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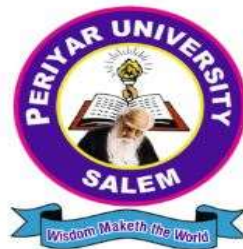
**SALEM - 636 011, Tamil Nadu, India.**

**CENTRE FOR DISTANCE AND ONLINE EDUCATION**

**(CDOE)**

**MASTER OF COMMERCE**

**SEMESTER - III**



**CORE PAPER – X: INTERNATIONAL  
BUSINESS**

**(Candidates admitted from 2024 onwards)**

**PERIYAR UNIVERSITY**

**CENTRE FOR DISTANCE AND ONLINE EDUCATION (CDOE)**

**M.Com 2023 -2024 onwards**

**Core Paper – X:**

**International Business**

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# **SYLLABUS**

## **INTERNATIONAL BUSINESS**

### **UNIT I**

International Business -Meaning, Nature, Scope and Importance- Stages of internationalization of Business-Methods of entry into foreign markets: Licensing- Franchising- Joint Ventures-Strategic Alliances- Subsidiaries and Acquisitions -Framework for analyzing international business environment- Domestic, Foreign and Global Environment-Recent Developments in International Business.

### **UNIT II**

Theoretical Foundations of International Business: Theory of Mercantilism- Theory of Absolute and Comparative Cost Advantage- Haberler's Theory of Opportunity Cost- Heckscher- Ohlin Theory Market Imperfections Approach-Product Life Cycle Approach - Transaction Cost Approach-Dunning's Eclectic Theory of International Production.

### **UNIT III**

Legal framework of International Business: Nature and complexities: Code and common laws and their implications to Business-International Business contract- Legal provisions, Payment terms.

## **UNIT IV**

Multi-Lateral Agreements and Institutions: Economic Integration – Forms: Free Trade Area, Customs Union, Common Market and Economic Union- Regional Blocks: Developed and Developing Countries-NAFTA- EU- SAARC, ASEAN-BRICS- OPEC-Promotional role played by IMF-World Bank and its affiliates- IFC, MIGA and ICSID – ADB-Regulatory role played by WTO and UNCTAD

## **UNIT V**

Multinational Companies (MNCs) and Host Countries: MNCs – Nature and characteristics. Decision Making-Intra Firm Trade and Transfer Pricing – Technology Transfer- Employment and labour relations- Management Practices- Host Country Government Policies-International Business and Developing countries: Motives of MNC operations in Developing Countries (Discuss case studies)-Challenges posed by MNCs.

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## INTERNATIONAL BUSINESS

### UNIT – I Introduction to International Business

International Business -Meaning, Nature, Scope and Importance- Stages of internationalization of Business-Methods of entry into foreign markets: Licensing- Franchising- Joint Ventures-Strategic Alliances- Subsidiaries and Acquisitions -Framework for analyzing international business environment- Domestic, Foreign and Global Environment-Recent Developments in International Business.

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## UNIT OBJECTIVES

The primary goals are to understand the fundamental concepts, meaning, and importance of international business, identify the stages of business internationalization, learn various methods of entering foreign markets, analyze the international business environment, and stay informed about recent trends and developments impacting global business strategies.

### Section 1.1.1 Introduction to International Business

International Business refers to the exchange of goods and services between different parties of two or more countries. IB may be understood as those business transactions involving the crossing of national boundaries.

Global business strategy is the systematic approach that directs an organization's resources and goals towards capitalizing on international opportunities and mitigating potential threats.



### 1.1.2 Meaning and Definition of International Business

International business means carrying on business activities past national boundaries. International business is the conduct of business activities with people outside of one's own country.

These activities commonly include the transaction of economic resources such as capital, goods, services (comprising technology, skilled labour, transportation, etc.), and international production.

Production may either involve the production of physical goods or the provision of services like banking, finance, insurance, construction, trading, and so on. Thus, global business comprises not only international trading of goods and services but also foreign investment, mainly foreign direct investment.

### **Definition of International Business**

According to Robock and Simmonds, "International business is defined as a field of management training (that) deals with the special features of business activities that cross national boundaries".

As per Czinkotra Grosse and Kujawa, "International business is defined as transactions devised and carried out across international borders to satisfy corporations and individuals".

International business comprises all commercial transactions private and governmental between two or more nations. Private companies undertake such transactions for profits, and governments may or may not do the same in their transactions. These transactions include investments, sales and transportation.

At one end IB is defined as, the organisation that buys and/or sells goods and services across two or more national boundaries, even if management is located in a single country. On the other end, multinational business is defined as it is equated only with those big enterprises that have operating units outside their own country.

In the middle, there are institutional arrangements that deliver some managerial direction of economic activity taking place abroad but stop short of controlling ownership of the business taking on the activity, e.g., The joint venture with locally owned businesses or with foreign governments.

### **1.1.3 Scope of International Business**

The scope and importance of international business is a very broad and varied area. There are some key areas of scope of international business which have been explained below:

**International trade** -International business involves the trade of goods and services between two countries. This also includes the exchange of intellectual property along with different purchase agreements.



**International negotiations** -International business between two countries helps the related parties for improving better relations among them as well as resolving disputes between them through these negotiations.

**Cross-cultural management** -A multicultural environment is created through this international business, where they have to manage various people from different cultures who come together under this international business. This also helps in improving better communication between the two parties.

**Global Marketing** -A specific company can target its customers not only in the domestic market but also in the markets of different countries while considering and adjusting their needs according to their culture.

**Foreign direct investment** -Through international business, the company of other countries are starting their investment in different countries whether from greenfield investment or by purchasing or acquiring a company which already exists in the foreign market and has a very good consumer base.

**Growth opportunities** -The countries that are related to international trade have their own benefit also in the way of creating more job opportunities in their own country and also strengthening their own economy.

**Exchange of foreign currency** -While the import and export of goods and services happen, the countries exchange their currency for the consideration of the goods and services, improving a country's foreign exchange reserve.

### 1.1.4. Importance of International Business

The scope and Importance of International business are crucial for the growth of the economy in generating employment, earning foreign currency and many more ways. The importance of international business can be understood through the following points:

**Economic growth** -By promoting more trade, investment and entrepreneurial activity among the countries plays an important role in the growth of the economy. Through international business job opportunities are generated which increases the income of the individuals.

**More innovation and technology** -Another importance of international business is that In today's globalisation era, everything is conducted through technological support which is also required for companies to improve and speed up their activity.

**Political cooperation** -Economic interdependence between two countries leads a better negotiation, communication or resolving disputes between two countries which leads to cooperation in various policies like trade policy, environmental policies etc.

**Cultural exchange** -International business between two different countries promotes the exchange and also understanding of people with different cultures who interact, learn from one another and respect each other's culture.

**Employment opportunity** -More employment opportunities are created through international business which helps in improving the standard of living of people of one country along with the other countries involved.

**Proper utilisation of resources** - Resources are properly used when the rest of the extra goods are exported to the other country while already meeting the needs of the consumers as per their needs.

### 1.1.5 Nature of International Business

Here are some key features of the nature of international business that are explained below:

**Complexity** -Due to the political risk, cultural differences and the different rules and regulations of the different countries the complexity increases in international business.

**Risk and uncertainty** -Currency fluctuation, different political policies and cultural differences involve various risks and uncertainties. The company must develop and acquire a way to cope with all these risks and uncertainty.

**Geographic spread** -The scope and importance of International business across the borders of the countries and deals with other countries with their different culture and economic environment along with the different needs of the target consumers of that country.

**More potential than the domestic market** -When the company moves from one country to another to serve the needs of the target consumers of that country then there are more growth opportunities for the company than staying within the boundaries of the domestic market.

**Importance of relationships** -The success of international business heavily depends on good relationships with the suppliers, the target customers and the partners of business in different countries to be successful in the global market.

### 1.1.6 Significance of International Business

International business plays a significant role in the global economy. The significance of international business can be understood from the following points:

**Cultural exchange** -When international business takes place the people involved in those trade get the chance to better understand the cultures of the other

people involved from the other countries and also the company makes its products to sell in the international market while keeping in mind the needs of the consumers in accordance with their culture.

**Competitive advantage** -Through international business the resources of one country, its markets and its knowledge and expertise in a particular area can be accessed by the other country. This helps in increasing the efficiency and differentiates them from the other companies.

**Corporate social responsibility** -Another significance of international business is that the companies involved in international business are required to follow the legal standards, respect the local culture and contribute towards the sustainable development of the company. As the company operates in society so it must consider its impacts on society and must work towards maintaining the balance.

**Market expansion**-International business has access to the new consumer base by diversifying the needs of the consumers according to their culture. But here the company can improve its revenue by diversifying the target consumers in other countries.

**Improving the standard of living**- Through international business new job opportunities are created which improves the income of the individuals and ultimately improves the standard of living of people in that country.

### 1.1.7 Role of International Business in Economic Development

International business plays a very vital role in the development of the economy. Some of the key points are explained below:

**Creation of employment** -Nature of International business helps in creating employment in the countries involved which increases the income of the individuals by providing them with employment opportunities.

**Proper utilisation of resources** -The importance of international business is to the proper utilisation of resources is done which helps in meeting the needs of the

customers in the domestic market along with meeting the needs of the target customers in a different country.

**More improvement in technology** -Nowadays more and more use of technology improves the way of dealing with international trade with other countries in a better way. Technology and innovation are the things which are making things easier in international business.

**Better economic policy** -To make international business easier many countries are forming better economic and political policies for the ease of trade of goods and services between two countries.

**Good relations** -International business forms good relations among the countries through better communication and negotiations in case of disputes, which are easily resolved by the two parties.

### **Examples of International Business**

Suppose an Indian company is selling its products in different countries in the world. For that, the company needs to export the goods to the other country but also in many cases, the company may also establish a manufacturing unit in any other country which needs local employment, local distribution channel and many others. In the international market, the company has to follow the rules and regulations and other specific environmental policies of a specific country to succeed in the international market.

International business helps in creating job opportunities, maintaining good relations between different countries as well as improving the living standards of people for improving the quality of life of people everywhere. Along with its growth factors, there are certain reasons why an international business might not be that beneficial like improving competition for the domestic company, the foreign company might exploit the resources of the country while may also increase child labour. After all international business has more benefits than that harms. But to reduce the harmful factors, proper and suitable policies are needed to be formulated so that the balance will be maintained.

## 1.1.8 Features of International Business

### Large-Scale Operations

In an International business environment, all the business operations such as production and marketing activities are conducted on a very large scale. Companies first sell their goods in the local market and then the surplus goods are exported.

### Integration of Economies

The global business integrates the economies of numerous countries by leveraging labour from one nation, financial resources from another, and infrastructure from yet another. It designs the product in one country, produces its parts in different countries, assembles it in another country and sells it worldwide.

### Dominated by developed countries and MNCs

Multinational business is dominated by developed countries and their multinational companies. Europe and Japan dominate foreign trade, this is because they have high financial and other resources.

### Benefits to Participating Countries

Global business benefits all the participating countries. However, the developed countries get the maximum benefits compared to the developing countries. They get foreign capital and technology. Developed countries get rapid industrial development. They get more employment opportunities.

### Keen Competition

Global Business has to face competition in the international business environment. The competition is between unequal partners. In this situation, the developed countries are in a favourable position as they produce superior quality goods and services, but developing countries find it difficult to face competition.

### The special role of science and technology

The pivotal role of science and technology holds immense significance in the international business environment. It helps the business to have large-scale production. Developed countries use high technology. It helps them to transfer top-end technology to developing countries.

### **International Restrictions**

Multinational companies face many restrictions on the inflow and outflow of capital, technology, and goods. Many governments do not allow international business to enter their countries.

They have many trade blocks, foreign exchange restrictions, tariff barriers, etc. All these factors pose significant challenges to international business which have detrimental effects on the international business.

### **Sensitive Nature**

Multinational business by its very nature is very sensitive. Any changes in technology, economic policies, and the political environment of business have a huge impact.

Therefore, it must conduct marketing to find and analyse these changes. They must adjust their business activities and adapt accordingly to survive changes in the business landscape.

## **1.1.9. Characteristics of International Business**

Characteristics of International Business are as follows:-

1. It involves two or more countries.
2. Use of diverse currencies.
3. It helps in global market expansion.
4. It involves Legal and Regulatory Compliance.
5. Companies involved in global business may have financial risks.
6. It includes cultural diversity.
7. It requires accurate information to make informed decisions.
8. Multinational business requires accurate and timely information.
9. It segments its markets based on the geographic market segment.

The term international business was not popular for two decades. It has emerged from the term 'international marketing', which in turn appeared from the phrase "International Trading".

### **International Trade to International Marketing**

Initially, producers exported their products to nearby nations and gradually expanded exports to foreign countries. Gradually, the companies extended their operations beyond trade.

For example, India used to export raw jute, raw cotton, and iron ore during the early 1900s. The massive industrialisation in the country enabled India to export steel, jute products and cotton garments during the 1960s.

India, during the 1980s, could create markets for its products, in addition to mere exporting through export marketing efforts to generate demand for Indian products like textiles, electronics, leather products, tea, coffee, etc. This process is true not only with India but also with nearly all developed and developing nations of the world.

### **International Marketing to International Business**

The multinational companies that were producing the products in their home countries and marketing them in different foreign countries before the 1980s started locating their plants and other manufacturing facilities in foreign/host countries. Later, they started producing in one foreign country and marketing in another country.

For example, Unilever established its subsidiary company in India, namely Hindustan Lever Limited (HLL). HLL produces its products in India and markets them in Sri Lanka, Bangladesh, Nepal, etc. Thus, the scope of international trade has been expanded into international marketing and international marketing has been expanded into a multinational business.

### **Developments and issues in international business**

International Business is increasingly recognized as a necessary engine for economic development. Developments in international business are driving the increasing pace of transactional systems development efforts.

Many multinational corporations are suffering from organisational paralysis caused by the need to continue the operation of systems which are most often broken down into many different “warring factions” strung around the world from one location to another.

Probably developments and issues most discussed concerning international business include major mergers and acquisitions from and into India. The huge strategic alliances are the most interesting issue of the global trade scenario. Whereas, outsourcing is considered the trend and issue for international business.

### Let's Sum Up

International business involves the exchange of goods, services, and investments across national borders, driven by market expansion, resource utilization, risk diversification, economic growth, and competitive advantage. It operates in a complex environment characterized by global operations, cross-cultural interactions, and diverse scopes including trade, investment, supply chains, and finance.

### Check Your Progress – Quiz – 1

1. Which of the following is a characteristic of international business?
  - A. Limited to domestic operations
  - B. Involves transactions only within a single country
  - C. Deals with cross-cultural interactions
  - D. Restricted by national laws
2. What does FDI stand for in the context of international business?
  - A. Foreign Direct Investment
  - B. Foreign Domestic Investment
  - C. Fiscal Duty Investment
  - D. Foreign Developmental Investment
3. Which factor is NOT a part of the scope of international business?
  - A. Global supply chains
  - B. Domestic market expansion
  - C. Export and import trade
  - D. International finance

4. Why is international business important?
  - A. It limits market expansion opportunities
  - B. It hinders resource utilization
  - C. It diversifies business risks
  - D. It restricts economic growth
5. Which term refers to the exchange of goods and services across national borders?
  - A. Domestic business
  - B. National trade
  - C. International business
  - D. Intra-regional business

## Section 1.2 Navigating Stages of Internationalization of Business

### 1.2.1 Stages of internationalisation of business

The journey of a company's expansion into international markets can be delineated through five distinct stages of internationalization. This progression encapsulates the evolution from a domestically focused entity to a globally integrated enterprise, each stage marked by a significant shift in strategy, operations, and market focus.

#### STAGES OF INTERNATIONALIZATION

Enter your sub headline here



## **Domestic Company¶**

At the inception, a Domestic Company confines its operations, vision, and strategic planning within the national boundaries. Such companies are primarily concentrated on leveraging domestic market opportunities, catering to local customer needs, and navigating through the national environmental constraints. The overarching belief driving their strategy is encapsulated in the adage, "If it is not happening in the home country, it is not happening." Examples of domestic companies include giants like Reliance Industries Limited and Tata Motors Limited, which initially focused on mastering the home market before considering any global footprint.

## **International Company¶**

Transitioning from a domestic outlook, an International Company ventures beyond its national borders, extending its operational wings to foreign countries. This stage is characterized by the strategic decision to tap into overseas markets by establishing branches or subsidiaries, thus stepping into the realm of international business. The move is driven by the desire to explore opportunities outside the domestic sphere, marking the company's initial foray into the global market.

## **Multi-National Company¶**

The evolution continues as international companies transform into Multi-National Companies (MNCs). This transition is signified by a shift towards addressing the specific needs of different country markets with tailored product offerings, pricing strategies, and promotional activities. MNCs, or Multi-Domestic companies as they are sometimes called, adopt a localized approach, formulating distinct strategies for diverse markets to resonate with the local customer base. This stage emphasizes the importance of understanding and integrating into the cultural and consumer fabric of each market they enter.

## **Global Company¶**

A further evolution is seen in the emergence of the Global Company, which adopts a comprehensive global strategy. Whether by producing in a single country and marketing products globally or by leveraging global production for domestic

marketing, global companies strive for efficiency and market penetration on a worldwide scale. The strategy here pivots towards exploiting global synergies, emphasizing the integration of global operations to achieve a seamless flow of goods and services across borders.

## **Transnational Company**

The pinnacle of internationalization is represented by the Transnational Company, which epitomizes the zenith of global integration. These companies are distinguished by their ability to produce, market, invest, and operate across the world, linking global resources with global markets to optimize profits. Despite the complexity, transnational companies like Coca-Cola, Apple, McDonald's, and Nike manage to maintain centralized control while operating extensively across international borders. They aim to combine global efficiency with local responsiveness, navigating the delicate balance between global standardization and local adaptation.

### **1.2.2 Modes of Entry into International Business**

The various modes of entry into international business have been stated. Importance of Economic System in business Environment can be understood here.

#### **Direct Exporting**

The explanation of direct exporting as a mode of entry into international business has been stated below.

Direct exporting means the firm sells its products directly to overseas clients without using a mediator.

The firm maintains full control over its products' distribution, pricing, and marketing.

Direct exporting initially allows the firm to enter global markets with low aid commitment.

No large upfront investments are needed reached to other modes like setting up a foreign subsidiary.

The firm is not needed to have local staff, exhibit facilities, or service centers in the foreign market.

However, the firm has to handle logistics, documentation, customs clearance, and payments, which can be challenging.

The firm has to find reliable foreign clients and ensure timely delivery of orders.

