependencies to maximize economies of production will be a key task of the global manager.

To operate effectively in these radically different, global organizations will take new skills and old skills honed to a new sharpness. Some of the abilities and characteristics needed by the global manager to function in flexible organizations will be:

1. New levels of creativity and inventiveness in organizational design.
2. High tolerance for ambiguity.
3. The ability to learn, be responsive, and be efficient, all simultaneously.
4. The ability to identify and implement diverse managerial behaviors and ideas for ongoing renewal of the organization.
5. The ability to coordinate complicated financial, human resource, marketing and manufacturing interdependencies, not only across functions, but also within each business activity.
6. The ability to recognize different manufacturing, marketing, and organizational problems and priorities across different locations and to accommodate these with new structures and processes.

5. Building Global Teams

Increased cultural diversity in today's global organisations, combined with the popularity of team based management techniques, makes the influence of cultural differences on work team process and function a salient management issue. Team-working is not the great panacea. It's not the latest management fad. It's not the easy way of reducing costs. Team-working is a means to an end. It enables organisations to employ a range of other techniques for improving quality and reducing unit costs. Teams provide the platform on which to build continuous improvement, just-in-time production systems, an empowered, motivated and self-managed workforce committed to common goals. Teams don't make these things happen - they enable them.

Even before the advent of global companies, effective teamwork was becoming essential for managerial success. As specialization of people and differentiation in organizations increased there was a concomitant increased need for integration-for putting the specialized units back together in the service of the organization's objectives. Teams, committees, and task forces were among the devices used to accomplish the desired integration.

The need for transnational teamwork shows up in different ways in different functions. Consider the different assumptions about the nature and purpose of accounting and auditing in various parts of the world, for example. In one country financial statements are meant to reflect fundamental economic reality and the audit function is to ensure that this is so. In another country the audit is to check the accuracy of the statements vis-à-vis the economic records. In still another country it is only to make sure legal requirements have been met. Imagine, then, the need for cross-cultural understanding and sensitivity in auditing an international subsidiary or the teamwork needed to develop international audit standards.

Other functions pick up the teamwork theme differently. In operations management, the literature emphasizes the need to develop system-sensitive outlooks and processes that will develop personal relationships across subsidiaries. The human resource literature emphasizes the need to develop capabilities for leading multinational teams in flexible and responsible ways. The ability to work effectively with other people and in teams will be critical to the successful implementation of a global strategy. Participation in global teams should, therefore, occur early in the careers of managers in order to transform these developing people into globally effective managers.

6. Ability to Communicate

Managers of global companies make decisions across a range of firm and plant-level activities encompassing activities associated with traditional functions such as finance, marketing and production, as well as those associated with less traditional actions such as international business-government relations and international accounting. Although it is difficult to define a homogeneous set of management principles that harmonize the heterogeneous set of activities ongoing in a global organization, it is possible to identify several core and common concerns. It is obvious that in a global environment managers will need to be able to communicate with diverse groups of people.

To do so effectively will require multilingual skills and high levels of cross-cultural awareness and sensitivity. In addition to the positive effects of good communication skills among colleagues and with customers, there is another advantage of particular importance to geographically dispersed and culturally diverse organizations. Sensitive communications will also build trust, and a common message can help build a strong corporate culture emphasizing shared, global value systems.

7. Ability to Learn and to Transfer Knowledge in an Organization

Given the diversity of market requirements and needs, the dispersion of manufacturing and sourcing, the rise of Research and Development leadership in developed countries, and the importance of technological advances for product and process innovations, learning and transfer of knowledge are key to global success. Managers who are globally competent will be deeply curious; organizations that are successful will be able to coordinate, transfer, and use the knowledge gained by curious executives rapidly and effectively.

The ability of organizations to learn and to transfer knowledge will only increase in importance as markets continue to globalize. In a global environment, the ability of people to learn from diverse sources and to transfer knowledge within their organization is essential for success.

Methods of Comparative Management

Today, the framework of planning, organizing, staffing, leading and controlling has become the most popular way of structuring managerial knowledge. Managerial experience based on this framework are widely used around the world. Still, there are challenging tasks ahead for integrating the body of managerial knowledge into a unified theory. There is evidence that the management theory jungle not only continues to flourish but get more dense, with nearly twice as many schools or approaches as were found more than 20 years ago.

At the same time, there are signs that the various schools of thought are converging. Realizing that these are only signs along the road to a more unified and operational theory of management, and that there is more of this road to travel, let us briefly examine some of methods towards comparative management.

1. The Empirical Approach

In reviewing the many programs that use cases as a means of educating managers, one finds that there appears to be much greater emphasis on distilling fundamentals that there was two or three decades ago. Likewise, in the field of business policy, there has been increased emphasis on teaching and research that goes beyond recounting what happened in given situation to analyzing the underlying causes. One major result of all this has been a new emphasis on strategic management.

2. Systems Approach

Practicing managers as well as operational theories increasingly use the basics of systems theory in analyzing managerial jobs. On the macro level, managers, especially those in multinational corporations, are viewing their operations as a global interdependent system. Japanese managers, for example, are in charge of their manufacturing plants in the United States, and U.S. managers direct their firms in Europe and other countries.

3. Situational Approach

It is now clear that the concept of situational, or contingency management are merely a way of distinguishing between science and art, knowledge and practice. Those writers and scholars who have emphasized situation or contingency approaches have done the field of management theory and practice a great service by stressing that what the intelligent manager actually does depends on the realities of the situation, whether it is in the United States or abroad.

4. The Motivational Theory Approach

Another interesting sign of the move toward a comparative management is the way that research and analysis have tended to merge motivation and leadership theory. Leadership research and theory have found that people tend to follow those who offer them a means for satisfying their own desires. Thus, explanations of leadership have been increasingly related to motivation.

Implied by most recent research and theory is the clear message that effective leaders design a system that takes into account the expectations of subordinates, the variability of motives between individuals, the factors specific to a situation, the need for clarity of role definition, interpersonal relations and types of rewards.

5. Organization Development Approach

Both "organization development" and the field ordinarily referred to as "organization behavior" have grown out of the interpersonal and group behavior approaches to management. Many specialists in these areas are now beginning to see that basic management theory and techniques fit well into their programs of behavior intervention.

Studies indicate that many experts in this field are beginning to understand that the study of behavioral elements in group operations must be more closely integrated with the study of organization structure design, staffing, planning, and control. This is a hopeful sign. It is recognized that analysis of individual and group behavior, at least in managed situations, easily and logically falls into place in the scheme of operational-management theory. By the application of comparative management firms can develop as an excellent international organization.

6. Impact of Technology: Research an Old Problem

Technology has wide impact on organization structure, behavior patterns, and other aspects of managing has been recognized by practitioners for many years. Fortunately, academic researchers in recent years have directed their attention to the impact of technology on managerial effectiveness.

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Lesson 3.2 - Management Styles and Practices in Different Countries

1-United States

The United States is a democratic country and it is more difficult to determine to what extent authority is centered at the top and to what extent it is balanced by the authority of the working population exercising their power through the withdrawal of their labour.

US managers are often under pressure by stockholders to show favorable financial results. This, unfortunately, may not encourage investments that have a payout in the more distant future. Also, Americans usually stay in their managerial positions only a relatively short time, and so a myopic decision can seldom be traced to the manager who had made it but in the meantime was promoted or even changed companies.

Decisions are made primarily by individuals, and usually only a few people are involved. Consequently, after a decision has been made, it has to be sold to others, often people with different values and different perceptions of what the problem really is and how it should be solved. In this way the making of a decision is rather fast, but its implementation is very time consuming and requires compromise with those managers holding different view points.

The management of human resource in USA is quite different from other countries. American firms also recruit employees from schools, but they hire employees from other companies too. A common practice in America is to appraise the performance of new employees rather soon after they join the company. If the performance does not meet the companion's expectations employment may be terminated. But even for those who have been with a company for many years, performance is evaluated at least once in a year. In general, the focus of performance appraisal is on short–term results and individuals contributions to the companies aims.

The managerial function of leading is carried out quite differently in U.S.companies. Leaders are seen as decision makers heading the group, they are expected to be directive, strong, firm, and determined. Their task is to integrate diverse values, but the emphasis on individualism in the society in general and in organization in particular may hinder cooperation.

Features

- Short-term orientation.
- Involvement of few people.
- Decision making at the top, flowing down.
- Fast decision making.
- Loyalty to profession.
- Comprehensive performance evaluation.
- Job insecurity.
- Face- to face confrontation.
- Fixing blame.

2-Japan

In the post-World War II era a set of Japanese cultural patterns and managerial practices came to be known collectively as the Japanese management style or Japanese management techniques. Many of these techniques were credited with helping vault the Japanese economy to its status as the world's second largest, behind only the United States. Japanese management styles have never been that different from those prevalent in Western business, although many managers and pundits appear to believe they are. However, there certainly have been several useful concepts emanating from or developed by Japanese entrepreneurs and management. Kaizen is a good example, although Edwards Deming and others from the West largely articulated this (Japanese) Buddhist view of organisation, influencing management pundits such as Masaaki Imai.

In Japan planning is greatly aided by the cooperation between government and business. After second world war II Japan developed policies for economic growth and strength as well as international competitiveness. These policies harmonized monetary and fiscal policies with in the industrial structure. One of the most interesting part of

Japanese management is the way, the decisions are made. In typical organisation, several levels are involved in making a decision. Actually, the most important aspect of the process is the understanding and the analysis of the problem and development of various alternative solutions.

Japanese managers are seen as social integrators who are a part of the work group. Using a paternalistic leadership approach, managers show great concern for the welfare of other subordinates. Common values and team spirit facilitates cooperation. The role of managers is to create an environment of spirit de corps, and they are willing to help out in doing the same work their subordinates do. In an attempt to maintain harmony at almost any cost, managers avoid face-to-face confrontation. This means that things may be purposely left ambiguous.

One of the major contributions of Japanese management to the world is Z theory. Theory Z is often referred to as the 'Japanese' management style, which is essentially what it is. It's interesting that Ouchi chose to name his model 'Theory Z', which apart from anything else tends to give the impression that it's a Mcgregor idea. One wonders if the idea was not considered strong enough to stand alone with a completely new name... Nevertheless, Theory Z essentially advocates a combination of all that's best about theory Y and modern Japanese management, which places a large amount of freedom and trust with workers, and assumes that workers have a strong loyalty and interest in team-working and the organisation.

Theory Z also places more reliance on the attitude and responsibilities of the workers, whereas Mcgregor's X,Y theory is mainly focused on management and motivation from the manager's and organisation's perspective. There is no doubt that Ouchi's Theory Z model offers excellent ideas, albeit it lacking the simple elegance of Mcgregor's model, which let's face it, thousands of organisations and managers around the world have still yet to embrace.

Features

- Long term orientation.
- Collective decision making.
- Slow decision making.

- Paternalistic leadership style.
- Common values facilitating cooperation.
- Control by peers.
- Saving face.

3-China

In the age of globalisation, China presents a unique setting for organizations. The unprecedented growth of China's economy, which remains the fastest growing in the world, offers significant potential for the practice of modern management concepts. As China's economy evolves — growing larger, more complex and more competitive — so is the way that multinational corporations (MNCs) are managing their operations there. CEOs and other senior executives at MNCs in the U.S., Europe and Asia are focusing more of their time and their companies' resources on China.

A research suggests that the MNCs that have had the most success in China are those whose top managers have gone out of their way to stress the importance of their China businesses in relation to their global operations. At the same time, the managers on the ground in China are also changing. Expatriates still hold the most senior positions in China, but Chinese locals are assuming a greater role in both middle- and senior-management ranks.

In years to come, multinationals will face new challenges in their China operations: nurturing the growing number of more educated and experienced Chinese managers and leveraging their China operations in a way that contributes to their global competitive advantage. In past years, the typical general manager in China was assigned the relatively straightforward task of either selling his multinational's products in that country or helping the parent firm establish operations to leverage China's strength as a low-cost producer. To be sure, there remain important responsibilities; indeed, the number of companies that wish to outsource to China is accelerating. But the demand on China managers has become more multifaceted.

For one thing, China managers still have to address significant growth in demand in China and all of the challenges inherent in competing against foreign and domestic companies in what is already a vast, difficult market. They also must deal with the global migration of customers. Industrial companies or suppliers that provide components to assembly plants are finding that more and more of their customers are migrating their manufacturing to China either because of demand or China's attractiveness as a low-cost space.

Hence, China managers must now interact with a constant stream of visits by customers from many parts of the world. Furthermore, general managers of MNCs in China must strengthen their ability to develop managerial talent — as well as engineers and scientists — within China.

In 2003, Boston Consulting Group and the Wharton School (BCG) conducted a survey to benchmark the best corporate approaches to China. The study focused on ways in which 14 MNCs manage their overall presence in China from a broad corporate perspective, as distinct from the level of individual business units.

BCG also looked at how MNCs ensure sufficient global visibility of their China operations and how functions and processes are carried out. Specifically, the consultancy analyzed the MNCs from a number of perspectives: how the multinational corporations manage its China operations; target setting and management processes; government and public relations; localization and human resources development; the role of the China operation; the relationship of sourcing to sales and marketing; and the extent of cross-product development activities.

The study found that leading MNCs treat China uniquely in at least 10 ways:

1. The China operation has a very senior, accountable sponsor at the global level; at Samsung, for example, the China CEO is one of three top group executives.
2. Clear, bold targets are set internally, and sometimes externally; GE has goals of $5 billion in sales and $5 billion in sourcing by 2005.
3. A continual, top-down management push is reinforced with management processes; Michael Dell of Dell Computer and other CEOs visit China atleast once a year.

4. The MNC is willing to change its rules regarding global priorities and norms to favor China; Kodak moved its Asia headquarters to China.

5. China-specific products are pursued; virtually all major MNCs have China-specific products.

6. The MNC works aggressively to bring the industry value chain, including R&D, into China; Samsung set up a 300-person handset R&D laboratory in Beijing.

7. Managers are nurtured for the long term; Motorola University runs management development programs in China.

8. Government relations and public relations are strongly emphasized; Pepsi has stepped up its government-relations focus on the central government and less on provincial governments.

9. The China operation is given a truly "value-added" role; Kodak's China organization prepares an integrated strategy across six businesses.

10. China is made a global or regional center — or both — for key responsibilities; Nike says its China operation will become increasingly important in the build-up to the 2008 Olympics.

4-Korea

Korea and the other countries adjacent to China have been under the influence of Chinese culture for two thousand years. Chinese culture, therefore, has dominated Korean society and their everyday lives through political, legal and social systems in addition to literature, religion and ethics. In Korea, Japanese management receives a greater deal of attention, partly because of the economic success of Japanese. Korea has also known for its fast and remarkable economic growth, but its management practices are less known to the world. It would be incorrect to assume that Korean management is simply an extension of Japanese management. It is not, although there are some cultural and structural similarities, such as the dominance of powerful conglomerate companies.

In Japan, managers emphasis group harmony and cohesion, expressed in the concept of *wa*; the Korean concept of *inhwa* also translates into harmony, but with less accept on group values.

There have also been cultural changes which reflect on the Korean way of doing business and of living. The knowledge and skills for coping with these changes need to be mastered by those who want to interact with Koreans. The need for interpersonal relationships and good communication should be emphasized. Korean organizations are quite hierarchical, with family members occupying key positions.Beyond blood relationships, the factors affecting hiring decisions often include the school attended or being from the same geographic region as the top person. The leadership style can best be described as top-down, or autocratic/paternalistic. This approach enables the firm to adjust quickly to the demands in the environment by issuing commands. Lifetime employment does not prevail.Indeed,the labor turnover rates are high when compared with the low rates in Japan. Turnover is primarily attributable to people quitting their job rather than being dismissed. All in all, Korean management is different from both Japanese and U.S. management practices.

5-India

Since 1991, the Indian industry has been exposed to a globally competitive marketplace. Despite the impact of globalisation, Indian companies have not completely discarded Indian managerial philosophy. India seems to be moving towards a unique `hybrid' form of management that seeks to remain grounded in selected `traditional' patterns of behaviour, while embracing many of the globally accepted management practices.

India has a rich and enduring cultural heritage that has shaped and reshaped itself over thousands of years. The country has not shut itself completely to global information and cultural flows. In the past three centuries, a British inspired institutional underpinning, a vigorous democratic political system and a highly-educated, English-speaking social elite have exposed the country to global trends. In that sense, India is quite unlike China, which shut itself off from the Western world for several years and only recently opened up to the outside world.

Management practices in India exhibits India's work culture. Hierarchical management, high power-distance, a low risk taking propensity and the importance of familial and social networks have been cited as reasons for India's relatively slow industrialisation. A high power-

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distance culture means that workers prefer authoritative and hierarchical forms of management. They also respond favourably to close supervision. Managers who demonstrate a high `power figure' type of behaviour are more likely to gain the respect of subordinates. Clear and direct orders are preferred. In order to enthuse and motivate workers, clear job descriptions and detailed instructions are needed.

One problem faced in professionalising Indian management is that many Indians derive their identity based on family. Additionally, age and seniority are given great respect in India. A typical Indian is also very loyal to his or her own group or team, and places the interest of the group before his or her own interests.

On the face of it, one would expect to see this collectivism to be carried over to the work place in the form of hard work, commitment, dedication and loyalty to the company. But a closer examination reveals that Indians are not that committed to their organisations as say the Japanese. Indeed, many Indians put their individual interests ahead of those of their organisations.

Another aspect of Indian management is that Indian CEOs receive greater idealisation from senior managers than their counterparts in the West. Consequently Indian leaders are insulated from critical feedback from their senior managers. Moreover in contrast to Western managers who are expected to react consistently, logically and objectively in different situations, place, time and person influence Indian managers. Some behaviour that is judged appropriate for a given place, time and person(s) may not be appropriate for other times, places and person. But here again, thanks to globalisation, things are changing, especially in industries like the IT.

Ultimately, it is the quality of management, which will determine India's progress in the next few decades. Indian managers need to introspect and show flexibility. They must accept the best practices from other countries and yet modify them to suit the country's unique needs.

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Lesson 3.3 - Organisation Design and Structure of International Corporation

Organisation design, sometimes called organisation structure, is the overall pattern of structural components and configurations used to manage the total organisation.

Organizational structures generally establish internal authority relationships, responsibility for work performance, and paths of communication and control required for a company to achieve its objectives. These structures are typically set up to blend the specialized expertise needed to facilitate decision making on a variety of short- and long-range problems. The development of structures should generally be planned and managed.

The type of structure managers select should take into consideration the social and psychological aspects of the environment and personnel and should be designed to achieve operational efficiency and control without inhibiting individual creativity and initiative. This task becomes much more complex when a domestic enterprise desires to internationalize its operations. This is because organizations' managers need to establish lines of authority and responsibility from top headquarters management to managers in a variety of foreign environments and at the same time keep open the necessary lines of communication required to manage effectively and efficiently in all the diverse environments.

Importance of Organisation Design

A firm through its organisation design (organisation structure)

1. Allocates organisational resources.
2. Assigns tasks to its employees.
3. Instructs those employees about the company's rules, procedures, and expectations relating to their job
4. Collects and transmits information necessary for problem solving and decision making.

International Organisation Structures

The term organization takes new meaning for a multinational company based on the dimensions of the business. The basic dimensions of an international business enterprise are technical or product needs, functional needs, and regional or environment needs. Technical or product needs are specialized factors such as construction, operation, manufacturing, research and development, special knowledge, and experience. Functional needs are special knowledge of such functions as personnel, planning, purchasing and finance. Regional or environmental needs are special knowledge of areas such as the foreign government, politics, trends and economy. To attain maximum over all benefit and to ensure effective communication and develop the means to make effective decisions, the international organizational structure managers must effectively integrate these three basic dimensions throughout the organization.

Traditional and Modern Organisation Structures

An organization's international structure is usually based on one of few traditional or contemporary models. The traditional models include the functional structure international division, foreign subsidiary, product division, and regional structure. The contemporary models include the matrix organization, the non-equity-based contractual/strategic alliance, and the mixed (hybrid) structure. These are discussed in the following sections.

The Functional Structure

This form of organization extends the traditional domestic functional hierarchy, and its development often bypasses the international division stage. Under the functional structure, major functions are the focus. Product knowledge is centered in manufacturing, engineering and marketing, and management of each of these departments is responsible for both the domestic and information activities. Large international companies rarely use this structure at the corporate level; it is sometimes used in regions, divisions, and / or subsidiaries. The functional structure is traditionally European. It is typically used by smaller firms, or by larger firms with one major product and stable demand. Domestic firms whose internationalization strategy entails indirect exporting often use this structure. A firm's low dependence on foreign sales and its staff's lack of international business experience often leads it to adopt this structure, as oppose to the international division structure. This structure works well in small companies, or in those with narrowly defined technologies where integrated manufacturing or service activities can achieve economic goals.

Advantages

1. Emphasis on functional expertise:. The key business tasks define work, and functional expertise is brought to bear on all aspects of the operation.
2. Tight control. This centralized functional approach permits a small staff to control the firm's operations. Top management has authority and operational responsibility.
3. Prevents "We" versus "Them" conflicts. The absence of secondary profit centers (there is no international division) prevents internal conflicts – the "we" versus the international division problems (discussed in the next section) is prevented.
4. Firms can develop and transfer expertise within each functional area.
5. It is possible to maintain highly centralised control over functional operations.
6. It focuses attention on the key functions of the firm. Accountability – someone is responsible for the section. Clarity in functional definition – know your and others' roles.

Disadvantages

1. Weak regional coordination. Disputes between functional managers must often be resolved at the corporate level. The CEO is often asked to solve problems in areas in which he or she lacks expertise, such as international business.
2. In firms with multiple product lines, functional structure can lead to top-heaviness. In multiproduct firms, functional managers need expertise in each product, or a functional manager is needed for each product. The latter, which is often the case, would lead to an expensive, top-heavy structure.

3. Much greater emphasis is often placed on domestic sales than on foreign sales.
4. It is practical only when the firm has relatively few products or customers.
5. It does not promote coordination between divisions.
6. It may result in duplication of resources between managers.
7. Closed communication could lead to lack of focus.
8. Departments can become resistant to change.
9. Coordination may take too long.Gap between top and bottom.

International Structure

When international business continue to grow companies can go for international division structure. After gaining some international business experience through indirect exporting and their reliance on international business has increased somewhat, many companies internationalize their operations further by creating an export department. Typically, the aim of the export department is simply to handle shipment of existing domestic products to foreign markets. But when firms' foreign transactions subsequently increase, the export department is generally developed into an international division. The international division usually supervises exports, distribution agreements, foreign sales forces, foreign sales branches, and the foreign sales subsidiaries. Staff members in the international divisions are selected on the basis of their general familiarity with corporate products, technology, and the culture, combined with their ability to the "hands on" managers who are culturally sensitive and adaptable to the constraints imposed by the foreign environmental factors.

In the international division structure, functional staff such as marketing, finance, and research and development are typically established, and an executive responsible for international operations is appointed. International businesses adopt this structure when they desire to have an expert responsible for managing each specialized function. Managing these functions across countries requires skills beyond those required for managing them in the home country.

The international division is generally given total authority and responsibility for the enterprise's foreign operations and activities. Historically, some smaller enterprises for whom an international division was not really necessary have nevertheless adopted such a structure because they saw it being used by larger, successful enterprises.

Advantages

1. International executive development: Managers and employees in such a division are forced to develop expertise in international business and will subsequently able to participate in, or direct, operations in foreign sites.
2. Focused international responsibility and authority: Foreign operations are generally more complex than domestic operations and distant from the home base. As experienced executive whose sole responsibility and authority is the international division is therefore more free to react to the needs of such areas than would be an executive whose responsibility and authority is for both domestic and international operations.
3. The International operation has a single, strong voice in the company's strategy/policy-setting process. Since heads of international divisions are usually totally responsible for profits and losses of the foreign operations, they will be forceful in acquiring the share of resources necessary to accomplish the firm's international goals. On the other hand, an executive in charge of both domestic and foreign operations may focus more on obtaining resources for domestic activities than for foreign operations.
4. Top management is cognizant of consequences: Because of the complexity of international business, many domestic executives focus mainly on their home-country operations and lose themselves in domestic issues, by ignoring global operations. By having an international division, top management is made cognizant of the consequences of focused decisions on global operations.
5. Company-wide view of international operations: Managers in the international division are usually concerned with the success of all of the firm's products in foreign markets. These managers are therefore impartial in determining the best overall corporate

strategy for international profits. On the other hand, managers of individual product lines made responsible for both domestic and foreign operations may be partial to their own international operations as opposed to the firm's overall international strategy.

Disadvantages

1. Exports slowdown: Production division may not always adequately supply what the foreign division needs because they favour the domestic operations. Consequently, foreign orders may go unfilled even if the profit potential is higher than that for domestic orders. On the other hand, the heads of product divisions who are responsible for both domestic and foreign business may pay more attention to foreign operations when they see a higher profit potential than in the domestic market.

2. Bottleneck: Managers of international divisions sometimes lack adequate product or technical expertise, and the physical separation between domestic and foreign operations often precludes enterprises from providing adequate technical support to international divisions. This cause bottlenecks.

3. Conflict between employees in the domestic division and the employees in the international divisions: Organizational struggles between domestic and foreign operations often occur. Because the international division cuts across all product areas, a "we-they" situation can occur.

4. International versus other divisions: In the ideal corporate organization, operating divisions should be equal in size and profit. In reality, however, the international division often becomes more profitable than the product divisions. When this occurs, the product divisions sometimes "gang-up" to reduce the international division's power.

5. International Managers spread too thin: Managers of international divisions are often made responsible for several disparate markets, such as South America, Europe, and Asia. This makes developing expertise difficult.

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Foreign Subsidiary Structure

Environmental changes, such as increased demand in foreign markets, or a foreign government's mandate, or changing conditions in the home market, often force international corporations to cease exporting and establishing manufacturing facilities in the foreign markets – they establish subsidiaries in foreign countries. These firms thus restructure their organization; they change from an international division structure to a foreign subsidiary structure. Each foreign subsidiary is treated as an entity. Each reports directly to top management at headquarters. Coordination between product and service departments is carried out at the headquarters office. These firms therefore apply the multidomestic strategy. Applying a multidomestic strategy, the headquarters' managers generally allow the subsidiaries to function as a loose federation with local managers processing substantial autonomy, allowing them to respond quickly to local situations.

Advantages

1. Autonomy of affiliates:. The affiliate subsidiaries operate free of layers of management between them and top management. These independent affiliate companies are generally allowed to operate with the little control from above and can thus develop their own local identity.

2. Direct top management involvement: Problems beyond the affiliates talents go to top management for response and resolution. This enables top management to reflect long-range corporate goals rather than parochial interests. Also, it forces top management to develop a stake in international business and acquire knowledge in that area.

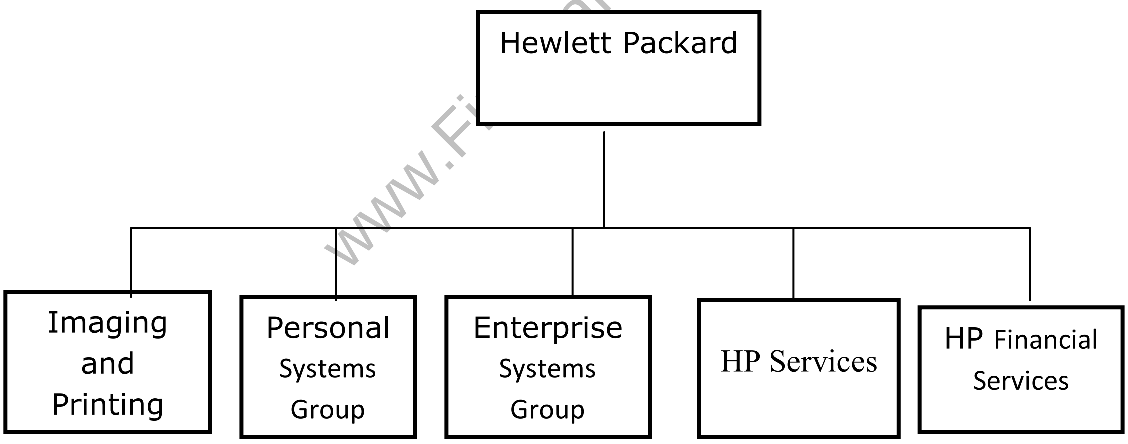
Disadvantages

1. Diffuseness of international responsibility: there is no center for international operations responsibility. With so many groups reporting directly to the board, clarity and focus can be lost – although the board can delegate the responsibility to certain expert members.

2. Potential unwieldiness: Many items that could be resolved without board action, such as by experts, are often pushed to the board level again, the board could delegate many responsibilities to expert members.

The Product Division Structure

A company that sells a diversified selection of goods or services will likely organized on a product group structure. Many corporations are diversified and use this structure. Under the product division structure, each of the enterprises product divisions has responsibility for the sale and profits of its product. Therefore, each division has its own functional, environmental, sales, and manufacturing responsibilities. When a product division decides to internationalize its operations, as in the case of one product companies, it may first begin by indirect exporting, subsequently establishing its own export division, and then establishing foreign subsidiaries. This means that if sales in foreign markets by firms with numerous product divisions became substantial, these enterprises could end up operating numerous subsidiary companies in a single foreign territory. Ford Motors began restructuring itself along the product line in the early 1990s Canon Corporation used the product division structure when it became a multi product enterprise in 1962. (Figure)



Product division structure

Advantages

1. Product and technology emphasis. Since both the domestic and international units report to the product division and compared

with the whole, product divisions tend to be small, closer ties could result. Therefore, because of the common product benefit and the closer ties, products and technology can be easily transferred between the domestic and international units.

2. Worldwide product planning. Foreign and domestic plans can be more easily integrated in a product division than in an international division. A worldwide division perspective could therefore evolve.
3. Conflict minimized. The problem of substantiating the difference between international and domestic needs may be less difficult than when the international function is in the international division. Having both functions in the same division may lead to similar loyalties and the "we-they" conflict often caused by placing the international function in an international division may be mitigated.
4. Managers are able to gain expertise in all aspects of a product or products
5. Efficiencies in production are facilitated.
6. Production can be coordinated at a variety of facilities reflecting global demand and cost fluctuations.
7. Managers are in a position to incorporate new technologies into their products and respond quickly and flexibly to technological changes that affect their market.
8. Clear focus on market segment helps meet customers' needs
9. Positive competition between divisions Better control as each division can act as separate profit centre

Disadvantages

1. Division managers often lack international skills. International product managers are often selected on the basis of domestic performance and may therefore lack the required international skills.
2. Weakness in worldwide know-how. Managers of individual product divisions may become knowledgeable in operating in certain markets, but worldwide knowledge is often impossible. For example, in the past, many managers of U.S. domestic enterprises

that internationalized their operations have developed strong skills in the Canadian and European markets but weaker skills in other parts of the world. This may result in weak performance in certain markets.