Direct exporting limits a firm's ability to provide after-sales service to foreign clients.

Cultural and language differences can create communication barriers with foreign clients.

Direct exporting is best suited for firms with well-established products and brand reputations seeking initial global exposure.

**i) Direct Importing/ Exporting:** The company handles all of the necessary paperwork for the shipment and financing of goods and services and deals directly with foreign suppliers or purchasers.

**ii) Indirect Importing/ Exporting:** The company uses a middleman to handle all the paperwork and negotiate with foreign suppliers or customers. The firm's involvement is limited.

## Licensing

Licensing means a firm grants rights to a foreign entity to use its intellectual property, i.e., brand name, technology, patent, design, etc., in return for license fees or royalties.

- The licensor, i.e., the firm, retains ownership of its property and earns income from license fees and royalties.
- The licensee, i.e., a foreign entity, gains the right to use the property to produce and sell products or services in the licensed territory.
- Licensing is a lower-risk mode of entry since the licensor does not incur high upfront costs or handle overseas operations.
- The licensor can quickly expand into international markets without making large aid commitments.

However, the licensor has limited control over how the licensee uses its property and operates in the foreign market.

- Licensing fees and royalties heavily depend on the licensee's performance, which may be out of the licensor's control.
- Licensing works best for firms with well-established brands, technologies, or products but lacks aids for direct foreign expansion.
- Licensing suits firms seeking regular income flows from their intellectual property assets.
- **For instance**, Pepsi and Fanta are made and distributed globally by local bottlers in other nations under the licensing system.

## Franchising

Franchising means a firm (franchisor) licenses its firm model, brand name, operating systems, and processes to independent entities (franchisees) for a fee and ongoing royalty payments.

- Franchisees are allowed to use the franchisor's brand name and trade systems to operate their firms under certain terms and conditions.
- Franchising allows the franchisor to expand globally with low upfront investment and minimal risk.
- The franchisee bears most of the investment and operational costs for running the franchised firm locally.
- The franchisor earns income from franchise fees, royalties, and supply contracts with franchisees.
- Franchising helps the franchisor leverage the local knowledge, relationships, and aids of franchisees for foreign market expansion.
- However, the franchisor has limited control over how franchisees operate and maintain brand standards in foreign markets.
- Franchising works best for firms with proven firm models, well-recognized brands, and standardized processes.
- Franchising is suited for firms seeking fast global growth while reducing risks via independent franchisees.

## Contract Manufacturing

Contract manufacturing means a firm outsources part or its entire exhibit

process to foreign contractors while retaining control over marketing, sales, and branding.

- The firm (original brand manufacturer) focuses on product design, R&D, marketing, and distribution while moving manufacturing to contract manufacturers.
- Contract manufacturing allows the firm to quickly scale up exhibit capacity without large capital investments in plants and equipment.
- The contract manufacturer bears most of the costs and risks associated with an exhibit in return for fees paid by the firm.
- Firms utilize lower costs of exhibit and skilled labor available in foreign countries via contract manufacturing.
- However, the firm has limited control over the exhibit process that contract manufacturers handle.
- The firm is dependent on contract manufacturers for timely delivery, quality control, and fulfilment of orders.
- Contract manufacturing works best for firms focused on product development, branding, and distribution rather than exhibit expertise.
- Contract manufacturing is suitable for firms seeking to optimize costs and focus on their core competencies like Maybelline, Loreal, Levis, and others use contract manufacturing to have their products or component parts produced in developing nations. Contract manufacturing is also known as international outsourcing.

## Joint Venture

A joint venture involves two or more firms coming jointly to form a new firm entity in which all parties have equity stakes.

- The joint venture partners pool their aid, expertise, technology, and capital to leverage each other's strengths for mutual use.
- Joint ventures allow firms to share the risks and costs of foreign market entry and operations.
- Each partner can benefit from the local knowledge, affinities, reputation, and webs of the other in the foreign market.

- Joint ventures help firms gain access to new technologies, expertise, markets, and clients that they needed help to achieve.
- Yet, joint ventures need complex negotiations and deal on strategic direction, control, funding, and profit and loss sharing.
- Cultural and corporate contrasts between partners can create conflicts and problems in working the joint venture.
- Partners may have splitting priorities and goals that affect the long-term success of the joint venture.
- Joint ventures work best when partner firms have complementary - rather than competing - capabilities and aids.
- Joint ventures are suitable when a wholly owned subsidiary is not feasible due to regulatory restrictions, aid constraints, or high risks.
- For instance, the Joint venture of the Indian company Maruti with the Japanese Company Suzuki.

### Wholly Owned Subsidiary

A wholly owned subsidiary is a separate legal entity that is fully owned and controlled by the parent firm.

- The parent firm sets and funds the subsidiary in the foreign nation to manage local operations and strategies.
- A wholly-owned subsidiary gives the parent firm full control over strategic decisions, operations, and management in the foreign market.
- The parent firm can leverage the subsidiary to quickly gain market share and client base in the new nation.
- Selecting a wholly-owned subsidiary needs large upfront investments and on-going funding from the parent firm.
- The parent firm takes on higher risks by investing fully in the foreign market via the subsidiary.
- Wholly owned associates provide the best means for the parent firm to execute standardized plans and maintain operational consistency globally.

However, associates need the product of local human aid goods to manage foreign operations alone.

- Wholly owned aids work best for firms seeking long-term commitment and control in high-potential foreign markets.
- Subsidiaries are suitable when rules need local incorporation or when proprietary technologies need to be protected.

## Acquisition

An acquisition occurs when a firm purchases an existing foreign firm to gain access to its aids, market share, and clients.

- Acquisitions allow firms to quickly show a sight, exhibit facilities, distribution network, and client base in a foreign market.
- Acquisitions give the acquiring firm control over the target firm's existing management, technologies, brands, and aids.
- Buys help firms expand into new global markets and product lines with minimal risk compared to building operations from scratch.
- However, acquisitions involve huge upfront costs for purchasing the target firm and integrating its operations.
- The acquiring firm inherits the target firm's existing issues like poor client relations, ancient technologies, internal conflicts, etc.
- Acquisitions need tough negotiations and, later, heavy assets in integrating organizational cultures, systems, and methods.
- Differences in management styles and work rituals between the acquiring and target firms can create integration challenges.
- Acquisitions work best for firms seeking accelerated market entry and growth via access to an established foreign firm.
- Acquisitions are suitable when organic expansion via other modes is too slow or risky for firms.

## Agent or Distributor Relationships

The firm appoints agents or distributors in foreign markets to define and sell its products locally. This allows the firm to enter new markets with low investment while agents handle marketing, sales, and client service. However, the firm has little control over how agents promote and service its products.

## Export Management Companies

The firm outsources its export function to an export management firm that handles all logistics, documentation, payments, and foreign client relationships on the firm's behalf. This reduces the aid needs for the firm, but it loses direct control over its export operations.

## Export Trading Companies

The firm sells its products to an export trading firm that then markets and spreads the products in foreign markets. This allows the firm to expand globally with minimal costs and risks. However, the firm has limited control over the pricing and marketing of its products overseas.

## Global Tenders

The firm bids for contracts to supply foreign government agencies or multinational firms. If successful, the firm may need to establish a local presence to fulfil the contract. This allows a "trial run" in the foreign market before making larger investments.

## Trading Houses

The firm sells its products to trading houses that import, stock, and resell the products across multiple foreign markets. This needs little investment from the firm, but the trading house sets product prices and markets alone.

Modes of Entry in International Business Advantages and Disadvantages

### 1.2.3 Benefits of Modes of Entry

**Low resource commitment** -Direct exporting, licensing, and agent/distributor affinities need little initial investment from the firm. This allows global expansion with minimal capital outlay.

**Reduced risks** -Modes like licensing, contract manufacturing, and joint ventures transfer some risks to foreign partners, lowering the firm's exposure.

**Leverage local expertise** -Options like joint ventures and acquisitions give firms access to the local knowledge, affinities, and experience of foreign partners.

**Quick market entry** -Modes like assets and subsidiaries enable firms to quickly establish operations and gain customers in international markets.

### Drawbacks of Modes of Entry

**Limited control** -With modes like exporting, licensing, and franchising, firms have limited control over foreign operations managed by partners.

**Dependency on partners** -The firm is reliant on the performance and cooperation of foreign agents, licensees, contractors, and joint venture partners.

**High costs** -Setting up foreign subsidiaries, joint ventures, and acquisitions typically involve huge expenditures for the firm.

**Intricacy of operations** -Managing international partners, integrating acquisitions, and running foreign subsidiaries can add intricacy to the firm's operations.

**Cultural and regulatory challenges** -Operating across multiple nations exposes the firm to cultural contrasts, tough regulations, and trade barriers.

### 1.2.4 Framework for Analysing the International Business Environment.

PESTLE framework enables us to study the international business environment that comprises the macro external environment.

#### Fundamental Elements of International Business Environment

##### Economic stability

Economic stability is evaluated (GDP growth rate, inflation, currency exchange rate & trade barriers). Choosing target nations for operations or investment requires companies to consider the way a country's economic situation may affect their cost structures and profitability.

## Political stability

Another important aspect for companies wishing to grow overseas is political stability. Alertness of possible uprisings, conflicts or war is important, as disruptions could seriously impact business continuity. Governmental policies on taxes, regulations and labor laws also need being analyzed.

## Geographic factors

Geographic factors include logistics, market accessibility and talent acquisition. Further, access to natural resources, especially to certain industries, should be thought about.

## Technology

With the improvement of communication and electronic infrastructure, technology turns into a central element in international business arena. Businesses should comprehend the effect of new technologies on their competitive positioning and the opportunity for brand new service or product offerings.

### 1.2.5 Benefits of International Business Environment (IBE)

Given below are the main benefits of IBE:

- Promotes global unity by linking nations, making the planet a linked global community.
- Promotes employment creation via cross-border flow of information, ideas, services and capital.
- Promotes fair economic growth by guaranteeing universal access to services and goods and keeping a stable value.
- Encourages progress, stability, prosperity, partnerships, innovation and technological development around the world.

### 1.2.6 Types of International Business Environment

#### Economic Environment:

The economic environment contains the currency exchange rates, inflation rates, economic stability and interest rates of a nation. Variations in exchange rates

impact international business transactions. Businesses also have to think about the economic health of the host country because it impacts consumer buying power and market potential.

### **Political & Legal Environment:**

The legal and political environment is the government's policies, rules and stability in a foreign market. Political stability is vital for a business climate. Legal factors are trade laws, intellectual property protection and foreign investment regulations. Modifications in political leadership and strategies could impact international business operations.

### **Socio Cultural Environment:**

The sociocultural environment includes cultural, demographic and social variables impacting consumer behaviour and market preferences. Knowing the local culture, language, practices and values is vital for marketing and product adaptation. Ignoring these factors could cause misunderstandings or marketing failures.

### **Technological Environment:**

The technological environment includes technology, infrastructure and the digital sector. Modern communication tools, dependable transport networks and the web can impact a company's ability to operate internationally. Companies should keep up with the technological advancements.

### **Competitive Environment:**

Competitive environment is the competitive landscape of the target market. This involves identifying existing competitors and their strengths and weaknesses, market share and tactics. Analysing competition is an important activity for formulating effective market entry strategies.

### **Worldwide Environment:**

The global environment considers broader global trends and events which could impact international business. Worldwide economic crises, geopolitical tensions and international trade agreements influence the international business landscape.

### 1.2.7 Factors Affecting the International Business Environment

Given here are factors that impact the IBE:

#### **Politics Factors:**

**Government Stability:** Stability of government in a host nation can impact foreign business. Political instability can result in abrupt policy changes adverse to international companies.

**Government Regulations:** The regulatory framework in a host country can facilitate or even hinder international business operations. Government policies that impact businesses include tariffs, trade barriers and import/export regulations.

**Geopolitical Relations:** Geopolitical differences between nations can sabotage international trade. Trade sanctions and diplomatic conflicts can restrict market access and create uncertainty for companies.

#### **Economic Factors:**

**Exchange Rates:** Variations in exchange rates impact import and export costs. Companies engaged in global trade must manage currency risk.

**Economic Stability:** Stable economic climate with low inflation and unemployment is favourable for international business. Economic instability might decrease consumer spending and market volatility.

**Market Size & Growth:** The size and growth potential of a foreign market are essential parameters. Bigger markets might provide better opportunities although smaller markets might be much easier to penetrate.

#### **Social Cultural Factors:**

**Cultural Differences:** Respect for the local culture is a requirement for international marketing. Cultural customs, customs and preferences might impact product design, advertising and consumer behaviour.

**Demographics:** Demographic variables like population size, gender & income also impact product demand & market segmentation.

**Consumer behaviour:**Local consumer preferences, purchasing patterns and brand loyalty can differ substantially from market to market. Businesses have to adapt their strategies accordingly.

### **Technological Factors:**

**Infrastructure:**Supply chain efficiency and market accessibility are impacted by reliable infrastructure including transportation and communication networks.

**Digital Transformation:**How digitally transformed a market is determines its potential for e-commerce and technology integration in business processes.

**Technological advancements:**Exactly how technologically advanced a nation is can impact a company's ability to introduce brand new services or products.

### **Legal Factors:**

**Intellectual Property Rights Protection:**Strong laws preserving intellectual property rights takes precedence for enterprises depending on patents, trademarks and copyrights.

**Contract Enforcement:**The ease with which contracts could be enforced and conflicts settled via the legal framework is of special relevance for global business dealings.

**Labour Laws:** Labour laws such as employment regulations and wage guidelines can differ widely among countries and impact labour costs and employee management.

### **Environmental/Ethical Factors:**

**Environmental Regulations:**Environmental regulations and laws are able to be applicable to industries with substantial environmental effects, including power, manufacturing, and farming.

**Ethical Considerations:**Ethics, corporate social responsibility and sustainability are becoming progressively more essential for international companies because customers and stakeholders expect dependable behaviour.

## 1.2.8 Components of the International Business Environment

### Market Analysis:

A thorough market analysis is a fundamental component of the IBE. This includes identifying target markets, evaluating market opportunity and analysing market trends & dynamics. Market analysis informs businesses on market entry and expansion plans.

### Assessment of Risk:

Risk evaluation along with management is vital in international business. Political, economic and market risks with a country or region are also evaluated by companies. Risk mitigation techniques might include diversifying markets or even hedging currency movements.

### Compliance with Regional Legal Frameworks:

Respecting indigenous statutes and rules is a need for international corporations. This consists of adherence to trade protocols, tax codes, labour laws & intellectual property protection. Noncompliance could cause legal conflicts and harm to a company's reputation.

### Cultural Understanding:

Cultural competence is an important advancement for success on global markets. This includes knowing cultural things, norms and etiquette. Companies will have to adapt marketing plans and offers to local culture.

### Strategy for Market Entry:

The selection of the proper market entry strategy is a strategic one. Options are exporting, franchising, licensing, joint ventures and FDI. The choice is dependent upon market size, competition and legal framework.

### Supply Chain Management:

IBE requires efficient supply chain management. Companies require good supply chains able to deal with international logistics, customs procedures and distribution networks.

## Financial Management:

Managing finances in the IBE involves international currencies, exchange rate risks and international tax issues. Financial planning and risk management are fundamental parts.

## Marketing & Branding:

Successful international marketing requires adaptation of branding, advertising and promotional efforts to local consumers. This includes language, culture references and consumer preferences.

## Let's Sum Up

The stages of internationalization of business involve progressing from exporting to establishing subsidiaries or acquiring firms in foreign markets. Methods of entry such as licensing, franchising, joint ventures, strategic alliances, subsidiaries, and acquisitions offer various levels of control, risk, and investment, catering to different strategic objectives and market conditions.

## Check Your Progress Quiz – 2

1. Which stage of internationalization involves selling domestic products in foreign markets?
  - A. Licensing
  - B. Joint Ventures
  - C. Exporting
  - D. Subsidiaries
2. What is a disadvantage of licensing as a method of entry into foreign markets?
  - A. Low-risk entry
  - B. Limited control over operations
  - C. Full ownership of intellectual property
  - D. Rapid market entry
3. Which method of entry involves collaboration between two or more firms to establish a new entity?
  - A. Subsidiaries

- B. Acquisitions
  - C. Strategic Alliances
  - D. Franchising
4. What is a key advantage of establishing subsidiaries in foreign markets?
- A. Low initial investment
  - B. Shared risks and resources
  - C. Full control over operations
  - D. Access to local expertise
5. Which method of entry into foreign markets involves purchasing an existing firm?
- A. Joint Ventures
  - B. Licensing
  - C. Exporting
  - D. Acquisitions

## **Section 1.3 Frameworks for Analyzing International Business Environment**

### **1.3.1 Introduction to International Business Environment**

The international Business environment (IBE) is a mix of many components which impact the functions and strategic options of worldwide operating enterprises. In our connected contemporary world, international business is now important to the worldwide economic system. Companies of any size are becoming more and more searching overseas for opportunities to broaden their market. To understand this, one needs to understand the different dimensions of the IBE including its categorizations, determinants and constituents.

### **1.3.2 Fundamental Elements of International Business Environment**

#### **Economic stability**

Economic stability is evaluated (GDP growth rate, inflation, currency exchange rate & trade barriers). Choosing target nations for operations or investment requires companies to consider the way a country's economic situation may affect their cost structures and profitability.

## Political stability

Another important aspect for companies wishing to grow overseas is political stability. Alertness of possible uprisings, conflicts or war is important, as disruptions could seriously impact business continuity. Governmental policies on taxes, regulations and labor laws also need being analyzed.

## Geographic factors

Geographic factors include logistics, market accessibility and talent acquisition. Further, access to natural resources, especially to certain industries, should be thought about.

## Technology

Technology With the improvement of communication and electronic infrastructure, technology turns into a central element in international business arena. Businesses should comprehend the effect of new technologies on their competitive positioning and the opportunity for brand new service or product offerings.

### 1.3.3 Benefits of IBE

- ❖ Promotes global unity by linking nations, making the planet a linked global community.
- ❖ Promotes employment creation via cross-border flow of information, ideas, services and capital.
- ❖ Promotes fair economic growth by guaranteeing universal access to services and goods and keeping a stable value.
- ❖ Encourages progress, stability, prosperity, partnerships, innovation and technological development around the world.

### 1.3.4 Types of International Business Environment

#### Economic Environment:

The economic environment contains the currency exchange rates, inflation rates, economic stability and interest rates of a nation. Variations in exchange rates impact international business transactions. Businesses also have to think about the

economic health of the host country because it impacts consumer buying power and market potential.