3. Inherent weakness of multiproduct systems. Managers of the overall corporate system may encounter conflicting international demands from the different product divisions. Since managers are part of the overall corporate system, they may not posses adequate abilities to handle such conflicting demands.

4. Foreign coordination problems. Managers of different product divisions operating in the same foreign country may not coordinate efforts to attain overall corporate efficiency because they are too busy looking out for each other's interests. For example, to cut costs, perhaps some support functions typically carried out in all product divisions, such as personnel and payroll, could be carried out by a single unit.

5. It may encourage expensive duplication in functional areas and even in physical facilities.

6. Each product group must develop its own knowledge about the local environment.

7. Coordination and corporate learning across product groups is more difficult.

8. Duplication of functions (e.g. different sales force for each division)

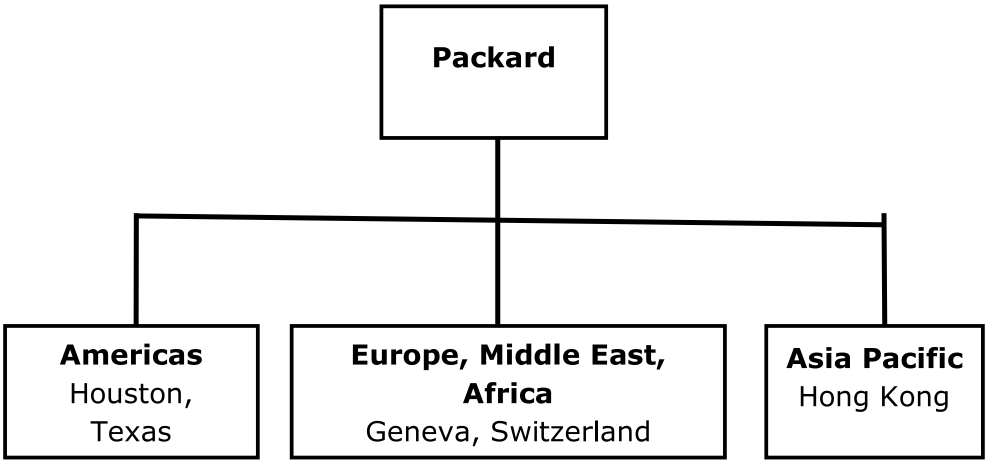
9. Negative effects of competition

10. Lack of central control over each separate division

Regional Structure

The most common form of the group structure defines activities by geographic regions. Under the regional structure, regional heads are made responsible for specific territories, usually consisting of areas such as, Asia, South America, North America, etc., and report directly to their CEO or his or her designated executives at the headquarters. In general, firms with low technology and a high marketing orientation tend to use this structure. Firms whose foreign subsidiary or foreign product structure has became too large and too complex to manage from a single headquarters often restructure themselves using this form.

This type of structure enables regional heads to keep abreast of, and provide for, the needs of their respective regional markets. Managers at regional headquarters are typically responsible for a range of activities, such as production for and marketing in their respective regions. Pharmaceutical, food, and oil companies tend to use this structure. (Figure)



Regional Structure

Advantages

1. Decentralization: Authority and responsibility, and therefore performance accountability, is delegated directly to the regional office. The management tasks of planning and strategy are less complex than if the central headquarters were to hold this responsibility.

2. Adaptation: Regional managers are better able to adapt to local needs than headquarters managers because they are in closer touch with local changes and requirements.

3. Single management units possess regional knowledge. Regional managers develop local expertise because they are responsible for regional strategies and daily operations. Regional differences exist throughout the world. Inputs from knowledgeable regional managers can enable central headquarters managers to use these differences effectively in developing and attaining overall corporate objectives.

Disadvantages

1. Policy barriers:. Inconsistent overall corporate management practices may evolve. This is specially so when central management tries to, or is persuaded to, satisfy specific regional needs.

2. Weak worldwide product emphasis and technical knowledge: Because technical knowledge is spread out, a global perspective on products is sometimes difficult to attain. And because the emphasis is usually on regional concerns, the formulation of worldwide strategy can be difficult.

3. Technology transfer barriers: Employee loyalty is often focused on the region rather than on the overall organization, and each regional manager tends to claim that things are different in his or her region. Therefore, when headquarters managers attempt to implement new technology on an overall corporate basis, it may not be readily accepted by the region.

4. Costly application: The typical support functions shown. Exist in each regional division. Costly duplication of efforts results. Efficiency could result if these support functions were combined, but in this structure, the number of functional product staff specialists tends to increase through the years.

5. Weak communications: Necessary information may not reach top management because of the regional managers' focus on regional performance. Overall corporate performance may therefore be weakened.

Matrix Structure

Matrix structure is a team approach to project development within an organisation. The team is comprised of members from different functional areas or departments within the company. The ideal global corporation is strongly decentralized. It allows local subsidiaries to develop products that fit into local markets. Yet at its core it is very centralized; it allows companies to coordinate activities across the globe and capitalize on synergies and economies of scale. To accomplish this, many international businesses have adopted matrix structures. Companies such as Nestle have adopted matrix organizations that allow for highly decentralized decision making and development while simultaneously maintaining a centralized corporate strategy and vision.

Advantages

1. It allows firms to draw on the functional and product expertise of its employees because it brings together the functional area, and product expertise of the firm into teams that can develop new products or respond to a changing marketplace.
2. Coordination and cooperation across subunits enable the firm to use its overall resources efficiently and therefore to respond well to global competition in any market.
3. Overall corporate global performance is highlighted.
4. Many internal conflicts are resolved at the lowest possible level, and those that cannot be resolved are pushed up.
5. It promotes organisational flexibility and promotes coordination and communication across divisions.
6. Improves individual motivation
7. Increases job satisfaction Enhance and evolve the organisation's pool of available expertise and knowledge, thus making the organisation more flexible

Disadvantages

1. World wide responsibility may be given to product managers with weak international experience.
2. The organization tends to create a mountain of paperwork.
3. The dual-boss, cross-communication system is expensive and complex.
4. Decisions sometimes must be made quickly. Quick decisions can be made by one person. In this matrix group decision-making process, decisions are usually made slowly.
5. It is inappropriate for firms that have few products and operate in relatively stable markets.

6. It creates a paradox regarding authority. It tends to promote compromises or decisions based on the relative political clout of the managers involved.

For a successful matrix organisation

1. Ensure everyone understands the rationale behind the structure—understanding the purpose behind the apparently complex structure contributes to people exploiting its features to deliver its objectives.
2. Document the relationships between the different axes of the matrix organisation in the form of protocols, contracts or service level agreements.
3. Foster close communication and understanding between the specialist managements of the different axes—this is likely to involve extensive networking between the senior management of the axes of the matrix.
4. Exploit latest communication technologies
5. To overcome problems of distance and potential information indigestion.
6. Reflect the multiple dimensions in budgeting and financial reporting.
7. Ensure that individuals "belong" to one dimension of the matrix—generally the axis that will support their career aspirations, reflecting professional specialism, limits to personal geographic mobility, personality or skill set.
8. Ensure that due allowance is provided by each axis for the development and training needs of staff "belonging" to one axis to support their continued career development and professional obligations.
9. Protect staff with dual reporting responsibilities from cross-fire by creating a culture in which it is okay to escalate to dispute resolution to the directors of the functions, profit centers, country units etc. making the conflicting demands.

Contractual Alliance Structures

Many enterprises enter foreign markets via non-equity based joint ventures, often referred to as contractual alliances and strategic alliances. For example. One firm's strength may be production and another firm's distribution. Instead of these two firms forming an equity-based joint venture to capitalize on each other's strengths, they form a non-equity-based contractual alliance. Thus, when the two firms no longer need each other, in theory, they simply break up the partnership. The advantage of this partnership arrangement is that when there is a breakup, there is no long, drawn-out-fight for the division of assets, as often is the case when equity-based partnership breaks up.

There are disadvantages to this approach, however. For instance, when one partner acquires the other partner's skills, and the reverse is not the case, the learned partner may leave the unlearned partner in a dubious situation or the learned partner may easily take over the unlearned partner. Of course, this type of arrangement can work only when neither partner possesses a secret motive.

Networking

Somewhat similar to the contractual alliance arrangement is networking. Applying this approach, a corporation subcontracts its manufacturing function to other companies. For example, Nike, the American shoe maker, subcontracts the manufacture of its athletic shoes and clothing to forty separate locations, mostly in Asia Networking, a typical twentieth-century organisation has not operated well in a rapidly changing environment. Structure, systems, practices, and culture have often been more of a drag on change than a facilitator. If environmental volatility continues to increase, as most people now predict, the standard organisation of the twentieth-century will likely become a dinosaur.

Organisational structures change with the changing business and social environment. Increasingly, organisations are project-based, expanding and contracting as projects of different sizes come and go. In some cases the organisation exists only for one major project, eg a film production. However in most cases there is a core organisation which continues between projects, and indeed holds the projects together. The individual projects are not only tied together administratively but more importantly are linked in terms of a central business strategy, charitable purpose or artistic mission. The core organisation selects projects strategically to fit its mission and core skills. In this way, synergies are achieved.

The characteristics of a network organisation are:

1. Independent teams.
2. Departments which share common values.
3. Projects which support each other
4. Multiple links between projects
5. Information and Communications Technology is used to connect the projects.

There is a key coordinating role for the Chief Executive to construct the teams and manage the interrelationship of projects. When an organization enters into such contractual alliances or networking agreements, it must create a unit whose responsibility is to monitor the arrangement. For instance, IBM has created an alliance council of key executives who meet monthly to keep track of more than forty partnerships throughout the globe.

Mixed (Hybrid) Structure

The traditional and contemporary alternative structures described above are not independent entities that cannot co-exist within the same company. By mixing the structural types, the weaknesses of each type can be minimized. For example, companies with worldwide product division structure can appoint regional coordinates who attempt to supply the concentrated environmental expertise that is usually absent in the product division structure. Similarly, companies with regional structures (either worldwide or within an international division) can set up positions for product coordinators. While such coordinator positions are not particularly new, giving them some real influence short of classical line authority is a relatively recent development. Furthermore, international organizations can centralize some functions, such as an accounting division that provides services for all worldwide subsidiaries, while other functions, such as marketing, remain decentralized.

Flat Structures

Regardless of which structure is used, it should be as flat as possible. That is, it should have fewer managerial layers than traditional hierarchical organizations. A flat structure is needed because a twelve-layer company cannot compete with the three-layer company. For example, a decade or so ago, General Motors, the U.S. based car manufacturer, had an organizational structure consisting of more than fifteen managerial levels. General Motors had a problem competing with Toyota, the Japanese car manufacturer at least partially because Toyota's organizational structure contained only four managerial levels. (This is in part because Japanese employees are not motivated by the opportunity to climb up the hierarchy as are American employees.) One reason companies with tall structures are less competitive than firms with flat structures is that they have to pay more managers at more levels, thus increasing their costs.

Another reason is that an organization can create an atmosphere of maximum creativity only if it reduces hierarchical elements to a minimum and creates a corporate culture in which its vision, company philosophy, and strategies can be implemented by employees who think independently and take initiative. The flatter structure means that managers have to communicate with more employees than do managers in tall structures. The ability to communicate with more subordinates has been made possible by the enormous advancements in communications technologies, which, as American management authority Peter F. Drucker noted, enables managers to communicate with a far wider span of individuals than was possible in the past. Spans of control thus give way to spans of communication.

Organic Versus Mechanistic Structures

Another problem confronting managers is determining how organic or how mechanistic the organizational structure should be. Basically managers in organic structures allow employees considerable discretion in defining their roles and the organization's objectives, In mechanistic organizations roles and objectives are clearly and rigidly outlined for employees – managers and subordinates are allowed little or on discretion. Historically, large organizations have tended to adopt the mechanistic form and small organizations the organic form; mass producing organizations have tended to adopt the mechanistic form and firms producing specialized products have tended to adopt the organic form. Thus, the form an organization adopts is determined by varying situational factors.

In making a determination as to which approach is appropriate for an organization functioning across nations, managers also need to consider national cultural factors. For example, organizational structures tend to be more mechanistic in strong uncertainty avoidance cultures, such as France and Germany, than in weak uncertainty avoidance cultures, such as Great Britain, and organic structures tend to be more prevalent in the latter cultures than in the former. If one adheres to the national cultural factors model, subsidiaries in some nations will be more structured than subsidiaries in other nations; but if one adheres to the situational factors model, the same structure is applied in the same situation in all nations.

Adaptable Management

The international organizational structure adopted by a firm's management is influenced by many factors, including the firm's economic situation, the type of product or technology, managerial preference (organizational culture), the foreign country's cultural, economic, technological, and political conditions, the wide separation of operations, and the different foreign market characteristics, including the nature of competition. Therefore, organization structures that work well for domestic operations are often not suitable for multifunctional operations. For example, matrix organizations are very scarce in Latin America. This is in part because Latin America's patron system does not lend itself to the power sharing that characterizes matrices. The structure is also influenced by the firm's level of experience in international business and its dependence and revenues from foreign markets.

Historically, when firm's first venture into foreign markets, and when both foreign sales and the diversity of products sold in the foreign country were limited, global companies generally managed their international operational division. Companies that subsequently expanded their sales in foreign markets without significantly increasing foreign products diversity generally adopted the regional structure. Those enterprises that subsequently increased foreign product diversity tended to adopt the product division structure. Firms that increase both foreign sales and foreign product diversity tended to adopt the matrix structure.

International business executives must be thoroughly familiar with the strengths and weaknesses of each organizational structure and be ready to switch from one form to another as a means of adapting to changing environments (including moving an important business unit's head quarters to foreign soil. The right structure must be matched to the right environment as both inertial and external situations change. And the fit must attain a balance between organizational complexity and simplicity. Adopting an organizational structure too complex for its environmental demands can be as ineffective as adopting a structure too simplistic to operate in a turbulent environment. Not adopting the right structure can be very costly-not only in sense that it will be ineffective, but in the sense that reorganizing is very expensive.

Information Technology and Organizational Structure

The advent of new information technologies such as the internet, world wide web, teleconferencing, portable telephones now allows organizations to implement inter and intra organizational structures that were impossible or economically unfeasible to far too long ago. These technologies enable small, medium and large organizations to access information from most parts of the world. This suggests that companies usually smaller ones, organized under the functional structure, can now have access to the same information as large companies. Therefore, smaller companies by selling their products/services through electronics commerce can more effectively compete with larger corporations.

Companies such as Wal-Mark that are organized under the international division structure with subsidiaries located in many parts of the world can now manage more effectively from single location and may often avoid the cost of establishing physical regional offices when they have grown. And many companies with regional offices throughout the globe can now revert to a single location or atleast reduce the number of locations. For example, Eastman Kodak Company consolidates 17 data centers (on 4 continents) into seven.

Perhaps some of the larger companies can even restructure themselves using the functional structure. As was mentioned earlier, General Electric, one of the largest corporations in the world, has plans to restructure itself from matrix to functional structure. Many of the functions carried out at several point in the matrix structure can now be performed more easily than in the past, when they were centralized. Therefore, the mixed structure is easier to manage, and the information technology makes global strategic alliances and networks easier to manage.

Summary

Identifying the ideal international organizational structure is a huge challenge for the managers of any organization; there may not even be an ideal structure. Nevertheless, regardless of which organizational structure firm adopts, a neat chart with neat boxes is useless, unless information and communications flow freely to develop proper business decisions. The relationship of domestic, international, and senior corporate organization can be described by three general guidelines (a) The organization must be formulated in such a way that planning and decision making on every aspect of the firm's operations can be done by people with the breadth of functional, geographic, and/or product knowledge and responsibility necessary to develop the potential for a unified strategy; (b) The channels for the flow of important or recurring decisions and information should be as directed and as short as possible; (c) Individuals with expert international knowledge and competence in overcoming the obstacles to international communication should be readily available within the organization and be used wherever their capacities are needed.

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Lesson 3.4 - Locus Of Decision Making

Quality and timely decision-making is essential for the success of any firm. In fact, how an organisation chooses to design its decision-making rules are one of the most fundamental aspects of its organizational design. It describes the assignment of decision rights, along with the reward system and the way performance is evaluated, as one the key aspects of an organization's architecture or design. A firm's ability to make good decisions is particularly important in the face of increasing global competition, and the greater uncertainty from exposure to more competitors and a greater number more markets that this brings.

The increasing globalisation of markets has generated new debates about the decision-making role of MNCs. Globalisation may be expected to result in greater centralisation of the decision-making process. For various reasons MNCs are adopting the strategy of decentralised decision making. Based on the importance of the issue things are changing. In most cases it was found that considerable authority was devolved to subsidiaries in terms of operational decisions. However, strategic decision making remained very much under the control of the parent.

Types of Decision Making

Locus of decision making refers to the degree to which the decision making authority is centralized or decentralized. Number of factors influencing the decision making authority that is likely to be given to subsidiary. Company size influences decision making in that large organizations have a greater need for coordination and integration of operations. To ensure that all subsidiaries are being effectively managed, the MNC will centralize the authority for a number of critical decisions.

This centralisation is designed to increase overall efficiency of operations, and to the extent that the centralization creates the desired uniformity and coordination, this is precisely what happens. The greater the MNC's capital investment, the more likely that decision making will be centralized. The home office wants to keep a tight rein on its investment and ensure that everything is running smoothly. The subsidiary manager will be required to continually submit periodic report, and on-site visits from home office personnel are quite common. The more important the overseas operation is to the MNC, the closer the MNC will control it.

Home office management will carefully monitor performance, and the subsidiary manager usually will not be allowed to make any major decisions without first clearing them with the MNC senior management. In fact, in managing important overseas operations, the home office will typically appoint someone who they know will respond to their directives and will regard this individual as an extension of the central management staff.

In domestic situations, when competition increases, management will decentralize authority and give the local manager greater decision making authority. This reduces the time needed in responding to competitive threats. In the international arena, however, just the opposite approach is used.

As competition increases and profit margins are driven down, home office management seeks to standardize product and makes decisions to reduce cost and maintain profitability. More and more upper level operating decisions are made by central management and merely implemented by the subsidiary.

Factors That Influencing Centralisation oOf Decision Making

The following factors are influencing the MNCs to go for centralisation of decision making authority.

1. Corporate culture — mainly referring to accepted management models and practices (decentralised, partly centralised or fully centralised)
2. Industry type and business maturity — including both generic industry features (e.g. manufacturing vs. services, wholesale vs. retail, market leadership, market and competition dynamics, etc.) as well as enterprise-specific characteristics (e.g. size, growth, geographic distribution, sophistication, etc.)

3. Technology infrastructure and architecture — current status in so far as an open and common environment, IT management models and strategies

4. Third-party services sourcing philosophy — attitude towards single rather than multiple providers, internal rather external service provision orientation, previous experience, etc.

5. Tax, legal and regulatory restrictions — deriving from the external environment as well as from the legal structure and the business model of the organisation

6. Highly competitive environment
7. Large size
8. Relatively high importance to MNC
9. Low level of product diversification
10. Homogeneous product lines
11. More experience in international business.

Factors That Influencing Decentralization Of Decision Making

1. Availability of experienced professionals
2. Stable environment
3. Small investment
4. High level of product diversification
5. Low interdependence between the units
6. Heterogeneous product lines

Participative Decision Making in Multinational Corporations

In almost all foreign countries, we are seeking more participation by the employees in decision making. No longer is the employee accepting a passive role of simply reacting to management decisions. What is now wanted is to know what is being considered and for one's views to be taken into account. In some way, the employee wants to feel associated with the decision-making process of the enterprise for which she or he works. What traditionally has been reserved for unilateral decisions by management members is now being opened to some degree for participation by all the employees or their representatives. No longer accepted as a matter of course is for the manager alone to decide the working hours, to determine how the work is organized, and to handle work distribution. In short, a recasting of the employer-employee work relationship is taking place in most foreign countries. The new relationships between employer and employee have met with approval by many U.S workers who work for foreign corporations. As one American auto worker employed by a Japanese firm said, " When something goes wrong, you're not afraid to tell the foreman. People used to try to hide their mistakes so they wouldn't get fired."

Work councils, work committees, or similar bodies are the main means through which the foreign employees participates, and the trend is toward widening and strengthening this activity. Typically in many European countries the trend of these bodies appears to be toward sharing, not merely advising or suggesting in the decision-making process on the matters of the economic and financial operations. For U.S workers with foreign bosses, the paternalistic approach of the company has been welcomed. "Here it feels like family," said one U.S worker. "Here you've got a name,"said another.

Around the world there are a variety of degrees and the ways in which employees participate in managerial decisions that affect them. Similarities and dissimilarities exist even within a given country. The most different and probably the most interesting in comparision to that of the United States is the arrangement in Japan. There decision making is by consensus or *ringisei*, which means "reverential inquiry about a superior's intentions." By nature, the Japanese spend much time finding out what others are thinking and how they feel about a issue. The prevailing belief is that the Japanese manager must know how subordinates feel about certain issue, otherwise he cannot maintain the peace and harmony of the group.

A decision is always started by an employee at a low level in the organization. This is justified by realizing that change within acompany should come from those closest to the thing being changed, hence change is elicited from below. For example, an employee who has an idea or a problem prepares an outline of that idea or problem, called the superior, and explains how it should be used or will help in solving a problem. This contribution is circulated to the various superiors in succession. The intention is to reach a consensus by coordinating very closely the activities of each area affected by the issue. The decision reached, usually after considerable discussion and exchange of thoughts, in essence creates a commitment of all parties to the chosen solution. To the Japanese this quality of commitment is vital-perhaps even more important than the quality of the decision itself. Keep in mind that the Japanese manager's status is well defined, but the manager is not burdened with decision making in the Western sense. Each manager plays a key role in shaping decisions by encouraging the subordinate to develop the proposal until it has merit and is worthy of referring to the next higher manager in the organization.

Decisions of considerable importance are analysed with extreme care, and the effort is taken to ascertain the viewpoints of all who may be affected by them as well as everyone in the company who may influence their outcome. The result is a minimum of disagreement over decisions implemented. The superior does not alter the decision but motivates and assists the writer of it to change and improve it so that consensus can be reached. The initiator of a decision always carefully checks it to make certain nothing in it will offend the superior or evoke outright disapproval. Thus conflict is avoided.

Decision Making: Practices of Foreign Companies

The Japanese decision-making procedure is centuries old, yet it features modern management techniques from the U.S viewpoint and is giving excellent results to Japanese industries. The approach stresses asking the right questions and logically from this the right answers emerge. It is also claimed that formulating the decisions after all have had their say is superior to making the decision at the beginning and then striving to sell it to others.

Perhaps the hallmark of foreign-run business in U.S is the open communication of workers with top management. A German manager of a U.S plant regularly walks the production floor. Foremen and workers at a Japanese-owned company hold 10- minute meetings twice a day and employees hear management reports on growth twice a day.Nuturing the individual has paid off for those firms in low turnover rates, improved productivity, and higher profits.

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Lesson 3.5 - Headquarters and Subsidary Relationships

The success of an international firm can be greatly affected by the control techniques they practices. To maintain proper control systems, an appropriate organizational structure is essential. Along with identifying the appropriate structure, headquarters management must decide whether the headquarters-foreign subsidiaries relationship should be centralized or decentralized. In a centralized system, most of the important decisions relative to local matters are made by the headquarters management. In a decentralized system, managers at the subsidiary are given the autonomy to make most of the important decisions relative to local matters.

When decision making is decentralized, judgments made by local managers may sometimes have negative consequences for other subsidiaries and/or may not be the best decision when overall firm's objectives are considered. For instance, a decision made by managers at the Riode Janeiro subsidiary to pay generous benefits to their workers may demoralize workers in other subsidiaries if they perceive their benefits to be comparatively unfair. Centralized decision making would thus enable headquarters managers to consider the consequences of a decision on all of the firm's subsidiaries. Centralization, in this respect, would be advantageous.

Headquarters-Foreign Subsidiary

Governance Mechanisms

- Centralization.
- Formalization.
- Normative Integration

A contemporary idea on headquarters-subsidiary governance relationships (HSRs) has been discussed by business professors Sumantra Ghoshal and Nitin Nohria, from INSEAD, France, and Harvard Business School, respectively. They described the relationships in terms of three basic head-quarters–subsidiary government mechanisms:

Centralization concerns to the role of formal authority and hierarchical mechanism in the company's decision making processes.

Formalization represents decision making through bureaucratic mechanisms such as formal systems, established rules, and prescribed procedures; and

Normative Integration relies neither on direct headquarters involvement nor on impersonal rules but on the socialization of managers into a set of shared goals, values, and beliefs that then shape their perspectives and behavior.

The following sections present two schemes that identify factors help to determine the right headquarters-foreign subsidiary control relationship. The first scheme proposes that certain situational factors influence the relationship in all countries. The second proposes that certain other factors influence the relationship in all countries.

Schemes for Control

- National culture scheme
- Situational scheme

The Natural Cultural Scheme

Cross-cultural researcher Geert Hofstede proposed a paradigm to study the impact of national culture on individual behavior. He developed a typology consisting of four national cultural dimensions by which a society can be Classified as:

1. Power distance
2. Individualism
3. Uncertainty avoidance
4. Masculinity
5. Confucianism

The ensuing section indicates whether the headquarters-subsidiary relationship (HSR) with subsidiaries located in these cultures leans toward low and high centralization (C), low or high formalization (F), or low or high normative integration (NI). (Table)

Cultural Determinants	Headquqrters -Foreign Subsidary Control Relationship
Large power distance	HC
Small power distance	LC, HF, or HNI
High power distance	HC or HF
Low individualism	LR,HNI
Strong uncertainty	HF OR HC
avoidance	LC or HNI
Weak uncertainty	LF,HC,HNI
avoidance	HF
Confucianism	LC,HNI
High masculinity	
Low masculinity	

Global Cultural Framework

C *= Centralization,* ***F*** *= Formalization,* ***NI*** *= Normative Integration,* ***H*** *= High,* ***L*** *= Low*

(Source: Empowerment in organizations, Carl.A.Rodrigues)

1) Power Distance

Power distance refers to the degree to which people in a society accept centralized power and depend on supervisors for structure and direction.

I. **Moderate-to-Large Power Distance:** Individuals in societies dominated by this dimension tend to accept centralized power and depend heavily on superiors for direction. Therefore, HSR leaning toward high C probably would be preferred by subsidiary managers who are dominated by this cultural dimension.

II. **Moderate-to-Small Power Distance:** Individuals in societies dominated by this cultural dimension do not tolerate highly centralized power and expect to be consulted, at least, in decision-making. Furthermore, Hofstede remarked that status differences in these countries are suspect. Thus, subsidiary managers who are dominated by this cultural dimension probably would favor a HSR leaning toward low C, high NI, or high F.

2) Individualism

I. **Moderate-to-High Individualism:** Individuals in societies dominated by this dimension think in "me" terms and look after primarily their own interests. Since these individuals often consider their own objectives to be more important than the organization's, the HSR that involves in subsidiaries managed by people influenced by this cultural dimension probably leans toward high C or high F.

II. **Moderate-to-low Individualism:** Low individualism societies are tightly integrated and individuals belong to "in-groups" from which they cannot detach themselves. People think in "we' as opposed to "me" terms and obtain satisfaction from a job well done by the group. Individuals in these societies are controlled mainly by the group's norms and values. These people would therefore require less formal structure than individuals who think in "me" terms. A HSR leaning toward high NI would thus fit these societies.

Finding by some researchers lend support to the above contentions. These researchers concluded that control systems in the United States are designed under the assumption that workers and management seek "primary control" over their work environments. primary control is manifested when employees with individualistic tendencies attempt to shape the existing social and behavioral factors surrounding them, including co-workers, specific events, or their environments, with the intention of increasing their rewards.

Thus many employees exhibit behaviors and establish goals that may diverge from those desired by the organization. For these reasons, control systems consisting of rules, standards, and norms of behavior are established to guide, motivate, and evaluate employees' behavioral performance (high F).

On the other hand, organizations in Japan (a low individualism culture) rely more on "secondary controls," controls that rely mostly on informal peer pressure (high NI). And Japanese corporations with subsidiaries in the United States tend to give American managers working for them little or no authority.

3) Uncertainty Avoidance

I. **Moderate-to-Strong Uncertainty Avoidance:** Individuals in these cultures feel uneasy in situations of uncertainty and ambiguity and prefer structure and direction. Therefore, because it tends to reduce uncertainty for individuals, managers of subsidiaries who are influenced by this cultural dimension probably would prefer a HSR leaning toward high F or high C. Hofstede has proposed that improving quality of life for employees in these societies implies offering more security and perhaps more task structure on the job.

II. **Moderate-to-Weak Uncertainty Avoidance:** Hofstede found that in countries dominated by a moderate-to-weak uncertainty avoidance dimension, individuals tend to be relatively tolerant of uncertainty and ambiguity; they do not require as much high C or high F as do people in strong uncertainty avoidance cultures. Thus, a HSR leaning toward low C or high NI, since it provides more challenge than does high C and high F, probably would be preferred by managers of subsidiaries who are dominated by this cultural dimension.

For example, managers in Britain, a weak uncertainty avoidance culture, end to value achievement and autonomy (low C or high NI behavior) and managers in France, a strong uncertainty avoidance society, value competent supervision, sound company policies, fringe benefits, security, and comfortable working conditions (high C and high F). French manages do not believe matrix organizations, which tend to apply high NI-like behavior, are feasible; they view them as violating the principle of unit of command.

4) Confucianism

Individuals in East Asian cultures (the People's Republic of China, South Korea, Japan, Hong Kong, and Singapore) are also influenced by the Confucian cultural dimension. In essence, individuals in Confucian based organizations are forced to adhere to rigid, informal group norms and values (high NI like relationship). Since individuals are so strictly bound to group norms, organizations based on the Confucian cultural dimension probably apply less formalization (low F) than do organizations in the West. This contention is partially supported by research findings that organizations in China, where the Confucian influence is still strong, tend to be far less formalized than Western organizations. There is evidence that Confucian-based organizations apply high C. for example, South Korean managers demonstrate the Confucian virtues of loyalty and obedience to authorities and they tend not to adopt systems of shared management and power equalization within organizations. Chinese subordinates have been found to be passive, preferring that orders make decisions for them (high C).

5) Masculinity

I. **Moderate-to-High Masculinity:** Societies dominated by this dimension stress material success and assertiveness and assign different roles to males and females. To review, males are expected to carry out the competitive roles in the society; females are expected to care for the nonmaterial quality of life. In strong masculine countries where people perceive such behavior as being inequitable, a HSR leaning toward high F, emphasizing reduction of such social inequities would probably preferred.

II. **Moderate-to-Low Masculinity**: Hofstede also concluded that those nations dominated by a low masculine cultural dimension stress interpersonal relationship, a concern for others, and the overall quality of life, and define relatively overlapping social roles for males and females. In these cultures, neither male nor female need be ambitious or competitive; both may aspire to a life that does not assign great values to material success and respects others. According to Hofstede, improved quality of work life for individuals in these societies means offering opportunities for developing relationships on the job, which is perhaps best accomplished through low C or high NI-like HSR. For example, people in Sweden, a low masculine society, generally prefer organic (low C, NI-like) organizational structures and they like to be involved in the decision-making process.

Situational Scheme

Headquarters-subsidiary control relationships not only influenced by the cultural factors but various other situational factors also plays a pivotal role The following section describes those factors.

1. Size of the Organization

This has been found to be a factor in determining HRRs. Large–scale operations have tend to apply structural relationships leaning toward high formalization and small-scale organisations tend to apply a high normative integration or high centralization relationship. However this factor is influenced by the organization's strategy. Some international business establish global strategy.

2. Subsidiary's Local Context

Local context of the subsidiary can be conceptualized based on the environmental complexity and amount of local resources available to the subsidiary. For different levels context a governing mechanism scheme is as follows: Low environmental complexity and low levels of local resources dictate a high level of centralization and low levels of formalization and normative integration. Low environmental complexity and high levels of resources dictate a low level of centralization and high level of formalisation and normative integration. High environment complexity and low resource levels dictate a moderate level of centralization, a Low level of formalization, and high level of normative integration. High environment complexity and high resource level indicate a low level of centralization, a moderate level of formalisation, and a high level of normative integration.

3. Preference of the Management

Preference of the management towards the control of the subsidiary also form the strategy. High centralization may be used to maintain strong control over activities of the subsidiary. When the management prefer a strong organizational stability high formalisation can be followed.

4. Communication

The availability of internet, web, and video-conferencing is forcing many organizations to rethink of their organization structure and control techniques. As improvement in technology reduce communication and coordination costs, the preferred way to make decisions moves in the following stages.When communication costs are high, the best way to make decision is via independent decentralized decision makers which means lower centralization. When communication costs are less organizations can prefer highly normative integration.

An effective global corporation needs to establish a balanced headquarters-subsidiary relationship and that balance can be attained through the implementation of a global corporate culture and values.

Self Assessment Questions

1. Define comparative management? Explain its importance.
2. Explain the different methods of comparative management.
3. Explain the various features of the American management system.
4. Explain the focus of Japanese management system.
5. Explain the merits and drawbacks of the functional organizational structure.
6. Briefly discuss the merits of product organization structure.
7. What are the merits and drawbacks of matrix organization?
8. Discuss the impact of modern technology on structuring organizations.
9. Which international organization structure allows local subsidiaries to use discretion in developing products or services to fit local markets and at the same time allows headquarters to coordinate activities around the globe to capitalize on synergies and economies of scale?
10. In what way do formalization, specialization, and centralization have impact on MNC organization structures?
11. Which organizational structure enables organizations to minimize the weakness of other structures?
12. Write a note on locus of decision making.
13. Explain the centralized and decentralized headquarters-foreign subsidiaries control relationships and some of the merits and drawbacks.
14. Why are foreign subsidiaries that provide a wide range of products less centrally controlled than those that provide a narrow range of products?

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UNIT – IV

Unit Structure

Lesson 4.1 - International Business Strategy

Learning Objectives

After reading this lesson you should be able:

- To provide basic ideas about the international business strategy
- To explain the different approaches to strategy formulation
- To explain the nature of the different steps in the process of strategic planning
- To describe the features and design of an effective control system

Introduction

International business operations are not operated initially at random. Proper strategy is formulated, planning follows to define the means to attain the goal, organisational structure provides a route for decision-making and control assesses the extent to which the goals have been achieved. The following sections deals with these issues. Many international markets are now extremely competitive due to liberalization of the world trade and investment environment. Among industries, capable competitors confront each other around the globe. To be profitable in such an environment, a firm must both reduce the costs of value creation and differentiate its product offering so that consumers value that product more and will pay more for the product compared to its cost of production.

Thus, strategy is often concerned with identifying and taking actions that will lower the costs of value creation and / or will differentiate the firm's product offering through superior design, quality, service, functionality, and so on.

Importance of Global Expansion

Expanding globally allows firms to increase their profitability in ways not available to purely domestic enterprises. Firms that operate internationally are able to:

1. Realize location economies by dispersing individual value creation activities to those locations around the globe where they can be performed most efficiently and effectively.
2. Realize greater cost economies from experience effects by serving an expanded global market from a central location, thereby reducing the costs of value creation.
3. Earn a greater return from the firm's distinctive skills or core competencies by leveraging those skills and applying them to new geographic markets.
4. Earn a greater return by leveraging any valuable skills developed in foreign operations and transferring them to other entities within the firm's global network of operations.

However, a firm's ability to increase its profitability by pursuing these strategies is to some extent constrained by the need to customize its product offering, marketing strategy, and business strategy to differing national conditions; that is, by the imperative of localization.

Different Approaches to Strategy Formulation

The strategy of a firm is of course to achieve superior performance (competitive advantage) on a sustainable basis. There is no single answer as to how this can be achieved. Michael Porter is of the view that a firm's competitive advantage depends on the selection of the most appropriate generic strategy, which incorporates three elements, namely, cost leadership, differentiation, and focus. If the cost of a product is lower than the competitors', the firm can maximise its sale/profit. Similarly, if the product is unique, differentiated from the rivals' product, and it meets consumers' preference, the firm will be able to maintain an edge over its rivals. Again, if the firm has focus on a particular segment of the market, either with a low-cost product or a differentiated product, the concentrated effort will definitely confer a competitive advantage upon it.

Porter (1986, 1990) developed the generic strategy theory for international business through the incorporation of the concept of configuration and coordination. The concept of configuration is based on the value chain concept. It shows whether it is better to concentrate the manufacturing activities in one or two nations and cater to the outside demand through export, or to disperse the manufacturing activities over a number of countries.

However, Porter is of the view that configuration alone does not assure competitive advantage unless and until the activities in different countries are properly coordinated. Prahalad and Doz (1987) support this view and are of the opinion that a sound global management requires (1) centralised management of the dispersed activities, (2) coordination of R&D, pricing and intra-firm technology transfer, and (3) the subsidiaries' ability to make decisions with respect to local issues.

The other approach, which has been developed by Prahalad and Hamel (1990) and Kay (1993) is known as competence-based strategy. It is the core competence or the distinctive capability of the firm that puts it in a superior position. Core competence can be possessed if the resources – physical, financial, technological, and human – are available at the least cost, conveniently and, without interruption. Again, the existing core competence can be strengthened and new core competence can be built up.

The above views boil down to the simple fact that the international business strategy of a firm manifests in, first, the development of core competency, which helps the firm either to market an innovated / differentiated product or to reduce the cost of the existing product so as to earn large profits; and, second, adaptation of the technology and product, which is known as local customisation, to suit the local consumers in different markets, leading to large profits. Normally, an international firm combines both these strategies. However, either of the two strategies various from one case to the other. In one case, development of the core competency gets greater emphasis; in the other, local customisation gets greater emphasis; in yet another case, both are given equal importance.

Various Levels of Strategy Formulation

a) Strategy at the International Level

Strategy at the international level depends on whether the structure of the international firm is ethnocentric, or polycentric or geocentric.

b) Corporate Level Strategy

Corporate level strategy allows successful business lines to grow, unsuccessful business lines to cut short their activities, and allows a few others to maintain stability.

c) Business Level Strategy

Business level strategy is formulated for either minimising costs or for differentiating the product by adding special features therein.

Strategic Choices

Firms use four basic strategies to enter and compete in the international environment: an international strategy, a multidomestic strategy, a global strategy, and a transnational strategy. Figure illustrates when each of these strategies is most appropriate. In this section we describe each strategy, identify when it is appropriate, and discuss the pros and cons of each. Each of these strategies has its advantages and disadvantages (Table). The appropriateness of each strategy various with the extent of pressures for cost reductions and local responsiveness.

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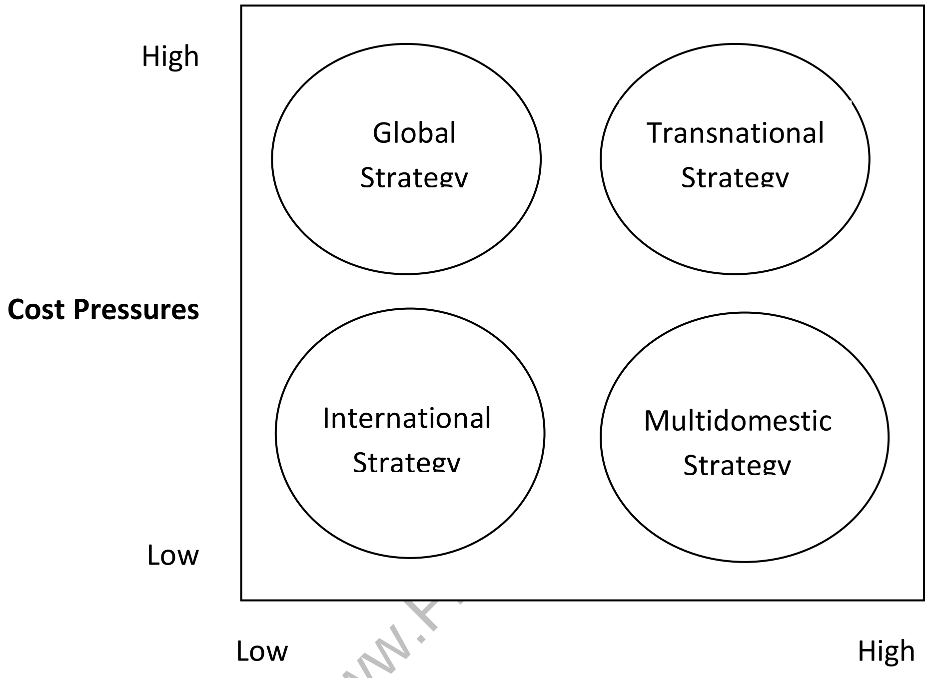
International Strategy

Firms that pursue an international strategy try to create value by transferring valuable skills and products to foreign markets where indigenous competitors lack those skills and products. Most international firms have created value by transferring differentiated product offerings developed at home to new markets overseas. Accordingly, they tend to centralize product development functions at home. (e.g. R&D). However, they also tend to establish manufacturing and marketing functions in each major country in which they do business. But while they may undertake some local customization of product offering and marketing strategy, this tends to be limited. In most international firms, the head office retains tight control over marketing and product strategy.



Strategic Choices

Multidomestic Strategy

Firms pursuing a multidomestic strategy orient themselves toward achieving maximum local responsiveness. The key distinguishing feature of multidomestic firms is that they extensively customize both their product offering and their marketing strategy to match different national conditions. Consistent with this, they also tend to establish a complete set of value creation activities, including production, marketing and R&D, in each major national market in which they do business. As a consequence, they are generally unable to realize value from experience curve effects and location economies. Accordingly, many multidomestic firms have a high cost structure. They also tend to do a poor job of leveraging core competencies within the firm.

Global Strategy

Firms that pursue a global strategy focus on increasing profitability by reaping the cost reductions that come from experience curve effects and location economies. That is, they are pursuing a low cost strategy. The production, marketing, and R&D activities of firms pursuing a global strategy are concentrated in a few favorable locations. Global firms tend not to customize their product offering and marketing strategy to local conditions because customization raises costs (it involves shorter production runs and the duplication of functions). Instead, global firms prefer to market a standardized product worldwide so they can reap the maximum benefits from the economies of scale that underlie the experience curve. They may also use their cost advantage to support aggressive pricing in world markets.

Transnational Strategy

In today's environment, competitive conditions are so intense that to survive in the global marketplace, firms exploit experience-based cost economies and location economies, they must transfer core competencies within the firm, and they must do all of this while paying attention to pressure for local responsiveness. They note that in the modern multinational enterprise, core competencies do not just reside in the home country. Valuable skills can develop in any of the firm's worldwide operations.

Thus, the flow of skills and product offerings should not be one way, from home firm to foreign subsidiary, as in the case of firms pursuing an international strategy. Rather, the flow should also be from foreign subsidiary to home country and from foreign subsidiary to foreign subsidiary-a process they refer to a global learning. Experts refer to the strategy pursued by firms that are trying to simultaneously create value in these different ways as transnational strategy.

The Advantages and Disadvantages of the Four Strategies

Strategy	Advantages	Disadvantages
Global	Exploit experience curve effects Exploit location economies	Lack of local responsiveness
International	Transfer core competencies to foreign markets	Lack of local responsiveness Inability to realise location economies Failure to exploit experience curve effects
Multidomestic	Customize product offerings and marketing in accordance with local responsiveness	Inability to realize location economies Failure to exploit experience curve effects Failure to transfer core competencies to foreign markets
Transnational	Exploit experience curve effects Exploit location economies Customize product offerings and marketing in accordance with local responsiveness Reap benefits of global learning	Difficult to implement due to organizational problems.

Strategic Planning Process

Strategic planning is a continuous process, it is not an end activity. However, for operational purpose organizations define and describe strategic plans. There are different steps in the process of strategic planning, which are adopted in sequence, although sometimes they occur simultaneously.

Assessment of the external environment and the internal resources: The assessment of the external environment has a greater relevance in case of an international company as host countries present varying environments. The assessment takes into consideration the present position and the future trends in relation to the size of the market, consumption pattern in different markets, the intensity of competition, and the business linkages in different markets.

Formulation of global strategy: This strategy involves the market as well as the product. As far as the market strategy is concerned, a suitable market representing a sufficiently large demand for the product or having the least competition is selected. The ease with which the parent company can allocate resources is yet another factor that influences market selection. Also, a foreign market that has some kind of resemblance with its existing markets is preferred, as in this case, it will be easier for the firm to cope with the market demand.

Development of global programme: This step includes planning, mainly with the respect to the degree of product standardisation, marketing programme, and location for production. Both standardisation of product and adaptation of product have merits and demerits. Therefore, the firm needs to assess how much adaptation / standardisation of the product can be recommended so as to achieve economies of scale and at the same time attract the consumers' abroad. The entire process of international strategy can be better viewed through an example of McDonald's everywhere (Insight.1) how the multinational fast food chain implementing its global strategy.

Organizational Structure: The organisational structure facilitates the implementation of measures designed through the planning process. When the involvement of a firm in international business is only ad hoc and fortuitous, the domestic division looks after the international business too, and as a result, the organisational structure of the international firm is not different from that of a domestic company. But with growing export of a permanent character, an export department is added to the marketing department. With massive growth in export, when the export department proves incapable of handling export, an international division is created independent of the domestic marketing department, although proper coordination is maintained between the domestic division and the international division. However, when the firm begins international operation, the challenges appear far greater. The organisational structure becomes global. The emphasis is the on product structure, area structure, or still on the functional structure.

The growing complexities in the organisational structure do not end here. If, with growing international involvement, all the three structures-product, area, and the function-need to be combined, the structure turns to be a global matrix structure that permits different types of inter-linking between products and areas. However, the organisational structure has also come to evolve in different shapes in different sets of countries.

Process of Control: Lastly, the process of control involves examination of whether the set goals have been achieved and also corrective measures in case of deviations from the set standards, if any. An effective control system is based on correct and timely information, which is judged against the set standards. It is difficult to set standards in view of wide heterogeneity in the international environment. Nevertheless, the standard maintains a proper balance between the firm's overall view and host country variations.

There are various techniques for control. One is accounting and audit control, used mainly for judging the financial performance. The other is control through plans, policies, and procedures, where performance is compared with the actual plans and policies. Procedures differ from one country to another and so they come in the way of process of control. Cultural control is based on the concept of socialisation where informal personal interaction is very significant. Again, the process of control may be centralised or decentralised, or a mixture of the two known as a coordinated decentralisation approach.

Insight.1

McDonald's Everywhere

Established in 1955, McDonald's faced a problem by the early 1980s: after three decades of rapid growth, the U.S. fast-food market was beginning to show signs of market saturation. McDonald's response to the slowdown was to expand abroad rapidly. In 1980, 28 percent of the chain's new McDonald's restaurant openings were abroad; in 1986 the figure was

40 percent, in 1990 it was close to 60 percent, and in 2000 it was almost 90 percent. Since the early 1980s, the firm's foreign revenues and profits have grown at 22 percent per year. By the end of 2000, the firm had 28,707 restaurants in 120 countries outside the United States. They generated $21 billion (53 percent) of the firm's $40 billion in the form of revenues.

McDonald's shows no signs of slowing down. Management notes there is still only one McDonald's restaurant for every 500,000 people in the foreign countries in which it currently does business. This compares to one McDonald's restaurant for every 25,000 people in the United States. Also, the firm currently serves less than 1 percent of the world's population. Plans call for this foreign expansion to continue at a rapid rate. The firm opened more than 500 restaurants in Europe in 1999 and again in 2000, while the figures for Asia were around 600. In 1997, McDonald's said it would open 2,000 restaurants per year for the foreseeable future, the majority of them outside the United States. This included major expansion plans for Latin America, where the company planned to invest $2 billion over the next few years.

One key to the firm's successful foreign expansion is detailed planning. When McDonald's enters a foreign country, it does so only after careful preparation. In what is a fairly typical pattern, before McDonald's opened its first Polish restaurant in 1992, the firm spent 18 months establishing essential contacts and getting to know the local culture. Locations, real estate, construction, supply, personnel, legal and government relations were all worked out in advance. In June 1992, a team of 50 employees from the United States, Russia, Germany, and Great Britain went to Poland assist with the opening of the first four restaurants. Primary objective was to hire and train local personnel. By mid-1994, all these employees except one had returned to their home country as polish nationals were groomed with the skills needed to run a McDonald's operation and ultimately replaced them.

Another key to the firm's international strategy is the export of the management skills that spurred its growth in the United States. McDonald's U.S. success was built on a formula of close relations with suppliers, nationwide marketing might, tight control over store-level operating procedures, and a franchising system that encourages entrepreneurial individual franchisees. Although this system has worked flawlessly in the United State, some modifications must be made in other countries. One big challenge has been to infuse each store with the same gung-ho culture and standardized operating procedures that have been the hallmark of U.S. success. To aid this task, McDonald's has enlisted the help of large partners through joint ventures in many countries. The partners play a key role in learning and transplanting the organization's values to local employees.

Foreign partners have also played a key role in helping McDonald's adapt its marketing methods and menu to local conditions. Although U.S.-style fast food remains the staple fare on the menu, local products have been added. In Brazil, for example, McDonald's sells a soft drink made from the guarana, an Amazonian berry. Patrons of McDonald's in Malaysia, Singapore, and Thailand serve shakes flavored with durian, a foul-smelling (to U.S. tastes, at least) fruit considered an aphrodisiac by the locals. In Arab countries, McDonald's restaurants maintain "Halal" menus, which signify compliance with Islamic laws on food preparation, especially beef. In 1995, McDonald's opened the first kosher restaurant in suburban Jerusalem. The restaurant does not serve dairy products. And in India, the Big Mac is made with lamb and called the "Maharaja Mac."

McDonald's biggest problem, however, has been to replicate its U.S. supply chain in other countries. U.S. suppliers are fiercely loyal to McDonald's, they must be, because their fortunes are closely linked to those of McDonald's. McDonald's maintains very rigorous specifications for all the raw ingredients it uses-the key to its consistency and quality control. Outside the United States, however, McDonald's has found suppliers far less willing to make the investments required to meet its specifications. In great Britain, for example, McDonald's had problems getting local bakeries to produce the hamburger bun. After experiencing quality problems with two local bakeries, McDonald's built its own bakery to supply stores there. In a more extreme case, when McDonald's decided to open a store in Russia, it found that local suppliers lacked the capability to produce goods of the quality it demanded. The firm was forced to vertically integrate through the local food industry on a vast scale, importing potato seeds and bull semen and indirectly managing dairy farms, cattle ranches, and vegetable plots. It also had to construct the world's largest food-processing plant, at a cost of $40 million. The restaurant itself cost only $4.5 million.

Now that it has a successful foreign operation, McDonald's is experiencing benefits that go beyond the immediate financial ones. The firm increasingly is finding that its foreign franchisees are a source for valuable new ideas. The Dutch operation created a prefabricated modular store that can be moved over a weekend and is now widely used to set up temporary restaurants at big outdoor events. The Swedes came up with an enhanced meat freezer that is now used firmwide. And satellite stores, or low overhead mini-McDonald's, which are now appearing in hospitals and sports arenas in the United States, were invented in Singapore.

Summary

Strategy involves setting of goals. The ultimate goal is the maximisation of corporate wealth, which can be achieved through superior performance (compared to the rivals), on a sustainable basis. There are different strategies to put the firm in a superior position. Some prominent strategies are the strategy of competitive positioning, competence-based strategy, and total global strategy. The spectrum of strategy may be broad, covering production, financial, marketing, and other vital aspects. Strategy is formulated at different levels. At the international level, it may be ethnocentric, polycentric, or geocentric strategy. At the corporate level, it may be a growth strategy, retrenchment strategy, stability strategy, or a combination of any two of these or more. At the business level, it may be a cost-minimisation strategy or product differentiation strategy, or both. At the department level, the strategy concerns both primary and supportive activities. Planning shapes strategy and defines the means to achieve goals. The process of planning has three sequential steps. The first is the assessment of the external environment and internal resources. The second is the formulation of global strategy, which involves identification of the market and matching of the products with market-specific needs. The third step is to develop a global programme that includes planning with respect to the degree of product standardisation, marketing programme, and the location for manufacturing. The planning may be centralised. Alternatively, it may be decentralised, leaving it to different strategic business units (SBUs). The choice depends, among other things, upon the level of technology used, mobility of funds and other factors of production, and the heterogeneity of host country environment.

Glossary

Strategy: A strategy is a long term plan of action designed to achieve a particular goal, as differentiated from tactics or immediate actions with resources at hand. Originally confined to military matters, the word has become commonly used in many disparate fields.

Strategic planning: Consists of the process of developing strategies to reach a defined objective. As we label a piece of planning "strategic" we expect it to operate on the grand scale and to take in "the big picture" (in contradistinction to "tactical" planning, which by definition has to focus more on the tactics of individual detailed activities). "Long range" planning typically projects current activities and programs into a revised view of the external world, thereby describing results that will most likely occur. "Strategic" planning tries to "create" more desirable future results by (a) influencing the outside world or (b) adapting current programs and actions so as to have more favorable outcomes in the external environment.

Purpose is deliberately thought-through goal-directedness. According to some philosophies, purpose is central to a good human life. Helen Keller wrote that happiness comes from "fidelity to a worthy purpose", and Ayn Rand wrote that purpose must be one of the three ruling values of human life (the others are reason and self-esteem).

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Lesson 4.2 - International Management- Production, Technology and Operations

Learning Objectives:

After reading this lesson you should be able:

- To observe the production management practices adopted by global Corporations
- To understand the technological developments and their influence on operations management
- To get more insight about international production practices

Introduction

As trade barriers fall and global markets develop, many firms increasingly confront a set of interrelated issues. First, where in the world should productive activities be located? Should they be concentrated in a single country, or should they be dispersed around the globe, matching the type of activity with country differences in factor costs, tariff barriers, political risks, and the like in order to minimize costs and maximize value added? Second, what should be the long-term strategic role of foreign production sites? Should the firm abandon a foreign site if factor costs change, moving production to another more favorable location, or is there value to maintaining an operation at a given location even if underlying economic conditions change? Third, should the firm own foreign productive activities, or is it better to outsource those activities to independent vendors? Fourth, how should a globally dispersed supply chain be managed, and what is the role of Internet-based information technology in the management of global logistics? Fifth, should the firm manage global logistics itself, or should it outsource the management to enterprises that specialize in this activity? In the following sections we shall consider all these questions and discuss the various factors that influence decisions in this arena.

Location for Production

An essential decision facing an international firm is where to locate its manufacturing activities to achieve the goals of minimising costs and improving product quality. For the firm contemplating international production, a number of factors must be considered. The can be grouped under broad categories; country factors, technological factors, and product factors.

a) **Country Factors:** Other things being equal, a firm should locate its various manufacturing activities where the economic, political, and cultural conditions, including relative factor costs, are conducive to the performance of those activities. Location economies have to be considered. Also important in some industries is the presence of global concentrations of activities at certain locations. Location externalities include the presence of an appropriately skilled labour pool and supporting industries can play an important role in deciding where to locate manufacturing activities. Formal and informal trade barriers obviously influence location decisions, as do transportation costs and rules and regulations regarding foreign direct investment. Adverse changes in exchange rates can quickly alter a country's attractiveness as a manufacturing base.

b) **Technological Factors:** The technology we re concerned with in this subsection is manufacturing technology – the technology that performs specific manufacturing activities. The type of technology a firm uses in its manufacturing can be pivotal in locations decisions. A number of technological factors support the economic arguments for concentrating manufacturing facilities in a few choice locations or even in a single location. Other things being equal, when fixed costs are substantial, the minimum efficient scale of production is high, and/or flexible manufacturing technologies are available, the arguments for concentrating production at a few choice locations are strong. This is true even when substantial differences in consumer tastes and preferences exist between national markets, since flexible manufacturing technologies allow the firm to customize products to national differences at a single facility. Alternatively, when fixed costs are low, the minimum efficient scale of production is low, and flexible manufacturing technologies are not available, the arguments for concentrating production at one or a few locations are not as compelling. In such cases, it may make more sense to manufacture in each major market in which the firm is active if this helps the firm better respond to local demands.

c) **Product Factors:** The product features affect location decisions. The first is the product's value–to-weight ratio because of its influence on transportation costs. Many electronic components and pharmaceuticals have high value-to-weight ratios; they are expensive and they do not weigh much. Other things being equal, there is great pressure to manufacture these products in the optimal location and to serve the world market from there. The opposite holds for products with low value-to-weight ratios. The other product feature that can influence location decisions is whether the product serves universal needs, needs that are the same all over the world. Since there are few national differences in consumer taste and preference for such products, the need for local responsiveness is reduced. This increases the attractiveness of concentrating manufacturing at an optimal location.

Technology

Nature of Technology

Technology means the utilisation of the materials and processes necessary to transform inputs into outputs. Understanding technology requires knowledge; operating a technology requires skills. Technology is created by people and it affects people; especially through the goods is produces and the working conditions (extent of the division of labour, employee involvement in operational decision making, use of discretion at work, etc.) it creates. Changes in technology affect (i) physical devices (such as machines, tools, instruments and equipment); and (ii) techniques and working methods (procedures, routines, application of specific skills, etc.). Accordingly, technology usually influences:

- Employee training needs
- The nature of employees tasks
- Organisation structures
- Employee job satisfaction and attitudes towards work.

Management has to choose which particular devices and techniques are best for improving efficiency and for achieving organizational goals.

Technology Transfer

Technology transfer is the transmission of innovations arising in one firm or country to others. Innovations might involve new products, processes or working methods, or the use of specialised know-how. In all cases knowledge passes from the innovator to one or more recipients, who thus avoid the need to conduct independent research, or to develop projects, or to test and evaluate the outcomes of research. International businesses are a primary vehicle for the transfer of technology between nations. Technology is a key factor in the economic and social development of nations, so the importation of new technology is actively encouraged by the government of many states. The European Commission is also very keen to encourage technology transfer, in order to prevent the 'cartelization' of technology within certain EU regions and / or nation states (Germany and France for instance). Note how the transfusion of technology is frequently accompanied by an exchange of new management ideas and methods, although some techniques might have to be simplified to make them understandable to local workers.

Point-to-point technology transfer occurs when a single donor transfers a technology to a single recipient, e.g. firm-to-firm or from one research institute to another. Diffusion, conversely, refers to the situation where there are many recipients all having easy access to the technology. Point-to-point technology transfer agreements require bilateral negotiations between the partners, and normally involve some contractual device for protecting the confidentiality of the transferred knowledge. The term 'hard technology' is the management, organisation and administration of technical processes. Typically the intellectual property embodied within hard technology can be legally protected. Accompanying soft technology, however, is usually non-copyright and / or non-patentable. It is essential to realise that modern industrial technology is multi-dimensional and involves much more than patents, designs and the use of machines and computers. Crucial aspects of today's new technologies concern management and support services, ongoing R&D and product development, and the expertise surrounding production techniques and methods. Technology, therefore, is a package of activities that might include a reinvestment study, capital equipment, technical support services, the training of personnel, and the implementation of quality control systems, as well as the provision of designs, drawings and materials specifications.

Key issues in Technology Transfer

The basic issues that need to be addressed by donor firms are how to transfer technology to another country (via licensing, direct foreign investment, contract manufacture under patent, etc.); whether to undertake research and technical development in foreign locations; the choice of the technology that suits best the foreign environment; and how to maintain a technology-based competitive advantage over time.

The latter will involve (i) measures to protect trade secrets, and (ii) ongoing R&D. Recipients of technology have to consider how best to integrate new technologies into existing administrative structures and working methods; the standards of skill required for their operation; the availability of training facilities in the local area; and the extent of local grants and subsidies for the introduction of new methods.

Reasons for Technology Transfer

Firms engage in technology transfer in order to:

- Increase overall company profitability. Production may be cheaper abroad, and output does not have to be sent long distances to reach end consumers.
- Gain a competitive edge in foreign markets through supplying technically superior products (irrespective of short-run profitability considerations).
- Obtain grants and subsidies from foreign governments. Note how certain underdeveloped countries require MNCs to bring with them the latest technology as a condition of being allowed to operate within the local market.
- Overcome capacity limitations in the home country.

- Exploit superior capital markets, access to skilled labour and other inputs in foreign countries.
- Increase the competence and potential of foreign subsidiaries.