### **Political & Legal Environment:**

The legal and political environment is the government's policies, rules and stability in a foreign market. Political stability is vital for a business climate. Legal factors are trade laws, intellectual property protection and foreign investment regulations. Modifications in political leadership and strategies could impact international business operations.

### **Socio Cultural Environment:**

The socio-cultural environment includes cultural, demographic and social variables impacting consumer behaviour and market preferences. Knowing the local culture, language, practices and values is vital for marketing and product adaptation. Ignoring these factors could cause misunderstandings or marketing failures.

### **Technological Environment:**

The technological environment includes technology, infrastructure and the digital sector. Modern communication tools, dependable transport networks and the web can impact a company's ability to operate internationally. Companies should keep up with the technological advancements.

### **Competitive Environment:**

Competitive environment is the competitive landscape of the target market. This involves identifying existing competitors and their strengths and weaknesses, market share and tactics. Analysing competition is an important activity for formulating effective market entry strategies.

### **Worldwide Environment:**

The global environment considers broader global trends and events which could impact international business. Worldwide economic crises, geopolitical tensions and international trade agreements influence the international business landscape.

### 1.3.5 Factors Affecting the IBE

#### Politics Factors:

**Government Stability:** Stability of government in a host nation can impact foreign business. Political instability can result in abrupt policy changes adverse to international companies.

**Government Regulations:** The regulatory framework in a host country can facilitate or even hinder international business operations. Government policies that impact businesses include tariffs, trade barriers and import/export regulations.

**Geopolitical Relations:** Geopolitical differences between nations can sabotage international trade. Trade sanctions and diplomatic conflicts can restrict market access and create uncertainty for companies.

#### Economic Factors:

**Exchange Rates:** Variations in exchange rates impact import and export costs. Companies engaged in global trade must manage currency risk.

**Economic Stability:** Stable economic climate with low inflation and unemployment is favourable for international business. Economic instability might decrease consumer spending and market volatility.

**Market Size & Growth:** The size and growth potential of a foreign market are essential parameters. Bigger markets might provide better opportunities although smaller markets might be much easier to penetrate.

#### Social Cultural Factors:

**Cultural Differences:** Respect for the local culture is a requirement for international marketing. Cultural customs, customs and preferences might impact product design, advertising and consumer behaviour.

**Demographics:** Demographic variables like population size, gender & income also impact product demand & market segmentation.

**Consumer behaviour:**Local consumer preferences, purchasing patterns and brand loyalty can differ substantially from market to market. Businesses have to adapt their strategies accordingly.

### **Technological Factors:**

**Infrastructure:**Supply chain efficiency and market accessibility are impacted by reliable infrastructure including transportation and communication networks.

**Digital Transformation:**How digitally transformed a market is determines its potential for e-commerce and technology integration in business processes.

**Technological advancements:**Exactly how technologically advanced a nation is can impact a company's ability to introduce brand new services or products.

### **Legal Factors:**

**Intellectual Property Rights Protection:**Strong laws preserving intellectual property rights takes precedence for enterprises depending on patents, trademarks and copyrights.

**Contract Enforcement:**The ease with which contracts could be enforced and conflicts settled via the legal framework is of special relevance for global business dealings.

**Labour Laws:**Labour laws such as employment regulations and wage guidelines can differ widely among countries and impact labour costs and employee management.

### **Environmental/Ethical Factors:**

**Environmental Regulations:**Environmental regulations and laws are able to be applicable to industries with substantial environmental effects, including power, manufacturing, and farming.

**Ethical Considerations:**Ethics, corporate social responsibility and sustainability are becoming progressively more essential for international companies because customers and stakeholders expect dependable behaviour.

### 1.3.6 Components of the International Business Environment

#### **Market Analysis:**

A thorough market analysis is a fundamental component of the IBE. This includes identifying target markets, evaluating market opportunity and analysing market trends & dynamics. Market analysis informs businesses on market entry and expansion plans.

#### **Assessment of Risk:**

Risk evaluation along with management is vital in international business. Political, economic and market risks with a country or region are also evaluated by companies. Risk mitigation techniques might include diversifying markets or even hedging currency movements.

#### **Compliance with Regional Legal Frameworks:**

Respecting indigenous statutes and rules is a need for international corporations. This consists of adherence to trade protocols, tax codes, labour laws & intellectual property protection. Noncompliance could cause legal conflicts and harm to a company's reputation.

#### **Cultural Understanding:**

Cultural competence is an important advancement for success on global markets. This includes knowing cultural things, norms and etiquette. Companies will have to adapt marketing plans and offers to local culture.

#### **Strategy for Market Entry:**

The selection of the proper market entry strategy is a strategic one. Options are exporting, franchising, licensing, joint ventures and FDI. The choice is dependent upon market size, competition and legal framework.

#### **Supply Chain Management:**

IBE requires efficient supply chain management. Companies require good supply chains able to deal with international logistics, customs procedures and distribution networks.

## Financial Management:

Managing finances in the IBE involves international currencies, exchange rate risks and international tax issues. Financial planning and risk management are fundamental parts.

## Marketing & Branding:

Successful international marketing requires adaptation of branding, advertising and promotional efforts to local consumers. This includes language, culture references and consumer preferences.

The reality of the IBE is vast and continuously developing and includes economic, technological, sociocultural, political, global and competitive areas. Businesses that operate internationally must carefully think about these diverse influences to succeed in international markets.

The types, components and factors of the IBE are pertinent for sound business decision making and risk reduction in a worldwide context. In a world which is progressively globalising, understanding the IBE is of essential importance for any business seeking success and growth for its future.

In international business, understanding the domestic, foreign, and global environments is crucial for success.

### 1.3.7 Different factors and forces that influence how companies operate across borders

These environments encompass different factors and forces that influence how companies operate across borders. Here's an overview of each:

#### Domestic Environment

The domestic environment refers to the factors and forces within a company's home country that affect its international business operations. Key elements include:

**Economic Conditions:** The economic stability, growth rate, and overall economic health of the home country. This includes inflation rates, employment levels, and consumer spending.

**Political and Legal Factors:**Government policies, regulations, and political stability. This includes tax policies, trade regulations, and government support for businesses.

**Cultural Factors:** The values, beliefs, and customs prevalent in the home country that shape business practices and consumer behavior.

**Technological Infrastructure:**The level of technological development and innovation within the home country that can support international business activities.

**Competitive Environment:**The level of competition within the domestic market, including the presence of local and international competitors.

## Foreign Environment

The foreign environment encompasses the factors and forces in the countries where the company operates or plans to operate. These factors can vary widely between different countries and regions. Key elements include:

**Economic Conditions:**Economic stability, growth, and market potential in the foreign country. This includes exchange rates, inflation, and income levels.

**Political and Legal Factors:**The political stability, legal systems, and regulatory environment in the foreign country. This includes trade policies, tariffs, and foreign investment regulations.

**Cultural Factors:**Differences in values, beliefs, customs, language, and business practices that can impact operations and marketing strategies.

**Technological Infrastructure:**The availability and advancement of technology in the foreign country that can support business operations.

**Market Characteristics:**Consumer behavior, preferences, and demand patterns in the foreign market. This includes the level of competition and market entry barriers.

## Global Environment

The global environment encompasses the broader, overarching factors and forces that impact international business activities across multiple countries and regions. Key elements include:

**Global Economic Trends:**Trends such as globalization, economic integration, and international trade dynamics. This includes global supply chains, trade agreements, and economic blocs.

**International Political Relations:**Relations between countries, including alliances, conflicts, and diplomatic relations that can influence international business.

**Global Legal and Regulatory Frameworks:**International laws, regulations, and standards that affect cross-border trade and investment. This includes international trade agreements, environmental regulations, and labor standards.

**Technological Advancements:**Global technological trends and innovations that impact international business operations, such as advancements in communication, transportation, and information technology.

**Cultural Convergence and Divergence:**The degree of cultural convergence (similarity) or divergence (difference) across countries, affecting consumer preferences, marketing strategies, and management practices.

**Environmental and Social Issues:**Global environmental challenges (e.g., climate change) and social issues (e.g., human rights, labor standards) that influence corporate social responsibility and sustainable business practices.

### 1.3.8 Successful international businesses must navigate these environments

**Conducting Thorough Market Research:**Understanding the unique characteristics of each market and adapting strategies accordingly.

**Building Flexibility into Operations:**Developing adaptable business models and strategies that can respond to changes in different environments.

**Establishing Strong Networks:** Building relationships with local partners, governments, and stakeholders to navigate foreign environments effectively.

**Leveraging Technology:** Utilizing advanced technology to manage operations, communication, and data analysis across multiple environments.

**Monitoring Global Trends:** Staying informed about global economic, political, and technological trends that can impact business operations.

### 1.3.9 Recent Developments in International Business

#### 1. Geopolitical Tensions and Economic Policies

**Geopolitical Tensions:** The conflict between Russia and Ukraine continues to impact global markets, leading to disruptions in supply chains, particularly in the energy and commodities sectors. Additionally, the war in Gaza has heightened regional instability, affecting business operations in the Middle East (World Economic Forum) (Foley & Lardner LLP).

**Economic Policies:** Central banks in major economies, such as the US Federal Reserve and the European Central Bank, are maintaining high-interest rates to combat inflation. This monetary policy environment influences global investment patterns and financing conditions, with emerging markets facing significant challenges due to capital outflows and debt pressures (World Economic Forum).

#### 2. Trade Agreements and International Cooperation

**New Trade Agreements:** Recent trade agreements, like the economic partnerships between the UAE and countries such as Colombia and Costa Rica, are designed to enhance bilateral trade by reducing tariffs, removing trade barriers, and fostering investment in key sectors like energy and infrastructure (World Economic Forum).

**EU-US Trade and Technology Council (TTC):** The TTC is working to strengthen cooperation on technology and supply chain issues, particularly for semiconductors. The council aims to avoid trade barriers and promote sustainable trade practices (World Economic Forum).

### 3. Technological Advancements

**Artificial Intelligence and 6G Networks:**The rapid development of AI and the upcoming rollout of 6G networks are set to revolutionize various industries. These technologies will enhance connectivity, data processing, and automation capabilities, significantly impacting international business operations (World Economic Forum).

**Blockchain and Digital Currencies:**Central banks are increasingly exploring blockchain technology and the potential introduction of central bank digital currencies (CBDCs). These innovations promise to improve the efficiency and security of international financial transactions (World Economic Forum).

### 4. Export Controls and Compliance

**Stricter Enforcement:**The US government is emphasizing stricter enforcement of export controls and economic sanctions. Companies must maintain robust compliance programs to avoid severe penalties. Recent policies highlight the importance of reporting violations and implementing effective export control systems (Foley & Lardner LLP).

**Economic Sanctions:**Businesses engaged in international trade need to be vigilant about complying with economic sanctions. Regulatory bodies like the US Office of Foreign Assets Control (OFAC) are actively monitoring compliance and imposing significant penalties for violations (Foley & Lardner LLP).

### 5. Market Dynamics

**China's Economic Role:**Despite slower growth, China remains a critical player in the global economy. Its economic policies and market conditions continue to influence international business strategies. Companies are closely monitoring China's economic performance and policy changes (World Economic Forum).

**Global Supply Chains:**The resilience of global supply chains is a top concern, especially in light of recent disruptions caused by geopolitical tensions and logistical challenges. Businesses are focusing on diversifying supply sources and increasing local production to mitigate risks (World Economic Forum).

The international business landscape in 2024 is shaped by a complex interplay of geopolitical tensions, economic policies, technological advancements, and regulatory changes. Companies must navigate these challenges by staying informed, adapting to new technologies, and ensuring compliance with international trade regulations.

### **Growing Emerging Markets**

Developing countries will see the highest economic growth as they come closer to the standards of living of the developed world. If you want your business to grow rapidly, consider selling into one of these emerging markets. Language, financial stability, economic system and local cultural factors can influence which markets you should favor.

### **Population and Demographic Shifts**

The population of the industrialized world is aging while many developing countries still have very youthful populations. Businesses catering to well-off pensioners can profit from a focus on developed countries, while those targeting young families, mothers and children can look in Latin America, Africa and the Far East for growth.

### **Speed of Innovation**

The pace of innovation is increasing as many new companies develop new products and improved versions of traditional items. Western companies no longer can expect to be automatically at the forefront of technical development, and this trend will intensify as more businesses in developing countries acquire the expertise to innovate successfully.

### **More Informed Buyers**

More intense and more rapid communications allow customers everywhere to purchase products made anywhere around the globe and to access information about what to buy. As pricing and quality information become available across all markets, businesses will lose pricing power, especially the power to set different prices in different markets.

## Increased Business Competition

As more businesses enter international markets, Western companies will see increased competition. Because companies based in developing markets often have lower labor costs, the challenge for Western firms is to keep ahead with faster and more effective innovation as well as a high degree of automation.

## Slower Economic Growth

The motor of rapid growth has been the Western economies and the largest of the emerging markets, such as China and Brazil. Western economies are stagnating, and emerging market growth has slowed, so economic growth over the next several years will be slower. International businesses must plan for profitability in the face of more slowly growing demand.

## Emergence of Clean Technology

Environmental factors are already a major influence in the West and will become more so worldwide. Businesses must take into account the environmental impact of their normal operations. They can try to market environmentally friendly technologies internationally. The advantage of this market is that it is expected to grow more rapidly than the overall economy.

## Let's Sum Up

The framework for analyzing the international business environment involves understanding the domestic, foreign, and global factors that influence business operations and strategies. Recent developments such as digital transformation, sustainability initiatives, trade policy shifts, technological innovation, and geopolitical uncertainty significantly impact how companies navigate and succeed in the global marketplace.

## Check Your Progress – Quiz – 3

1. Which environment includes factors specific to the host country where a business operates?
  - A. Domestic environment
  - B. Global environment

- C. Foreign environment
  - D. Macro environment
2. What recent development in international business emphasizes environmental and social responsibility?
    - A. Digital transformation
    - B. Technological innovation
    - C. Sustainability initiatives
    - D. Geopolitical uncertainty
  3. Which element is NOT part of the global environment impacting international business?
    - A. Global economic trends
    - B. Political stability in host countries
    - C. Technological advancements
    - D. Trade policies and agreements
  4. Which recent development involves advances in AI, blockchain, and IoT?
    - A. Digital transformation
    - B. Sustainability initiatives
    - C. Trade policy shifts
    - D. Geopolitical uncertainty
  5. Which environment includes factors within the home country that influence international business operations?
    - A. Global environment
    - B. Foreign environment
    - C. Domestic environment
    - D. Micro environment

### 1.4 Unit Summary

International business involves commercial activities across national borders, encompassing exporting, importing, foreign direct investment, licensing, franchising, joint ventures, and operations of multinational corporations. Its nature includes complex economic, legal, political, and cultural interactions, while its importance lies in fostering economic growth, job creation, and technological innovation. Businesses typically internationalize through stages, from domestic to global integration, utilizing

entry methods such as licensing, franchising, joint ventures, strategic alliances, and subsidiaries. Analyzing domestic, foreign, and global environments is crucial for strategic planning, while recent developments like digitalization, global supply chains, trade agreements, sustainability, and technological advancements continue to shape the landscape of international business.

## 1.5 Glossary

**Exporting:** Selling goods or services to another country.

**Importing:** Buying goods or services from another country.

**Foreign Direct Investment (FDI):** Investing directly in business operations in another country.

**Licensing:** Allowing another company to produce and sell products under your brand.

**Franchising:** Extending a business model and brand to a foreign company.

**Joint Venture:** A business arrangement where two or more parties agree to pool resources for a specific task.

**Strategic Alliance:** A cooperative agreement between businesses to pursue shared objectives.

**Subsidiary:** A company controlled by another company (parent company).

**Acquisition:** Buying a controlling interest in another company.

**Globalization:** The process of interaction and integration among people, companies, and governments worldwide.

## 1.6 Self – Assessment

1. Explain the concept of international business and its significance in the global economy. Provide examples to support your explanation.
2. Discuss the various stages of internationalization for a business.
3. What are the key characteristics and challenges associated with each stage?

4. Compare licensing and franchising as methods of entering foreign markets. What are the benefits and potential drawbacks of each approach?
5. Analyze the role of joint ventures in international business. How do joint ventures help companies enter and succeed in foreign markets?
6. Describe the strategic advantages of establishing subsidiaries in foreign markets.
7. How do subsidiaries differ from acquisitions in terms of control and operational alignment?
8. Outline the key components of a framework for analyzing the international business environment. Why is it important for companies to consider both domestic and global factors?
9. How has digitalization impacted international business operations? Provide examples of companies that have successfully leveraged digital technologies for global expansion.
10. Discuss the importance of global supply chain management in international business.
11. What are the key challenges and benefits associated with managing a global supply chain?

## 1.7 Case Study

### McDonald's Expansion through Franchising:

McDonald's has expanded globally primarily through franchising. Franchising allows McDonald's to leverage local entrepreneurs' knowledge and capital while maintaining global brand standards. McDonald's provides franchisees with training, operational support, and marketing strategies. Franchising also helps McDonald's mitigate risks associated with local market conditions and regulatory environments.

McDonald's franchise model involves selling the rights to operate a McDonald's restaurant in a specific geographic area. Franchisees pay initial fees and ongoing royalties in exchange for using McDonald's brand, systems, and support. This strategy has facilitated rapid global expansion, enabling McDonald's to enter diverse markets with varying consumer preferences and regulatory landscapes.

## Question 1 How does McDonald's use franchising to balance global brand consistency with local market adaptation?

### Starbucks' Joint Ventures in China:

Objective Starbucks entered China through joint ventures (JVs), forming partnerships with local companies to navigate regulatory challenges and cultural nuances. JVs allowed Starbucks to access local market knowledge, resources, and distribution networks while leveraging its global brand and operational expertise.

Starbucks initially faced challenges entering the Chinese market due to cultural differences and competition from local tea culture. To overcome these barriers, Starbucks formed joint ventures with local partners like Uni-President Enterprises Corporation and Tingyi Holding Corporation.

## Question 1 Why did Starbucks choose joint ventures as its market entry strategy in China, and what advantages did it gain from these partnerships?

### Toyota's Subsidiaries and Global Strategy:

Toyota operates a global strategy through subsidiaries, establishing manufacturing plants and sales networks in key markets worldwide. This approach allows Toyota to localize production, adapt vehicles to regional preferences, and effectively penetrate diverse markets while maintaining global standards of quality and efficiency.

Toyota's global strategy involves establishing wholly-owned subsidiaries in strategic locations, such as North America, Europe, and Asia. By setting up subsidiaries, Toyota can:

- **Localize Production:** Manufacturing vehicles closer to end markets to reduce costs and respond quickly to market demands.
- **Market Penetration:** Tailoring vehicle models and features to meet local consumer preferences and regulatory requirements.
- **Supply Chain Efficiency:** Integrating global supply chains to optimize sourcing, production, and distribution operations.