Make-Or-Buy Decisions

International businesses frequently face sourcing decisions, decisions about whether they should make or buy the component parts that go into their final product. Should the firm vertically integrate to manufacture its own component parts or should it outsource them, or buy them from independent suppliers? Make-or-buy decisions are important factors of many firm's manufacturing strategies.

Advantages of making inputs within the firm

- Full control over the quality and timing of supply
- Availability of input at lower cost
- Easy modification in design
- Maintenance of secrecy of technology
- Generation of profit through arbitrary pricing of inputs

Advantages of buying inputs from outside

- No additional investment for input manufacturing
- No need for acquiring technology required for input manufacturing, which may be inappropriate / obsolete
- Freedom to get inputs from the cheapest source
- Diversification of the sources of inputs leading to lower political and exchange rate risk
- Operational flexibility in face of changing demand

Material Management

Materials management encompasses all the activities that move materials to a manufacturing facility, through the manufacturing process, and out through a distribution system to the end user. Distance, time, exchange rates and custom barriers are the major factors that complicate at the materials management function in an international business setting. Just-in-time systems generate major cost savings from reducing warehousing and inventory holding costs and from reducing the need to write off excess inventory. In addition, JIT systems help the firm spot defective parts and remove them from the manufacturing process quickly, hereby improving product quality. For a firm to establish a good materials management function, it needs to legitimize materials management within the organization. It can do this by giving materials management equal footing with other functions.

International Services

Although goods and services are more often complementary to each other, they have different identities. So the operations management in an international service-providing firm is to some extent different. It is also different between a service firm that is closely tagged with some manufacturing firms and an independent service firm.

There has been phenomenal growth in international services such as banking, insurance, tourism consultancy, engineering and communication services. Factors responsible for growth are mostly the same as those applicable to manufacturing firms; however, there are some additional factors.

Services providing firms have to face restrictive regulations in a number of developing host countries; but the WTO has eased the problem by assuring most-favoured-nations treatment for trade in services, by providing for transparency in rules and regulations and by the free flow of payments in this context. The operations management of service providing firm's should stress, among other things, a close relationship with consumers and flexibility in prices as well as in the structure of operations.

With the developments in information communication technology, it is now possible to offshore a part of service functions. It avails the cost advantage and is beneficial for both the home country and the host country. Insight 1 describes the Make or Buy decisions at the Boeing Company. Insight 2 throws light on how Dell Computers uses information to reduce inventories.

Insight 1

Make-or-Buy Decisions at the Boeing Company

The Boeing Company is the world's largest manufacturer of commercial aircraft with a 55 to 60 percent share of the global market. Despite its large market share, in recent years Boeing has found it tough going competitively. The company's problems are twofold. First, Boeing faces a very aggressive competitor in Eurpoe's Airbus Industrie. The dogfight between Boeing and Airbus for market share has enabled major airlines to play the two companies off against each other in an attempt to bargain down the price for commercial jet aircraft. Second, the airline business is quite cyclical and airlines sharply reduce orders for new aircraft when their own business is in a downturn. This occurred in the early 1990s and again in the early years of the new century. During downturns, some of which can be extended, intense price competition often occurs between Airbus and Boeing as they struggle to maintain market share and order volume in the face of falling demand. Given these pricing pressures, the only way that Boeing can maintain its profitability is to reduce its own manufacturing costs. With this in mind, during the 1990s Boeing launched an ongoing company wide review of its make-or-buy decisions. The objective was to identify activities that could be outsourced to subcontractors, both in the United States and abroad to drive down production costs.

When making outsourcing decisions, Boeing applies a number of criteria. First, Boeing looks at the basic economics of the outsourcing decision. The central issue here is whether an activity could be performed more cost-effectively by an outside manufacturer or by Boeing. Second, Boeing considers the strategic risk associated with outsourcing in activity. Boeing decided it would not outsource any activity that it deemed to be part of its long-term competitive advantage. For example, the company has decided not to outsource the production of wings because it believed that doing so might give away valuable technology to potential competitors. Third, Boeing looks at the operational risk associated with outsourcing an activity. The basic objective is to make sure Boeing does not become too department on a single outside supplier for critical components. Boeing's philosophy is to hedge operational risk by purchasing from two or more suppliers. Finally, Boeing considers whether it makes sense to outsource certain activities to a supplier in a given country to help secure orders for commercial jet aircraft from that country. This practice is known as offsetting, and it is common in many industries. For example, Boeing decided to outsource the production of certain components to China. This decision was influenced by forecasts suggesting that the Chinese will purchase over $100 billion worth of commercial jets over the next 20 years. Boeing's hope is that pushing some subcontracting work China's way will help it gain a larger share of this market than its global competitor, Airbus.

One of the first decisions to come out of this process was a move to outsource the production of insulation blankets for 737 and 757 aircraft to suppliers in Mexico. Insulation blankets are wrapped around the inside of the fuselage of an aircraft to keep the interior warm at high altitudes. Boeing has traditionally made these blankets in-house, but found that it could save $50 million per year by outsourcing production to a Mexican supplier. In total, Boeing reckons that outsourcing cuts its annual cost structure by $500 million per year.

Insight 2

Dell Computer – Replacing Inventories with Information

Michael Dell started Dell Computer Corporation in 1984 when he was an undergraduate student at the University of Texas. Sixteen years later Dell had grown to become one of the world's great computer companies, with a leading share in the personal computer and server businesses, and global sales of $32 billion, one-third of which are made outside the United States. To support its global business, Dell has manufacturing sites in Brazil, Ireland, Malaysia, and China, in addition to the United States. Its suppliers, more than half of which are located outside the United States. Some 30 suppliers accounting for about 75 percent of Dell's total purchases. Over 50 percent of its major suppliers are in Asia.

From inception, Dell's business model was based on direct selling to customers, cutting out wholesalers and retails. The o original thought was that by cutting out the middleman in the distribution chain, Dell could offer consumers lower prices. Initially, direct selling was achieved through mailings and telephone contacts, but since the mid-1990s the majority of Dell's sales have been made over the Internet, and by 2000, some 80 percent of all sales were made through this medium. Internet selling has enabled Dell to offer its customers the ability to customize their orders, mixing and matching product features such as microprocessors, memory, monitors, internal hard drives, CD and DVD drives, keyboard and mouse format, and the like, to get the system that best suits their particular customer's requirements.

While the ability to customize products, when combined with low prices, has made Dell very attractive to customers, the real power of the business model is to be found in how Dell manages its global supply chain to minimize inventory while building PCs to individual customer orders within three days. Dell uses the Internet to feed real-time information about order flow to its suppliers. Dell's suppliers have up-to-the-minute information about demand trends for the components they produce, along with volume expectations of the next 4 to 12 weeks that are constantly updated as new information becomes available. Dell's suppliers use this information to adjust their own production schedules on a real-time basis, producing just enough components for Dell's needs and shipping them by the most appropriate mode, typically truck or air express so that they arrive just in time for production. This tight coordination is being pushed back even further down the supply chain, with Dell sharing key data with its supplier's principal suppliers. For example, Selectron builds motherboards for Dell that incorporate digital signal processing chips from Texas Instruments. To better coordinate the supply chain, Dell passes information to Texas Instruments in addition to Selectron, This allows Texas Instrument to adjust its schedules to Selectron's needs, which in turn adjusts its schedule to order data from Dell.

Dell's ultimate goal is to drive all inventories out of the supply chain apart from that in transit between suppliers and Dell, effectively replacing inventory with information. Although Dell has not yet achieved this goal, the firm has reduced inventory to the lowest level in the industry. Dell caries about five days of inventory on hand, compared to 30, 45, or even 90 days' worth at competitors such as Compaq Computer inventory, where component costs account for 75 percent of revenues and typically fall by 1 percent per week due to rapid obsolescence. For example, when larger, faster hard drives are introduced, which occurs every three to six months, the value of previous-generation hard drives is significantly reduced. So if

Dell holds one week of inventory, and a competitor holds four weeks, this translates immediately into 3 percent worth of component cost advantage to Dell, which can mean a 2 percent advantage on the bottom line.

Dell's Internet-based customer ordering and procurement systems have also allowed the company to synchronize demand and supply to an extent that few other companies can. For example, if Dell sees that it is running out of a particular component, say 17-inch monitors from Sony, it can manipulate demand by offering a 19-inch model at a lower price until Sony delivers more 17-inch monitors. By taking such steps to fine-tune the balance between demand and supply, Dell can meet customer's expectations. Also balancing supply and demand allows the company to minimize excess and obsolete inventory. Dell writes off between 0.05 percent and 0.1 percent of total materials costs in excess or obsolete inventory. Its competitors write off between 2 percent and 3 percent, which again gives Dell a significant cost advantage.

Summary

The operations strategy of an international firm is concerned primarily with the location of the manufacturing activities, inventory management, sourcing of the inputs, and supportive logistics. Location may be centralised, reaping economies of scale and some other benefits. It may be decentralised at the subsidiaries level, keeping in view the specific demand of consumers. Again, the firm may have a vertical set up, locating different activities of production in different countries. The decision depends on the size of the market; availability of inputs; state of logistics; and political, legal, and socio-cultural environment. The strategy aims at minimising cost, maintenance of quality, and at production flexibility.

As regards inventory management, an international firm normally places orders for a greater amount of stock than warranted by the economic order quantity. This is known as stockpiling, and is done in order to avoid various risks in international transactions. Similarly, the re-order point lies much earlier, keeping in view the distance between the user and the supplier and the obstructions coming in the way. The JIT system of inventory management is often applied. It saves carrying cost, but the risk of delayed transit of goods cannot be easily avoided. Inputs are either sourced from another independent firm or manufactured by the

firm itself. The international manager takes the "make or buy" decision only after weighing the cost and benefits of the two alternatives. The procurement may be made through imports, through procurement offices abroad, or through direct investment.

International logistics are concerned with the movement of inventory. However, there are a couple of problems associated with logistics. One is of general nature, and is common to all host countries. The other is specific, and varies from one host country to another. The transportation issue dominates logistics management. The transportation network should be well developed. The mode of transport should be chosen based on the cost, availability, and actual need. Packaging and storage are other important elements of international logistics. Packaging should consider cost and quality. Similarly, when warehouses are created, their location, size, and the availability facilities are the main points for consideration.

Glossary

Flexible manufacturing technology: Also known as lean production covers a range of manufacturing technologies designed to (1) reduce setup times for complex equipment, (2) increase the utilization of individual machines through better scheduling, and (3) improve quality control at all stages of the manufacturing process. Flexible manufacturing technologies allow the company to produce a wider variety of end products at a unit cost that at one time could only be achieved through the mass production of a standardized output.

Minimum Efficient Scale: As plant output expands, unit costs decrease. However, beyond a certain level of output, few additional scale economies are available. Thus, the "Unit Cost Curve" declines with output until a certain output level is reached, at which point further increases in output realize little reduction in unit costs. The level of output at which most plant-level scale economies are exhausted is referred to as the minimum efficient scale of output. This is the scale of output a plant must operate at to realize all major plant-level scale economies.

Logistics is a process involving movement of inputs from supplier to the firm and of the finished product from the firm to the market.

JIT system: In Just In Time (JIT) system inputs reach the manufacturing location just when they are required.

Make-or-Buy decision refers to procurement of inputs: from within the firm/from outside sources.

Diffusion of technology means transfer of technology without much care to maintain secrecy.

Technology Audit: Technology audit is the process of, identifying a particular technology, the firm's capabilities to develop it, and the funds required developing it.

Patent: Innovated technology can be protected through and Patent Trademark. Patent rewards the innovator with temporary monopoly rights.

Trademark is a unique mark on the product that differentiates it from similar products of rival firms.

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Lesson 4.3 - International Business Strategy - Marketing and Financial Dimensions

Learning Objectives:

After reading this lesson you should be able to:

- Understand issues related to marketing of goods and services globally
- Know the international marketing strategies adopted by MNCs
- Know basic concepts of Multi National Financial Management

Introduction

Global business management in today's world is full of prospects as well as issues problems. The parameters of global business management need to be evaluated in their functional setting. That includes international marketing, international finance, international negotiations, international legality and ethics, international management of staff across different culture. Given the perspective of the emerging international business environment, the challenges of global business management can be identified, analysed and appreciated.

After all, business has to always operate under risks and uncertainty. Business risks are numerous in number and various in forms – there are market risks, product risks, process risks, technology risks, investment risks, etc. Country risk analysis is a precondition for business strategy formulation. Some of these risk elements are not calculable and the risks, which are undefined, constitute the element of business uncertainty. Global business forecasting is an attempt to minimize and control these risks and uncertainties involved in global business operations. The following sections throws light on some of the important functional dimensions of international business strategy.

International Marketing

The world is getting smaller day by day. As trade barriers among nations get reduced, communication, travel, and transport have made the world a smaller place, customer needs across the world are getting homogenized. Global marketing is the only way to satisfy these needs. Global marketing differs from export and inter-national marketing in terms of focus, goals, and content. In global marketing, the firm's focus is the world as a market place, thus diffusing the difference between the home, domestic, or foreign markets. The goal is to maximize efficiency and returns on investment in the world market and the strategy is dictated by local country market conditions like customer preferences, laws, and competition. In evolving a global marketing strategy the firm has to consider alternatives like standardization (full or partial), differentiation (full or partial), localization, and nichemanship. Lead market model and insiderization are important tools for developing a global product. Headquarters should involve local management teams for an effective marketing strategy and gaining higher market penetration in different country markets. Exhibit depicts the major decisions in international marketing.

Major Decisions in International Marketing:

Companies cannot simply stay domestic and expect to maintain their markets. Despite the many challenges in the international arena (shifting borders, unstable governments, foreign-exchange problems, corruption, and technological pirating), companies selling in global industries need to internationalize their operations. In deciding to go abroad, a company needs to define its international marketing objectives and policies. The company must determine whether to market in a few countries or many countries. It must decide which countries to consider. In general, the candidate countries should be rated on three criteria: market attractiveness, risk, and competitive advantage.

Once a company decides on a particular country, it must determine the best mode of entry. Its broad choices are indirect exporting, direct exporting, licensing, joint ventures, and direct investment. Each succeeding strategy involves more commitment, risk, control, and profit potential. In deciding on the marketing program, a company must decide how much to adapt its marketing mix (product, promotion, price, and place) to local conditions. The two ends of the spectrum are standardized and adapted marketing mixes, with many steps in between. At the product level, firms can pursue a strategy of straight extension, product adaptation, or product invention.

At the promotion level, firms may choose communication adaptation or dual adaptation. Exhibit depicts the five international product and promotion strategies. At the price level, firms may encounter price escalation and gray markets. At the distribution level, firms need to take a whole-channel view of the challenge of distributing products to the final users. In creating all elements of the marketing mix, firms must be aware of the cultural, social, political, technological, environmental, and legal limitations they face in other countries. Depending on the level of international involvement, companies manage their international marketing activity in three ways: through export departments, international divisions, or a global organization.

Five International Product and Promotion Strategies

		Product		
		Do not change Product	Adapt Product	Develop New Product
Promotion	Do not change Promotion	Straight extension	Product adaptation	Product invention
	Adapt Promotion	Communication adaptation	Dual adaptation	

Global Competitive Strategy

A global competitive marketing strategy is based on the strategic intent of a global firm. Hamel and Prahlad in their article 'Do you really have a global strategy' published in Harvard Business Review found that their sample firms had three strategic intents, as mentioned below:

(a) Building a global presence
(b) Defending a domestic position
(c) Overcoming national fragmentation

The authors studied the world television industry and found that Japanese firms focused on building a global presence. US firms defend their domestic position in the US market against the Japanese onslaught, and European firms fought to overcome national fragmentation.

They also found that in each of these firms the different strategies were like a loose brick, each of which helped them achieve their goal. In developing a global competitive marketing strategy, a firm needs to adopt an innovative approach to valuing the market share in different countries. Competitiveness of a firm will vary in different markets.

Several firms have become truly global organizations. People in different countries are using more global brands than local brands. Some of the local brands become global. Developing a global strategy is of paramount importance to brand builders everywhere. For many companies, however, global branding has been both a blessing and a curse.

A global branding program can lower marketing costs, realize greater economies of scale in production, and provide a long-term source of growth; but if not designed and implemented properly, it may ignore important differences in consumer behaviour and/or the competitive environment in the individual countries. How McDonald's designing its business model in Indian context can be known through Insight 1. How local celebrities from India became brand ambassadors to global companies can be observed from Insight 2.

McDonald's Gears up for Home Run

After making its way to your hearts through your stomachs, fastfood major McDonald's is now planning another strategy to build its brand across India. The company will soon have a national footprint for its McDelivery format. The quick service restaurant (QSR) chain will be rolling out its home delivery format across the country within the next few months. Soft-launched in '04, the company had maintained a low profile on the home delivery channel. "We were soft-pedalling it (the channel) because we were deliberating on a uniform model for all our stores.

Having finalised the systems, we are now ready to make that channel more visible," said Vikram Bakshi, managing director, Connaught Plaza Restaurants, Mcdonald's franchisee for north and west India, told ET. The effort would result in incremental sales of 15% of its total revenue. The fastfood chain has finalised one toll-free number, which will lead all the calls for home delivery to the store in the respective areas. The orders would be recorded accordingly. Both the Indian franchisees of McDonald's are jointly making some substantial investment in telecom and logistics for the effort. Mr Bakshi, however, declined to share the figure. For areas, which are congested and where access is difficult, for instance, the Chandani Chowk area in Delhi, the company has flagged off McDelivery on bicycles. The ongoing initiative coincides with McDonald's ten years in India. The fastfood chain has lined up major expansion plans in the coming months. "We plan to add 30 new stores this year and set foot in the East," Mr Bakshi said. The company has just signed up for two stores in Kolkata. McDonald's is quiet bullish on the Indian market as a whole. While the parent company is making huge investments in supply chain and media communication, it has now begun to help the back-end supplier through direct investments in the joint ventures with them. "While India is the youngest market for the Big Mac in the Asia Pacific region, the penetration it has achieved in the country matches most of the countries, where the chain is 20-30 years old," Mr Bakshi said. That is probably the reason why, while McDonald's had put a cap on rapid store expansions across the world, it desisted from putting any such restrictions on the Indian operations.

Local Celebrities Global Connect

What's Saif Ali Khan doing on Mexican television? And why is Shah Rukh Khan wooing super-rich Canadians? Or for that matter, why is Sania Mirza featuring in North American and European tennis channels and what are Rahul Dravid posters doing in a non-cricketing nation like the US? No, we aren't testing your trivia quotient. This is about desi celebs and their brand muscle. Outside the country, Indian celebrities are finally coming of age in the world of international advertising. There is an emerging trend where multinational brands which have signed Indian brand ambassadors are now using them for international campaigns. Interestingly, in some cases these brands are not targeting the NRI market alone. Sometimes the commonalties between India and other international markets drive the celeb choice. Take Lenovo. The company signed on Saif Ali Khan recently as its brand ambassador and is using him in Mexico as well as Latin America, apart from North America. Says Anirban Das Blah, VP, Globosport, the sports and entertainment management company which manages Saif Ali Khan, "Lenovo asked for Saif for their brand promotions in Mexico. It even beats us why they are using him but it is definitely proof that the Indian brand ambassador has grown." Miss India aspirants who went on to win global pageants have been used for international campaigns in the past, but now, a whole host of other Indian celebs are also being tapped. And it's not just Bollywood all the way.

MNCs are using Indian brand ambassadors for their brands in global campaigns. Take the case of Rahul Dravid, the latest brand ambassador for Japanese watch maker Citizen. He has signed a global endorsement contract with the brand which will see him promote Citizen products not just in India but also in the US. According to Hideaki Nakazaki, managing director of Citizen Watches India, "Our brand managers in America would be using Rahul Dravid in ad campaigns prior to the upcoming cricket World Cup in the West Indies. Citizen looks at the Indian diaspora as a sizeable market with high disposable income." The trend of using Indian celebs abroad is also linked to the product category to which the brand belongs. It is more common for luxury products like watches. So, Bollywood star

Shah Rukh Khan is a global brand ambassador for Tag Heuer. "Shah Rukh Khan is a bigger star outside India than he is in India. Even in a country like China, where language is a great barrier, Shah Rukh Khan is known and recognised. His movie Asoka was a big hit here," says Manishi Sanwal, brand manager for Tag Heuer operations in India and China. Ditto for Longines, which has Aishwarya Rai as one of its global brand ambassadors. Omega, which recently signed on Abhishek Bachchan as its brand ambassador for India, also has rights to use him for promotions abroad.

International Finance

The field of multinational business finance is somewhat a blend, which combines elements of corporate finance with international economics. However, it is not merely an extension of these fields using international examples. On the contrary, it challenges some of the basic concepts of these fields. MNCs face unique risks that do not hamper domestic firms as much. These risks are related to foreign exchange risks and political risks. The following subsections deal with some of the important factors, which influence international financial strategy.

Foreign Exchange Risk

Foreign exchange risks for MNCs might raise their cost of capital and lower their optimal debt ratios. Foreign exchange risks cause MNCs to alter – typically upward - their hurdle rates for projects located in countries with volatile currencies and economies. MNCs encounter three types of currency exposure: (1) transaction exposure; (2) operating exposure; and (3) accounting (translation) exposure.

a) **Transaction exposure** measures gains or losses that arise from the settlement of financial obligations whose terms are stated in a foreign currency. Transaction exposure arises from (1) purchasing or selling on credit goods or services whose prices are stated in foreign currencies; (2) borrowing or lending funds when repayment is to be made in a foreign currency; (3) being a party to an unperformed forward foreign exchange contract; and (4) otherwise acquiring assets or liabilities denominated in foreign currencies.

b) **Operating exposure** measures the change in value of the firm that results from changes in future operating cash flows caused by an unexpected change in exchange rates. The objective of operating exposure management is to anticipate and influence the effect of unexpected changes in exchange rates on a firm's future cash flow, rather than being forced into passive reaction to such changes. This task can best be accomplished if a firm diversifies internationally both its operations and its financing base.

c) **Accounting exposure** results from translating foreign-currency-denominated statements of foreign affiliates into the parent's reporting currency so the parent can prepare consolidated financial statements. Accounting exposure is the potential for loss or gain from this translation process.

Political Risk

MNCs face political risk premiums on their activities in unstable or emerging overseas markets. Political risk premiums may increase the cost of debt and equity for MNCs resident in such markets. Most political risk arises because of a conflict in goals between host governments and firms when the normal functioning of governmental administrative and legislative process leads to regulations that influence the well being of the firm. In recent years, ethnic, religious, racial, and civic strife have added another dimension to the political risks faced by MNCs. MNCs are usually welcome in host countries to the extent that they transfer technology, market access, and investment capital. The FDI decision results from a complex process involving strategic, behavioral, and economic considerations.

International Monetary System

The international monetary system gives the structure within which foreign exchange rates are determined, international trade and capital flows are accommodated, and balance of payments adjustments made. It also includes all the instruments, institutions, and agreements that link together the world's currency, money markets. Securities, real estate, and commodity markets. Understanding contemporary currency regimes, shielding against the ill affects of currency crises, knowing the derivative products, following hedging technique, and observing the exchange rate changes forms the basic set of duties of global manger.

Interest Rates

The increasing volatility of world interest rates, combined with the increasing use of short-term and variable-rate debt by firms worldwide, has led many firms to actively manage their interest rate risks. The primary sources of interest rate risk to a multinational non-financial firm are short-term borrowing and investing, as well as long-term sources of debt. The techniques and instruments used in interest rate risk-management in many ways resemble those used in currency risk-management: the old tried-and-true methods of lending and borrowing combined with the new methods of option-based derivatives. The primary instruments and techniques used for interest rate risk-management include forward rate agreements (FRAs), forward swaps, interest rate futures, and interest rate and currency swaps. The interest rate and currency swap markets allow firms that have limited access to specific and interest rate structures to gain access at relatively low costs. This access in turn allows these firms to manage their currency and interest rate risks more effectively.

Market Imperfections

Market imperfections provide the rationale for the continued prosperity of MNCs. This rationale allows MNCs to make abnormal profits and to reduce risk through diversification. Capital market segmentation is a financial market imperfection caused by government constraints and investor perceptions. The most important imperfections are

(1) Asymmetric information:
(2) Transaction costs;
(3) Foreign exchange risk;
(4) Takeover defenses;
(5) Small-country bias:
(6) Political risk; and
(7) Regulatory barriers.

MNCs with their superior information tries to encash market imperfections. They use arbitrage as a means to achieve profit. Arbitrage has traditionally been defined as the purchase of securities or commodities on one market for immediate resale on another in order to profit from a price discrepancy. However, in recent years arbitrage has been used to describe a broader range of activities. Tax arbitrage, for example, involves the shifting of gains or losses from one tax jurisdiction to another in order to profit from differences in tax rates. In a broader context, risk arbitrage, or speculation, describes the process that leads to equality of risk-adjusted returns on different securities, unless market imperfections that hinder this adjustment process exist. In fact, it is the process of arbitrage that ensures market efficiency. MNCs constantly seek opportunities at global level.

Capital Budgeting Decision- Adjusting for Risk in Foreign Investments

Capital budgeting for foreign projects involves many complexities that do not exist in domestic projects. A foreign project should be judged on its net present value from the viewpoint of funds that can be freely remitted to the parent. Comparison of a project's net present value to similar projects in the host country is useful for evaluating expected performance relative to potential. Rates of return were calculated from both the projects' viewpoint and the parent's viewpoint. Once the most likely outcome has been determined, a sensitivity analysis is normally undertaken. Foreign project returns are particularly sensitive to changes in assumptions about exchange rate developments, political risk, and the way the repatriation of funds is structured.

A MNC undertaking foreign direct investment (FDI) must determine the cost of funds and the required returns on the investment. The MNC must weigh the expected cash flow returns and business prospects against the possibilities of political disruption or intervention, political and economic actions that undermine the business environment, or restrictions and regulations on the activities of foreign MNCs operating in the country. Risks associated with foreign investments are inherently subjective, qualitative not quantitative. Shareholders, however, expect the management of the MNC to assess the risks, make informed and consistent judgements, and manage them responsibly. Traditional definitions of risk emphasize the potential for loss, a form of one-sided risk. For an MNC, examples of these one-sided risks include the risk of expropriation and the risk of funds blockages. Other risks, however, are definitively two-sided in character. The most obvious one for MNCs is foreign exchange risk. The "foreign risks" of a project from the viewpoint of the parent company include the risk of host government interference-**political risk**; the ability to exercise effective control over the foreign affiliate within the country's legal environment-**governance risk**; the ability to move capital freely and efficiently in and out of the host country-**transfer risk**; and the value of the local currency cash flows generated and remitted to the parent in parent currency terms-**foreign exchange risk.** These risks from the parent perspective are collectively referred to as **country risk**.

Tax Planning

Tax planning for multinational operations is a complex technical subject that requires the inputs of experienced tax and legal counsel in both parent and host countries. Nevertheless, the financial manager of an MNC should be acquainted with the national tax environments in the host countries in which the firm operates. This environment includes the role of local income taxes, value-added taxes, and other indirect taxes, and the less tangible aspects of local tax morality. The financial executive must also understand how the parent country taxes foreign-source income in order to organize efficiently for foreign operations. Important considerations include how the parent's country views tax neutrality as well as how it treats tax deferral, foreign tax credits, and intercompany transactions. Bilateral tax treaties may also influence the way foreign operations are structured. Finally, the financial manager must choose the specific organization form that would be optimal for each foreign location as well as for the group as a whole. This activity typically involves choosing the branch or corporate form of organization. It also might require use of one or more special-purpose corporations or tax-haven affiliates.

By shifting profits from high-tax to lower-tax nations, the MNC can reduce its global tax payments. Similarly, the MNC's ability to transfer funds among its several units may allow it to circumvent currency controls and other regulations and to tap previously inaccessible investment and financing opportunities. However, since most of the gains are derived from the MNC's skills in circumventing funds various nations a new domain in tax laws or regulatory barriers are setup. Governments do not always appreciate the MNC's capabilities and global profit-maximizing behaviour. Thus, controversy has accompanied the international orientation of the multinational corporation.

Summary

Most companies would prefer to remain domestic if their domestic market were large enough. Managers would not need to learn other languages and laws, deal with volatile currencies, face political and legal uncertainties, or redesign their products to suit different customer needs and expectations. Yet several factors are drawing more and more companies into the international arena. Because of the competing advantages and risks, companies often do not act until some event thrusts them into the international arena. Someone – a domestic exporter, a foreign importer, a foreign government – solicits the company to sell abroad, or a company saddled with overcapacity must find additional markets for its goods. The business organizations have to decide whether to go abroad or not. If yes then they have to decide which markets to enter. Then they have to decide how to enter the market. After that, the crucial issue is about deciding the marketing program. Then they have to decide about the structure of marketing organization. MNCs have to plan several issues before they finalise finance strategy. Developments in global financial markets, introduction of new financial securities, changes in regulatory framework, interlinkages of various financial markets throws up a challenge on global financial manager. Both international finance and international marketing functions are crucial for the success of global business organizations.

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Lesson 4.4 - International Business Strategy – Legal, Political, Ethical and Social Responsibility Dimensions

Learning Objectives:

After reading this lesson you should be able to:

- Provide basic ideas and insights about the international business practices
- Observe the legal issues involved in international business
- Understand the political issues having bearing on international business strategy
- Appreciate the importance of ethical process in business decision making

Introduction

In a world in which change is the rule and not the exception, key to international competitiveness is the ability of management to adjust to change and volatility at an ever faster rate. In the words of General Electric former Chairman Jack Welch, "I'm not here to predict the world. I'm here to be sure I've got a company that is strong enough to respond to whatever happens."

The rapid pace of change means that the new global manager needs detailed knowledge of his or her own operation. The global manager must know how to make the product, where the raw materials and parts come from, how they get there, the alternatives, where the funds come from, and what their changing relative value does to his or her bottom line. He or she must also understand the political and economic choices facing key nations and how these choices will affect the outcomes of his or her decisions. In making decisions for the global company, managers search their array of plants in various nations for the most cost-effective mix of supplies, components, transport, and funds. All this is done with the constant awareness that the choices change and have to be made again and again. The problem of constant change disturbs some managers. It always has. But today's global managers have to anticipate it, understand it, deal with it, and turn it to their company's advantage. The payoff to thinking globally is a quality of decision making that enhances the firm's prospects for survival, growth, and profitability in the evolving world economy. Understanding legal, political, ethical and social issues of international business helps global business firm in strategizing its business policy. In the following sections an attempt is made to describe these factors.

Legal Issues in International Business

This section examines the various legal issues to the conduct of international business activities. Due to variety of legal systems and the different interpretations and enforcement mechanisms, the discussion must, of necessity, be some-what general. Based on the same rationale, it is impossible for the top management and legal staff at corporate headquarters to completely master the knowledge of foreign law on their own. To appreciate the problem and subtlety of foreign law, it is clearly necessary to consult local attorneys to find out how a company's operation may be constrained by particular laws. Procedures to deal with problems related to bribery, incorporation, counterfeiting, and infringement, the services of local attorneys are essential. Just as essential is the cooperation of the governments of both the host and home countries.

All countries regulate trade and commerce with other countries and control the access of foreigners to national resources. Each country has its own unique system of law, regulation, and custom that impacts the ability of the global marketer to address market opportunities in a country. There are rules for exporting and importing goods, people, money, and experience across national boundaries. In addition there are industrial and consumer healthy and safety standards and regulations as well as packaging labeling and advertising and promotion regulations. The global marketer must operate in conformance with each of these unique sets of national constraints. Frequently these constraints are ambiguous and they are always undergoing change.

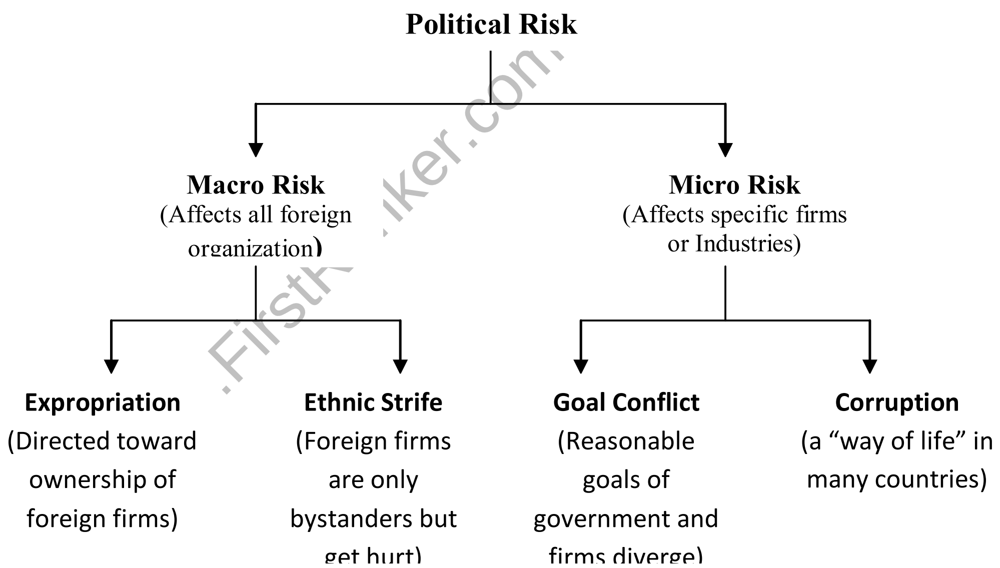
The legal environment is complex and dynamic, with different countries claiming jurisdiction (or a lack of jurisdiction) over business operations. The interaction among domestic, foreign, and international legal environments creates new obstacles as well as new opportunities. A host country may use an MNC's subsidiary in its country as a method of influencing the MNC and subsequently its home country's policies. Likewise, the home country may instruct the parent company to dictate its foreign subsidiary's activities. It is thus not uncommon to find a situation in which the firm is being pressured in opposing directions by two governments. Even than MNC can use its global network to counter such a threat by shifting or threatening to shift the affected operations to other countries, thus lessening the governments' influence on its behavior. It is this countervailing power that allows the company to have a great deal of freedom in adjusting its business strategies. It is important to keep in mind that legal contracts and agreements can only be as good as the parties who create them and the countries that enforce them. Therefore, a contract cannot be used as a substitute for trust and understanding between parties or careful screening of business partners.

Political Issues in International Business

The international manager's political environment is complex and difficult because of the interaction among domestic, foreign, and international politics. If a product is imported or produced overseas, political groups and labor organizations accuse the marketer of taking jobs away from people in the home country. On the other hand, foreign governments are not always receptive to overseas capital and investment be cause of suspicions about the marketer's motives and commitment. When both the host country and the home country have different political and national interests, their conflicting policies can complicate the problem further. As a result of the diversity of political and economic systems, governments develop varying philosophies. In some circumstances, their political motives overshadow their economic logic. The result is often that political risks – such as expropriation, nationalization, and restrictions – are created against exports and/or imports and are likely inevitable. Exhibit illustrates micro and macro decomposition of Political risk.

International business decisions are thus affected by political considerations. When investing in a foreign country, companies must be sensitive to that country's political concerns. Because of the dynamic nature of politics in general, companies should prepare a contingency plan to cope with changes that occur in the political environment. To minimize political risk, companies should attempt to accommodate the host country's national interests by stimulating the economy, employing nationals, sharing business ownership with local firms, and being civic-oriented. On the other hand, to protect their own economic interests companies should maintain political neutrality, quietly lobby for their goals, and shift risks to a third party through the purchase of political insurance.

Finally, a company should institute a monitoring system that allows it to systematically and routinely evaluate the political situation. A few companies view politics as an obstacle to their effort to enter foreign markets and as a barrier to the efficient use of resources. For other companies, political problems, instead of being perceived as entry barriers, are seen as challenges and opportunities. According to firms with the more optimistic view, political situations are merely environmental conditions that can be overcome and managed. Political risks, through skillful adaptation and control, can thus be reduced or neutralized.



Micro-Macro Decompositions of political Risk

There are a number of political risks with which marketers must contend. Hazards based on a host government's action include confiscation, expropriation, nationalization, and domestication. Such actions are more likely to be levied against foreign investments, though local firm' properties are not totally immune. **Confiscation** is the process of a government's taking ownership of a property without compensation. **Expropriation** differs somewhat from confiscation in that there is some compensation, though not necessarily just compensation. More often than not, a company whose property is being expropriated agrees to sell its operations – not by choice but rather because of some explicit or implied coercion. After property has been confiscated or expropriated, it can be either nationalized or domesticated. **Nationalization** involves government ownership, and it is the government that operates the business being taken over. In the case of **domestication**, foreign companies relinquish control and ownership, either completely or partially, to the nationals. The result is that private entities are allowed to operate the confiscated or expropriated property.

Ethical Issues

Public confidence in business ethics has declined. Many critics say that we live in the time of "the ethics crisis". As a result, many experts are calling for a broader examination of business ethics. Because most business decisions have an ethical component (i.e., they affect the intentions of others), managers must add ethics to their understanding of organizations. Many companies have made a commitment to ethics in business. Many decisions that managers make require them to consider who may be affected-in terms of the result as well as the process. The term ethics refers to rules or principles that define right and wrong conduct. Whether a manager acts ethically or unethically is the result of a complex interaction between the manager's stage of moral development, his or her individual characteristics, the organization's structural design, the organization's culture, and the intensity of the ethical issue.

A comprehensive ethics program would include selection to weed out ethically undesirable job applicants, a code of ethics and decision rules, a commitment by top management, clear and realistic job goals, ethics training, comprehensive performance appraisals, independent social audits, and formal protective mechanisms. Consciously or unconsciously, we engage in some kind of ethical reasoning every day of our lives. To improve our ethical reasoning, we must analyze it explicitly and practice it daily. The key terms of the ethical language are values, rights, duties, rules, and human relationships.

Four Different Views of Ethics

There are four different perspectives on business ethics. They are:

a) **Utilitarian view of ethics:** Decisions are made solely on the basis of their outcomes or consequences.

b) **Rights view of ethics:** Decisions are concerned with respecting and protecting basic rights of individuals.

c) **Theory of justice view of ethics:** Decision makers seek to impose and enforce rules fairly and impartially.

d) **Integrative social contracts theory:** A view that proposes decisions should be based on empirical (What is) and normative (What should be) factors. It recognizes the implicit contracts between organizations and the ethical standards of the community within which they operate.

Four Levels of Ethical Questions in Business

We cannot avoid ethical issues in business any more than we can avoid them in other areas of our lives. In business, most ethical questions fall into one or more of four categories: societal, stakeholder, internal policy, or personal.

a) **Societal**. At the societal level, we ask questions about the basic institutions in a society. Issues like racism, apartheid, terrorism, hunger, poverty, and illiteracy raises several ethical questions. For example,

- Is it ethically correct to have a social system in which a group of people is systematically denied basic rights?
- Is capitalism a just system for allocating resources?
- What role should the government play in regulating the marketplace?
- Should we tolerate gross inequalities of wealth, status, and power?

Societal-level questions usually represent an ongoing debate among major competing institutions. As managers and individuals, each of us can try to shape that debate.

b) **Stakeholder**. The second kind of ethical questions concern stakeholders like suppliers, customers, shareholders, and the rest. Here we ask questions about how a company should deal with the external groups affected by its decisions, as well as how stakeholders should deal with the company. There are many stakeholder issues. Insider trading is one; another is a company's obligation to inform its customers about the potential dangers of its products. What obligations does a company have to its suppliers? To the communities where it operates? To its stockholders? How should we attempt to decide such matters?

c) **Internal Policy** A third category of ethics might be called "internal policy." Here we ask questions about the nature of a company's relations with its employees. What kind of employment contract is fair? What are the mutual obligations of managers and workers? What rights do employees have? These questions, too, pervade the workday of a manager. Layoffs, benefits, work rules, motivation, and leadership are all ethical concerns here.

d) **Personal** Here we ask questions about how people should treat one another within an organization. Should we be honest with one another, whatever the consequences? What obligations do we have- both as human beings and as workers who fill specific work roles- to our bosses, our employees, and our peers? These questions deal with the day-to-day issues of life in any organization. Behind them lie two broader issues: Do we have the right to look at other people primarily as means to our ends? Can we avoid doing so?

The following are questions for examining the ethics of a business decision.

1. Have you defined the problem accurately?
2. How would you define the problem if you stood on the other side of the fence?
3. How did this situation occur in the first place?
4. To whom and to what do you give your loyalty as a person and as a member of the corporation?
5. What is your intention in making this decision?
6. How does this intention compare with the probable results?

7. Whom could your decision or action injure?
8. Can you discuss the problem with the affected parties before you make your decisions?
9. Are you confident that your decision will be as valid over a long period of time as it seems now?
10. Could you disclose without qualm your decision or action to your boss, your CEO, the board of directors, your family, society as a whole?
11. What is the symbolic potential of your action if understood? If misunderstood?
12. Under what conditions would you allow exceptions to your stand?

These questions help business leaders to seek answers regarding values, purpose, and goals of business. The answers will provide clarity and sense of direction. Majority of organizations are now explicitly stating their code of conduct, and designing ethical standards and committed towards ethical practices to suit global standards. Hewlett Packard's commitment to ethical standards can be observed from Insight 1. It can be observed from Insight 2 how Chennai's leading construction company has proved that ethical business is profitable.

Insight 1

We are Committed to Uncompromising Integrity

At HP we are guided by enduring values that stretch back to our roots — values that reflect basic, fundamental ideas about who we are. Ideas like these:

- there is no substitute for personal and professional integrity;
- doing well and doing good can go hand in hand; and
- trust and respect have always been the cornerstones of our success.

The open doors to our offices reflect the ethical, transparent business practices at every level of the company. They also help foster the open communication that fuels our creativity and camaraderie. We strive to be a company that manages by inspiration, not fear; by sharing information, not guarding it; by empowering people to make decisions; and by unleashing people's talents for the common good. As a business we must remain profitable to remain viable. But profitable operations are not our only concern. At HP we seek uncompromising integrity through what each individual can contribute — to our customers, our co-workers, our company and our communities. Our business success is dependent on trusting relationships. Our reputation is founded on the personal integrity of the company's personnel and our dedication to our principles of:

- **Honesty** in communicating within the company and with our business partners, suppliers and customers, while at the same time protecting the company's confidential information and trade secrets
- **Excellence** in our products and services, by striving to provide high-quality products and services to our customers
- **Responsibility** for our words and actions
- **Compassion** in our relationships with our employees and the communities affected by our business
- **Citizenship** in our observance of all the laws of any country in which we do business, respect for environmental concerns and our service to the community by improving and enriching community life.
- **Fairness** to our fellow employees, stakeholders, business partners, customers and suppliers through adherence to all applicable laws, regulations and policies, and a high standard of behavior.
- **Respect** for our fellow employees, stakeholders, business partners, customers and suppliers while showing willingness to solicit their opinions and value their feedback

Insight 2

Ethical Business the Alacrity Way

Alacrity is the undisputed leader amongst apartment construction companies in Chennai. It's got to that position, with a turnover of more than ₹ 100 crore, without ever having paid a bribe or dealt in black money or any other illegal operation. In India at least, a company that has proved that it is possible to do ethical business and still be a commercial success, is an exception. Launched in 1978, Alacrity is owned by its employees. The undertaking is based on the values of honesty, commitment and accountability. Today the company is the undisputed leader not only in the fields of construction but also energy management, health and education in Chennai. Alacrity has changed the rules of construction in this city. The company represents a house of trust for the common man. More than 60 per cent of the respondents in a recent market survey in Chennai named Alacrity as their most preferred company. The company has constructed more than 30 per cent of Chennai's apartments, effectively minimising the problem of housing in this metropolis. Moreover, each housing project undertaken by this company subscribes to the rules of the Director of Development Control, the nodal government agency. Recalling the nascent stages of this undertaking, Amol Karnad, chairman of the Alacrity group of companies, says, "The central idea of starting this venture was to bring about a merger between the quality of social life and individual life." Not being satisfied only with ethical business, this company has also provided employment opportunities and fair wages for a migrant labour force, thereby showing that its concern transcends class barriers. Although there have been problems by way of political pressure and acute competition, the organisation has been successful in persisting with its values of discipline, renewal and commitment. Says a customer who has benefited from the Alacrity experience, "When you are investing the savings of your life, you need a builder you can trust and we have found one in Alacrity." Alacrity has effectively proved that value-based management does not curb profits and that economic growth and social development can go together

Social Responsibility

The classic statement of corporate social responsibility was created by Andrew Carnegie in his The Gospel of Wealth (1899). Carnegie's gospel was based on the charity principle (Society's more fortunate members are obligated to help the less fortunate) and the stewardship principle (the rich are the caretakers of wealth and public property). Carnegie was a noted philanthropist and his philosophy inspired a concern for corporate social responsibility between the 1930s and 1960s. The drawbacks of Carnegie's gospel were that it preserved the status quo and protected business from other forms of pressure, and that the term social responsibility was so vague that it left too much to individual discretion. In the 1970s and 1980s, the developments of a number of economic forces led to reexamine the notion of corporate social responsibility. Many experts like Friedman believe that if businesses were to survive, they must be relived of inappropriate social responsibilities and allowed to get back to basics: making money. A business's primary responsibility is to maximize profits. A company's contribution to the general welfare should be the efficient production of goods and services. Social problems should be left to concerned individuals and government agencies.

Keith Davis has said that there is "an iron law of responsibility which states that in the long run those who do not use power in a manner that society considers responsible will tend to loose it. " So it may be that it is in the enlightened self-interest of organizations to be socially responsible – or at least responsive to social forces. Many organizations are now designing their business models taking into consideration of emerging social context.

Corporate social responsibility (CSR) is an expression used to describe what some see as a company's obligation to be sensitive to the needs of all of the stakeholders in its business operations. A company's stakeholders are all those who are influenced by, or can influence, a company's decisions and actions. These can include (but are not limited to): employees, customers, suppliers, community organizations, subsidiaries and affiliates, joint venture partners, local neighborhoods, investors, and shareholders (or a sole owner). CSR is closely linked with the principles of "Sustainable Development" in proposing that enterprises should be obliged to make decisions based not only on the financial/ economic factors but also on the social and environmental consequences of their activities.

Arguments For and Against Social Responsibility

Arguments for

1. Public expectations. Social expectations of business have increased dramatically since the 1960s. Public opinion now supports business pursuing social as well as economic goals.

2. Long-run profits. Socially responsible businesses tend to have more secure long-run profits. This is the normal result of the better community relations and improved business image that responsible behavior brings.

3. Ethical obligation. A business firm can and should have a social conscience. Business should be socially responsible because responsible actions are right for their own sake.

4. Public image. Firms seek to enhance their public image to get increased sales, better employees, access to financing, and other benefits. Since the public considers social goals important, business can create a favorable public image by pursuing social goals.

5. Better environment. Business involvement can help solve difficult social problems, helping create a better quality of life and a more desirable community in which to attract and keep skilled employees.

6. Discouragement of further government regulation. Government regulation adds economic costs and restricts management's decision flexibility. By becoming socially responsible, business can expect less government regulation.

7. Balance of responsibility and power. Business holds a large amount of power in society. An equally large amount of responsibility is required to balance against it. When power is significantly greater than responsibility, the imbalance encourages irresponsible behavior that works against the public good.

8. Stockholder interests. Social responsibility will improve a business's stock price in the long run. The stock market will view the socially responsible company as less risky and open to public criticism. Therefore, it will award its stock a higher price-earnings ratio.

9. Possession of resources. Business organizations have the financial resources, technical experts, and managerial talent to support public and charitable projects that need assistance.

10. Superiority of prevention over cures. Social problems must be addressed at some time. Business should act before these problems become more serious and costly to correct, taking management's energy away from accomplishing its goal of producing goods and services.

Arguments Against

1. Violation of profit maximization. This is the essence of the classical viewpoint. Business is being socially responsible when it attends strictly to its economic interests and leaves other activities to other institutions.
2. Dilution of purpose. The pursuit of social goals dilutes business's primary purpose: economic productivity. Society may suffer if both economic and social goals are poorly accomplished.
3. Costs. Many socially responsible activities don't cover their costs. Someone has to pay these costs. Business must absorb the costs or pass them on to consumers through higher prices.
4. Too much power. Business is already one of the most powerful sectors of our society. If it pursues social goals, it would have even more power. Society has given business enough power.
5. Lack of skills. The outlook and abilities of business leaders are oriented primarily toward economics. Businesspeople are poorly qualified to address social issues.
6. Lack of accountability. Political representatives pursue social goals and are held accountable for their actions. Such is not the case with business leaders. There are no direct lines of social accountability from the business sector to the public.
7. Lack of broad public support. There is no broad mandate or outcry from society for business to become involved in social issues. The public is divided on the issue of business's social responsibility. In fact, it is a topic that typically generates heated debate. Actions taken under such divided support are likely to fail.

Despite the arguments against for businesses being socially responsible, many firms globally embracing the Corporate Social Responsibility philosophy with open mind. Now a days, individuals like Warren Buffet, Bill Gates leading philanthropic movements by sharing their personal wealth to the social causes. Insight 3 highlights how LG Electronics as a global corporation fulfills its corporate social responsibilities. Insight 4 throws light on how IT major Infosys putting public good ahead of private good. Insight 5 gives an idea how pharma company Cipla combines its business goals with social goals.

Insight 3

LG Electronics

As a global corporation, LG Electronics diligently and passionately fulfills its corporate social responsibilities. Not only does the company donate money toward these goals, but it also participates in voluntary social activities, inspiring people in need the world over to pursue their hopes and dreams. LG Electronics takes part in these corporate activities with the primary goal of serving society. Since its inception, LG Electronics has strived to create a society in which people enjoy happiness and comfort, and has been at the forefront of Korea's electronics industry. As a global corporation, LG Electronics is now endeavoring to do its part all over the world, as "a global corporate citizen".

LG Electronics has set an example at home and abroad, giving generously to its neighbors and others in need. Currently LG Electronics' executives offer one percent of their monthly salaries, and other employees offer one percent of their performance incentives, to give something back to societies around the world. The company then matches these monthly contributions and donates the entirety as corporate social contribution funds. Since 1958, LG Electronics and its overseas subsidiaries have endeavored to serve communities all over the world through participating in various voluntary social activities. In addition, in performing its duties as a "corporate citizen", LG Electronics' corporate business activities enrich worldwide economic development. LG Electronics, as a "global corporate citizen", is committed to giving hope to neighboring communities and inspiring them to purse their visions, as members of society, with courage and pride.

Insight 4

Infosys Believes in Putting Public Good Before Private Good

"Unless you create wealth by legal means, you cannot distribute it. And without the two, you do not have progress," says N R Narayanamurthy of the celebrated and very successful Indian IT company Infosys. "Putting public good ahead of private good in every decision you make will, in fact, result in enriching the private good." To distribute its substantial wealth and formalise its social support initiatives, Narayanamurthy and his wife Sudha set up the Infosys Foundation in March 1997, which receives 1 per cent of all the company's after-tax profits. All financial assistance to the needy is given in the form of a rule-based distribution of money.

The Infosys Foundation supports disadvantaged people directly or through organisations. The Foundation prefers to work through smaller organisations and donate in kind rather than cash. For instance, recently it gave books in Kannada worth ₹ 10,000 to a village library, so that it could help strengthen the local language. In the field of education the Foundation has instituted 26 scholarships for PhD scholars in 13 prestigious institutions. It has also anchored the Train the Trainee programme in which computer science students from engineering colleges are exposed to the latest IT trends. The Foundation has also played an important role in setting up science centres and libraries and to date 1001 libraries have been inaugurated with assistance from this Foundation. Infosys Technologies has rationalised the Foundation's distribution of funds. Money is distributed according to the ratio of its employees in the four states where it has offices: Karnataka gets 70 per cent, Maharashtra 15 per cent, Orissa 5 per cent and Tamil Nadu 10 per cent. The Infosys Foundation is committed to giving 30 per cent of its funds to old people, the destitute and the handicapped, 15 per cent for rural development, 30 per cent for the education of talented but poor children, 15 per cent for cultural activities and 10 per cent for healthcare, both in villages and cities.

Each applicant is selected after the Foundation has met the person or a company executive has visited the applying institution, so that the bona fides of the applicant are verified. Infosys also asks that the organisations it supports do not discriminate against people according to caste or creed. The company's policies of transparent accounting and its socially-relevant HR policies are extended to the management of the Foundation.

Insight 5

Cipla Prompts a Worldwide Slide in the Price of Anti-HIV Drugs

The Indian pharmaceutical's move has made anti-HIV drugs more accessible to patients According to the National Aids Control Organisation (NACO), the total number of HIV patients in India is about

3.7 million, of which 5 lakh have AIDS. Unofficial sources place the figures much higher. The threat of AIDS in India is aggravated by highly-priced medicines as well as the lack of a concrete medical strategy. However, Cipla, an Indian generic drug manufacturing firm founded in 1935, offered to slash prices of three anti-HIV drugs in February 2001. Cipla has offered to sell a cocktail of three anti-HIV drugs, Stavudine, Lamivudine and Nevirapine, to the Nobel Prize-winning voluntary agency Medicine Sans Frontieres (MSF) at a rate of $350, and at $600 per patient per year to other NGOs over the world. In the international market the price of these triple combination anti-retroviral drugs ranges from $1,000-15,000. With the Cipla offer, prices have tumbled to $750. This has not only made the drugs accessible to a wider range of people but it has also forced other pharmaceutical houses to lower their prices. Cipla's offer has triggered a movement towards reduced drug prices amongst drug manufacturing giants like GlaxoSmithKline and Merck and Abbot. Although Cipla's offer remains unmatched in the international market, two Indian firms, Hetero and Aurobindo, have also made offers at a price lower than Cipla's. While Hetero has offered a package for $347, Aurobindo has promised the cocktail at $297. MSF, an organisation that has tremendous work experience in the field of providing emergency medical provisions all over the world, is positive about the Cipla offer. The offer not only matches price expectations, but has redefined the entire concept of HIV care. Recently, MSF has started using drugs obtained from Cipla in its AIDS treatment project in Cambodia and ten other countries. However, MSF feels that even at such reduced rates, the drugs would be unaffordable to the majority in the developing world. Corporate houses must actively help in combating the disease

Summary

Global strategic planning is more complex than purely domestic planning. Global firms face multiple political, economical, legal, social, and cultural environments as well as various rates of changes within each of them. Interactions between the national and foreign environment are complex, because of national sovereignty issues and widely differing economic and social conditions. Geographic separation, cultural and national differences, and variations in business practices all tend to make communication and control efforts between headquarters and overseas affiliates difficult. Global firms face extreme competition, because of differences in industry structures. Global firms are restricted in their selection of competitive strategies by various regional blocs and economic integrations, such as the European Economic Community, the European Free Trade Area, and the Latin American Free Trade Area. MNCs must understand how to adapt to the local needs of host countries. Political, legal, ethical issues influence their performance in this changing business world. Resurgence of enviromentalism, increasing buying power, and the globalization of business are driving businesses to adopt Corporate Social Responsibility framework. "Do well by doing good" is the accepted mantra of global firms.

Glossary

Code of ethics: A formal statement of an organization's primary values and the ethical rules it expects its employees to follow.

Corporate social responsiveness: A theory of social responsibility that focuses on how companies respond to issues, rather than trying to determine their ultimate social responsibility.

Ethics: The study of rights and of who is-or should be-benefited or harmed by an action.

Enlightened self-interest: *Organizations' realization that it is in their own best interest to act in ways that the community considers socially responsible.*

Expropriation: Official government seizure of private property, recognized by international law as the right of any sovereign state provided expropriated owners are given prompt compensation and fair market value in convertible currencies.

Political Risk: The possibility that political events in a particular country will have an influence on the economic well being of firms in that country.

Social audit: Report describing a company's activities in a given areas of social interest, such as environmental protection, workplace safety, or community involvement.

Lesson 4.5 - International Business – Strategic Alliances

Learning Objectives

After reading this unit you should be able to

- Understand Merger and Acquisitions as a means of corporate restructuring process
- Know about joint ventures and how they are useful to pursue global strategies
- Understand different corporate restructuring methods

Introduction

Mergers and acquisitions (M&A) and corporate restructuring are a big part of the corporate finance world. Every day, Wall Street investment bankers arrange M&A transactions, which bring separate companies together to form larger ones. When they're not creating big companies from smaller ones, corporate finance deals do the reverse and break up companies through spinoffs, carve-outs or tracking stocks. Not surprisingly, these actions often make the news. Deals can be worth hundreds of millions, or even billions of dollars. They can dictate the fortunes of the companies involved for years to come.

For a CEO, leading an M&A can represent the highlight of a whole career. And it is no wonder we hear about so many of these transactions; they happen all the time. Next time you open the newspaper's business section, odds are good that at least one headline will announce some kind of M&A transaction. Mergers and acquisitions, joint ventures and other restructuring methods are becoming common in global business world. In the following sections we discuss mergers and acquisitions, joint ventures and other corporate restructuring methods through examples.

Mergers & Acquisitions

One plus one makes three: this equation is the special alchemy of a merger or an acquisition. The key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies. Two companies together are more valuable than two separate companies - at least, that's the reasoning behind M&A. This rationale is particularly alluring to companies when times are tough. Strong companies will act to buy other companies to create a more competitive, cost-efficient company. The companies will come together hoping to gain a greater market share or to achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone.

Distinction Between Mergers and Acquisitions

Although they are often uttered in the same breath and used as though they were synonymous, the terms merger and acquisition mean slightly different things. When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded. In the pure sense of the term, a merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals." Both companies' stocks are surrendered and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created. In practice, however, actual mergers of equals don't happen very often. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it's technically an acquisition. Being bought out often carries negative connotations, therefore, by describing the deal as a merger, deal makers and top managers try to make the takeover more palatable. A purchase deal will also be called a merger when both CEOs agree that joining together is in the best interest of both of their companies. But when the deal is unfriendly - that is, when the target company does not want to be purchased - it is always regarded as an acquisition. Whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced. In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders.

Synergy

Synergy is the magic force that allows for enhanced cost efficiencies of the new business. Synergy takes the form of revenue enhancement and cost savings. By merging, the companies hope to benefit from the following:

a) **Staff reductions** - As every employee knows, mergers tend to mean job losses. Consider all the money saved from reducing the number of staff members from accounting, marketing and other departments. Job cuts will also include the former CEO, who typically leaves with a compensation package.

b) **Economies of scale** - Yes, size matters. Whether it's purchasing stationery or a new corporate IT system, a bigger company placing the orders can save more on costs. Mergers also translate into improved purchasing power to buy equipment or office supplies - when placing larger orders, companies have a greater ability to negotiate prices with their suppliers.

c) **Acquiring new technology** - To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can maintain or develop a competitive edge.

d) **Improved market reach and industry visibility** - Companies buy companies to reach new markets and grow revenues and earnings. A merge may expand two companies' marketing and distribution, giving them new sales opportunities. A merger can also improve a company's standing in the investment community: bigger firms often have an easier time raising capital than smaller ones.

It is said that, achieving synergy is easier said than done - it is not automatically realized once two companies merge. Sure, there ought to be economies of scale when two businesses are combined, but sometimes a merger does just the opposite. In many cases, one and one add up to less than two. Sadly, synergy opportunities may exist only in the minds of the corporate leaders and the deal makers. Where there is no value to be created, the CEO and investment bankers - who have much to gain from a successful M&A deal - will try to create an image of enhanced value. The market, however, eventually sees through this and penalizes the company by assigning it a discounted share price.

Varieties of Mergers

From the perspective of business structures, there is a whole host of different mergers. Here are a few types, distinguished by the relationship between the two companies that are merging:

a) **Horizontal merger** - Two companies that are in direct competition and share the same product lines and markets.

b) **Vertical merger** - A customer and company or a supplier and company. Think of a cone supplier merging with an ice cream maker.

c) **Market-extension merger** - Two companies that sell the same products in different markets.

d) **Product-extension merger** - Two companies selling different but related products in the same market.

e) **Conglomeration**- Two companies that have no common business areas.

There are two types of mergers that are distinguished by how the merger is financed. Each has certain implications for the companies involved and for investors:

f) **Purchase Mergers** - As the name suggests, this kind of merger occurs when one company purchases another. The purchase is made with cash or through the issue of some kind of debt instrument; the sale is taxable. Acquiring companies often prefer this type of merger because it can provide them with a tax benefit. Acquired assets can be written-up to the actual purchase price, and the difference between the book value and the purchase price of the assets can depreciate annually, reducing taxes payable by the acquiring company. We will discuss this further in part four of this tutorial.

g) **Consolidation Mergers** - With this merger, a brand new company is formed and both companies are bought and combined under the new entity. The tax terms are the same as those of a purchase merger.