Toyota's subsidiaries play a crucial role in implementing Toyota's lean manufacturing principles and continuous improvement initiatives globally. This strategy enhances Toyota's competitive advantage by ensuring flexibility, efficiency, and responsiveness in a highly competitive automotive industry.

#### 4. Apple's Global Supply Chain:

Apple manages a complex global supply chain to manufacture and distribute its products worldwide. The supply chain spans multiple countries and involves suppliers, contract manufacturers, logistics providers, and retail partners to ensure timely production and delivery of Apple products to global markets.

Apple's global supply chain strategy focuses on:

- **Supplier Relationships:** Partnering with suppliers worldwide to source components and materials for its products.
- **Contract Manufacturing:** Outsourcing manufacturing to contract manufacturers (e.g., Foxconn in China) to scale production capacity and meet demand fluctuations.
- **Logistics and Distribution:** Coordinating logistics operations to transport finished products from manufacturing sites to distribution centers and retail stores globally.
- **Retail Network:** Managing a global network of Apple Stores and authorized resellers to reach customers in diverse markets.

Apple's supply chain management emphasizes efficiency, cost-effectiveness, and responsiveness to market demands, enabling the company to maintain high product quality and customer satisfaction while achieving global market leadership in the technology industry.

#### 5. Walmart's Acquisition Strategy:

Walmart has expanded globally through acquisitions, purchasing established retail chains in various countries to enter new markets quickly and gain market share. Acquisitions have allowed Walmart to leverage existing infrastructure,

customer base, and local market knowledge while implementing its operational efficiencies and low-cost leadership strategy.

Walmart's acquisition strategy involves acquiring local retail chains, such as Asda in the UK and Flipkart in India, to:

- **Accelerate Market Entry:** Enter new markets without building stores from scratch, saving time and resources.
- **Access Local Expertise:** Tap into acquired companies' knowledge of local consumer preferences, supply chains, and regulatory environments.
- **Expand Market Share:** Increase market presence and competitive advantage by integrating acquired operations into Walmart's global network.

Acquisitions support Walmart's strategy of offering everyday low prices and convenience to customers worldwide while adapting to local market conditions and competitive dynamics.

These case studies illustrate how multinational corporations strategically use franchising, joint ventures, subsidiaries, global supply chains, and acquisitions to navigate international markets, overcome challenges, and achieve sustainable growth and competitive advantage.

1. **Question for McDonald's Expansion through Franchising:***How does McDonald's use franchising to balance global brand consistency with local market adaptation?*
2. **Question for Starbucks' Joint Ventures in China:***Why did Starbucks choose joint ventures as its market entry strategy in China, and what advantages did it gain from these partnerships?*
3. **Question for Toyota's Subsidiaries and Global Strategy:***How does Toyota's use of subsidiaries enhance its ability to adapt to local market conditions while maintaining global standards of efficiency and quality?*
4. **Question for Apple's Global Supply Chain:***What are the key challenges and advantages of Apple's complex global supply chain management strategy?*

5. **Question for Walmart's Acquisition Strategy:** *How has Walmart's acquisition strategy helped it achieve rapid international expansion and competitive advantage in diverse global markets?*

### 1.8 Answer for check your Progress

<b>Section 1.1</b>	<b>Introduction to International Business</b>
1	C. Deals with cross-cultural interactions
2	A. Foreign Direct Investment
3	B. Domestic market expansion
4	C. It diversifies business risks
5	C. International business
<b>Section 1.2</b>	<b>Navigating Stages of Internationalization of Business</b>
1	Answer: C. Exporting
2	Answer: B. Limited control over operations
3	Answer: C. Strategic Alliances
4	Answer: C. Full control over operations
5	Answer: D. Acquisitions
<b>Section 1.3</b>	<b>Frameworks for Analyzing International Business Environment</b>
1	C. Foreign environment
2	C. Sustainability initiatives
3	B. Political stability in host countries
4	A. Digital transformation
5	C. Domestic environment

## 1.9 Reference and Suggested Readings

International Business: Competing in the Global Marketplace, Charles W.L. Hill & G. Tomas M. Hult, McGraw-Hill Education, New York, USA, 13th Edition, 2023

International Business: Strategy, Management, and the New Realities, S. Tamer Cavusgil, Gary Knight, John Riesenberger, Pearson Education, Hoboken, USA, 5th Edition, 2023

International Business: Text and Cases, Francis Cherunilam, PHI Learning Pvt. Ltd, New Delhi, 7th Edition, 2023.

## Theoretical Foundations of International Business

### Unit – II Theoretical Foundations of International business

Theoretical Foundations of International Business: Theory of Mercantilism- Theory of Absolute and Comparative Cost Advantage- Haberler's Theory of Opportunity Cost- Heckscher- Ohlin Theory Market Imperfections Approach-Product Life Cycle Approach - Transaction Cost Approach-Dunning's Eclectic Theory of International Production.

### Unit Objectives

In this topic, the learners will be able to learn about the key theories in international business, including both classical and modern approaches. Students will learn the historical foundations of trade through concepts like **Mercantilism**, **Absolute Advantage**, and **Comparative Advantage** and explore the evolution of trade theories with **Haberler's Opportunity Cost** and the **Heckscher-Ohlin Theory**. Additionally, they will understand modern approaches such as the **Market Imperfections Approach**, **Product Life Cycle Theory**, **Transaction Cost Approach**, and **Dunning's Eclectic Theory**. By the end of this unit, students will be able to apply these theories to real-world business scenarios, analyze global trade patterns, and evaluate international investment decisions.

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## SECTION 2. 1: CLASSICAL TRADE THEORIES

### 2.1.1 Theory of Mercantilism

Mercantilism is economic nationalism for the purpose of building a wealthy and powerful state. **Adam Smith** coined the term “mercantile system” to describe the system of political economy that sought to enrich the country by restraining imports and encouraging exports. This system dominated Western European economic thought and policies from the sixteenth to the late eighteenth centuries. The goal of these policies was, supposedly, to achieve a “favorable” balance of trade that would bring gold and silver into the country and also to maintain domestic employment. In contrast to the agricultural system of the physiocrats or the laissez-faire of the nineteenth and early twentieth century’s, the mercantile system served the interests of merchants and producers such as the British East India Company, whose activities were protected or encouraged by the state.

The most important economic rationale for mercantilism in the sixteenth century was the consolidation of the regional power centres of the feudal era by large, competitive nation-states. Other contributing factors were the establishment of colonies outside Europe; the growth of European commerce and industry relative to agriculture; the increase in the volume and breadth of trade; and the increase in the use of metallic monetary systems, particularly gold and silver, relative to barter transactions.

#### Mercantilism involves

- \* Restrictions on imports – tariff barriers, quotas or non-tariff barriers.
- \* Accumulation of foreign currency reserves, plus gold and silver reserves. (also known as bullionism) In the sixteenth/seventeenth century, it was believed that the accumulation of gold reserves (at the expense of other countries) was the best way to increase the prosperity of a country.
- \* Granting of state monopolies to particular firms especially those associated with trade and shipping.

- \* Subsidies of export industries to give a competitive advantage in global markets.
- \* Government investment in research and development to maximise the efficiency and capacity of the domestic industry.
- \* Allowing copyright/intellectual theft from foreign companies.
- \* Limiting wages and consumption of the working classes to enable greater profits to stay with the merchant class.
- \* Control of colonies, e.g. making colonies buy from Empire country and taking control of colonies wealth.

### Examples of mercantilism

- \* England Navigation Act of 1651 prohibited foreign vessels engaging in coastal trade.
- \* All colonial exports to Europe had to pass through England first and then be re-exported to Europe.
- \* Under the British Empire, India was restricted in buying from domestic industries and were forced to import salt from the UK. Protests against this salt tax led to the 'Salt tax revolt' led by Gandhi.
- \* In seventeenth-century France, the state promoted a controlled economy with strict regulations about the economy and labour markets
- \* Rise of protectionist policies following the great depression; countries sought to reduce imports and also reduce the value of the currency by leaving the gold standard.
- \* Some have accused China of mercantilism due to industrial policies which have led to an oversupply of industrial production – combined with a policy of undervaluing the currency.

### 2.1.2 Adam Smith's Theory of Absolute Advantage

The mercantilist economic theory, which was widely followed between the 16th and the 18th century, came under a lot of criticism with the emergence of economists like John Locke and David Hume. Mercantilism advocated a national economic policy designed to maximize the nation's trade and its gold and money reserves. Mercantilism gained influence due to the emergence of colonial powers such as

Britain and Portugal, before Adam Smith, and later Daniel Ricardo, both staunch critics of the concept, came up with their own theories to counter mercantilism.

Smith was the first economist to bring up the concept of absolute advantage, and his arguments regarding the same supported his theories for a laissez-faire state. In “The Wealth of Nations”, Smith first points out that, through opportunity costs, regulations favoring one industry take away resources from another industry where they might have been more advantageously employed.

Secondly, he applies the opportunity cost principle to individuals in a society, using the particular example of a shoemaker not using the shoes he made himself because that would be a waste of his productive resources. Each individual thus specializes in the production of goods and services in which he or she has some sort of an advantage.

Thirdly, Smith applies the same principles of opportunity costs and specialization to international economic policy, and the principle of international trade. He explains that it is better to import goods from abroad where they can be manufactured more efficiently because it allows the importing country to put its resources into its own most productive and efficient industries. Smith thus emphasizes that a difference in technology between nations is the primary determinant of international trade flows around the globe.

### 2.1.3 Assumptions of the Absolute Advantage Theory

- \* Smith assumed that the costs of the commodities were computed by the relative amounts of labor required in their respective production processes.
- \* He assumed that labor was mobile within a country but immobile between countries.
- \* He took into consideration a two-country and two-commodity framework for his analysis.
- \* He implicitly assumed that any trade between the two countries considered would take place if each of the two countries had an absolutely lower cost in the production of one of the commodities.

### 2.1.4 Achieving an Absolute Advantage

An absolute advantage is achieved through low-cost production. In other words, it refers to an individual, company, or country that can produce at a lower marginal cost. Such an advantage is established when (compared to competitors):

- \* Fewer materials are used to produce a product
- \* Cheaper materials (thus a lower cost) are used to produce a product
- \* Fewer hours are needed to produce a product
- \* Cheaper workers are (in terms of hourly wage) used to produce a product

### 2.1.5 Benefits of an Absolute Advantage

#### \* **Absolute Cost Advantage**

Absolute cost advantage results from the specialization of labor proposed by Smith in his theory. Specialization of labor, or division of labor, results in a significantly higher productivity per unit of labor, and in turn, a lower cost of production. Smith also used the concept of “Economies of Scale” to explain the lowering of production costs, as a higher output due to labor diversification would significantly reduce production costs.

#### \* **Natural Advantage**

A country should produce those goods that are naturally favoring its climatic environment. The type of goods produced would also depend on the availability of natural resources. The presence of lots of natural resources would significantly provide an advantage to such a country while producing the goods.

#### \* **Acquired Advantage**

Acquired advantage includes advantages in technology and level of skill development.

### 2.1.6 COMPARATIVE COST ADVANTAGE

Ricardo (1817), though adhering to the absolute cost advantage doctrine of Adam Smith, pointed out that cost advantage to both the trade partners was not a necessary condition for trade to occur. It would still be beneficial to both the trading countries even if one country can produce all the goods with less labour cost than the other country. According to Ricardo, so long as the other country is not equally

less productive in all lines of production, measurable in terms of opportunity cost of each commodity in the two countries, it will still be mutually gainful for them if they enter into trade. Ricardo's theory may be explained by referring to Table.

	<b>1 Unit of Goods A</b>	<b>1 Unit of Goods B</b>
<b>Country I</b>	80	90
<b>Country II</b>	120	100

In Table, country I enjoys absolute cost advantage in the production of {both the goods A and B as compared to their production in country II. But country I has comparative cost advantage in good A and country II in good B. We take the help of the concept of opportunity cost in order to know the relative comparative advantage in the production of the goods in the two countries. The opportunity cost to produce one unit of good A is the amount of good B which has to be sacrificed for producing the additional unit of good A.

In the example given in Table, the opportunity cost of one unit of A in country I is 0.89 unit of good B and in country II it is 1.2 unit of good B. On the other hand, the opportunity cost of one unit of good B in country I is 1.125 units of good A and 0.83 unit of good A, in country II. The opportunity cost of the two goods are different in both the countries and as long as this is the case, they will have comparative advantage in the production of either, good A or good B, and will gain from trade regardless of the fact that one of the trade partners may be possessing absolute cost advantage in both lines of production. Thus, country I has comparative advantage in good A as the opportunity cost of its production is lower in this country as compared to its opportunity cost in country II which has comparative advantage in the production of good B on the same reasoning.

The gains from trade in terms of Ricardo's doctrine may be understood by distinguishing the terms of trade under 'autarky' (i.e., having no trade with the outside world because of the closed economy) and in terms of trade with the outside world. The domestic exchange ratio is determined by internal cost of production. Both the absolute advantage and comparative advantage theories failed to realise that the welfare of society does not depend only on the gains from the international trade but depends upon the way the gains are distributed. The individual gains under

the theories are not guaranteed unless the government adopts an appropriate redistribution policy. There have to be certain incentives for the producers also in order to keep them engaged in the exportable production. These theories have also been criticised on the ground that labour is not the only input determining the cost of production.

### Let's Sum Up

The theoretical foundations of international business began with Mercantilism, an economic theory prevalent from the 16th to 18th centuries. It emphasized national wealth accumulation through a favorable trade balance, where exports exceed imports, thereby increasing a country's stock of gold and silver. Governments played an active role by restricting imports and promoting exports. However, this theory was criticized for neglecting the mutual benefits of trade and promoting zero-sum thinking. Later, Adam Smith introduced the Theory of Absolute Cost Advantage, arguing that nations should specialize in producing goods they can manufacture more efficiently than others, encouraging trade that benefits all parties. Building on this, David Ricardo proposed the Theory of Comparative Cost Advantage, which showed that even if one country is less efficient in producing all goods, it can still gain from trade by focusing on goods it can produce at a lower opportunity cost. This concept laid the groundwork for modern trade theory by highlighting the benefits of specialization and free trade based on relative efficiency rather than absolute productivity.

## Section 1: Classical Trade Theories

### Check your progress – Quiz 1

1. Which economic theory advocates for a positive trade balance to increase national wealth?
  - a) Comparative Advantage
  - b) Mercantilism
  - c) Heckscher-Ohlin Theory
  - d) Product Life Cycle Theory
2. According to Adam Smith's theory of absolute advantage, countries should specialize in producing goods they:

- a) Can produce with lower opportunity cost
  - b) Have an absolute cost advantage in producing
  - c) Have a trade deficit in
  - d) Can import easily
3. Which economist introduced the theory of comparative advantage?
- a) Adam Smith
  - b) David Ricardo
  - c) John Dunning
  - d) Raymond Vernon
4. What is the main limitation of Mercantilism?
- a) Encourages free trade
  - b) Supports protectionism and neglects mutual trade benefits
  - c) Focuses on labor efficiency
  - d) Emphasizes opportunity costs
5. The theory of absolute advantage fails to explain trade when:
- a) Countries have equal efficiencies in all products
  - b) Countries have different production costs
  - c) There are no trade barriers
  - d) Countries specialize in one product

## 2.2 Neo-Classical and Modern Trade Theories

### 2.2.1 HABERLER'S THEORY OF OPPORTUNITY COST

**Gottfried Haberler** has attempted to restate the comparative costs in terms of opportunity cost. He demonstrates that the doctrine of comparative costs can hold valid even if the labour theory of value is discarded. The theory determines the cost of producing a commodity in terms of the alternative production that has to be foregone for producing the commodity in question.

Elaborating upon the opportunity cost, Haberler writes that “the marginal cost of a given quantity  $X$  of a commodity  $A$  must be regarded as that quantity of commodity  $B$  which must be foregone in order that  $X$ , instead of  $(X-1)$  units of  $A$  can be produced. The exchange ratio on the market between  $A$  and  $B$  must equal their costs in this sense of the terms.”

The opportunity cost is what has been given up in order to have some quantity of another thing. If an additional unit of one commodity has to be produced, the productive resources are to be diverted from the production of some other commodity to the given commodity.

The resultant decrease in the quantity of the second commodity represents the opportunity cost of the additional quantity of the given commodity. For instance, if India has to reduce the production of cotton by 2 lakh bales in order to raise the production of wheat by 1 lakh tons, then the opportunity cost of one unit of wheat is two units of cotton ( $1W = 2C$ ).

Haberler made use of opportunity cost curve to express the opportunity cost of one commodity in terms of the other. The opportunity cost curve has been called as the 'transformation curve' or 'production possibility curve' by Paul Samuelson and 'production frontier' or 'production indifference curve' by A.P. Lerner.

### **2.2.2 Assumptions of Haberler's Opportunity Cost Theory**

Haberler's opportunity cost theory rests upon the following main assumptions:

- \* The economic system is in a state of full employment equilibrium.
- \* There is perfect competition in commodity and factor markets.
- \* Price of each commodity equals the marginal cost of producing it.
- \* Price of each factor equals its marginal productivity.
- \* The supply of factors is fixed.
- \* The state of technology is given.
- \* There are two trading countries A and B.
- \* Each country produces two commodities, say X and Y.
- \* Each country has two productive factors- capital and labour.
- \* There is perfect factor mobility within each country.
- \* The factors of production are perfectly immobile between the two countries.
- \* Neither of the two countries imposes any restrictions upon international trade.

On the basis of the above assumptions, it is possible to determine the opportunity cost curve or the production possibility curve of any country.

The production possibility curve indicates different combinations of two commodities that a country can produce with the given factor endowments and

technology. The slope of the production possibility curve is determined by the ratio of units of the commodity given up in order to have one unit of the other commodity. This ratio is termed as a marginal rate of transformation (MRT).

If two commodities X and Y are being produced by a country and some quantities of labour, capital and other inputs are diverted from the production of Y to the production of X, the additional production of X involves the sacrifice of some quantity of Y. In other words, certain units of Y given up have been transformed into the marginal unit of X. The rate at which marginal unit of X is being substituted for certain units of Y is called the marginal rate of transformation.

$$MRT_{xy} = - \frac{\delta Y}{\delta X}$$

Alternatively, the  $MRT_{xy}$  can be defined as a ratio of the marginal cost of X to the marginal cost of Y.

$$\delta C = \frac{\delta C}{\delta X} \cdot \delta X + \frac{\delta C}{\delta Y} \cdot \delta Y$$

Here  $\delta C$  stands for change in total cost,  $\delta C/\delta X$  and  $\delta C/\delta Y$  are the marginal costs of X and Y commodities respectively.

Assuming infinitesimally small changes in X and Y,  $\delta C$  will be equal to zero.

$$\begin{aligned} \delta C &= 0 \\ \therefore \frac{\delta C}{\delta X} \cdot \delta X + \frac{\delta C}{\delta Y} \cdot \delta Y &= 0 \\ \text{or } \frac{\delta C}{\delta Y} \cdot \delta Y &= - \frac{\delta C}{\delta X} \cdot \delta X \\ \text{or } - \frac{\delta Y}{\delta X} &= \frac{\delta C/\delta X}{\delta C/\delta Y} \\ \text{or } MRT_{xy} &= - \frac{\delta Y}{\delta X} = \frac{\delta C/\delta X}{\delta C/\delta Y} \end{aligned}$$

Since the  $MRT_{xy}$  is negative, the opportunity cost curve or transformation curve slopes down from left to right. The opportunity cost curve may be a straight

line, convex to the origin or concave to the origin, depending on whether return to scale in a country is constant, increasing or decreasing respectively.

At every point on the straight-line opportunity cost curve AB in Fig. 6.1 (a) the  $MRT_{xy}$  remains equal,  $MRT_{xy} = -\delta Y/\delta X = PP_1/OQ_1 = P_1P_2/Q_1Q_2$ . It also signifies that marginal costs of X and Y remains unchanged and production of both the commodities is governed by constant returns to scale or constant opportunity cost. It implies that all factors of production are equally efficient in all lines of production. Since this is not true in real life, the production possibility curve is not likely to be a falling straight line.

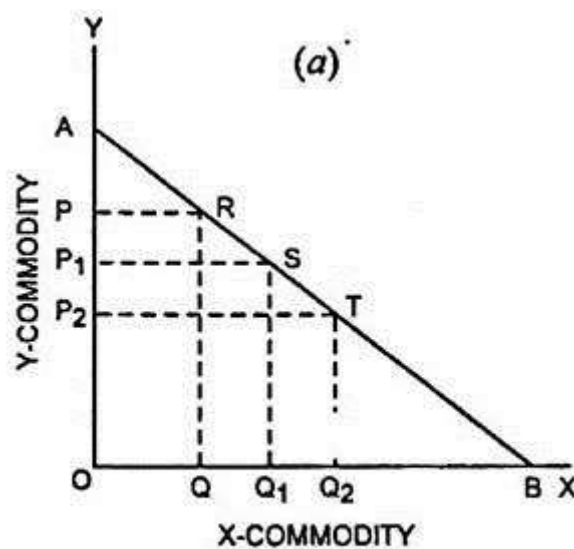


Fig. 6.1(a)

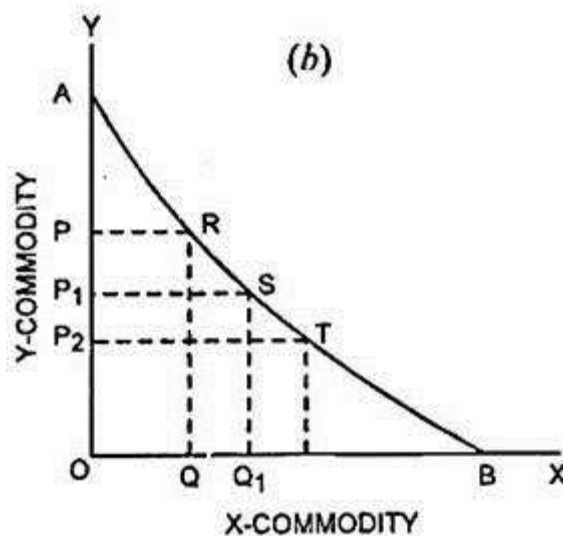


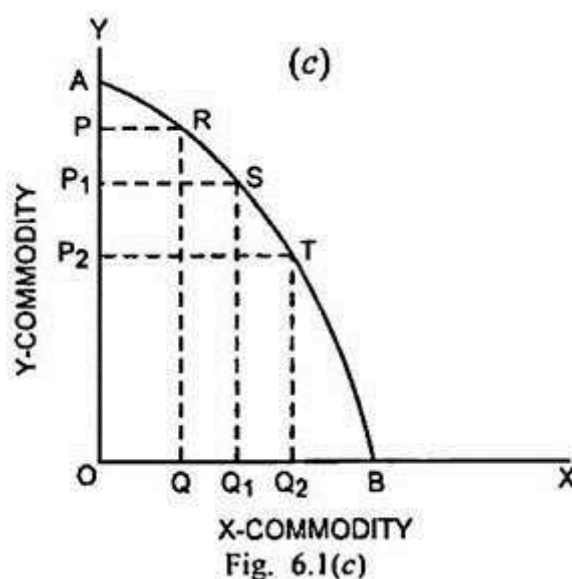
Fig. 6.1(b)

In Fig. 6.1 (b), the opportunity cost curve AB is a falling convex towards the origin, MRT<sub>xy</sub> in this case goes on decreasing.

$$(PP_1/QQ_1 > P_1P_2/Q_1Q_2)$$

This happens when production is governed by increasing returns to scale or the cost of X in terms Y goes on diminishing as less and less units of Y are given up in order to have more units of X. Even this situation is not realistic because larger production of X will cause reduced significance of X for the commodity in terms of the commodity Y. This figure, on the opposite, indicates increasing marginal significance of X.

In Fig. 6.1 (c), the opportunity cost curve AB is a falling concave curve towards the origin. In this case, MRT<sub>xy</sub> goes on increasing ( $PP_1/QQ_1 < P_1P_2/Q_1Q_2$ ).



The opportunity cost curve assumes this slope, when production is governed by diminishing returns to scale. As there is an increase in the production of X commodity, MC of X rises while that of Y decreases. This case seems to be more realistic because in this situation, a greater availability of X commodity shows a decreasing significance of this commodity in terms of units of Y commodity.

### 2.2.3 HECKSCHER - OHLIN THEORY

The Heckscher-Ohlin theory was developed by Swiss Eli Heckscher and Bertil Ohlin in 1977 at the Stockholm School of Economics. The Heckscher-Ohlin model demonstrates that comparative advantage is determined by the interaction between

a country's resources, the relative abundance of factors of production, and technology.

Heckscher-Ohlin's theory is based on the idea that countries have different resources. These resources can be things like land, labour, and capital (which includes things like machines and factories).

The theory suggests that countries tend to export (sell to other countries) the goods that use their abundant resources and import (buy from other countries) the goods that use their scarce resources.

#### **2.2.4 Assumptions based on the Heckscher-Ohlin's theory**

- \* Countries are endowed with different factors of production, such as labour, land, and capital.
- \* Factors of production are mobile within a country but not between countries.
- \* Goods are produced using different combinations of factors of production.
- \* Countries that use their abundant factors of production intensively tend to specialise in producing goods.

The theory emphasises the interrelation between the proportion in which the factors of production are available in different countries and the proportion in which they are used in the production of different goods (Theory of the endowment of factors of production).

#### **The Heckscher-Ohlin Theory – Example**

Here's a simplified example to illustrate the concept:

- \* Imagine two countries, Country A and Country B.
- \* Country A has a lot of fertile land, so it has abundant agricultural resources like soil and sunshine.
- \* Country B, on the other hand, has a well-educated and skilled workforce, so it has an abundance of labour.
- \* The Heckscher-Ohlin theory is a useful tool for understanding global trade in the 21st century. The theory provides a framework for analyzing the factors that influence trade patterns and the potential benefits of trade.

- \* According to the Heckscher-Ohlin theory, Country A is likely to specialise in producing agricultural products because it has lots of land, and it can produce these goods more efficiently.
- \* Meanwhile, Country B might produce things that require skilled labour, like technology or machinery.
- \* As a result, Country A will export agricultural products to Country B, and Country B will export technology or machinery to Country A. This trade benefits both countries because they can get the goods they don't have in abundance, than by trying to produce everything themselves.

### **Heckscher-Ohlin Theory Applications in Real-World**

Here are some examples of how the Heckscher-Ohlin theory applies in the real world:

- \* Countries with large populations and relatively lower wages, such as China and India, specialise in labour-intensive manufacturing, including textiles, toys, cosmetics, clothing, and consumer electronics. They export these goods to countries with higher labour costs.
- \* The USA is a capital-abundant country, so it exports capital-intensive goods, such as machinery and electronics.
- \* Brazil is a land-abundant country, so it exports agricultural products, such as soybeans and coffee.
- \* Nations like Saudi Arabia and Russia, with abundant natural resources like oil, specialise in the production and export of petroleum products.
- \* Developed countries like Germany and Switzerland specialise in capital-intensive manufacturing, such as precision machinery and automobiles.

### **Let's sum Up**

Haberler's Opportunity Cost Theory modernized Ricardo's comparative advantage by introducing the concept of opportunity cost, allowing for multiple factors of production beyond just labor. It states that a country should specialize in producing goods with the lowest opportunity cost and trade for those with higher costs, making the theory more realistic and widely applicable. The Heckscher-Ohlin Theory further expands trade theory by linking it to a country's factor endowments, suggesting that nations export goods that use their abundant and cheaper factors (like labor or capital) and import goods requiring scarce resources. While both

theories enhance the understanding of international trade, the Heckscher-Ohlin model has faced empirical challenges, such as the Leontief Paradox, which questioned its predictive accuracy.

## Section 2: Neo-Classical and Modern Trade Theories

### Check your Progress – Quiz 2

1. Haberler's theory focuses on:
  - a) Trade surplus
  - b) Opportunity cost
  - c) Positive trade balance
  - d) Production cost
2. According to the Heckscher-Ohlin theory, a labor-abundant country will:
  - a) Import capital-intensive goods
  - b) Export capital-intensive goods
  - c) Export labor-intensive goods
  - d) Import raw materials
3. Which theory introduced the concept of opportunity cost in trade?
  - a) Absolute Advantage
  - b) Comparative Advantage
  - c) Haberler's Theory
  - d) Mercantilism
4. The Heckscher-Ohlin theory explains trade based on:
  - a) Comparative advantage
  - b) Factor endowments
  - c) Product life cycle
  - d) Transaction costs
5. What paradox challenged the Heckscher-Ohlin theory?
  - a) Smith Paradox
  - b) Ricardo Paradox
  - c) Leontief Paradox
  - d) Dunning Paradox

## Section 2.3 Modern Approaches to International Business

### 2.3.1 MARKET IMPERFECTIONS APPROACH

The rise of the MNEs continuously puzzled the minds of neoclassical economists as to how these enterprises could make profits in foreign countries where production costs are more than at home. Being generally unaware of the host country's environment, it should be rather difficult to take advantage there. It may be better for the foreign company to pass on its advantages to the local entrepreneurs who, together with other local (inherent) advantages, could produce at a lower cost than the foreign investors.

The answer to this paradoxical situation is available in the presence of the imperfect market in the foreign countries. Hymer presented a case for market imperfection approach. According to him, the orthodox theories of the international trade and capital movements were inadequate to explain the involvement of MNEs in international business. Their presence is due to market imperfections. The advocates of this approach thought that the prevailing market imperfections were 'structural' (imperfections of monopolistic nature), and arose from the innovation of superior technology, access to capital, control of distribution system, economies of scale, differentiated products (by the introduction of different advertising methods) and superior management. These factors enabled the foreign enterprises more than offset the disadvantages from their operations in the foreign environment and the additional cost incurred there.

Hymer was basically concerned with the market power of the MNEs, which restricted the entry of other firms. The market power arises from collusion with others in the industry to avoid competition: which results in the larger profits.

There is one way causal link between the behaviour of the firm and the imperfect market structure. The market power is first developed in the domestic country and after the profit margin becomes lower in the home country, the firm invests abroad and controls the foreign markets by its patent rights.

### 2.3.2 PRODUCT LIFE CYCLE APPROACH

The product life-cycle approach is associated with the work of Raymond Vernon. Published in 1966, it deals with the evolution of the U.S. multinationals and

foreign direct investment patterns. In Vernon's model, three stages are followed in the introduction and establishment of new products in the domestic and foreign markets, with emphasis on innovation and oligopoly power as being the first basis for export and later for the FDI.

The first stage in the sequential development of the product is the new product stage which emerges in the home country following innovations as a result of intense R&D activities by the company. The product is introduced in the overseas market through export, and the innovating firm earns excessive profits both from domestic sales and exports abroad because of its monopoly position.

The second stage is, characterised by the mature product stage, when the demand in the foreign countries expands and the host country firms begin to produce competing products. The home country enterprise is induced to invest abroad for taking advantage of its technology and increasing demand for the product. As the company specific advantages of the firms controlling the technology are much higher than the local firms, the production in the host country would be cheaper. It stimulates foreign investment in subsidiaries.

In the third stage, the product becomes standardized; and competition grows in, the world market. The MNEs invest even in the LDCs, where the cost of production is lower. The host country, otherwise, has to import these products from abroad because its own production cost is more. The foreign investment may take the form of licensing arrangements also.

The initial analysis of the product life cycle approach gives a good account of the nature of the expansion of the U.S. companies after World War H. The theory was modified by Vernon in 1971 and 1977 in the light of the oligopoly threat arising from global innovative activities. He identified the first stage as the emerging oligopoly, the second stage as the mature oligopoly and the third stage as the senescent oligopoly, referring to the state of production when the standardized product is entirely produced abroad. The home country, where the product was initially innovated, imports all of the goods that it needs. Vernon's PCM model may be summarised in Table.

Nature of Stage Product	Product at Home or Abroad (1966)	Nature of Internal Business	Foreign Investment	Modified (1977)
New product I	Home	Export	Nil	Emerging Oligopoly (innovation based)
Maturing Product II	Abroad	Import	FDI (By Subsidiaries)	Mature Oligopoly)
Standardized Product III	Abroad	Import	(By Licensing arrangement)	Senescent Oligopoly

### 2.3.3 Product Life Cycle Model

The product life cycle model is useful in explaining the foreign investment patterns of the U.S. companies, but it has limited application to the firms going international, which were motivated by locational advantages. The location advantages led to the establishment of assembly plants of automobiles in the foreign countries. The FDI is also stimulated by the import restrictions and currency realignments. When a domestic devaluation of dollar occurred in the 1970s in relation to such major currencies as Japanese Yen and German Deutsche Mark, the exports of these countries no longer remained profitable in the U.S. market. The Japanese and German firms increased their investment in the U.S. economy to establish production facilities there.

### 2.3.5 TRANSACTION COST APPROACH

The transaction cost or internalisation approach was brought into prominence in the 1970s by McManus et. al. by emphasising the effects of the MNE on the internalisation of the external markets. The imperfections in the foreign markets are assumed of natural types rather than of structural type, i.e., imperfections of monopolistic nature. The analysis of the proponents of the Transaction Cost

Approach is based on the criticism of neoclassical economics which arises from the non-realization of the assumptions of perfect competition.

In the absence of the perfect market and the price system giving flawed signals, the transaction costs, such as the cost of information, enforcement of agreements, and the cost of bargaining are often quite high. The price existing in the

foreign countries may not be based on market forces. The agents of the corporation in the foreign markets may exploit the multinational by generating non-pecuniary externalities.

Such disadvantages to the company may be neutralised by adopting a mode of organisation which attempts to coordinate the different production units in a hierarchical manner.

The multinationals adopt a hierarchy for reducing the transaction costs. The MNEs through the FDI create opportunities for interactions in the host country for the appropriate mode of production and distribution patterns. Such interactions increase the gains from trade, benefiting the interacting parties. Hymer and Kindleberger have treated the FDI as a way to maximise the monopoly position for internalizing the pecuniary externalities. The transaction cost theorists have considered, the FDI for reducing the transaction costs and internalizing non-pecuniary externalities.

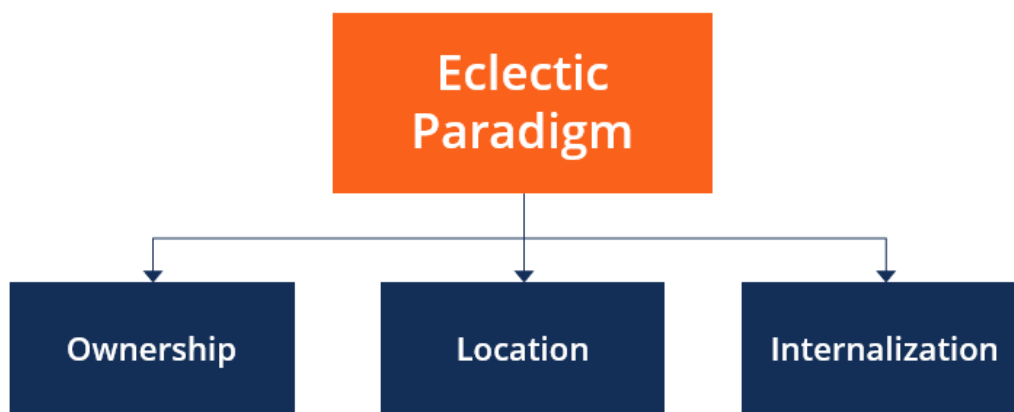
The distinction between pecuniary and non-pecuniary externalities is made on the basis of the type of market. If the market is of the structural imperfections type, where the monopolists differentiate their products, the pecuniary externalities arise out of the monopolistic behaviour of the participating companies. The non-pecuniary externalities occur in natural type market imperfections. For transaction cost approach, it is not necessary for a firm investing abroad to possess monopolistic power. It needs the market to be of such a type as to make hierarchical coordination possible, thereby reducing the cost of -production as compared to coordination through the price system.

Thus, the MNEs undertake the organisation of their production in a hierarchical manner rather than through the market for eliminating the cost of natural imperfection.

The internalization is possible in many through horizontal investments as well as vertical investments. The latter type consists of both backward and forward integration. The internalization is also possible through equity joint ventures, spot purchases and long-term contracts, new forms of investment and counter trade.

### 2.3.5 DUNNING'S ECLECTIC THEORY OF INTERNATIONAL PRODUCTION

Based on the internalization theory of British economist J.H Dunning, the eclectic paradigm is an economic and business method for analyzing the attractiveness of making a foreign direct investment (FDI). The eclectic paradigm model follows the OLI framework. The framework follows three tiers – ownership, location, and internalization.



The eclectic paradigm assumes that companies are not likely to follow through with a foreign direct investment if they can get the service or product provided internally and at lower costs.