Acquisitions

As you can see, an acquisition may be only slightly different from a merger. In fact, it may be different in name only. Like mergers, acquisitions are actions through which companies seek economies of scale, efficiencies and enhanced market visibility. Unlike all mergers, all acquisitions involve one firm purchasing another - there is no exchange of stock or consolidation as a new company. Acquisitions are often congenial, and all parties feel satisfied with the deal. Other times, acquisitions are more hostile. In an acquisition, as in some of the merger deals we discuss above, a company can buy another company with cash, stock or a combination of the two. Another possibility, which is common in smaller deals, is for one company to acquire all the assets of another company. Company X buys all of Company Y's assets for cash, which means that Company Y will have only cash (and debt, if they had debt before). Of course, Company Y becomes merely a shell and will eventually liquidate or enter another area of business.

Another type of acquisition is a **reverse merger,** a deal that enables a private company to get publicly-listed in a relatively short time period. A reverse merger occurs when a private company that has strong prospects and is eager to raise financing buys a publicly-listed shell company, usually one with no business and limited assets. The private company reverse merges into the public company, and together they become an entirely new public corporation with tradable shares. Regardless of their category or structure, all mergers and acquisitions have one common goal: they are all meant to create synergy that makes the value of the combined companies greater than the sum of the two parts. The success of a merger or acquisition depends on whether this synergy is achieved.

Mergers and Acquisitions: Why they can Fail

It's no secret that plenty of mergers don't work. Those who advocate mergers will argue that the merger will cut costs or boost revenues by more than enough to justify the price premium. It can sound so simple: just combine computer systems, merge a few departments, use sheer size to force down the price of supplies and the merged giant should be more profitable than its parts. In theory, 1+1 = 3 sounds great, but in practice, things can go awry. Historical trends show that roughly two thirds of big mergers will disappoint on their own terms, which means they will lose value on the stock market. The motivations that drive mergers can be flawed and efficiencies from economies of scale may prove elusive. In many cases, the problems associated with trying to make merged companies work are all too concrete. Also, mergers are often attempt to imitate: somebody else has done a big merger, which prompts other top executives to follow suit. A merger may often have more to do with glory-seeking than business strategy. The executive ego, which is boosted by buying the competition, is a major force in M&A, especially when combined with the influences from the bankers, lawyers and other assorted advisers who can earn big fees from clients engaged in mergers. Most CEOs get to where they are because they want to be the biggest and the best, and many top executives get a big bonus for merger deals, no matter what happens to the share price later.

On the other side of the coin, mergers can be driven by generalized fear. Globalization, the arrival of new technological developments or a fast-changing economic landscape that makes the outlook uncertain are all factors that can create a strong incentive for defensive mergers. Sometimes the management team feels they have no choice and must acquire a rival before being acquired. The idea is that only big players will survive a more competitive world. Coping with a merger can make top managers spread their time too thinly and neglect their core business, spelling doom. Too often, potential difficulties seem trivial to managers caught up in the thrill of the big deal. The chances for success are further hampered if the corporate cultures of the companies are very different. When a company is acquired, the decision is typically based on product or market synergies, but cultural differences are often ignored. It's a mistake to assume that personnel issues are easily overcome. For example, employees at a target company might be accustomed to easy access to top management, flexible work schedules or even a relaxed dress code. These aspects of a working environment may not seem significant, but if new management removes them, the result can be resentment and shrinking productivity. More insight into the failure of mergers is found in the highly acclaimed study from McKinsey, a global consultancy. The study concludes that companies often focus too intently on cutting costs following mergers, while revenues, and ultimately, profits, suffer. Merging companies can focus on integration and cost-cutting so much that they neglect day-to-day business, thereby prompting nervous customers to flee. This loss of revenue momentum is one reason so many mergers fail to create value for shareholders. But remember that not all mergers fail. Size and global reach can be advantageous, and strong managers can often squeeze greater efficiency out of badly run rivals. Nevertheless, the promises made by deal makers demand the careful scrutiny of investors. The success of mergers depends on how realistic the deal makers are and how well they can integrate two companies while maintaining day-to-day operations.

Walt Disney a major company in global entertainment industry is all set to acquire Hungama TV of UTV in India. (Insight 1). Sasken Communication Technologies has acquired Finland-based Botnia Hightech recently (Insight 2).

Insight 1

Walt Disney to buy out Hungama TV

Walt Disney, which has two kids' channels in India – Toon Disney and the Disney Channel – is all set to acquire UTV's sole television channel, Hungama TV. Disney will shell out US$ 30.5 million (approximately ₹ 137.25 crore) for Hungama. In addition, Disney has bought a 14.9 per cent stake in the parent company, UTV Software, which is worth US$ 14 million (approximately ₹ 63 crore). In total, Disney has invested around ₹ 200 crore in the Indian television software company. According to Rajat Jain, managing director, Walt Disney, India, this deal is part of the company's long-term expansion plans in India. A few months ago when agencyfaqs (media house) had asked Ronnie Screwvala, CEO of UTV, if he would be ready to sell off Hungama TV if he was offered a hefty price, he had replied that they were trying to build an overall integrated business model. So, building a brand for two years and then selling it off didn't make sense. However, in the last two years, Hungama TV has evolved as a strong brand and Jain of Disney is looking forward to strengthen Disney's network in India with its acquisition.

When quizzed about what would be the new colours for Hungama TV under the new banner, Jain said that it would be premature to comment on this. "The channel has successfully created a distinct identity for itself in the kids' genre and it will take at least four-five months before we decide how to rejuvenate it while maintaining its core strengths." While Disney and Toon Disney are believed to be more international in their programming, Hungama has always had an Indian flavour to it. After all, it was the only local kids' entertainment channel. Walt Disney plans to continue with the distinct identity that Hungama has carved for itself. "Disney has a lot of expectations from this acquisition. Hungama TV will strengthen the current bouquet of channels under Walt Disney," said Jain. The stake in UTV is also significant for Disney's plans in India and, as Jain pointed out, this strategic partnership between the two groups will see lots of opportunities for synergy between the two brands. When asked if UTV's animation division will provide content for Disney both in India as well as internationally, Jain did not rule out the possibility, but said that they would consider it now that they are formally associated with UTV.

Insight 2

Sasken buys Finland Company for ` 210 crores

Making its first overseas acquisitions, Sasken Communication Technologies, the Bangalore-headquartered provider of software services and products for telecom sector announced in June 2006 that it has acquired 100% of Finland-based Botnia Hightech for E35.5m (₹ 210.3 crore) in an all cash deal. The acquisition, which is expected to close by August 2006-end will be funded by Sasken through a combination of internal accrual and other sources. It has already received the board approval to raise \$50m (₹ 225 crore), which could be either through the debt or equity route.

Botnia, which started its operations in 1989 is a provider of hardware, software, mechanical design and testing services. Sasken through this acquisition gets 230 people including a development centre in Finland. Botnia and its two subsidiaries had revenues of E17.7m (₹ 104 crore) with a net profit of E2.9m (₹ 17 crore) for the year ended April 30, '06. Neeta Revankar, CFO, Sasken, said the valuation of Botnia was two times its revenue and 12.2 times its EBITDA. Sasken CEO Rajiv C Mody said, "This acquisition takes us into the unchartered territory and helps us to provide end-to-end solutions." Botnia, whose margins are in line with Sasken, will operate as a subsidiary and its development centre in Finland will be the global centre of excellence for hardware and mechanical design. Sasken COO Prabhas Kumar said the Botnia acquisition will provide it the scale to target large projects as well as address the European market.

He said the integration process of both the companies are already on and from September 1, it will have to market strategies jointly. Ms Revankar said this acquisition is expected to be EPS accretive though its margins might take a hit in the short-term and the situation is expected to change in Q3 of the current fiscal, when its product-related activity gains momentum. Currently, Sasken generated 96% of its revenues from services and the remaining from products. For Q1 of FY07, Sasken reported revenues of ₹ 91.1 crore and a net profit of ₹ 8.6 crore, while recording an annual growth of 40% in services. It expects handsets containing Sasken IP to start shipping from November 2006, fuelling its products segments.

Joint Ventures

A joint venture is a legal organization that takes the form of a short-term partnership in which the persons jointly undertake a transaction for mutual profit. Generally each person contributes assets and share risks. Like a partnership, joint ventures can involve any type of business transaction and the "persons" involved can be individuals, groups of individuals, companies, or corporations. Joint ventures are also widely used by companies to gain entrance into foreign markets. Foreign companies form joint ventures with domestic companies already present in markets the foreign companies would like to enter. The foreign companies generally bring new technologies and business practices into the joint venture, while the domestic companies already have the relationships and requisite governmental documents within the country along with being entrenched in the domestic industry. As there are good business and accounting reasons to create a joint venture (JV) with a company that has complementary capabilities and resources, such as distribution channels, technology, or finance, joint ventures are becoming an increasingly common way for companies to form strategic alliances. In a joint venture, two or more "parent" companies agree to share capital, technology, human resources, risks and rewards in a formation of a new entity under shared control.

Factors to be considered before a Joint Venture is formed

a) **Screening of prospective partners**: All parties must screen other partners before they venture into deal;

b) **Business Plan:** Joint development of a detailed business plan and shortlisting a set of prospective partners based on their contribution to developing a business plan;

c) **Due diligence:** checking the credentials of the other party ("trust and verify" - trust the information you receive from the prospective partner, but it's good business practice to verify the facts through interviews with third parties);

d) **Exit strategy:** Development of an exit strategy and terms of dissolution of the joint venture;

e) **Organization structure:** most appropriate structure (e.g. most joint ventures involving fast growing companies are structured as strategic corporate partnerships);

f) **Allocations:** special allocations of income, gain, loss or deduction to be made among the partners;

g) **Compensation**: compensation to the members that provide services to form joint venture;

Benefits of Joint Ventures

a) Provide companies with the opportunity to obtain new capacity and expertise;

b) Allow companies to enter into related businesses or new geographic markets or obtain new technological knowledge;

c) Have a relatively short life span (5-7 years) and therefore do not represent a long-term commitment;

d) In the era of divesture and consolidation, offer a creative way for companies to exit from non-core businesses: companies can gradually separate a business from the rest of the organization, and ultimately, sell it to the other parent company (approximately. 80% of all joint ventures end in a sale by one partner to the other).

Insight 3 and Insight 4 throws light on how Indian Auto majors forming joint ventures to pursue their global strategies.

Insight 3

Tatas, Fiat Strike 50:50 JV to make Cars, Engines

In a long-awaited move, Tata Motors chairman Ratan Tata and Fiat SpA chairman Sergio Marchionne have decided to shift gears and strengthen a relationship which had begun with a low-key distribution tie-up last year. In June 2006 the companies announced that they had signed a new MoU, which commits the two to a 50:50 joint venture in India. Tata Motors and Fiat now plan to use Fiat's existing facility in Ranjangaon, near Pune, to manufacture passenger cars from both stables as well as engines and transmissions. The deal will also enable India's biggest auto maker to gain an entry into Latin America for its utility vehicles and pickups. Under the terms of the MoU, Fiat will manufacture its two future launches, the B segment Grande Punto and a new C segment premium sedan, at the Ranjangaon facility. It will also make its small multijet diesel engine there, which will be fitted into a yet-to-be disclosed Tata Motors product. It is not clear what products Tata Motors will be manufacturing at the facility, though sources said that the facility would give them "more flexibility". Fiat and Tata have also signed a 60-day study aimed at exploring the possibility of using Fiat's production facility in Cordoba, Argentina to manufacture and sell Tata Motors' utility vehicles and pickups in Latin America. The joint venture will give the Fiat group, which has worked up huge accumulated losses though its 100% subsidiary Fiat India in its first ten years of operation, a much-desired foothold in the Indian passenger car market. Its Indian operations had spun out of control, after a string of marketing and distribution glitches. The high cost of operating the Kurla facility also hurt its overall performance. In his earlier visit to India, Mr Marchionne had admitted that the debacle in India had been a humbling experience for the European carmaker, forcing it to look for a local partner with necessary market expertise. Tata Motors and Fiat signed a distribution agreement in January '06, by which they established a chain of joint dealerships. Fiat had begun hawking its hatchback Palio and its sedan Petra through the co-branded dealerships. The distribution tie-up, which may have helped Fiat regain some amount of consumer confidence, was seen as a run-up to a more comprehensive arrangement between the two. On Tuesday, the Italian major provided some early evidence that its overall global strategy of entering into strategic alliances with other global auto companies like Ford, Suzuki and Peugeot was working. Backed by strong sales of its hatchback Punto, Fiat reported a 56% jump in its second-quarter profits, clearly signalling that it could be finally emerging out of the woods.

Insight 4

Bajaj Auto Sets up Assembling Unit in Indonesia

Bajaj Auto will set up a joint venture in Indonesia, for which it has got necessary approval from the Indonesian Government, said executive director of the company Sanjiv Bajaj said. The approval to set up the assembling unit, at a cost of 50 million dollars, was received a month ago and the JV would be called P T Bajaj Auto Indonesia, Bajaj told reporters. Initially, 12.5 million dollars would be invested in the JV, he said, adding that the Indonesian partner Doentora would hold a five per cent stake. Bajaj Auto would hold 95 per cent stake in the JV. Work at the unit would begin from next month for three-wheelers and three months later, Pulsar motorcycles would be introduced in Indonesia, Bajaj said. Annual output from the facility for three-wheelers is expected to be 10,000 units and for two-wheelers, it would be about one lakh units. The completely knocked down units (CKDUs) would be shifted to Indonesia. The distribution and marketing facilities for the JV in Indonesia are being worked upon, he said. Critical components would be sourced from India while the bulky ones would come from other places, Bajaj said. Four weeks ago, around 400 CKDUs of Boxer S 100 cc motor- cycles were shipped to Nigeria and were sold within a span of ten days, he said, adding by the end of the last quarter of the current fiscal, Pulsars would enter the Iran market and CNG-powered three-wheelers would make a foray into Jakarta. Bajaj Auto Managing Director Rajiv Bajaj said the company would launch 80 three-wheelers in Pune, which would have direct fuel injection engines and also be fitted with catalytic convertors. The company would study the response of the customers and work towards raising fuel efficiency of this model by 30 per cent and lowering its emission level by 50 per cent, he said. They would be manufactured at Bajaj Auto's Chakan facility in the outskirts of Pune.

Other Restructuring Methods

There are several restructuring methods: doing an outright sell-off, doing an equity carve-out, spinning off a unit to existing shareholders or issuing tracking stock. Each has advantages and disadvantages for companies and investors. All of these deals are quite complex.

a) Sell-Offs

A sell-off, also known as a divestiture, is the outright sale of a company subsidiary. Normally, sell-offs are done because the subsidiary doesn't fit into the parent company's core strategy. The market may be undervaluing the combined businesses due to a lack of synergy between the parent and subsidiary. As a result, management and the board decide that the subsidiary is better off under different ownership. Besides getting rid of an unwanted subsidiary, sell-offs also raise cash, which can be used to pay off debt. In the late 1980s and early 1990s, corporate raiders would use debt to finance acquisitions. Then, after making a purchase they would sell-off its subsidiaries to raise cash to service the debt. The raiders' method certainly makes sense if the sum of the parts is greater than the whole. When it isn't, deals are unsuccessful.

b) Equity Carve-Outs

More and more companies are using equity carve-outs to boost shareholder value. A parent firm makes a subsidiary public through an initial public offering (IPO) of shares, amounting to a partial sell-off. A new publicly listed company is created, but the parent keeps a controlling stake in the newly traded subsidiary. A carve-out is a strategic avenue a parent firm may take when one of its subsidiaries is growing faster and carrying higher valuations than other businesses owned by the parent. A carve-out generates cash because shares in the subsidiary are sold to the public, but the issue also unlocks the value of the subsidiary unit and enhances the parent's shareholder value. The new legal entity of a carve-out has a separate board, but in most carve-outs, the parent retains some control. In these cases, some portion of the parent firm's board of directors may be shared. Since the parent has a controlling stake, meaning both firms have common shareholders, the connection between the two will likely be strong. That said, sometimes companies carve-out a subsidiary not because it's doing well, but because it is a burden. Such an intention won't lead to a successful result, especially if a carved-out subsidiary is too loaded with debt, or had trouble even when it was a part of the parent and is lacking an established track record for growing revenues and profits. Carve-outs can also create unexpected friction between the parent and subsidiary. Problems can arise as managers of the carved-out company must be accountable to their public shareholders as well as the owners of the parent company. This can create divided loyalties.

c) Spinoffs

A spinoff occurs when a subsidiary becomes an independent entity. The parent firm distributes shares of the subsidiary to its shareholders through a stock dividend. Since this transaction is a dividend distribution, no cash is generated. Thus, spinoffs are unlikely to be used when a firm needs to finance growth or deals. Like the carve-out, the subsidiary becomes a separate legal entity with a distinct management and board. Like carve-outs, spinoffs are usually about separating a healthy operation. In most cases, spinoffs unlock hidden shareholder value. For the parent company, it sharpens management focus. For the spinoff company, management doesn't have to compete for the parent's attention and capital. Once they are set free, managers can explore new opportunities. Investors, however, should beware of throw-away subsidiaries the parent created to separate legal liability or to off-load debt. Once spinoff shares are issued to parent company shareholders, some shareholders may be tempted to quickly dump these shares on the market, depressing the share valuation.

d) Tracking Stock

A tracking stock is a special type of stock issued by a publicly held company to track the value of one segment of that company. The stock allows the different segments of the company to be valued differently by investors. Let's say a slow-growth company trading at a low price-earnings ratio (P/E ratio) happens to have a fast growing business unit. The company might issue a tracking stock so the market can value the new business separately from the old one and at a significantly higher P/E rating. Why would a firm issue a tracking stock rather than spinning-off or carving-out its fast growth business for shareholders? The company retains control over the subsidiary; the two businesses can continue to enjoy synergies and share marketing, administrative support functions, a headquarters and so on. Finally, and most importantly, if the tracking stock climbs in value, the parent company can use the tracking stock it owns to make acquisitions. Still, shareholders need to remember that tracking stocks are class B, meaning they don't grant shareholders the same voting rights as those of the main stock. Each share of tracking stock may have only a half or a quarter of a vote. In rare cases, holders of tracking stock have no vote at all.

Insight 5 highlights how Indian companies in recent past stepped up their international foray through different strategic routes. Insight 6 throws light on how Pfizer earmarking considerable money for making strategic deals in the coming future. Insight 7 discuses the tie-up proposal between Renault and General Motors.

Insight 5

Companies Take the Integration Route to Success

There's no doubt that India has made the cut in global business and will be the main driver of the Asian century. But, to be a powerhouse, you need to dominate, and that's precisely what Indian companies are doing now. They are integrating vertically, and in the process, scooping up some foreign companies as well. The strategy is simple: become a dominant player in your sector, and then take on the world. From raw material to retailing, Indian business groups are creating fully-integrated businesses in their respective sectors. Over the past year, corporates that have started creating future business power-houses through acquisitions include Videocon (electronics), GHCL (home textiles), Bilt (paper) and Rajesh Exports (gold jewellery). Significantly, all these companies have at least one global face for their fully-integrated businesses. In a few cases, they are in the process of creating the world's first fully-integrated business in their sectors. They, therefore, get to control a big chunk of margins through production and retail cycle in their sectors. Take Videocon, which was primarily a consumer durable maker till two years ago. It entered the electronic component business big time by acquiring Thomson's global picture tube business. It is an added advantage that it also makes glass that goes into the making of picture tubes, the single biggest component of TV. So from sand, which is used to make glass, to tubes to TV, and finally, retail, which the group has entered the over past year, it completes a fully-integrated global operation in the electronics business. The Videocon Group's Next branded stores already form the largest electronics retail chain in India in terms of number of outlets. Another such case is GHCL, a small-time soda ash and textile manu-facturer that hit big league as the world's first fully-integrated global player in the home textile business. Its operations span from spinning and weaving to having international home textile brands. Now, with its latest acquisition in the UK, it's a specialised home textile retail chain. GHCL is not stopping at Rosebys, the UK-based chain it has ac-quired, and is scouting for other retail chains in Europe. Says Nikhil Sen, who looks after corporate finance and strategy at GHCL, "The overall strategy is built around creating a fully-integrated home textile business." The Gautam Thapar-led Bilt is also headed in a similar direction. The paper manufacturer now has international plantation rights, pulp mills in India and abroad, apart from core paper manufacturing business

Insight 6

Pfizer to Earmark $17 BN for Deals

Pfizer, the world's largest drugmarker, yesterday detailed plans to spend $17 billion in 30 months on acquisitions, using its financial muscle to buy products and companies to help boost growth. The group also aimed to reasure investors, saying its size and financial flexibility would help it overcome challenges. Pfizer faces patent expiries on a series of big drugs, new generic competition, market pricing pressures, and questions that its sheer scale could keep it from position consistently high profit growth. Its share price has flirted with eight-year lows. The company side it was seeking smaller acquisitions, primarily new drug candidates or technology, and was not looking for a big merger because it felt its global reach and infrastructure was sufficient. Hank McKinnell, chairman and chief executive, said: "We're looking in a universe that tends to be about

$1 billion-$4 billion in cost. We don't see much benefit to us with a big acquisition."

Pfizer has taken steps to boost its value. It recently agreed to sell its consumer products business to Johnson & Johnson for $16.6 billion, has employed an aggressive share buy-back scheme and increased the dividend. Pfizer's acquisition warchest will be half of the $34 billion expected from the combination of the $13.5 billion after-tax proceeds of the consumer products sale, and its projected cashflow. Pfizer also boosted its share repurchase plans to a $17 billion stock buy-back over this year and next. Its shares rose 2 per cent to $23.79 in New York trading. Investors were relieved yesterday with Pfizer's second-quarter results, which were helped by an aggressive cost-cutting plan, and strong sales of critical durgs Lipitor, cholesterol reducer, and painkiller Celebrex. Excluding one-time items, second quarter net income rose 10 per cent to $3.66 billion. Sales increased 3 per cent to $11.7 billion. Lipitor and Celebrex are key components in Pfizer's plan to reignite sales and profit growth next year. Lipitor, the world's biggest-selling drug, is under threat from generic competition following the June patent expiry of its competitor Zocor, made by Merck. The momentum allowed Pfizer to raise its profit forecast this year to $2 per share or 7 cents higher than its previous estimate.

Insight 7

Renault to take up GM Tie-Up Proposal

An audacious plan for a tie-up between General Motors and Renault that would create a $100bn global auto giant was set to come before the board of the French carmaker. GM's most high-profile investor, billionaire Kirk Kerkorian, urged the US company to consider a three-way partnership with Renault and its partner Nissan. Renault and Nissan CEO Carlos Ghosn has said that the board and management of GM would need to fully support the project before any study of the plan could take place. Nissan said after its board meeting that its directors had approved exploratory talks and charged Mr Ghosn with leading the discussions. A tie-up would put the Brazilian-born French executive of Lebanese parents at the helm of a global auto group that will be breathing down the neck of Japan's Toyota, which has a market value of some $190 bn. But analysts doubted that the deal would benefit Renault, which has a controlling 44% stake in Nissan, because of the risk involved just as the French company has embarked on a recovery plan drawn up by Ghosn after he turned Nissan around.

Mr Ghosn has expressed interest in acquiring a stake of up to 20% in the world's largest automaker at a dinner several days ago with Kerkorian, a source familiar with the situation said on Friday. Kerkorian owns 9.9% of GM. GM shares rose as much as 8.5% on Friday on Kerkorian's proposal and prospects of a speedier turnaround at the struggling US automaker. Analysts estimate that the stake could cost Renault about E2.6bn ($3.3bn). Renault already owns the Romanian Dacia brand and has a stake in Samsung Motors of Korea. GM is the maker of Cadillac, Corvette, Saab, Hummer, Opel/Vauxhall and Chevrolet cars. "We struggle to see short-to medium-term synergies for both sides," Dresdner Kleinwort credit analyst Christophe Boulanger said in a note to clients on Monday. Boulanger said a 10% GM stake would cost Renault about E1.3bn ($1.66bn), which would likely trigger at least a one-notch credit rating cut to the BBB level with all three rating agencies, and a potential negative outlook given the challenges to make a three-way partnership work. The cost of insuring Renault's debt against default rose on Monday, reflecting the worries about the impact of any deal on Renault's credit rating. CM-CIC Securities analyst Pierre-Yves Quemener said Renault could easily finance such a stake but added the gains of a three-way tie-up for Renault were limited.

"We would like to simply stress that the challenges could offset the advantages in a period where Renault is restructuring," Quemener said. The Kerkorian suggestion about a GM stake came after media speculation that Ford had wanted Ghosn to jump ship. At UBS, an analyst said that while a tie-up with GM would give the alliance the much discussed "third leg," it would also create problems. "Renault-Nissan already has all of the purchasing and engineering scale it can possibly use. Investing in GM would see management distracted for years. GM faces a difficult legacy, labor, brand and distribution challenges that may not be solved by target-setting management," UBS said, adding that the 2.6 billion euros needed to buy 20 percent in GM could be financed by Renault itself if it sold its stake in truck maker Volvo (VOLVb.ST). Bruno Lapierre of CA Cheuvreux said a tie-up would work against the interests of Renault shareholders for the next three years at least. "Renault is at the start of an ambitious plan that requires many cultural changes within the group and dearly needs Mr Ghosn's management expertise in this process," he said.

Summary

One size doesn't fit all. Many companies find that the best way to get ahead is to expand ownership boundaries through mergers and acquisitions. For others, separating the public ownership of a subsidiary or business segment offers more advantages. At least in theory, mergers create synergies and economies of scale, expanding operations and cutting costs. Investors can take comfort in the idea that a merger will deliver enhanced market power.

By contrast, de-merged companies often enjoy improved operating performance thanks to redesigned management incentives. Additional capital can fund growth organically or through acquisition. Meanwhile, investors benefit from the improved information flow from de-merged companies. M&A comes in all shapes and sizes, and investors need to consider the complex issues involved in M&A. The most beneficial form of equity structure involves a complete analysis of the costs and benefits associated with the deals. Mergers and acquisitions, Joint ventures, Tie-ups, and other forms of strategic alliances give flexibility to corporate managers in restructuring their business portfolio.

Glossary

Strategic Alliance: An arrangement between two companies who have decided to share resources in a specific project. A strategic alliance is less involved than a joint venture where two companies typically pool resources in creating a separate entity.

Consortium: A group made up of two or more individuals, companies or governments that work together toward achieving a chosen objective. Each entity within the consortium is only responsible to the group in respect to the obligations that are set out in the consortium's contract.

Keiretsu: A Japanese term describing a loose conglomeration of firms sharing one or more common denominators. The companies don't necessarily need to own equity in each other. This term has been in the news every now and then, especially when they talk about Silicon Valley. One example would be the close relationship between AOL and Sun Micro. The two firms don't have ownership in each other, but they work closely on various projects.

Self Assessment Questions

1. What are the different approaches to strategy formulation? Explain its broad spectrum.
2. "The characteristics of strategy formulation at different levels are different" Comment.
3. What are the different steps in the process of strategic planning?
4. What are the different options for the location of an international firm? What are the factors influencing location?
5. What are the major issues in Technology Management that an international firm may confront?
6. Comment on the "make or buy" decision as far as sourcing of input is concerned in an international firm.
7. What are the objectives of global competitive marketing strategy?
8. Describe various product and promotion strategies of international marketing.
9. Describe the importance of international finance and list out various factors to be considered while framing it.
10. Describe Mergers and Acquisitions. List out the types of mergers.
11. What are the advantages of mergers and acquisitions? Why normally mergers fail?
12. Define Joint Venture. What factors to be considered before forming joint venture?
13. List out various methods of corporate restructuring.
14. Illustrate how Indian corporate firms are venturing for global deals with examples.

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UNIT - V

Unit Structure

Lesson – 5.1 - International Mergers and Acquisions

Learning Objectives

After reading this lesson you should be able to

- Understand what is International M&A
- Acquaint with the motivation for International M&A
- Explain the role of technology in M&A
- Discuss the changing policy and the Cross-Border M&A

Introduction

Prior to the 1980's merger and acquisitions, simply meant that one company would attempt to take over another by gaining enough of its common stock to gain control. In the simplest sense, merger means two companies becoming one with the acquirer being in the commanding position, the Government only became involved if the deal was deemed inimical to competition or if the potential acquirer was foreign, seeking control of a company or industry deemed vital to the national defense.

After introduction of Globalization, Liberalization, the term, 'Merger and Acquisition' became very popular. Merger and Acquisition, which had taken place here and there with in the national frontiers, crossed national borders and it has been taking more in numbers between the countries now. Merger & Acquisition, which takes place between two companies of the two countries, is called International Merger (or) Cross-Border Merger and Acquisition.

Significance of International M&A

International Merger and Acquisition are playing an increasingly important role in the growth of international production. A firm can undertake FDI in a host country in of two ways: Greenfield investment in either a new facility, or acquiring or merging with an existing local firm. The local firm may be privately or state owned privatizations involving foreign investors known as cross-border M&As, which entail a change in the control of the merged or acquired firm. In a cross-border merger, the assets and operations of two firms belonging to two different countries are combined to establish a new legal entity. In a cross-border acquisition, the control of assets and operations is transferred from a local to a foreign company, the former becoming an affiliate of the latter.

To the extent that both Greenfield investment and cross-border M&As place host country assets under the governance of TNCs and, hence, contribute to the growth of an international production system. There is no reason to distinguish between them. Both involve management control of a resident entity in one country by an enterprise resident in another, to the extent, however, that the assets placed under TNC control are newly created in the case of cross-border M&As, then there is reason to consider them separately. The normal definitions of FDI and existing assets are transferred from one owner to another in the case of cross-border M&As, then there is reason to consider them separately. The normal definitions of FDI apply to entry through M&As as well. The country of the acquirer or purchaser is the "home country" and the country of the target or acquired firm is the "host country". In mergers, the headquarters of the new firm can be in both countries (e.g. the Netherlands and the United Kingdom, in the case of Royal Dutch/Shell) or in one (the United Kingdom, in the case of BP-Amoco; Germany, in the case of Daimler-Chrysler). Acquisitions can be minority (foreign interest of 10 to 49 per cent of a firm's voting shares), majority (foreign interest of 50-99 per cent), or full or outright acquisitions (foreign interest of 100 per cent). Acquisitions involving less than 10 per cent constitute portfolio investment. However, the distinction between portfolio and direct investments is not always obvious. While FDI involves a long-term relationship reflecting an investor's lasting interest in a foreign company, portfolio acquisitions can also involve management control, e.g. if there are accompanying no equity arrangements, especially where non-institutional investors are involved.