#### Ownership Advantage

The ownership advantage can also be seen as the competitive advantage that comes with the FDI. Ownership, in this instance, can be defined as the proprietorship of a unique and valuable resource that cannot easily be imitated, thereby creating a competitive advantage against potential foreign competitors.

#### Location Advantage

The potential business host countries being considered for FDIs must present numerous competitive advantages; location is one of them. The location advantage focuses more on the geographic advantages of the host country or countries. An example of a geographic advantage can be access to the ocean (for sea freight or other purposes) versus a land-locked country.

#### Internalization Advantage

In order for companies to choose which investment pathway or method is best suited for their needs, their management team must analyze the internalization advantage. They normally need to consider whether it would be more sensible to get the value chain activity performed locally with their own team or outsource it to a foreign country.

The advantages of outsourcing from different countries can include (but are not limited to) lower costs and better skills to perform the value chain activities and/or better knowledge of the local markets.

### **Let's Sum Up**

The Market Imperfections Approach explains international business by highlighting barriers to the free flow of goods, services, and factors of production, such as tariffs, quotas, and knowledge transfer limitations. Firms expand abroad to capitalize on these imperfections, gaining cost advantages or accessing new markets. The Product Life Cycle Approach, introduced by Raymond Vernon, suggests that a product goes through stages—introduction, growth, maturity, and decline—which influence where and how it is produced and marketed globally. Initially produced in the innovating country, production later shifts to developing countries as the product matures. The Transaction Cost Approach focuses on minimizing the costs of doing business across borders, such as search, bargaining, and enforcement costs. Firms internalize operations (e.g., through foreign direct investment) when it's cheaper than using external markets. Dunning's Eclectic Theory (OLI Framework) combines these perspectives, stating that firms invest internationally when three conditions are met: Ownership advantages (O) like brand or technology, Location advantages (L) such as low costs or resources, and Internalization advantages (I) where internal control is more efficient than outsourcing. Together, these approaches provide a comprehensive explanation for why and how firms engage in international production.

**Section 2.3: Modern Approaches to International Business****Check Your Progress quiz 3**

1. Which approach explains international business as a way to exploit market imperfections?
  - a) Product Life Cycle Approach
  - b) Market Imperfections Approach
  - c) Heckscher-Ohlin Theory
  - d) Comparative Advantage
2. The Product Life Cycle Theory was introduced by:
  - a) John Dunning
  - b) Raymond Vernon
  - c) David Ricardo
  - d) Adam Smith
3. In the Product Life Cycle Approach, where are products typically produced during the maturity stage?
  - a) In developing countries
  - b) In the innovating country
  - c) In the home country
  - d) In multiple markets simultaneously
4. Dunning's Eclectic Theory combines which three types of advantages?
  - a) Trade, Labor, and Capital
  - b) Ownership, Location, and Internalization
  - c) Export, Import, and Production
  - d) Transaction, Opportunity, and Cost
5. What is the primary goal of the Transaction Cost Approach?
  - a) To minimize transportation costs
  - b) To minimize transaction costs in market exchanges
  - c) To maximize trade surplus
  - d) To promote product innovation

## 2.4 Unit Summary

The theoretical foundations of international business encompass a range of perspectives that explain the motivations and patterns of global trade and investment. Mercantilism emphasizes national wealth accumulation through exports and protectionism. Absolute and comparative cost advantage theories argue for specialization based on production efficiencies and opportunity costs. Haberler's theory adds nuance by considering opportunity costs in trade decisions. Heckscher-Ohlin theory relates trade patterns to countries' factor endowments. Market imperfections theory highlights strategic behavior due to imperfect competition and information. The product life cycle approach tracks how products evolve through stages impacting international trade. Transaction cost theory explains why firms internalize transactions through FDI. Dunning's eclectic theory integrates ownership advantages, location advantages, and internalization advantages to explain multinational strategies.

## 2.5 Glossary

1. **Mercantilism:** An economic policy focused on increasing a nation's wealth by maximizing exports and minimizing imports.
2. **Absolute Advantage:** The ability of a country to produce a good more efficiently than another country.
3. **Comparative Advantage:** A country's ability to produce a good at a lower opportunity cost than another country.
4. **Opportunity Cost:** The cost of forgoing the next best alternative when making a decision.
5. **Heckscher-Ohlin Theory:** A theory suggesting that countries export goods that use their abundant resources intensively.
6. **Market Imperfections:** Situations where market factors prevent perfect competition, leading to opportunities for international business.
7. **Product Life Cycle:** The stages a product goes through—introduction, growth, maturity, and decline—affecting trade patterns.

8. **Transaction Costs:** Costs associated with economic exchanges, such as information, enforcement, and bargaining costs.
9. **Eclectic Theory (OLI):** A theory of foreign direct investment combining Ownership, Location, and Internalization advantages.
10. **Leontief Paradox:** An empirical finding that contradicted the Heckscher-Ohlin theory by showing that the U.S. exported labor-intensive goods despite being capital-rich.
11. **Factor Endowments:** The amount of land, labor, capital, and entrepreneurship a country possesses.

## 2.6 Self – Assessment

1. What are the key assumptions of mercantilism?
2. Explain the concept of absolute cost advantage with an example.
3. How does the comparative cost advantage theory differ from absolute advantage theory?
4. What role did Adam Smith play in shaping international trade theory?
5. State two limitations of the mercantilist theory in the context of modern trade.
6. What is opportunity cost according to Haberler's theory?
7. How does Haberler's theory improve upon Ricardo's theory of comparative advantage?
8. State the main assumptions of the Heckscher-Ohlin theory.
9. Explain the concept of factor endowments in the Heckscher-Ohlin model.
10. What is the Leontief Paradox and how does it relate to the Heckscher-Ohlin theory?
11. What are the key elements of the Market Imperfections Approach?
12. Describe the four stages of the Product Life Cycle in the context of international trade.
13. What is meant by "transaction costs" in international business?

14. Explain the concept of Ownership advantage in Dunning's OLI framework.
15. How does the Product Life Cycle theory explain the shift of production from developed to developing countries?

### Essay-Type Questions

1. Compare and contrast the theories of Absolute and Comparative Cost Advantage. Provide relevant examples.
2. Critically evaluate the mercantilist theory and its relevance (or irrelevance) in the 21st century.
3. Explain David Ricardo's theory of Comparative Cost Advantage. How does it justify international trade even when one nation is more efficient in producing all goods?
4. Discuss the evolution of international trade theories from Mercantilism to Comparative Advantage.
5. Analyze how the theory of Comparative Advantage supports the idea of free trade.
6. Discuss Haberler's Opportunity Cost Theory and explain how it overcomes the limitations of the labor theory of value.
7. Explain the Heckscher-Ohlin Theory of International Trade. How does it differ from classical trade theories?
8. Compare and contrast the theories of comparative advantage (Ricardo), opportunity cost (Haberler), and factor endowments (Heckscher-Ohlin).
9. Critically analyze the assumptions and implications of the Heckscher-Ohlin model.
10. Evaluate the practical relevance of the Heckscher-Ohlin theory in light of real-world trade patterns and the Leontief Paradox.
11. Discuss the Market Imperfections Approach and how it explains the existence of multinational enterprises.

12. Explain the Product Life Cycle Approach and its relevance in the global expansion of firms.
13. Describe the Transaction Cost Approach and how it justifies foreign direct investment over licensing or exporting.
14. Analyze Dunning's Eclectic Theory (OLI model) of international production and how it integrates various theories of international business.
15. Compare and contrast the Transaction Cost Approach and Dunning's Eclectic Theory in explaining foreign direct investment decisions.

## 2.7 Case Study

### Case Study 1: Comparative Advantage in the Textile Industry

Country A has an abundance of high-quality wool but lacks the technology to manufacture advanced textiles. Country B, on the other hand, excels in producing state-of-the-art textile machinery but has limited natural resources for wool. Both countries agree to trade: Country A exports wool to Country B, while Country B exports textile machinery to Country A.

#### Question:

How does the concept of Comparative Advantage ensure that both countries benefit from this trade, even if one country is more efficient in producing both goods?

### Case Study 2: Product Life Cycle of Mobile Phones

A leading U.S. tech company launches an innovative smartphone. Initially, production takes place in the U.S. due to the need for highly skilled labor. As the product becomes more standardized and demand increases, production shifts to countries like South Korea. During the maturity stage, manufacturing moves to lower-cost regions such as Vietnam and India.

#### Question:

How does Product Life Cycle Theory explain the shift in production locations, and what advantages does the company gain from this strategy?

### Case Study 3: Dunning's Eclectic Theory and Foreign Direct Investment

A German automotive company decides to establish a manufacturing plant in Mexico to produce cars for the North American market. The decision is driven by their superior automotive technology (Ownership Advantage), Mexico's lower labor costs and proximity to key markets (Location Advantage), and the desire to control production internally rather than outsourcing (Internalization Advantage).

#### Question:

Why is it beneficial for the company to adopt Dunning's Eclectic Theory (OLI Framework) in deciding where to invest, rather than relying solely on cost considerations?

### 2.8 Answer for Check Your Progress

<b>Section 2.1</b>	<b>Classical Trade Theories</b>
1	b) Mercantilism
2	b) Have an absolute cost advantage in producing
3	b) David Ricardo
4	b) Supports protectionism and neglects mutual trade benefits
5	a) Countries have equal efficiencies in all products
<b>Section 2.2</b>	<b>Neo-Classical and Modern Trade Theories</b>
1	b) Opportunity cost
2	c) Export labor-intensive goods
3	c) Haberler's Theory
4	b) Factor endowments
5	c) Leontief Paradox
<b>Section 2.3</b>	<b>Modern Approaches to International Business</b>

1	b) Market Imperfections Approach
2	b) Raymond Vernon
3	a) In developing countries
4	b) Ownership, Location, and Internalization
5	b) To minimize transaction costs in market exchanges

## 2.9 Reference and suggested readings

1. International Business: Competing in the Global Marketplace Charles W.L. Hill & G. Tomas M. Hult McGraw-Hill Education, New York, USA, 13th Edition, 2023
2. International Economics: Theory and Policy Paul R. Krugman, Maurice Obstfeld & Marc J. Melitz Pearson Education, London, UK 12th Edition, 2022
3. International Business: Environment and Operations John D. Daniels, Lee H. Radebaugh & Daniel P. Sullivan Pearson Education, New Jersey, USA, 17th Edition, 2022
4. World Economy: International Trade and Finance Dominick Salvatore McGraw-Hill Education, New York, USA 12th Edition, 2020

## UNIT III

### Unit – III Legal framework of International Business

Legal framework of International Business: Nature and complexities: Code and common laws and their implications to Business-International Business contract- Legal provisions, Payment terms.

### Unit Objectives

The objective of this unit is to enable learners to understand the legal framework governing international business operations, emphasizing the nature and complexities of global trade laws. It aims to provide insight into the distinction between code law (civil law) and common law systems and their respective implications for international business practices. The unit also seeks to familiarize students with the essential components of international business contracts, including the formation, interpretation, and enforcement of agreements across jurisdictions. Furthermore, learners will explore relevant legal provisions affecting international trade, dispute resolution mechanisms, and payment terms such as letters of credit and bills of exchange, ensuring they can navigate the legal and financial intricacies of conducting business globally in a compliant and effective manner.

### SECTION 3.1 LEGAL FRAMEWORK OF INTERNATIONAL BUSINESS

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## SECTION 3.1 LEGAL FRAMEWORK OF INTERNATIONAL BUSINESS

### 3.1.1 MEANING AND NATURE OF LEGAL FRAMEWORK OF INTERNATIONAL BUSINESS

#### Meaning of legal framework

The legal framework in international business comprises national and international laws that regulate commercial activities across borders. It includes treaties, conventions, agreements, domestic statutes, and customary practices. The framework provides predictability, order, and a foundation for resolving disputes, enforcing contracts, protecting investments, and standardizing business practices

The legal framework of international business refers to the system of rules, regulations, treaties, conventions, and laws that govern business transactions across

national borders. It ensures that international trade and investment activities are conducted fairly, transparently, and in compliance with global and domestic legal systems.

This framework addresses important questions:

Who regulates business practices?

What laws do corporations operate under?

When and how do banks and companies corporations join together?

What could happen if a company violates rules?

In other words, the legal and regulatory framework sets the boundaries of every aspect of business. It prevents fraud, protects the rights of people, and promotes clean and fair practices. Now, for any particular area, if you see the legal and regulatory framework of merger and acquisition or you see the legal and the regulatory framework of microfinance in India, both have different laws governing in that domain.

### **What is a Legal and Regulatory Framework?**

The legal and regulatory framework is the set of laws, rules and regulations that govern and constrain the behaviour of people and businesses. These rules can cover contracts, taxes, employment, the environment, banking and more.

All of these rules also apply to every business or risk they face, lawsuits, or even closure. A company, for example, must follow labor regulations, pay taxes on time, and safely handle customer data.

### **These laws ensure that:**

Where Businesses Do Right by People

Companies stay ethical

Investors feel safe

### **Important Legislation Affecting Business Operations**

Some key laws that fall under the umbrella of business legal and regulatory framework include:

- Companies Act, 2013
- Income Tax Act, 1961
- Consumer Protection Act, 2019
- Factory Labour Laws (Factories Act, Minimum Wages Act)

These laws set up a list of do's and don'ts for companies. They also established systems to resolve disputes and punish law-breakers.

### **Legal and Regulatory Framework of Merger and Acquisition**

Legal and regulatory framework of merger and acquisition provides guidance on how one company buys or joins with another. It stops discriminatory contracts and safeguards the rights of stockholders. When an acquisition or merger occurs, ownership, power, and value shifts. So the law needs to ensure that its fair for both sides.

### **Laws That Apply to Mergers in India**

Some important Indian laws in this regard are as follows:

- The Companies Act, 2013 – It describes the legal amalgamation provisions for Companies.
- The SEBI Takeover Code – These safeguards the investors when a company is being taken over.
- Competition Act, 2002 – This prevents one player from becoming too powerful.
- Income Tax Act, 1961 – It deals with tax benefits and issues related to mergers.

Government like SEBI (Securities and Exchange Board of India) and CCI (Competition Commission of India) ensures these laws are maintained.

These rules ensure that:

- Mergers don't harm the market
- Investors get a fair deal
- Businesses never abuse their power

### **Legal and Regulatory Framework of Merchant Banking**

Merchant bankers assist large corporations in raising funds, IPOs, mergers, and investments. Merchant banking is surrounded by the legal and regulatory framework that makes them act fairly.

In India, merchant bankers are controlled and regulated by SEBI. They have to comply with strict regulations to register and continue functioning.

### **Main Laws and Regulations**

- SEBI (Merchant Bankers) Regulations, 1992 – This law characterized the working of the merchant bankers.
- Companies Act, 2013 – Ensures appropriate corporate behavior.
- SEBI ICDR Regulations – These govern the issuance of shares by companies.

These rules ensure:

- Investors are safe from fraud
- It should be also noted that Merchant bankers provide genuine information
- IPO process is fair and clean

Merchant Bankers crucially work in helping to build the business expansion. They might misuse their power without proper laws to hold them to account.

### **Legal and Regulatory Framework of Business**

There is every rule a business must follow from day one to the closing day of the business, it's the legal & regulatory framework of business. This framework informs how companies are organized, how and who they hire, how they move their money, and with what intent they move day to day.

The key laws that govern the business of companies in India are as follows:

- Companies Act, 2013
- Contract Act, 1872

- Factories Act, 1948
- Labour Laws
- GST Laws

These laws guarantee businesses cannot do the following:

- Exploit workers
- Cheat customers
- Avoid taxes
- Harm the environment

They also help companies to comply with fair trades, promote growth and cultivate public trust.

### **Legal and Regulatory Framework of Microfinance in India**

Microfinance provides small loans to poor individuals or small businesses. Legal and regulatory framework of microfinance in India is regulated by a strong legal framework that keeps the interests of the lenders in mind. It also ensures that the borrowers are not exploited.

In India, microfinance is regulated by the Reserve Bank of India (RBI). It supplants authoritative standards that hinder banks from charging high interest or using power to gather cash.

### **Laws Pertaining to Micro Finance Institutions (MFIs)**

- NBFC-MFIs – RBI Master Directions
- Development and Regulation Bill, 2020 Micro Finance Institutions
- Companies Act, 2005

These laws ensure:

- The oppressor, poor borrowers do not exploit.
- Loans are given responsibly
- Creditworthiness: The ability to pay back
- Restorative measures (non-violence recovery)

This ecosystem enables millions of small borrowers to fund to grow their livelihood.

### **Legal and Regulatory Framework of Environmental Law**

Environmental legislation legal and regulatory framework laws and regulations that protect natural resources, including nature, water, air, animals, and people. Companies have to comply with these regulations when they construct factories, utilize land or discharge waste.

These rules are made and verified in India by the Ministry of Environment, Forest and Climate Change (MoEFCC).

### **Environmental Laws of India**

- Environmental (Protection) Act, 1986
- (Prevention and Control of Pollution) Act, 1974 Water
- Air (Prevention and Control of Pollution) Act, 1981'
- Forest Conservation Act, 1980

These laws ensure that:

- Businesses do not pollute rivers, land or air
- Forests and the animals that inhabit them remain intact
- Public health is not harmed
- Sustainable practice is encouraged

If a company violates these rules, it faces stiff penalties or shut down. Environmental regulations balance growth with nature.

### **Regulatory Framework and Legal Issues in Business**

All businesses have some type of legal problem. Depending on your business, these can be about employees, customers, taxes or even technology use. You also have solutions to these problems working with the regulatory framework and legal issues in business.

Some common issues include:

- Employee disputes
- Data privacy and protection
- Intellectual property theft
- Unfair trade or monopolies

Courts and laws are there to resolve such issues justly. The framework also teaches businesses how to stay legally out of trouble in the first place.

- Official Departments of Business Law
- Ministry of Corporate Affairs
- SEBI
- RBI
- Income Tax Department
- Consumer Courts

These organisations also co-operate to ensure the business world remains a clean, ethical, and legal place.

### What is the Difference between Legal and Regulatory Framework?

A lot of folks believe that legal and regulatory are interchangeable terms. But they are different. So, let's see what is the difference between legal and regulatory framework.

### What is a Legal Framework?

Laws and principles from a legal point of view which are guiding a country is called as a legal framework. These are laws made by the parliament or legislative bodies. A legal framework provides individuals and entities with fundamental rights, obligations and fairness.

#### Examples:

- The Indian Companies Act, 2013 (or the Act) are to govern the formation and operation of companies in India.
- It governs agreements and legal obligations – The Contract Act, 1872

A legal framework will have to narrow down its focus to what is right and what is wrong. They provide a baseline for justice and delineate the parameters of acceptable conduct.

#### Examples:

- The Indian stock market is regulated by the SEBI Guidelines.
- Guidelines for Banks to operate under financial laws (RBI Circulars)

Legal Framework	Regulatory Framework
Set by legislations passed by parliament	Set by government agencies like SEBI

Has penalties if breaks law and legal penalties	Can receive suspension, fines or warnings
Based on Companies Act	Based on SEBI regulations
Focus on rights and laws	All about how rules get executed

### 3.1.1 NATURE OF LEGAL FRAMEWORK OF INTERNATIONAL BUSINESS

Legal Framework of International Business is all pervasive, standardized, dynamic, governed by supra-national bodies and sustenance-oriented.

1. **All Pervasive:** International Business laws are all pervasive. These cover almost every aspect of business and also geographically all pervasive. The international legal environment pushes international laws into each state. In fact, laws developed by states concerning business relations are often limited to operations connected to their borders. In this way, national legislation is often un-adaptable to international trade and presents the further difficulty of sometimes being incompatible with one another. From then on, states are accepting the loss of a part of their sovereignty more and more for the purpose of harmonization and to make the different legal systems compatible, but also to simplify rules governing international business operations. In this way, international commercial law has created a new legal framework, which it is advisable to refer to in certain economic situations such as, for example sales contracts or distribution agreements.
2. **Standardized:** Multilateral agreements are leading towards unification and harmonization of international law, paving way for standardization. As a result many international treaties, agreements, institutionalized business-legal system and the like have evolved over the years. There are international treaties in certain areas such as transport or international sales. The International Organization for Standards, the International Chamber of Commerce and the International Bank for Settlement have given many standards to make global business follow standard practices. International law is a source of order and clarity. There are many conventions agreed upon by nations as well, like the listed ones below to make global business platform standardized.

- \* International Convention dealing with the international transport of goods by Road (CMR)
  - \* International Convention dealing with the international transport of goods by Rail (CIR)
  - \* Warsaw Convention on air transport of goods by Air
  - \* The New York convention on (1958) on the recognition and carrying out of foreign arbitrary sentences
  - \* Rome Convention on (1980) on laws applying to contractual Obligations
3. **Dynamic:** International business laws keep pace with newer developments in global business as well. The Money Laundering Control Acts are passed by nations making money laundering a crime prohibiting individuals from engaging in financial transactions with proceeds that were generated from certain specific crimes, known as “specified unlawful activities”. International transfer pricing laws exist which bring related party transactions under scanner for possible tax avoidance. Business laws are dynamically adopted and new ones are passed to facilitate global trade.
4. **Governed By Supra-National Bodies:** World Trade Organization(WTO), International Court of Justice, International Chamber of Commerce, International Commercial Arbitration, United Nations Commission on International Trade Law, International Centre for Settlement of Investment Disputes, International Monetary Fund (IMF), World Bank and the United Nations, World Tourism Organization, Interpol, World Health Organization (WHO) and dozens of international agencies now work to regulate world trade, telecommunications, transportation, labour, business, health and the environment, among other issues. National laws are not to override respective international convention.
5. **Sustenance-oriented:** International Business laws give importance for sustained business development across the globe. The Kyoto Protocol under the aegis of the UN Framework Convention on Climate Change (UNFCCC) is an international treaty that sets binding obligations on industrialized countries to reduce emissions of green-house gases. The Convention on Biological Diversity (CBD), known informally as the Biodiversity Convention, is an international legally binding treaty. The Convention has three main goals: conservation of biological diversity, sustainable use of its components; and

fair and equitable sharing of benefits arising from genetic resources. In other words, its objective is to develop national strategies for the conservation and sustainable use of biological diversity. It is often seen as the key document regarding sustainable development. The Convention was opened for signature at the Earth Summit in Rio De Janeiro, past (until 1960) capital of Brazil on 5 June 1992 and entered into force on 29 December 1993.

### 3.1.2 Objectives of Legal Framework of International Business

The objectives of a legal framework in international business are to facilitate smooth and fair trade by establishing clear rules, mitigating risks, and protecting the interests of businesses, governments, and consumers. It promotes fair practices and prevents discriminatory acts, ensuring that transactions can be completed securely and efficiently while building trust between nations and stakeholders.

- To ensure compliance and mitigate risk: The legal framework helps businesses navigate the complexity of different national laws, reducing the risk of penalties, lawsuits, and damage to their credibility from non-compliance.
- To facilitate trade and investment: It establishes the "rules of the road" for international commerce, including treaties, to allow for the smooth and predictable exchange of goods and services across borders.
- To create a predictable and stable environment: By setting standards, maintaining order, and protecting rights, it provides the certainty that businesses need for long-term, sustainable growth in global markets.
- To protect stakeholders: It includes laws to protect intellectual property, ensure fair employment practices, and guarantee consumer safety, which builds trust among all parties involved.
- To resolve disputes: It provides mechanisms and principles for resolving conflicts that may arise, such as those involving contracts or differing legal interpretations between nations.
- To prevent unfair practices: It aims to promote fair trade and prevent discrimination between nations by establishing principles like "Most Favored Nation" status and national treatment, often enforced by bodies like the World Trade Organization (WTO).

### 3.1.3 COMPLEXITIES OF LEGAL FRAMEWORK OF INTERNATIONAL BUSINESS

Legal framework of international business is known for its complexities because of geographical, cultural, development, population, poverty-wealth, governmental, political, endowment, and technological, societal, ecological and environmental diversities of nations.

- 1. Complexity due to Regional variations in operative aspects of multilateral laws:** Every international treaty/convention/law need to provide for regional variations for one or other reason. The goodness is the internet is global, but the bad news is that copyright law is country by country. Copyright royalties eat up big chunk of revenue, and the difficulty that a publishing company has had in its attempts to strike deals in other countries, is enormous. International business law attorneys need to be engaged to tailor strategies that navigate the legal and regulatory complexities of global business.
- 2. Complexity due to conflicting or unclear rules:** International law can actually exacerbate complexity with conflicting or unclear rules, uncertain enforcement, and overlapping and competing jurisdiction. International law must demonstrate the flexibility to embrace new issues, to look beyond the State, and to integrate new players (who may not follow its rules). Transparency, accountability, and participation must be guaranteed in new private regulatory regimes, shorn from State control. The instruments and processes of international law must provide means for scientific evidence to be sifted, understood, and translated into law. And yet, even as it adapts, international law must also remain a force for stability and predictability.
- 3. Complexity due to Nationalism is not accepting Globalism:** Just from the titles of these treaties it is worth remarking that it is a long way before a general unification of law for international contracts. It is little by little, domain by domain, that states come to an agreement on uniform rules. It is also important to note that this unification of law in small measures is not truly efficient in a measure where treaties are ratified in a large number of states. But this ratification is often random as it creates new legal rules which states are not always ready to adhere to.

4. **Complexity due to Counterfeiters and Imitators:** Apart from protecting their intellectual property rights, business enterprises are faced with a more complex problem of dealing with piracy and counterfeit goods. Pirates and counterfeiters cause great harm as they deprive the owner of the protected work his share of royalty, the authorized dealer his profit and the buyer of quality product. The US government through an amendment of the Trade Act of 1974, attempts to counteract such practices under Section 301 of the said Act.

### **3.1.4 Sources of International Business Law (Domestic & International Sources)**

The sources of international business law refer to the origins, authorities, and institutions that create, influence, and enforce the legal rules governing business and trade activities between nations and private parties across borders.

In international business, companies are not governed by a single global legal code; instead, they operate under a combination of domestic laws (national legislation) and international legal instruments (treaties, conventions, and customary practices).

Understanding these sources is essential for global managers, exporters, importers, and multinational corporations (MNCs) to ensure compliance, minimize disputes, and operate effectively in foreign markets.

#### **1. Classification of Sources**

Broadly, the sources of international business law can be classified into two main categories:

**Domestic Sources** — National-level laws and regulations enacted by sovereign countries that affect international trade and investment activities within their borders.

International Sources — Rules and norms developed through international cooperation among states, organizations, and trade institutions that govern cross-border business activities.

### **A. DOMESTIC SOURCES OF INTERNATIONAL BUSINESS LAW**

Domestic sources are national laws that apply to foreign trade, investments, and business transactions within a particular country.

Each country enacts its own set of laws governing business operations, including the registration of foreign companies, taxation, import/export rules, and foreign exchange controls.

These laws ensure that all foreign business activities comply with national policies and economic interests.

#### **Key Domestic Legal Sources:**

##### **1. Constitutional Provisions**

The constitution of a country serves as the supreme law that determines how international agreements, treaties, and foreign policies are framed.

For example, in India, Article 253 of the Constitution empowers the Parliament to make laws for implementing international treaties and agreements.

Thus, international trade agreements become part of domestic law through parliamentary approval.

##### **2. Statutory Laws (Acts and Legislations)**

Statutory laws directly regulate foreign business operations and transactions. Examples include:

Foreign Exchange Management Act (FEMA), 1999 – Governs foreign exchange transactions, capital flows, and cross-border investments in India.

Customs Act, 1962 – Regulates the import and export of goods, determines tariffs, and prevents illegal trade.

Companies Act, 2013 – Provides rules for registration and operation of foreign companies in India.

Income Tax Act, 1961 – Prescribes taxation norms for foreign income, royalties, and transfer pricing.

Foreign Trade (Development and Regulation) Act, 1992 – Controls export and import licensing and promotes international trade.

These domestic statutes ensure that international business activities are monitored, transparent, and aligned with national interests.

### **3. Judicial Decisions (Case Law)**

Judicial precedents or court rulings are important sources of business law. Courts interpret statutes and treaties, setting examples for future cases.

For example, Indian courts have clarified how arbitration awards under international agreements like the New York Convention (1958) can be enforced in India.

### **4. Administrative Regulations and Government Policies**

Governments often issue notifications, circulars, and policy guidelines that directly impact foreign trade and investments.

For instance:

The Reserve Bank of India (RBI) issues circulars under FEMA governing foreign exchange transactions.

The Directorate General of Foreign Trade (DGFT) announces the Foreign Trade Policy regulating imports and exports.

These administrative tools act as secondary but powerful sources of international business law within the country.

### 5. Bilateral and Multilateral Agreements Incorporated into Domestic Law

Once a country signs and ratifies an international treaty (like a double taxation avoidance agreement or free trade agreement), it often becomes part of domestic law.

For instance, India's Double Taxation Avoidance Agreements (DTAAs) with more than 90 countries ensure that the same income is not taxed twice.

Thus, domestic and international laws work together to create a coherent legal environment for business.

## **B. INTERNATIONAL SOURCES OF INTERNATIONAL BUSINESS LAW**

International sources refer to rules, treaties, and conventions developed by cooperation between states and international organizations.

These sources aim to create uniformity, fairness, and predictability in the conduct of international business and trade.

### **Key International Legal Sources:**

#### 1. International Conventions and Treaties

These are formal agreements between two or more nations that create binding legal obligations.

Some major examples include:

The Vienna Convention on Contracts for the International Sale of Goods (CISG), 1980 – Standardizes international sales contracts.

The New York Convention, 1958 – Provides for the recognition and enforcement of foreign arbitral awards.

The Paris Convention, 1883 and Berne Convention, 1886 – Protect industrial property and copyrights globally.

The TRIPS Agreement (1995) under WTO – Regulates intellectual property rights in international trade.

These conventions provide a uniform framework for resolving cross-border legal issues.

## **2. Customary International Law**

Customary law consists of long-standing practices followed by states out of a sense of legal obligation (*opinio juris*).

Examples include the principle of free navigation in international waters or the doctrine of sovereign immunity.

In business, customary law plays a role in international shipping, trade routes, and commercial usage (like bills of lading or trade credits).

## **3. Decisions of International Courts and Tribunals**

Judgments by international judicial bodies serve as persuasive authorities for resolving international disputes.

### **Key institutions include:**

International Court of Justice (ICJ) – Resolves disputes between nations.

International Centre for Settlement of Investment Disputes (ICSID) – Handles investor–state disputes.

World Trade Organization (WTO) Dispute Settlement Body (DSB) – Adjudicates trade conflicts between member countries.

These decisions influence the development and interpretation of international business law principles.

## **4. Acts and Declarations of International Organizations**

International organizations create soft laws, model laws, and declarations that guide trade and business conduct.

Examples include:

UNCITRAL (United Nations Commission on International Trade Law) – Drafts model laws on arbitration, electronic commerce, and insolvency.

UNCTAD (United Nations Conference on Trade and Development) – Provides policy guidance and standards for developing countries.

OECD Guidelines for Multinational Enterprises – Promote responsible business conduct.

Although not always binding, these acts influence national legal systems and business behavior.

### **5. International Commercial Practices and Usages**

Business customs or trade usages, such as INCOTERMS (International Commercial Terms) published by the International Chamber of Commerce (ICC), are widely accepted as part of international commercial law.

For instance:

FOB (Free on Board) and CIF (Cost, Insurance, and Freight) terms define delivery and payment responsibilities in trade contracts.

These usages reduce misunderstandings and create uniformity in international business transactions.

### **Integration of Domestic and International Sources**

Modern international business law is not a rigid separation between national and international systems; instead, it is interconnected and complementary.

For example:

A company importing goods into India must comply with Customs Act (Domestic Source) and WTO Tariff Rules (International Source) simultaneously.

Arbitration awards given under the New York Convention (International) are enforced through India's Arbitration and Conciliation Act, 1996 (Domestic).

Hence, businesses operate within a multi-layered legal system where both domestic and international sources jointly determine their rights and obligations.

### **3.1.5 Role of WTO, UNCTAD, and IMF in the International Legal Environment**

The international legal environment of business is shaped by multiple organizations that establish and maintain the rules of global trade, finance, and investment. Among them, the World Trade Organization (WTO), the United Nations Conference on Trade and Development (UNCTAD), and the International Monetary Fund (IMF) play critical roles.

These institutions provide the legal architecture and regulatory frameworks necessary for the smooth functioning of global markets. Their roles include policy formulation, dispute resolution, monitoring, technical assistance, and promoting equitable participation of developing nations in the world economy.

#### **3.1.5. Role of the World Trade Organization (WTO)**

##### **1. Establishment and Objective**

The World Trade Organization (WTO) was established on 1 January 1995, succeeding the General Agreement on Tariffs and Trade (GATT, 1947).

It is the only global international organization that sets and enforces the rules governing trade between nations.

The main objectives of the WTO are to:

Promote free and fair international trade.

Reduce tariffs, quotas, and other trade barriers.

Provide a forum for trade negotiations.

Ensure non-discrimination through the principles of Most-Favoured Nation (MFN) and National Treatment.

## **2. Legal Role in International Business**

The WTO establishes a legal structure for global trade through a series of binding agreements that member countries must follow.

Some key legal instruments under WTO include:

GATT 1994 (Goods) – Regulates international trade in goods.

GATS (General Agreement on Trade in Services) – Covers trade in services like banking, insurance, and telecom.

TRIPS (Trade-Related Aspects of Intellectual Property Rights) – Protects intellectual property rights globally.

Agreement on Trade-Related Investment Measures (TRIMs) – Ensures fair treatment of foreign investors.

These agreements together create a legal code of conduct for international business, promoting transparency, predictability, and equal opportunity.

## **3. Dispute Settlement Mechanism**

The WTO Dispute Settlement Body (DSB) provides a structured legal forum for resolving trade disputes between member countries.

The process includes consultations, panel hearings, appellate review, and implementation of rulings.

For example, India has used the WTO dispute mechanism to challenge unfair trade restrictions, such as the US ban on shrimp imports.

This mechanism ensures that member nations comply with their obligations and that global trade operates under a rule-based system, not political power.

## **4. Role in Trade Policy Review and Monitoring**

The WTO conducts Trade Policy Reviews (TPRs) of member nations to ensure compliance with global trade rules.

It also provides technical assistance to developing countries to help them implement WTO agreements effectively, thus strengthening the legal infrastructure for global trade.

### **5. Importance to International Business**

The WTO's role in the legal environment of international business includes:

Creating uniform trade rules applicable to all member countries.

Reducing legal uncertainty in international contracts and tariffs.

Promoting stability and fairness in global markets.

Providing a legal remedy system through arbitration and dispute resolution.

## **B. Role of the United Nations Conference on Trade and Development (UNCTAD)**

### **1. Establishment and Objective**

The United Nations Conference on Trade and Development (UNCTAD) was established in 1964 as a permanent organ of the United Nations General Assembly.

It was created to address the concerns of developing countries regarding unequal participation in international trade and the global economy.

#### **Its primary objectives include:**

Promoting inclusive and sustainable development.

Assisting developing countries to integrate into the global trading system.

Formulating policy recommendations to balance trade and development interests.

### **2. Legal Role in International Business**

UNCTAD's influence in the international legal environment arises from its work in developing legal principles, model laws, and frameworks that support developing economies.

It does not create binding laws but provides soft law instruments, policy frameworks, and research to guide national legislation and international negotiations.

For instance:

UNCTAD contributes to international investment agreements (IIAs).

It prepares model bilateral investment treaties (BITs) that safeguard investor rights while protecting national interests.

It promotes codes of conduct for multinational enterprises to ensure ethical business practices.

### **3. Key Areas of Legal Contribution**

Investment Policy Framework for Sustainable Development (IPFSD): Offers guidelines for countries to reform investment laws and treaties.

Trade and Development Reports: Analyze the effects of international trade law on developing nations.

Technology Transfer Agreements: Encourages equitable access to technology through fair licensing and patent systems.

Competition and Consumer Protection: Provides model laws and capacity-building programs.

Through these, UNCTAD ensures that international trade law evolves with fairness, inclusiveness, and development orientation.

### **4. Importance to Developing Countries**

UNCTAD helps developing nations by:

Strengthening their legal and institutional capacity for trade negotiations.

Advocating special and differential treatment under WTO agreements.

Supporting regional cooperation and South–South trade.

Thus, it acts as a policy bridge between developed and developing economies in the international legal order.

### C. Role of the International Monetary Fund (IMF)

#### 1. Establishment and Objectives

The International Monetary Fund (IMF) was established in 1944 at the Bretton Woods Conference and began operations in 1945.

It was designed to maintain monetary stability and financial order among member countries.

#### **The main objectives of the IMF are to:**

Promote international monetary cooperation.

Ensure exchange rate stability.

Facilitate balanced growth of international trade.

Provide financial assistance to countries facing balance of payments crises.

#### 2. Legal Role in the International Environment

The IMF operates through the Articles of Agreement, which serve as a legally binding treaty among its 190+ member countries.