Classification of International M&As.

1. Horizontal M&As (between competing firms in the same industry). They have grown rapidly recently because of the global restructuring of many industries in response to technological change and liberalization. By consolidating their resources, the merging firms aim to achieve synergies (the value of their combined assets exceeds the sum of their taken separately) and often greater market power. Typical industries in which such M&As occur are pharmaceuticals, automobiles, petroleum and, increasingly, several services industries.

2. Vertical M&As (between firms in client-supplier or buyer-seller relationships). Typically they seek to reduce uncertainly and transaction costs as regards forward and backward linkages in the production chain, and to benefit from economies of scope. M&As between parts and components makers and components makers and their clients (such as final elections or automobile in unrelated activities). They seek to diversify risk and deepen economies of scope.

3. Conglomerate M&As (between companies in unrelated activities). They seek to diversify risk and deepen economies of scope. The balance between these types of M&As has been changing over time. The importance of horizontal M&As has risen somewhat over the years. In 1999, 70 per cent of the value of cross-border M&As were horizontal compared to 59 per cent years ago. Vertical M&As have been on the rise since the mis-1992s, but staying well below 10 per cent. In the late-1980s M&A boom, conglomerate M&As were very popular, but they have diminished in importance as firms have tended increasingly to focus on their core business to cope with

intensifying international competition. They declined from a high of 42 per cent in 1991 to 27 per cent in 1999.

4. M&As can be driven primarily by short-term financial gains, rather than strategic or economic motivations such as the search for efficiency. Typical examples include deals where buy out firms and venture capital companies acquires other firms.

5. Friendly M&As can be distinguished from those that are hostile. In friendly M&As, the board of a target firm agrees to the transaction. Hostile M&As are undertaken against the wishes of the target firms, i.e. the boards of the latter reject takeover/merger offers. Regardless of whether hostile M&As involve bidding by several prospective acquirers, the price premium tends to be higher than in friendly transactions. The overwhelming to data from Thomson Financial Securities Data Company, there were only 30 hostile takeovers out of 17,000 M&As between domestic firms. Hostile cross-border M&As that were completed accounted for less than 5 per cent of the total value and less than 0.2 per cent of the total number of M&As during the 1990s. In fact, according to the same source, 1999 saw only 10 hostile cross-border cases out of a total of some 6,200 all in developed countries. But some, such as the takeover of Mannesmann by Vodafone Air Touch that succeeded in 2000, involve high-profile battles. Over the period 1987-1999, out of the 104 hostile cross-border M & As, 100 targeted developed country firms, four targeted developing country firms, while none targeted firms in Central and Eastern Europe.

Why do Firms Engage in International M&As?

Why are firms increasingly engaging in cross-border M&As when undertaking FDI? Although cross-border M&As represent one mode of FDI entry into foreign locations, the received literature international production can only party explain this phenomenon. Indeed, the "OLI paradigm" the most prominent explanation of FDI does not distinguish between different modes of entry and was formulated primarily in reference to Greenfield FDI. Thus, it is useful to consider first the basic reasons for M&As in general, and for cross-border M&As in particular.

Reaching Desired Goal

Speed in crucial M&As often represent the fastest means of reaching the desired goals when expanding domestically or internationally. For example, when time to market is vital, the takeover of an existing firm in a new market with an established distribution system is far more preferable to developing a new local distribution and marketing organization. For a latecomer to a market or a or a new field of technology, M&As can provide a way to catch up rapidly. Enhanced competition and shorter product life cycled accentuate the necessity for firms to respond quickly to opportunities in the economic environment, preferably before competitors move.

Quest for Strategic Assets

The second main motivation for firms to merge with or acquire an existing company, rather than to grow organically, is the quest for strategic assets, such as R&D or technical know-how, patents, brand names, the possession of local permits and licenses, and supplier or distribution networks. Ready made access to proprietary assets can be important because, by definition, they are not available elsewhere in the market and they take time to develop.

Search for New Markets

The search for new markets and market power is a constant concern for firms. Through M&As, firms can quickly access new market opportunities and develop critical mass without adding additional capacity to an industry. By taking over an existing company, immediate access to a local network of suppliers, clients and skills can be obtained. This motivation is of particular importance for cross-border M&As a the need for knowledge about local conditions increases when leaving the home market. Beyond this, and especially in markets characterized by oligopoly, M&As can also be motivated by the pursuit for market power and market dominance.

Anticipated Efficiency Gains

Anticipated efficiency gains through synergies are probably the mot cited justification for M&As. Synergies can be static (cost reduction or revenue enhancement at a given point in time) or dynamic (e.g.

innovation-enhancing) in character. Examples of the former kind of synergies include the pooling of management resources (one head office instead of two), revenue enhancement by using each other' marketing and distribution networks, purchasing synergies (greater bargaining power), economies of scale in production leading to cost reductions, and the avoidance of duplication of production, R&D or other activities. Dynamic synergies may involve the matching of complementary resources and skills to enhance a firm's innovatory capabilities with long-term positive effects on sales, market shares and profits. The search for static synergies may be particularly important in industries characterized by increased competitive pressure, falling prices and excess capacity, such as in the automotive and defense industries. Meanwhile, dynamic synergies may be crucial in industries experiencing fast technological change and that are innovation driven, such as in information technology and pharmaceuticals. The efficiency-through-synergy motive is present for both domestic and cross-border M&As.

Greater Size

In a globalizing economy, greater size, can be a crucial parameter, particularly in operations requiring economies of scale, large expenditures for R&D and the expansion of distribution networks for example. Size in itself can also make it more difficult to be taken over and, therefore, can have a protective' function. Large size can furthermore create financial, managerial and operational synergies that reduce the operational vulnerability of firms. Sheer size normally means lower-cost access to ingestible funds as there are economies of scale in capital raising. Information asymmetries between corporate insiders and investors can make internal financing more favorable. Another advantage of size is that larger firms with multiple operations across geographical locations and segments can have an advantage in the collection and adoption of new information and innovation. The size motive can apply to both domestic and cross-border M&As.

Risk reduction

A fifth driver behind M&As is the desire for risk reduction (operational risks, foreign exchange risks, etc.,) through product or geographical market diversification.

Financial Gains

The Sixth motive behind M&As is financial Motive. Stock prices do not always reflect the true value of a firm. A potential acquirer can, for example, value a company's anticipated earnings stream higher than current shareholders do. Bad management of a firm, imperfections in the capital market and major exchange rate realignments may provide short-term capital gains to be made by acquiring an undervalued firm, or affect the timing of planned M&As. Such motivations are particularly important in the case of portfolio-type M&As and in economies with poorly developed capital markets or in financial crisis. In addition, some M&As are undertaken partly for tax considerations, e.g., to exploit unused tax shields.

Personal Gains

The personal gains (or behavioral) explanation argues that corporate managers pursue their own self-interest, especially where corporate governance is weak (a manifestation of what economists have denoted the principal-agent proble). They may seek expansion or empire building to enhance executives' power, prestige, job security or remuneration, even when this is not technologically efficient or in the interest of shareholders.

Technology and M&A

The rapid pace of technological change has intensified competitive pressures on the world's technology leaders. Consequently, the costs and risks of innovation have risen in most industries, as has the need to incorporate continuously new technologies and management practices. Firms thus need more efforts to maintain innovative leads, to find new areas of technological leadership, and to keep up with new knowledge and shorter product life cycles. In an environment characterized by rapid technological change and rising expenditure for risky R&D projects, many firms feel compelled to enter into cross-border M&As as a way of sharing the costs of innovation and accessing new technological assets to enhance their innovatory capabilities. M&As allow firms to do this quickly. Such asset seeking FDI by TNCs from developed (and increasingly from developing) countries is a rising form of FDI. It is likely to become more common as intangible, knowledge-based assets and access to a pool of skilled people and work teams become more important in the world economy.

Regulatory Environment Policies on Fdi and Cross-Border M&As

The liberalization of FDI regimes has continued apace, typically on a unilateral basis. Most countries are now trying to attract direct investment, not just by removing restrictions, but also through active promotion and by providing high standards of treatment, legal protection and guarantees. Of the 1,035 FDI regulatory changes between 1991 and 1999in over 100 countries in all regions, 974 went in the direction of facilitating FDI inflows. Examples of such changes relevant to M&As include the removal of compulsory joint venture requirements, restrictions on majority ownership and authorization requirements. The international regulatory framework has also been strengthened, especially through the conclusion of bilateral investment protection and double taxation treaties. Multilateral agreements support these trends. For instance, WTO agreements limit the use of certain investment-related measures that affect trade, like local content requirements on TNCs, and certain types of export requirements. World Bank and IMF programmes encourage countries to adopt more open, transparent and welcoming régimes towards foreign investors.

Changes in the Regulatory Environment

Trade liberalization gathered pace in the 1990s with the conclusion of the Uruguay Round. The cumulative effect has been a radical change in the signals and competitive setting for international investors. Firms now face more intense competition at home as well as abroad.

The formation of regional free trade areas has facilitated both Greenfield investment and cross-border M&As in several ways. Regional trade agreements enlarge the size of the immediately accessible market for firms, and so attract foreign investors to serve them by setting up new facilities. They can enhance market transparency and, if they link national currencies, lower the costs of cross-border transactions. If they incorporate investment agreements, they make M&As more feasible.

In parallel with trade liberalization and regional integration processes, there has bee widespread privatization and deregulation of activities, most notably in such service industries as telecommunications, transportation, power generation and financial services. These changes have provided another stimulus to M&As in general and cross-border ones in particular. Privatization programmes in many developing countries for sale. In fact, the combination of privatization and deregulation has created a number of new TNCs.

Changes in Capital Markets

Cross-border M&As have been facilitated by changing world capital markets. The liberalization of capital movements, new information technology providing instant information across the globe, more active market intermediaries, and new financial instruments have had a profound impact on M&A activity worldwide. Whereas the liberalization of capital markets since the mid-1980s had already greatly facilitated the growth of cross-border M&As, most developed countries now have completely liberalized their capital accounts, with virtually unrestricted facilities for cross-border loans and credits, foreign currency deposits and portfolio investment. Most recently, financial transactions have also been substantially liberalized in many developing countries.

The liberalization of foreign equity ownership has facilitated M&As based on stock swaps rather than cash deals. Major M&As have also been facilitated by the rise of stock markets and ample liquidity in capital markets, which has allowed firms by the introduction of the single European currency, which has created a liquid market in European corporate bonds. Companies are increasingly issuing Euro-denominated bonds to refinance debt and to raise money for takeovers. For example, the rise of the Euro-denominated corporate bond market and the underlying Euro-syndicated loan market greatly facilitated Olivetti's acquisition of Telecom Italia.

The Tows Matrix: A Modern Tool for Analysis of the Situation

Today, strategy designers are aided by a number of matrices that show the relationships of critical variables, such as Boston Consulting Group's business portfolio matrix, which will be discussed later. For many years, the SWOT analysis has been used to identify a company's strengths. Weaknesses, opportunities, and threats. However, this kind of analysis is static and seldom leads to the development of distinct alternative strategies based on it. Therefore, the TOWS Matrix has been introduced for analyzing the competitive situation of the company or even of a nation that leads to the development of four distinct sets of strategic alternatives".

The TOWS Matrix has a wider scope and a different emphasis from the business portfolio matrix. The former does not replace the latter. The TOWS Matrix is a conceptual framework for a systematic analysis that facilitates matching of the external threats and opportunities with the internal weakness and strengths of the organization.

It is common to suggest that companies should identify their strengths and weaknesses, as well as the opportunities and threats in the external environment, but what is often overlooked is that combining these factors may require distinct strategic choices. To systematize these choices, the TOWS Matrix has been proposed, where ***T*** stands for threats, ***O*** for opportunities, ***W*** for weaknesses, and ***S*** for strengths. The TOWS model starts with the threats (T in TOWS) because in many situations a company undertake strategic planning as a result of perceived crisis, problem, or threat.

Application of the TOWS Merger Matrix for Mergers, Acquisitions, Joint Ventures, and Alliances.

Companies around the world now use the TOWS Matrix; the matrix has also been included in several modern textbooks on strategic management. Recently, the TOWS Matrix concept has been introduced for planning mergers, acquisitions, joint ventures, and alliances. Whenever two partners consider joint activities. It is prudent to analyze the strengths and weaknesses for each partner as well as their opportunities and threats. Moreover, their alternative strategies before their association should be considered: these two TOWS Matrices provide a better understanding of the prospective partners before the actual linkage. For example, complementary strengths and weaknesses could result in a competitive advantage for both companies. On the other hand, reception and overlap may result in duplication of efforts. After the two matrices are evaluated, a third matrix should be developed for the partnership. This is especially important for acquisitions and mergers because of the relative permanency of the resulting entity. Preparing the three TOWS Matrices can also allow potential problems to be identified in more loosely coupled partnerships such as a strategic alliance.

Case - Global Car Industry

Daimler + Chrysler=New Car Company

In the late 1980s and the early 1990s, the Japanese made great strides in the auto industry through efficient production methods and high-quality products. However, a new trend was set by the German car maker that changed the car industry with the Daimler-Chrysler merger, in which the former has 53 percent ownership and the latter the rest. The new car company is now the fifth largest in the world and could become the volume producer in the whole product range.

The respective strengths are that Daimler is known for its luxury cars and its innovation in small cars (A-Class, Smart car). Chrysler, on the other hand, has an average profit per vehicle that is the highest among the Big 3 (GM, Ford, and Chrysler) in Detroit, thanks to high margins derived from the sale of minivans and jeeps. It is also known for its highly skilled management and efficient production. Low costs and simplicity (e.g. the Neon model) are other hallmarks of Chrysler.

Mercedes-Benz (a part of Daimler Corporation) was known for its excellence in engineering and product quality, the company's brand image was luxury cars. The high development costs and the need for gaining economies of scale called for finding a partner that would enable it to other a complete product line from high-priced to low-priced vehicles.

They can now offer a full product line in all segments in their respective home markets. There is little product overlap with the exception of the Jeep Cherokee competing directly with the Mercedes M-Class SUV, which is produced in Alabama. Moreover, the partners can now utilize the innovation in both their particular areas of expertise. Their facilities in various countries can be used for the production and assembly of both low-and premium-priced cars. In all, the merged Daimler Chrysler Corporation may achieve synergy and cost savings.

Notes

Despite the potential advantages of the merger, challengers remain. The company has little experience in penetrating the worldwide market of lower priced products. There is also the potential for conflicts in the integration of the operational and management systems of the merged companies. External threats remain and may get worse. Car markets in the European union and NAFTA are becoming saturated, and economic deterioration in developed and emerging economies reduce and stagnate the growth in those countries. In addition, competition (especially in the luxury segments) becomes fiercer.

The challenge for Daimler's ECO, Jurgen Schrempp, is to integrate the two companies and achieve the efficiencies that were one of the important aims of the merger. In addition, integrating the organization cultures of the two companies will be a major challenge.

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Lesson 5.2 - Internationalisation of Business Firms and their Operations Abroad

Learning Objectives

After reading this lesson you should be able to

- Understand the importance of interdependent
- Describe the motivation to export
- Discuss the modes of International Business

Introduction

The world today is more closely knit than ever before by Globalization. Organizations, production process, communication and technologies are subjected to a rapid change. Patterns of international trade, capital and completion have been changing dramatically in recent decades, with serious conservancies for business strategy. Increasing number of firms are going international, and a growing percentage of their overall sales is from overseas markets.

There are new opportunities and pressures to utilize them. The opening of global markets creates new geographical space for TNCs to extend and access tangible and intangible resources. Global market produces a wider choice of methods, that firms can use in trade, FDI, licensing, subcontracting, franchising, partnering and so on to operate in different locations. At the same time, advances in information, communication and transportation technologies, as well as managerial and organizational methods, facilitate the transnationalisation of many firms, including small and medium enterprises. The combination of better accesses to resources and a better ability of organize production. Transnational increases the pressure on the organization to utilize new opportunities best their competitions do so first and gain a competitive advantage.

Today, more large and small firms, from more countries, virtually all industries are investing abroad, be in through the expansion of existing facilities, Greenfield projects, merger and acquisition, the acquisition of assets in the framework of privatization programmes or through various form of non-equity relationships. Infact, the fragmentation of production processes across national borders is an important new trend, particularly for developing economics. This slicing up the value chain involves separate stages of production being conducted in different countries. Declaring communication cost and improved transportation systems permit just in time delivery and the co-ordination of production across borders.

Developing economics can expedite their integration into the new production systems by liberalizing and improving their tele-communications and transportation sectors. Global trade rules have fostered global production networks, and an associated rise in intrafirm trade, by progressively lowering trade barriers and reducing the likelihood of unpredictable increase. Foreign capital has played a catalytic role in pushing policies in the right direction and contributing a number of resources to the development effort.

Globalization is praised for the new opportunities it brings, such as access to markets and technologies transfer-opportunities that holdout the promise of increased productivity and higher living standards.

Economic Interdependence of Nations

International trade has increased economic interdependence of nations. Modern Industries are dependent upon a variety of raw materials all of which cannot be conveniently and economically produced in any one country. If the flow of imported raw materials is disturbed in any way, production in industries that dependent on them will be seriously dislocated. At present, goods are not exported merely because there is a surplus for exports. Often goods are produced specially to satisfy export demands. Sometimes exports are encouraged to obtain essential imports. During the period of acute dollar shortage, the U.K. exported Scotch whisky to the U.S.A. not because there was a surplus but to obtain dollars. Even now, a substantial portion of the production of Scotch whisky is earmarked for export. Once the production pattern of a country has been adjusted to producing surplus for exports, any dislocation in its export markets will create serious problem for it and its people by seriously reducing their purchasing power. And if the prosperity of the particular industry is affected, other industries would not remain unaffected. Not only that, international trade also transmits economic disturbances from one country to other countries.

The extent of dependence upon international trade differs from country to country. Among the leading nations, the U.K. is highly dependent upon foreign trade. She needs to import not only half of her supplies of food but also nearly all the raw materials needed by her industry. Therefore, she must export a major portion of her manufactures in order to pay for her heavy imports. Her need to export increased after World War II due to the liquidation of most of her foreign investments and a consequential reduction in her invisible income. Belgium exports 45 per cent of her gross national product and about 65 per cent of all her industrial output. Similar is the case with South Korea and most West European countries.

The U.S.A, Russia, and China are among the countries least dependent upon foreign trade. But even they depend upon imports for a variety of foodstuffs and raw materials which they do not produce in adequate quantities. In the case of the U.S.A. even though total U.S. imports constitute only a small percentage of U.S. aggregate national consumption, there are many important commodities in respect of which the U.S.A is a large importer, i.e., natural rubber, tin, coffee, asbestos, chromites, tungsten, raw silk, carpet wool. Jute, tea nickel, cocoa, manganese and spices. Similarly, in the case of exports, even though merchandise exports constituted only 8 per cent of her gross national product. In 1980's, a substantial percentage of the production of a number of industrial and agricultural products were exported.

Importance of International Trade

No country has within its own boundaries resources for economical production of all its requirements. Through international trade, it is possible for a country to obtain goods it cannot produce or cannot produce as cheaply as other countries. Hence, a country's well-being is determined to a great extent by the nature of its foreign trade. This was recognized as early as in 1628 when Thomas Mun wrote his book on England's Treasure by foreign Trade. New products are being developed almost every year and the existing ones are being improved upon and produced in greater numbers. As a result, standards of living throughout the world are improving.

Every citizen is interested in foreign trade whether he is interested as a consumer, producer, investor or taxpayer. The importance of foreign trade to consumers lies in the fact that they can purchase from the cheapest source. India depends upon foreign countries partially for capital equipment and maintenance. US consumers depend upon imports for the supply of coffee and sugar while the U.K. consumers obtain the major portion of their foodstuffs and the entire supply of tea from foreign countries.

Foreign trade leads to an increase in overall employment. For example, 4 out of 5 new manufacturing jobs crated during 1978-82 in the U.S.A. were in export – related industries. Development of exports and imports gives a fillip to auxiliary services such as transport, shipping, banking, and insurance which further increases employment.

Countries rely on foreign trade not only to obtain domestically non-available goods but also for the disposal of their produces, in some cases the degree of dependence being substantial. For example, the Indian producers of jute manufactures and tea are mainly dependent upon export markets. Japanese industry is mainly dependent upon exports for its prosperity. Similarly, in the U.S.A. though the overall dependence is not so great, yet more than 25 per cent of the U.S. production of a number of agricultural and industrial products is exported. In many cases, the existence of an export market enables the producers to increase their production and thus avail themselves of the economics of large-scale production.

If industries prosper, investors too get good returns. If foreign trade and investment are free, there is a good possibility of investing in other countries too if the return in the domestic market is not satisfactory. That explains why investments are flowing to countries like Hong Kong and Singapore where there are good prospects of higher return.

As tax payers, we are interested in foreign trade as the cost of imported goods is higher than what it would be in the absence of import duties. Importance of customs duties can be realized by the fact that they contributed 35.5 per cent of the total tax revenue in India in 2002-03. Again, in some cases exports are subsidized at the cost of tax payers. For example, India subsidized exports to the extent of ₹ 1,300 crores in 1990-91.

Motivation to Export

There are some basic economic reasons, which might influence a company decision regarding export business. These are:

a. Bulk Sales. You have the advantage of selling in bulk. Export orders are larger than those from the domestic market.

b. Relative Profitability. The rate of profit to be earned from export business may be higher than the corresponding rate on the domestic sales. Further, experience shows that there has been a progressive improvement in the unit value realization of certain export products.

c. Insufficiency of domestic Demand. The level of domestic demand, either at a point of time or over time, may be insufficient for utilizing the installed capacity in full. Export business offers a suitable mechanism for utilizing the unused capacity. This will reduce costs and improve the overall profitability of the firm. Recession in the domestic market often serves as a stimulus to export ventures. In fact, export of engineering goods from India picked up momentum at the time of recession in the Indian economy during 1967-69, when Indian manufacturing units faced with large inventories and weak order book position, turned to export markets. Developing diversified export markets thus provides a firm with a degree of protection against cyclical domestic economic slowdown. But it must be emphasized that there is an inherent danger in looking at exports to merely supplement the domestic business at the time of crisis. Penetrating foreign markets is a difficult job but sustaining them is even more onerous. Therefore, once a decision is taken to enter international markets, every effort will have to be made to retain them. And this can be done only when export marketing operations are recognized as an integral part of the total corporate activity. In fact, what is needed is full involvement in a commitment to exports.

d. Reducing Business Risks. A diversified export business may help in mitigating sharp fluctuations in the overall activity of a company. When a firm is selling in a number of markets, the downward fluctuation in sales in one market, which may be the domestic market, may be fully or party counterbalanced by a rise in the sale in other markets. Secondly, geographic diversification also provides the momentum to growth inasmuch as a single or a few markets will have only limited absorptive capacity.

e. Legal Restrictions. Governments may impose certain restrictions on further growth and capacity expansion of some firms within the domestic market in order to achieve certain social objectives. But there may not be any such restrictions on making investments overseas or the restrictions may be relaxed even in the domestic market, provided the additional capacity envisaged by the company is utilized for exports. In such situations, a firm may contemplate export operations, because it offers a way to achieve corporate growth, which may otherwise not be possible. This was the position in India before industrial licensing was virtually removed.

f. Obtaining imported Inputs, Nations have to export to pay for imports of materials, technology or processes not available within their national boundaries. Governments, therefore, may be compelled to impose export obligations of the firms, specially those in need of imported inputs

g. Social Responsibility. In many cases, businessmen themselves feel a sense of responsibility and contribute towards the national exchequer by increasing their exports. Incidentally, by exporting at a time when it is difficult to export they build up their image in the domestic market. They also look at exporting to attain status and prestige.

h. Increased Productivity. Increased productivity is necessary for ultimate survival of a firm. This itself may lead a company to increase production and then seek export markets. Moreover, in these days of technological developments, bigger companies have to spend a lot in research and development. To meet the increased costs of research and development, larger markets become a necessary and exports become unavoidable.

i. Technological Improvement. Entry into export markets may enable a firm to (i) pick up new product ideas and to add to product line, (ii) improve its product, (iii) reduce costs, and (iv) discover new applications for its General Meeting. "Export expose us to the fiercely competitive international market and compels us to update our products. This up gradation of our vehicles unmistakably benefits the Indian customer also."

j. A product can be near the end of its life cycle in the domestic market while beginning to generate growth abroad.

Reasons for Firms Become Multinational Enterprises

Companies become MNEs for a number of reasons. One is to diversify themselves against the risks and uncertainness of the domestic cycle. By setting up operations in another country, multinationals can often diminish the negative effects of economic swings in the home country. This is a form of international diversification and it has been widely used by Japanse MNEs, for example, which have found that, while their home economy has been in an economic slump since the 1990s, their US operations have done quite well.

A second reason is to tap the growing world market for foods and services. This is part of the process of growth in an integrated world market, sometimes called 'globalization' (i.e. the rapid growth of similar goods and services produced and distributed by MNEs on a worldwide scale). For example, many MNEs have targeted the US because of its large population and high per capita income. It is the world's single largest market in terms of gross domestic product. And since Americans have both a desire for new goods and services and the money to buy them, the US can be an ideal market. MNEs are also targeting China. While per capita gross domestic product is not very high, the country's large population and growing economy make it very attractive to multinationals. In 2001, china entered the World Trade Organization and this acceptance of international rules made china more attractive for MNEs.

Firms also become MNEs in response to increased foreign competition and a desire to increase product their home market share. Using a 'follow the competitor' strategy, a growing number of MNEs now set up operations in the home countries of their major competitors. This approach serves a dual purpose: (1) it takes away business from their competitors by offering customers other choices, and (2) it lets competitors know that, if they attack the MNEs home market, they will face a similar response. This strategy of staking out global market shares is particularly important when MNEs want to communicate the conditions under which they will retaliate.

A fourth reason why companies become an MNE is to reduce costs. By setting up operations close to the foreign customer, these firms can eliminate transportation expense, avoid the overhead associated with having the middlemen to handle the product, respond more accurately and rapidly to customer needs, and take advantage of local resources. This process, known as 'internalization' of control within the MNE, can help to reduce overall costs.

A fifth reason is to overcome protective devices such as tariff and non-tariff barriers by serving a foreign market from within. The EU provided such an excellent example. Firms outside the EU are subject to tariffs on goods exported to EU countries. Firms producing the goods within the EU, however, can transport them to any other country in the block without paying tariffs. The same is now occurring in North America, thanks to the North America Free Trade Agreement (NAFTA), which has eliminated tariffs between Canada, the US, and Mexico.

A sixth reason for becoming an MNE is to take advantage of technological expertise by manufacturing goods directly (by FDI) rather than allowing others to do it under a license. Although the benefits of a licensing agreement are obvious, in recent years some MNEs have concluded that it is unwise to give another firm access to proprietary information such as patents, trademarks, or technological expertise, and they have allowed current licensing agreements to lapse. This has allowed them to reclaim their exclusive rights and then to manufacture and directly sell the products in overseas markets.

Modes of Internationalization

A firm can choose among several modes of operation to extract economic rent from its comparative advantages in the use of resources associated with a foreign project. In reality, there are many forms of business associated with less commitment of capital, less operating control, and less risk than DFI that nonetheless allow a firm to capture economic rent.

International Trade, License/Franchise Agreements, Joint Ventures, and Wholly-Owned DFI.

The hierarchy of modes typically examined in international business, from the least amount of risk to the greatest, is:

1. an export or import operation based at home.
2. a license or franchise agreement with a foreign firm or individual.
3. a joint venture with a foreign firm
4. a wholly-owned direct foreign investment.

The international trade operation-an export or import business-represents the least risky mode because it requires no capital investment abroad, although it would generally require capital investment at home. Such an operation is designed to exploit the firm's comparative advantage in the use of resources either on the input side through imports or on the output side through exports. The main disadvantage of an international trade operation is that it typically involves higher transportation costs, international tariffs, and other expensive barriers associated with crossing an international border.

License and franchise agreements represent low-risk alternatives because they generally require no capital investment either abroad or at home. Licensing is an arrangement in which a firm with a comparative advantage in the use of resources (the licensor) grants legal permission to another firm or individual (the licensee) to use specified components of its production or marketing process, typically for a limited amount of managerial skills, and the like. The licensee then typically produces and markets a product in the foreign country similar to one of the licensor producer and markets at home.

Franchising is an arrangement in which a firm with a comparative advantage in the use of resources (the franchisor) grants a package of support services to another firm or individual (the franchisee) to undertake production and /or marketing in a specified location. Franchisee contracts generally cover more aspects of the foreign operation and have a longer duration than licensing contracts. The package might include product input supplies, production equipment, ongoing management assistance, advertising and promotional materials, strategic planning, and so on. Franchising may also involve some financing, particularly in the early stages of developing the foreign business.

With both licensing and franchising agreements, the licensee/ franchisee typically compensates the licensor/franchisor with royalties and fees. This income is the main incentive for the firm to enter into a licensing or franchising agreement, and is particularly attractive as there is no capital commitment. However, the firm must recognize that licensing or franchising is a substitute for import/export operations and FDI the main reason for a corporation to enter into a license or franchise agreement with a foreign country as the licensee/franchisee may be more familiar with the local business environment or may have better access to local distribution channels.

In addition, the licensee or franchisee may be able to avoid some costs associated with distance that import/export operations or FDI would incur. The transportation and tariff costs associated with import/export operations are obviously avoided. Similarly, costs of international travel and international communication (phones, faxes), which MNCs would incur to manage and monitor the foreign project, are reduced. With licensing and franchising, however, there are some costs that would not be associated with import/export operations or FDI. These include the costs of monitoring the licensee or franchisee to ensure quality, and the opportunity cost of sharing the economic rents to preserve performance incentive for the licensee or franchisee. There is an additional risk inherent in sharing corporate secrets with an outside party, the outside party could become a full-fledged competitor.

In comparison to international trade and licensing/franchising operations, an international joint venture with one or more foreign firms represents a riskier form of international business for most MNCs because it typically requires the commitment of capital abroad and substantial responsibility for running the foreign project. In comparison to wholly-owned FDI, though, an international joint venture is usually not as risky because it requires less commitment of capital abroad and somewhat less responsibility for running the foreign project. The capital committed by the firm going abroad to enter into a joint venture is nevertheless considered FDI because the firm maintains operating control over its share of the investment.

Typically, the perception of the advantage of a joint venture is that the firm does not have to contribute the entire amount of capital required for a foreign project. In addition, the firm may be able to exploit its own comparative advantages in the use of resources without sustaining a comparative disadvantage from undertaking a foreign project if it selects partner corporations with knowledge of the foreign environment, or some other advantage that the home country firm does not have. However, the benefits of a joint venture may be partially reduced if extra costs result from having to negotiate with, circumstances, the benefits of a joint venture may be more than completely offset if the marriage does not work out, if the partner turns out to be incompetent or corrupt, or if the partner turns into a full-fledged competitor. Hence, not all joint ventures create value.

The riskiest form of international business is typically the wholly-owned direct foreign investment, such as a foreign subsidiary. In this operation, the parent company maintains 100 percent operating control, takes responsibility for all of the financing, and accordingly takes on all the risk involved in the foreign project.

The four modes of international business-ranging from import/export operations through licensing/franchise agreements and joint ventures to wholly-owned DFI-can be through of as competing ways to extract economic rents. In this sense, they are mutually exclusive projects. That is, a firm can typically undertake a foreign project through only one of the four modes, and selection of one mode precludes the others. If a company makes a license or franchise agreement with a foreign firm, for example, import/export operations, joint ventures with other firms, and a wholly-owned subsidiary in that location are usually not possible. Hence, in selecting the mode of internationally business, the firm with the competitive advantage in the use of resources should determine which mode produces the highest present value.

The Internationalization Process

Not all international business is done by MNEs. Indeed, setting up a wholly-owned subsidiary is usually the last stage of doing business abroad; in the internationalization process the firm regards foreign markets as risky due to the fact that, as these markets are unknown to it, the firm faces export marketing costs. To avoid such information costs and risk, its strategy is to go abroad at a slow and cautions pace, often using the services of specialists in international trade outside the firm. Over time, familiarity with the foreign environment will reduces the information costs and help to alleviate the perceived risk of foreign involvement.

Initially the firm may seek to avoid the risks of foreign involvement by arranging a licensing deal. A license agreement is a contractual arrangement in which one firm, the licensor, provides access to some of its patents, trademarks, or technology to another firm, the licensee, in exchange for a fee or royalty. This fee often involves a fixed amount upon signing the contract and then a royalty of 2-5 per cent on sales generated by the agreement. A typical licensing contract will run from five to seven years and be renewable at the option of either or both parties. This strategy is most suitable for a standardized product where there is no risk of dissipation of the firm's technological or managerial advantages. Otherwise, licensing will be reserved for a much later stage of entry. Indeed, when it is important for the firm to retain control over its firm specific advantage in technology (as in internalization theory), licensing will come as the last mode of entry. The firms involved in the process of internationalization, on the other hand, typically are not concerned about losing their firm specific advantages. Rather, they want to avoid exposure to an uncertain foreign environment. Abstracting from the licensing option (and the more complex problem of joint ventures), the major types of foreign entry for a firm are as follows:

1. The firm sees potential extra sales by exporting and uses a local agent or distributor to enter a particular market. Often the firm uses exporting as a "vent" for its surplus if it does well abroad, then it may set up its own local sales representative or marketing subsidiary, in the hope of securing a more stable stream of export sales.

2. As exports come to represent a large share of sales, the firm may increase its capacity to serve the export market. It will set an office

for its sales representative in a major market, or set up a sales subsidiary. This stage marks an important departure for the firm from simply viewing exports as a marginal contributor to sales volume or as a vent for surplus in times of excess capacity.

3. After the firm has become more familiar with the local market, some of the uncertainty associated with foreign production side. Initially it may start to use host country workers to engage in local assembly and packaging of its product lines. This is a crucial step, since the firm is now involved in the host-country factor market and must deal with such environmental variables as wage rates, cultural attitudes, and worker expectations in its new labor force.

4. The final stage of foreign involvement comes when the firm has generated sufficient knowledge about the host country to overcome its perceptions of risk. Because it is more familiar with the host-country environment, it may now consider a foreign direct investment activity. In this it produces the entire product line in the nation and sells its output there, or it may even be able to re-export back to the home country. These decisions depend on the relative country specific costs; for example, if labor is inexpensive in the host nation (as in southeast Asia), more exporting takes place than if it is expensive (as in Western Europe and the US).

It has become clear that the internationalization process is more complicated than it seems at first glance. Like all generalizations, this schematic path of export commitment relies in simplification. In reality, the process of foreign entry is sufficiently complicated to depend on a careful weighing of many firm specific and country specific factors.

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Lesson 5.3 - Foreign Investment

Learning Objectives

After reading this lesson you should be able to:

- Explain the role of Foreign investment
- Discuss the components of Foreign investment and its recent Trends
- List out the motivation which attract FI

Introduction

Foreign investment has long been a subject of interest. This interest has been renewed in recent years due to number of reasons. One of them is the rapid growth in global foreign investment flows in the 1990s. Another reason is the possibility offered by foreign investment for channeling resources to developing countries. Although the component of foreign portfolio investment and direct foreign investment in the total capital inflows into developing countries has not been significant, its relative Importance may increase now since many countries have very limited access to other sources of financing.

To integrate the Indian economy with global economy, the reforms introduced under the new economic policies reflect India's determination to facilitate the introduction of foreign capital, management methods, industrial technology and economic information, and its commitment to the modernization of its economy in the context of open international economic relations, in order to overcome poverty build a fair society, and achieve true self-sufficiency. These reforms include short-term measures which were taken to bring the crisis situation of June 1991 under control, as well as longer term structural reforms aimed at improving efficiency and accelerating economic growth. The longer term reforms include abolition of industrial licensing for most industries, relaxation of regulations relating to foreign direct investment and technical collaboration, measures to improve the efficiency of public sector enterprises, reduction of non-tariff restrictions on imports and steps to achieve convertibility of the rupee in the near future. These reforms greatly increase the role of the market and the private sector, as well as open up the economy to greater external and internal competition. The government has also introduced measures to restore fiscal discipline and restructure the tax system to improve incentives.

A piecemeal approach will not do. Macro-economic stability, structural adjustment, appropriate price and investment policies are crucial to create "an enabling environment" for private sector activities. Foreign investment is a valuable non-debt creating external resource to supplement inadequate savings and has a major role in transferring technology, improving managerial skills, and facilitating market development. We must promote foreign investment-not just permit it.

Role of Foreign Investment

Foreign investment has to be considered as an instrument of international economic policy aimed at economic development and globalization of Indian companies. Approaching foreign investment in this way, the distinction between relevant and irrelevant effects can be solved by looking at the aim of economic development. For an appraisal of foreign investment, two important dimensions are to be examined:

(a) Role of multinationals in foreign investment, of those few who are already here, and several others who may want to come in;

(b) Foreign investment and our export effort-and capability to export, relative to need, in the context of our balance of payments prospects and external debt servicing.

What contribution can foreign investment make to Indian exports? Considering foreign investment as an instrument of international economic policy aimed at economic development, its effects can be measured by analyzing the contribution made to aims of economic development, such as growth of GNP, employment, a greater income equality, an improvement in the balance of payments, etc., as laid down in national as well as international development strategies.

In South Asia, only India can claim to have a deeply ingrained democratic ethos. India offers foreign investors a large and diversified market, an industrial base and infrastructure which have been in place for a considerable time, abundant scientific and engineering talent, a relatively low cost and well trained labour force, and a democratic political environment that has remained remarkably resilient in spite of the many religious and ethnic conflicts which have from time to time erupted in the subcontinent. India's long-overdue move to join the global economy presents plenty of opportunities. The size of the middle class ranges from 150 million to 300 million based on different estimates and is the fastest growing segment.

Investors in Emerging Markets and their Motivation

The nature of the transactions involving portfolio investments in emerging markets (a large proportion of which are private placements and over-the-counter offerings) makes it difficult to obtain detailed information on the composition of investors and the magnitudes involved in emerging markets. Investment banks maintain proprietary information on such transactions involving their clients but are not required to disclose this information on a transaction involving their clients but are not required to disclose this information on a transaction-by-transaction basis to public reporting agencies like the OECD, the IMF, and the World Bank.

Broadly speaking, there are five groups of investors in the emerging markets, each having a tolerance for different degrees of risks and returns:

1. Domestic residents of developing countries with overseas holding and other private foreign investors, who constitute the dominant category of portfolio investors who are currently active in the major emerging markets. These investors keep abreast of development in their country on a regular basis and monitor change in government policy. Their investments in emerging markets are motivated by expected short-term high yields. Preference is given to instruments that are in bearer form and provide returns in hard currency. These external fund as "Hot Money" which are kept uin the "Latin American Bank" which may or may not be beneficial to the long-term growth prospects of developing country depending on the manner in which they are invested.

2. Managed funds (closed-end country funds and mutual funds), whose portfolio managed buy and sell shares and high-yield bonds in one or more of the emerging markets for performance-based trading purposes.
3. Foreign banks and brokerage firms, who allocate their portfolio for inventory and trading purposes.
4. Retail clients of Eurobonds houses who are involved in emerging securities markets due to portfolio diversification motives. They are generally interested in high-yield, high-risk portfolio investments in the emerging markets.
5. Institutional investors (such as pension funds, life insurance companies), who have a longer time horizon for expected gains from their portfolio and look for stability and long-term growth prospects in the market in which they invest.
6. Non resident nationals of developing countries, who could be a potential source of portfolio investment from abroad (as opposed to flight capital).
7. Introduction of economic reforms in most of the LDC is an important reasons which FIIs to investment in this market.
8. Removal of those barriers which hither to affected the free flow of investment across the border.
9. Attractive rate of interest and repatriation of dividend to the home country.
10. Attractive incentive and tax concessions.

The above mentioned reasons are considered as motivation for the FIIs to investment in large volumes in LDCs.

Foreign Investment in India: Recent Trends

After a sharp set back in 1998-99, foreign investment inflows, made a smart recovery in 1999-2000 and the position was broadly-maintained in 2000-01. Total foreign investments, comprising direct and portfolio, which averages about US $5.39 billion during the four years ended 1997-98, fell sharply to US $2.40 billion in 1998-99, as a fall out of the Asian

Crisis. In 1999-2000, they recovered to US $5.18 billion and the recovery was maintained in 2000-02, with the total inflow of US $5.10 billion. During the first eight months of 2001-02, total foreign investment inflows have risen by about 47 per cent to US $3.68 billion from US $2.51 billion in the corresponding period in 2000-01, due, mainly, to about 61 per cent increase in foreign direct investments (FDI). The trends in foreign investment flows in 2000-01 and 2001-02 augur well when seen against the background of private capital flows (net) to emerging market economies being only marginal in 2000 and negative in 2001.

a) Foreign Direct Investment

Foreign direct investment is an investment made by the MNCs, TNCs in the form of direct currency loan, Technology Transfer and joint Venture in the ongoing projects abroad. FDI is seen as a means to supplement domestic investment for achieving a higher level of economic growth and development. FDI benefits domestic industry as well as the Indian consumers by providing opportunities for technological up-gradation, access to global managerial skills and practices, optimal utilization of human and natural resources, making Indian industry internationally competitive, opening up export markets, providing backward and forward linkages and access to international quality goods and services. Towards this end, the FDI policy has been constantly reviewed, and necessary steps have been taken to make India a most favorable destination for FDI.

The source and direction of FDI remained, by and large, unchanged during the 1990's. Companies registered in Mauritius and the US were the principal source of FDI into India during 2000-01, followed by Japan and Germany. The bulk o FDI was channeled into computer hardware and software, engineering industries, services, electronics and electrical equipment, chemical and allied products and food and dairy products. Foreign direct investment (FDI) flows, after reaching a peak of US $3.56 billion in 1997-98, receded gradually to US $2.16 billion in 1999-2000. FDI inflows rose only marginally to US $2.34 billion in 2000-01. FDI inflows during the current financial year (2001-02) so far have been encouraging. During April-November, 2001, they show an increase of 61 per cent to US $2.37 billion from US $1.47 billion during April- November, 2000.

b) Portfolio Investment

Portfolio capital has emerged as the key channel for integrating capital markets worldwide. For developing countries, the growth process in the initial phase is often characterized by self financed capital investment, which is replaced gradually by bank-intermediated debt finance and supplemented over time by both and equity from the capital market. Portfolio capital flows can ease the constraint on growth imposed by illiquid and small sized capital markets in the early and intermediate stages of the growth process. Countries that reduces berried to portfolio flows exhibit significant improvements in the functioning of their stock markets. Greater liquidity in the capital market makes it possible to take up investment projects in developing countries that require lumpy and long-term capital. Equity, unlike debt, allows a permanent access to capital.

Fresh inflows for portfolio investment by foreign institutional investors (FIIs) during 2000-01 were US $1.85 billion, slightly lower than the inflows of US $2.14 billion in the previous year. During the first eight months of 2001-02, such inflows amounted to US $799 million, an increase of US $532 million over the inflows during the corresponding period in 2000-01. The policy in regard to portfolio investments by FIIs is reviewed constantly and major initiatives are taken, when necessary. In the Budget for 2001-02, it was proposed to raise the limit for portfolio investment by FIIs from the normal level of 24 per cent of the paid up capital of the company to 49 per cent, subject to the approval of the General Body of the shareholders by a special resolution. More recently, Indian companies have been permitted to raise the aggregate ceiling for portfolio investment by FIIs through secondary market from the normal level of 24 per cent up to the applicable sect oral cap levels of the issued and paid up capital of the company, subject to compliance with the special procure, viz., (a) approval by the Board of Directors of the Company to the enhanced limit beyond 24 per cent, and (b) a Special Resolution passed by the General Body of the Company approving the enhanced limit beyond 24 per cent.

c) Non-Resident Indian Deposits

Fresh accruals to non-Resident deposits, including accrued interest, rose by over50 per cent to US $ 2.32 billion in 2000-01, on top of an increase of over 60 per cent in 1999-2000 (Table). During the first eight months of the current financial year, 2001-02, accruals to NRI deposit were about US $ 1.98 billion, higher than the US $ 1.52 billion in the same period last year. The outstanding balances under non-resident deposit Indians in the strength of the economy. Outstanding balances under all the non-resident deposit schemes amounted to US $ 24.65 billion at the end of November 2001, up from US $ 23.07 billion at end-March 2001 and US $ 21.68 billion at end-March 2000.

d) External Commercial Borrowings

The External Commercial Borrowings policy continues to provide flexibility in borrowings by Indian corporatism and public sector undertakings (PSUs), while at the same time, marinating safe limits for total external borrowings, consistent with prudent debt management. The guiding principles for ECB policy are to keep maturities long, costs low, and encourage infrastructure and export sector financing, which are crucial for overall growth of the economy.

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Lesson 5.4 - Foreign Institutional Investors

Learning Objectives

After reading this lesson you should be able to:

- Understand FII
- Discuss the policy and legal framework of FIIs
- Analyze the FIIs perception on Indian Markets

Introduction

The liberalization of India economy has enables the foreign institutional Investors (FIIs) to play an import role in the Indian capital market. In their view, India is an attractive place in terms of return for their investments. The returns available in India are considerable when compared to other countries. Institutional investors includes financial Institutions, foreign Institutional Investors, Mutual funds and Banks. Foreign Institutional Investors have been permitted to invest in India securities market since September 1992 when the government of India issued the guidelines for foreign institutional Investments (FII). In November 1995, the SEBI (Foreign Institutional Investors) Regulations, 1995 have been notified, which are largely based on the earlier guidelines of Government of India. The Regulations require foreign Institutional Investors to register with SEBI and to obtain approval from the Reserve Bank of India under the foreign Exchange Regulation Act, 1973 to enable them to buy and sell securities, to open foreign currency and rupee bank accounts and to remit and repatriate funds.

Policy Framework of Fii

Investments in Indian securities is also possible through the purchase of global Depository Receipts, foreign Currency convertible bonds and Foreign currency bonds issued by Indian issuers which are listed, traded and settled overseas and are mainly denominated in Us Dollars.

Foreign investors, whether registered as foreign Institutional Investors route. Such investments require case by case approval from the Foreign Investment Promotion Board in the Ministry of Industry in the central government and the Reserve Bank of India, or only by the Reserve Bank of India depending on the size of the investments and the industry in which this investment is to be made. Foreign financial service institutions have also been allowed to set up joint ventures in stock broking, management companies, merchant banking and other financial services firm along with Indian partners. The foreign participation in financial services requires the approval of Foreign Investment Promotion Board (FIPB).

Foreign Institutional Investor mean an institution established or incorporated outside India which proposes to make investments in India in securities, endowments, foundations, charitable trust societies with a track record would also be eligible for investment of FIIs.

Prior to the introduction of financial sector reforms introduced by the Government of India, investment by foreign nationals, foreign corporate bodies and institutions were regulated by the fiscal policy in force from time to time. The flow of foreign investment was very much restricted and at one time, the foreign collaborators were forced to reduce their holding below 51 per cent of the paid up capital of the company.

Realizing the need for rapid industrialization and sophisticated technology and in concurrence with the world? Bank's advice, Indian economy have opened or a comparatively free flow of foreign investments.

The Government of India was narrowly saved from a foreign currency reserve crisis in 1991, finally determined to open up her capital market to foreign investors, In September 1992, the government of India through the SEBI, introduced the concept of Foreign Institutional Investor (FII), which essential permits reputed Foreign Institutional Investor to invest in Indian primary and secondary market FII are permitted to invest in.

- Securities in primary and Secondary market, Shares, debentures, warrants of companies listed or unlisted on a recognized stock exchanges (including Over the Counter Exchange of India).

- Specific schemes floated by domestic mutual funds for institutional investors and such other securities as may be approved by the SEBI from time to time.
- Unlisted securities were added to the scope of investments in which FIIs are allowed to invest in October 1996. In category of FII was introduced for debt investment in November 1996.
- SEBI is authorized to grant qualified foreign institutional investors the FII status.

The scheme allows FII applicants to obtain such RBI permission for all proposed activities at one time, under a single window approach, since an approval from SEBI includes such RBI permissions. This scheme of foreigner's portfolio investment has significantly simplified the formalities that overseas investors have to go through in order to built up their portfolio investment in India. Such investments in Indian securities also requires foreigners to obtain various permissions firm the Reserve Bank of India (RBI) for foreign exchange control purpose.

Areas of Investments

Foreign Institutional Investor may invest through two routes:

1. Equity Investment route: 100% investments could be in equity related instruments or up to 30% could be invested in debt instruments i.e. 70 (Equity Instruments): 30 (Debt instruments).
2. 100% Debt route: 100% investment has to be made in debt securities only in case of Equity route the Foreign Institutional Investor can invest in the following instruments:
   - Securities in the primary and secondary market including shares which are unlisted, listed or to be listed on a recognized stock exchange in India.
   - Units of schemes floated by the Unit Trust of India and other domestic mutual funds, whether listed or not.
   - Warrants.

In case of Debt Route the Foreign Institutional Investors can invest in the following instruments:

- Debentures (Non convertible Debentures, Partly Convertible Debentures etc.,)
- Bonds
- Dated Government securities
- Treasury Bills
- Other Debt Market Instruments

The 100% Route

Foreign Institutional Investors can make 100% investments in debt securities subject to specific approval from SEBI as a separate category of Foreign Institutional Investor or sub-account. Foreign Institutional Investors investment in debt through the 100% debt route is subject to an overall cap under the category of external commercial borrowings. SEBI allocates individual ceilings to Foreign Institutional Investors or sub-accounts within this overall limits on the basis of their track record or experience in debt markets. Foreign institutional Investors investing through the 100% debt route may either invest proprietary funds or on behalf of broad based funds. Foreign corporate and foreign individuals shall not be eligible to invest through the 100% debt route. Foreign institutional investors may invest in the following securities through the 100% debt route.

- Debentures of companies which are listed or to be listed.
- Dated Government securities.
- Treasury Bills

There is no limit on investment in the debt securities of any particular issuer.

Foreign Investment Flows in Developing Countries

While FDI has been traditionally been concentrated in developed markets, new interest has been sparked by the so-called 'emerging' capital markets. The emerging markets has at least three attractive qualities two of which are their high average returns and their low correlations with developed markets. Diversification into these markets are expected to give higher expected returns and lower overall volatility.

Many individual investors, as well as portfolio and pension fund managers, are reexamining their basic investment strategies. In 1990s, fund managers realized that significant performance gains could be obtained by diversifying into high-quality global equity markets. These gains are limited, however, by the high cross-correlations returns in these markets. The resulting investment strategy reflects current information. In terms of portfolio theory, adding low-correlation portfolios to an optimization enhances the reward-to-risk profile by shifting the mean-variance frontier to the left.

The portfolio optimization problem requires important inputs-the expected returns and the variance-covariance matrix. In principal, all of these measures should be forward-looking. That is, the returns, volatilities and correlations should be forecasted.

An upsurge in portfolio investment in developing countries has marked the end of the debt crisis, or perhaps even helped to end it. Using the World Bank's definition of portfolio flows as consisting of bonds, equity (comprising direct stock market purchases, American Depository Receipts (ADRs), and country funds), and money market instruments (such as certificates of deposits(CDs) and commercial paper.

With the increased integration of the world through communication networks, advancement in information technologies with automation of trading across countries, and the availability of up-to-date information of different stock markets in the world, investors are moving toward global allocation of their investment portfolios. Innovations in the regulatory and supervisory structures in the securities and exchange practices in some developed countries have made it less costly for firms to make public offerings of shares in developed countries' stock markets, for example, in the United States "Regulation S" of the SEC was recently revised such that offerings and sales of securities outside the united States will not be subject to SEC registration requirements. Similarly, the introduction in the United States of SEC Rule 144A has facilitated the easy entry of entities in developing countries to the U.S. private placement markets by reduced SEC disclosure and registration requirements. According to Rule 144A, securities issued in the U.S. private placements markets can be purchased by U.S. qualified institutional investors. The passing of Rule 144A and Regulation S has facilitated the use of ADRs, Global Depository

Receipts (GDRs), "Side-by-Side" Facilities and other equity-related vehicles that can be adopted by U.S. and non firms to raise capital in the U.S. stock markets, it also broaden the investor base abroad. Although many developing countries have, albeit with some restrictions, allowed foreign investors to trade directly in the ESMs, some of these countries, such as India and Korea, are only recently beginning to permit direct portfolio investment in their stock markets in an attempt to raise capital from abroad (including the repatriation of flight capital).

Fii Impact in the Indian Markets

A new force of support and discipline, ever since 1993 when FIIs were welcomed into Indian capital market, FIIs have indeed come a long way. They have become an integral part of the Indian markets. Indian corporate got benefited by increased institutionalization of the market. They have been ruthless and uncaring towards the companies that did not care for the interests of investors, and have voted with their feet. At the same time they have lent support to companies that have steadfastly focused on shareholders' wealth and corporate governance. Analyst chronicles the role they have played in shaping the Indian markets.

The gross purchase and sales made by the FIIs are ₹ 16,115 crores and ₹ 17,699 crores, respectively during 1998-99 and 1999-2000. the gross turnover on BSE and NSE for the same period is ₹ 3.11 lakh crores and ₹ 4.14 lakh crores. Thus as a proportion of total turnover on the exchanges, the FII figures do not appear to be substantial. However, since the FII trades are delivery based, the actual impact on the market is much higher.

The clout of institutional investors is immense. They posses funds running into more than $20 trillion. Even a tiny fraction of this would mean lot of money to the emerging markets.

FIIs cannot afford to ignore the Indian market Lot of thorny issues have been addressed over the years. The post reform Indian corporate sectors story has won the hearts of FIIs. It has restricted and adopted itself to globalize order. It isn't just the fact that the Indian companies' performance is better today, which is attracting the Foreign Institutional Investments. The restructuring is expected to lend efficiency gains that promise a better tomorrow for these companies and hence for the investors.

Some xenophobic (fear of foreigners) overtones are heard in the wake of raising of FII investment limit recently. Apprehensions of dilution in Indian promoted' stake have arisen. Since, in a majority of Indian companies the owners' are less than thirty per cent, FIIs as a class have put the promoters on their toes.

Shareholder activism spearheaded by the institutional investors in the U.S. has delivered a great deal of corporate governance than any amount of regulation could achieve Indian markets have already begun experiencing the gains of institutionalization of the market. This trend bodes well for Corporate India and investor community at large.

Regulatory Frame Work of Fiis in India

The foreign‘s portfolio investment has significantly simplified the formalities that overseas investors have to go through in order to built up their portfolio investment in India.

1. Reserve Bank of India, by its general permission, allows a registered FII to buy, sell and realize capital gains on investments made through initial corpus remitted to India. Subscribe renounce rights offerings of shares, invest on all recognized stock exchange through a designated bank branch.
2. The FIIs has to apply a certificate of registration or renewal with the SEBI, showing its track record, professional competence, financial soundness, experience, general reputation of fairness and integrity.
3. SEBI will grant or renew certification of registration to FII subject to fulfillment of SEBIs regulations 1995.
4. SEBI, if satisfied that the application made by the FII is complete in all respects, the particulars required by SEBI have been furnished and the FII is found to be eligible for grant of such a certificate, it shall grant it within three months after submission of all information called for, grant a certificate in form B.

5. A FII may make an application to SEBI in form A for renewal of the certificate three months before the expiry of the period of certificate. SEBI will deal with such application in the manner as in the case of an application for grant of certificate.

6. Every application for grant of certificate of registration as FII shall pay a registration certificate fee US $ 10000. This fee shall be paid at the time of initial registration and for each renewal of certificate.

Procedure for Making Investments

Nature of Securities

An FII may invest only in the following securities:

1. Securities in the primary and secondary market including shares, debentures and warrants of companies unlisted, listed or to be listed on a recognized Stock Exchange in India.
2. Units of schemes floated by domestic mutual funds including Unit Trust of India, whether, listed on a recognized stock exchange or not.
3. Dated Government Securities.
4. Derivate traded on a recognized stock exchange.
5. Investment in debt securities.

Procedures

1. Any FII or sub account already registered with SEBI or to be registered would continue to be governed by the ceiling of 30 percent on debt instrument.
2. In addition, any registered FII willing to make 100 percent investment in debt securities will be permitted to do so subject to specific approval from SEBI as a separate category of FII or sub account as 100 percent debt fund. In such cases, the registration of 30 percent SEBI will not be applicable.
3. FII investment through the 100 percent debt route will be subjects to an overall debt capital of US $1.0-1.5 billion for investment by all FIIs mentioned in (ii) above.

4. SEBI will impose individual ceiling on individual fund or sub account. This ceiling will be based on the track record of the FII and its objective criteria. Individual debt funds would be informed of the respective ceiling at the time of the registration.

5. Investment by FIIs in debt securities through the 100 percent route would be permitted only in debt securities of companies, which are listed, or to be listed.

6. Investment by FIIs in debt securities through the100 percent route would be without any restriction on maturity of the debt securities invested in.

7. Investment by FII in debt securities through the 100 percent route would be without any limit on investment in the debt securities of any particular issuer.

Conditions for Investment in Secondary Market

In respect of investment in the secondary market, the FIIs shall comply with the following:

- The FII shall not engage in short selling securities.
- The FII shall transact of securities bought and sold provided this shall not apply in respect of transactions in derivates traded on a recognized stock exchange.
- Compulsory delivery and or short selling in respect of FII transaction is also applicable during the no delivery period of a security.
- No transactions of the stock exchange shall be carried forward.
- The transaction of business in securities shall be only through stockbrokers who have been granted a certificate of registration by SEBI pursuant to section 12 (1) of the SEBI Act, 1992.
- However, in case of an offer by a company to buy-back its securities, the FII may sell the securities held by it to such company in accordance with the Securities and Exchange Board of India (Buy back of securities) Regulations, 1998.

Self-Assessment Questions

1. Explain the different types of International M&A.
2. Discuss the reasons why firms go for International M&A.
3. Explain the role of Technology in Cross-border M&A.
4. Explain the significance of Cross-border M&A in the context of Indian Economy.
5. What do you mean by economic interdependence? Explain the reasons for it.
6. Discuss the reasons why firms opt for internationalizing there business or international business.
7. Discuss the importance of International Trade.
8. Explain the processes of Internationalization.
9. What is Foreign investments? Explain the various components of Foreign Investment.
10. Explain the Role of Foreign Investment in building the economy of a country.
11. Discuss the recent trends of foreign Investments in India.
12. Describe the recent Trends in FI.
13. Explain the areas of investment by FIIs in India
14. Explain the impact of FIIs role in the Indian Market.
15. Discuss the procedure for making investment.
16. Elucidate brief the condition for marketing investment in Secondary Markets.

CASE STUDY

If you don't want the Chinese to get you, get them. Even as the scare of low-cost, high quality Chinese imports flooding in has sent one section of India. Inc; Scurrying for Cover and Protectionism, organized players in the home appliance industry are taking advantage of it. Instead of lobbying to keep out the Chinese, companies like Bajaj Electrical and Japan Industries are switching over to Chinese manufacturers to source products for Indian Market, and they're not alone.

Chinese products are expected to have a significant impact on the consumer electronics segment like televisions and refrigerators in the next few years. Industry experts say that majors such as LG and Samsung would exit the television and other consumer durable business in the long run and focus on digital products, making way for the Chinese makes. It's just sign of things to come. Consumer electronics experts predict that unless the Indian Policies change, Indian players will increasingly switch over to marketing Chinese Products in India.

Bajay Electricals is bringing in a range of products – Fans and toasters- into India at Cheaper prices and providing the brand support and after- sales service here. Home appliances like toaster, iron, fans and microwave ovens are being brought in from China at rates which are cheaper by as much as 35 to 50 percent vis-à-vis other Indian makes.

Mr.Shekar Bajaj, chairman and Managing Director of Bajaj Electricals says that the products imported from China are not only proving to be qualitatively better, but also 15-20 percent cheaper than those manufactured within the Country.

Mr.J.N.Agarwal, Managing Director of Japan Industries, a leading player in no-stick utensils, toasters, roti-makers and mixer grinders told ET that Japan is also planning to tie up with one of the Chinese manufacturers next year. "Chinese products are proving to be so competitive that it makes sense for us to tie up with them and market these products under our brand name in India", he said.

These companies are moving over from local manufacturers to sourcing from China mainly because of better quality products at cheaper prices, thanks to their strong manufacturing bases and backward integration. It's just a sign of things to come. Industry circles say that a number of big distributors are planning to bring in Chinese products, which could well play complete havoc with the Indian Market.

Questions

(a) How do you define strategy "If you fail to compete with your close competitor, marry it"? Comment in the context of competition between Indian and China.

(b) Explain the limitations of Indian manufacturers in competing with the Chinese manufacturers.

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