These articles form the legal foundation for international monetary cooperation.

#### **Key legal aspects include:**

Surveillance over member countries' exchange rate policies.

Guidelines for foreign exchange convertibility.

Conditional lending arrangements that require macroeconomic and fiscal reforms.

Monitoring compliance with global financial rules and reporting standards.

### **3. Role in Exchange Rate and Foreign Exchange Regulation**

The IMF's role extends to ensuring stable exchange rates and preventing competitive devaluation of currencies.

It influences the legal framework for currency convertibility, foreign borrowing, and international payments, which are directly relevant for international business.

For example, India's foreign exchange laws (such as FEMA, 1999) align with IMF principles to maintain external stability and promote international investment.

### **4. Role in Financial Stability and Legal Reforms**

The IMF provides legal and policy advice to member countries on banking laws, fiscal management, and debt restructuring.

It supports developing nations in modernizing their financial and central banking regulations.

For instance, during financial crises, IMF programs often require recipient countries to reform their financial laws, thereby influencing domestic legal systems globally.

### **5. Importance to International Business**

IMF policies directly affect international business by ensuring:

Stable currency exchange rates, essential for cross-border contracts.

Predictable financial policies, improving investor confidence.

Regulated capital movements, reducing risks of defaults and currency crises.

Hence, the IMF plays a vital role in maintaining the financial legal order on which global business depends.

#### **D. Interrelationship Between WTO, UNCTAD, and IMF**

Though these three institutions have distinct mandates, they complement each other in shaping the legal environment for international business:

The WTO focuses on trade law and market access.

The IMF manages monetary stability and payments systems.

The UNCTAD promotes development-oriented and equitable trade laws.

Together, they ensure that the international economic system operates on principles of stability, legality, and inclusiveness.

For instance, WTO rules on trade liberalization must align with IMF's currency convertibility requirements, while UNCTAD ensures developing nations' interests are not undermined.

#### **3.1.6 Impact of Legal Framework on Global Trade**

Global trade refers to the exchange of goods, services, technology, and capital across national borders. Its smooth functioning depends heavily on the legal framework — the system of laws, treaties, regulations, and institutions that define and govern international business activities.

A clear, predictable, and harmonized legal environment ensures that businesses can trade confidently, resolve disputes fairly, and operate under consistent rules. Conversely, a weak or inconsistent legal system can lead to trade barriers, protectionism, and commercial uncertainty.

The impact of the legal framework on global trade is both direct (through trade laws, treaties, and agreements) and indirect (through enforcement, dispute settlement, and investor confidence). Let's examine these in depth.

#### **A. Significance of Legal Framework in Global Trade**

The legal framework of international business acts as the foundation of global trade governance. It:

Promotes fairness and uniformity in cross-border transactions.

Prevents trade disputes and fraud through legal certainty.

Facilitates predictable trade practices by defining rights and obligations.

Encourages foreign investments by protecting property rights and enforcing contracts.

Enhances economic cooperation among countries through shared legal standards.

Without a strong legal framework, trade relations can deteriorate into chaos, protectionism, or economic exploitation.

## **B. Positive Impacts of Legal Framework on Global Trade**

### **1. Ensures Stability and Predictability in Trade Relations**

A codified legal framework — supported by international treaties like GATT, GATS, TRIPS, and TRIMS under the WTO — ensures that all member nations adhere to consistent trade rules.

Predictability reduces uncertainty for businesses involved in long-term cross-border contracts.

For example, multinational corporations like Toyota or Unilever rely on WTO tariff commitments to plan global production and supply chains.

### **2. Promotes Fair Competition and Reduces Trade Barriers**

Legal instruments such as antidumping agreements, subsidy control measures, and competition laws prevent unfair trade practices.

The WTO's Most-Favoured-Nation (MFN) and National Treatment principles ensure equal market access, preventing discrimination against foreign goods or services.

This creates a level playing field where efficiency and innovation drive trade, not political favoritism or hidden tariffs.

### **3. Facilitates Cross-Border Investments**

International business law encourages foreign direct investment (FDI) by establishing legal protection for investors.

Agreements such as Bilateral Investment Treaties (BITs) and Multilateral Investment Guarantees (MIGA) ensure that foreign investors are protected from expropriation, unfair treatment, or currency transfer restrictions.

Stable legal frameworks thus attract global capital flows and promote industrial growth in developing economies.

### **4. Strengthens Intellectual Property Protection**

The TRIPS Agreement (1995) under the WTO standardizes global protection of patents, trademarks, and copyrights.

By providing legal certainty, TRIPS encourages multinational corporations to transfer technology, share innovations, and expand globally.

For instance, pharmaceutical companies can safely export patented drugs, knowing their intellectual property is protected internationally.

### **5. Simplifies Dispute Resolution**

A structured legal environment ensures the efficient resolution of cross-border commercial disputes.

Institutions like:

#### **The WTO Dispute Settlement Body (DSB)**

The International Centre for Settlement of Investment Disputes (ICSID)

The International Chamber of Commerce (ICC)

provide platforms for arbitration and mediation.

Businesses thus avoid costly litigation in foreign courts and instead use international arbitration, governed by conventions like the New York Convention (1958).

This enhances global trade confidence and reduces risks.

#### 6. Promotes Trade Liberalization

The global legal framework, especially under WTO and regional trade blocs like EU, ASEAN, and NAFTA (now USMCA), promotes free trade and tariff reduction.

For instance, the WTO's Uruguay Round (1995) led to significant tariff cuts across 123 countries, expanding global merchandise trade volumes.

Such liberalization allows countries to specialize in comparative advantage and gain from efficiency and economies of scale.

#### 7. Enhances Consumer and Environmental Protection

Modern trade laws include provisions for sustainability, consumer rights, and environmental standards.

Agreements under UNCTAD and OECD ensure responsible trade practices.

For example, the Basel Convention restricts transboundary movement of hazardous waste.

Thus, the legal framework ensures that globalization does not come at the cost of environmental degradation or human rights violations.

#### 8. Promotes Harmonization of Trade Procedures

Uniform legal standards under INCOTERMS, UNCITRAL Model Laws, and International Accounting Standards (IAS) simplify documentation, payments, and logistics.

Businesses using standard legal formats for contracts, invoices, and bills of lading save time and costs.

This harmonization reduces misunderstandings and ensures smooth cross-border trade operations.

### **C. Challenges and Limitations of Legal Frameworks in Global Trade**

Despite its benefits, the legal environment also creates challenges for developing countries and small businesses.

#### **1. Complexity and Compliance Costs**

The global trade legal framework involves multiple overlapping agreements, making compliance expensive and difficult for small exporters.

For instance, WTO rules require detailed documentation and certification, which may burden small and medium enterprises (SMEs).

#### **2. Power Imbalance in Negotiations**

Developed countries often dominate international trade negotiations, leading to unequal legal outcomes.

For example, while WTO rules on agriculture are strict for developing countries, developed economies often protect their farmers with subsidies.

This creates legal asymmetry, limiting fair benefits to poorer nations.

#### **3. Enforcement Gaps**

Although global treaties are binding, enforcement largely depends on national governments.

Some nations delay compliance or selectively apply rulings.

For instance, WTO decisions can take years to be implemented, reducing their effectiveness in real-time trade scenarios.

#### **4. Conflicts between Domestic and International Laws**

National sovereignty sometimes clashes with international obligations.

For example, domestic laws protecting local industries may violate WTO's non-discrimination clauses.

Balancing domestic priorities and international commitments remains a key challenge for policymakers.

### **5. Legal Risks in Cross-Border Transactions**

Differences in legal systems (Code Law vs. Common Law), judicial procedures, and contract enforcement mechanisms can create ambiguity and litigation risks.

This underscores the need for international harmonization of business laws.

### **D. Case Example: Legal Framework and India's Global Trade**

India's participation in global trade illustrates how a nation's legal environment shapes its international performance:

Adoption of FEMA (1999) liberalized foreign exchange and boosted FDI inflows.

Implementation of WTO agreements facilitated tariff reduction and export diversification.

Establishment of Special Economic Zones (SEZ) Act, 2005 created favorable legal conditions for export-led growth.

Thus, India's evolving trade law framework has contributed significantly to its integration into the global economy.

### **E. Interconnected Role of WTO, UNCTAD, and IMF**

The combined influence of international institutions enhances the overall legal environment:

WTO ensures predictable trade laws.

UNCTAD advocates development-focused reforms.

IMF maintains currency stability for smooth international payments.

Together, they promote a balanced and legally robust trading system that supports both developed and developing countries.

### Let's Sum Up

This section explains the nature, scope, and challenges of the legal environment in international business. The legal framework is multifaceted, involving national laws of multiple countries, regional agreements, and international conventions. It governs aspects such as export-import regulations, foreign investment, taxation, and intellectual property protection. The complexity arises because every country has its own legal, political, and economic systems, which can differ significantly. Businesses must navigate these differences to ensure compliance and avoid legal disputes. Globalization, rapid technological changes, and evolving trade policies further increase the dynamic nature of international law. Thus, understanding the legal environment is essential for minimizing risks and promoting ethical, lawful global trade operations.

### Check Your Progress – Quiz 2.1

1. The term “legal framework” in international business refers to:

- A. The set of economic policies guiding a country's trade
- B. The system of laws and regulations governing business operations across borders
- C. The political agreements among nations
- D. The financial system of a country

**Answer: B**

2. Which of the following best describes the nature of a legal framework in international business?

- A. Static and uniform across countries
- B. Dynamic and varies between jurisdictions
- C. Concerned only with domestic business

D. Unrelated to trade practices

**Answer: B**

3. One of the objectives of an international legal framework is to:

- A. Eliminate all trade between countries
- B. Encourage monopolistic practices
- C. Promote fair and predictable trade relations
- D. Restrict foreign investments

**Answer: C**

4. Which of the following contributes most to the complexity of the international business legal environment?

- A. Uniformity of global laws
- B. Differences in national legal systems and enforcement
- C. Lack of trade agreements
- D. Similar political ideologies

**Answer: B**

5. Domestic sources of international business law include:

- A. International treaties and conventions
- B. National legislation and judicial decisions
- C. UN resolutions
- D. WTO agreements

**Answer: B**

6. International sources of business law include all of the following EXCEPT:

- A. Multilateral treaties
- B. International customs and practices
- C. Foreign investment policies of one country

D. Decisions of international tribunals

**Answer: C**

7. The World Trade Organization (WTO) primarily aims to:

- A. Provide loans to developing countries
- B. Regulate international monetary policy
- C. Facilitate smooth and fair international trade
- D. Promote cultural exchange

**Answer: C**

8. The United Nations Conference on Trade and Development (UNCTAD) focuses on:

- A. Regulating exchange rates
- B. Promoting trade and investment for developing countries
- C. Lending to governments
- D. Managing international disputes

**Answer: B**

9. The International Monetary Fund (IMF) plays a key role in the international legal environment by:

- A. Administering trade agreements
- B. Providing short-term financial assistance and promoting monetary stability
- C. Regulating multinational corporations
- D. Overseeing international arbitration

Answer: B

10. The impact of legal frameworks on global trade is that they:

- A. Create uncertainty and hinder cross-border transactions
- B. Establish order, reduce risk, and encourage investment

C. Eliminate competition

D. Restrict globalization

Answer: B

### 3.2.1 MEANING AND ORIGIN CODE LAW AND COMMON LAWS

A code is a type of legislation that purports to exhaustively cover a complete system of laws or a particular area of law as it existed at the time the code was enacted, by a process of codification. The legal code was a common feature of the legal systems of the ancient Middle East. In the Roman Empire, a number of codifications were developed, such as the Twelve Tables of Roman law (first compiled in 450 BC) and the Corpus Juris Civilis of Justinian, also known as the Justinian Code (429 - 534 AD). However, these codes did not exhaustively describe the Roman legal system.

In ancient China, the first comprehensive criminal code was the Tang Code, created in 624 AD. This, and subsequent imperial codes, formed the basis for the penal system of both China and other East Asian states under its cultural influence. The last and best preserved imperial code is the Great Qing Legal Code created in 1644 upon the founding of the Qing Dynasty. This code was the exclusive and exhaustive statement of Chinese law between 1644 and 1912. Though it was in form a criminal code, large parts of the code dealt with civil law matters and the settlement of civil disputes.

In Europe, Roman Law, especially the Corpus Juris Civilis became the basis of the legal systems of many countries. Roman law was either adopted by legislation or through processing by jurists. The accepted Roman law is usually then codified and forms part of the central Code.

Meanwhile, African civilizations developed their own legal traditions, sometimes codifying them through consistent oral tradition, enumerating regulations in both constitutional and civil matters, and transmitted to this day. The Continental civil law tradition spread around the world along with European cultural and military dominance in recent centuries.

Side by side, codifications also became more common in commonlaw systems. For example, a criminal code is found in a number ofcommon law jurisdictions in the USA, UK and Australia. In the Americas, the influence of Continental legal codes has manifested itself in two ways. In civil law jurisdictions, legal codes in the Continental tradition are common. In common law jurisdictions, however, there has been a strong trend towards codification. The result of such codification, however, is not always a legal code as found in civil law jurisdictions.

**Criminal Procedure Code:** Criminal procedure code refers tothe adjudication process of the criminal law. While criminal procedure differs dramatically by jurisdiction, the process generally begins with a formal criminal charge, right to be heard for the accused and results in the conviction or acquittal, appeals and disposal. Currently, in many countries with a democratic system and the rule of law, criminal procedure puts the burden of proof on the prosecution – that is, it is up to the prosecution to prove that the defendant is guilty beyond any reasonable doubt, as opposed to having the defence prove that s/he is innocent, and any doubt is resolved in favour of the defendant. This provision is known as the presumption of innocence, until one is proved otherwise. However, in practice it operates somewhat differently in different countries. Similarly, all such jurisdictions allow the defendant the right to legal counsel and provide any defendant who cannot afford their own lawyer with a lawyer paid for at the public expense (which is in some countries called a “court appointed lawyer”).

**Civil Procedure Code:** Civil procedure code is the body of law that sets out the rules and standards that courts follow when adjudicating civil suits. These rules govern how a lawsuit or case may be commenced, what kind of service of process (if any) is required, the types of pleadings or statements of case, motions or applications, and orders allowed in civil cases, the timing and manner of depositions and discovery or disclosure, the conduct of trials,, the process for judgment, various available remedies, and how the courts and clerks must function.

### **SECTION 3.2.2 – CHARACTERISTICS OF CODE LAW**

The Code Law system, also known as the Civil Law system, operates on principles that emphasize comprehensive legal codification and systematic application of laws. Below are its key characteristics explained in detail:

### **1. Comprehensive Written Codes**

The foundation of Code Law is the existence of written legal codes that encompass all major areas of law—civil, criminal, and commercial. These codes are enacted by the legislature and serve as the principal source of law.

For example, France's Code Civil, Germany's Bürgerliches Gesetzbuch (BGB), and Japan's Civil Code form the backbone of their legal systems. Courts rely primarily on these statutes rather than past judicial decisions.

### **2. Limited Role of Judges**

In Code Law systems, the role of judges is primarily to interpret and apply the law as it is written, not to create new legal rules. Judicial decisions are not binding on other courts in future cases, meaning that precedent has limited importance. The emphasis lies in ensuring that the written law is applied uniformly and consistently.

### **3. Separation of Powers**

Code Law systems maintain a clear separation between legislative and judicial functions. Law-making is the responsibility of the legislature, while judges ensure its implementation. This reduces the discretion of courts in shaping law but promotes legal certainty and predictability for businesses.

### **4. Inquisitorial System of Trial**

Unlike the adversarial system used in Common Law countries, Code Law systems often adopt an inquisitorial approach—especially in civil and criminal proceedings. Here, judges play an active role in investigating the facts, questioning witnesses, and seeking truth rather than relying solely on lawyers' arguments.

### **5. Uniformity and Predictability**

Because Code Law is written and standardized, it provides clarity and predictability to citizens and businesses. Legal outcomes can often be anticipated by

consulting the relevant code, which reduces ambiguity and ensures uniform application of law across regions.

## 6. Codification of Commercial Law

In Code Law countries, commercial transactions are often governed by specialized commercial codes (e.g., Code de Commerce in France). These define business relationships, contracts, trade practices, and corporate obligations. This codification simplifies business operations, reduces legal uncertainty, and encourages foreign investment.

## 7. Emphasis on Legal Principles Rather than Precedents

Code Law focuses on legal principles derived from statutes rather than judicial precedents. Legal professionals rely on interpretation of the code's intent rather than examining past case outcomes. This helps maintain a stable and systematic body of law.

## 8. Advantages for International Business

For international traders, Code Law systems offer certain advantages:

Laws are accessible, clear, and uniform.

Disputes can often be resolved quickly since judges apply written rules directly.

The predictability of decisions supports long-term contracts and stable investments.

However, the rigid nature of Code Law can sometimes limit flexibility in adapting to complex or unforeseen business issues, unlike the more adaptable Common Law system.

## Section 3.2.3 – Characteristics of Common Law

The Common Law system is one of the two primary legal traditions in the world, the other being Code (Civil) Law. Common Law is primarily based on judicial precedents—that is, decisions made by judges in earlier cases form the guiding principles for deciding future cases with similar facts. This system evolved in England and was spread to many other countries, such as the United States, Canada, Australia, India, and other Commonwealth nations, through British colonization.

Unlike Code Law, which relies on comprehensive written statutes, Common Law develops through case law, customs, and judicial interpretations. This makes it a more flexible and adaptable legal system, capable of evolving with changing business and social conditions. It plays a major role in international business because many major trading nations follow the Common Law tradition.

### **1. Judicial Precedent as the Primary Source of Law**

The most distinctive feature of Common Law is the doctrine of precedent, also known as stare decisis (“to stand by things decided”). Under this principle, the decision of a higher court is binding on lower courts in future similar cases.

This ensures consistency and predictability in judicial decisions, as courts are expected to follow previously established rulings. For instance, if a superior court interprets a commercial clause in a particular way, that interpretation will guide similar disputes in the future.

In business contexts, judicial precedent provides stability, helping companies anticipate how courts are likely to interpret contracts, torts, and liabilities.

### **2. Role of Judges in Law-Making**

In the Common Law system, judges play an active role in shaping the law. Through their rulings, judges interpret statutes, resolve ambiguities, and sometimes even create new legal principles to address issues not covered by legislation.

This dynamic function allows the Common Law to adapt to new social and commercial realities. For example, modern legal concepts such as negligence and fiduciary duty were not established by legislation but developed through judicial reasoning.

In international business, this flexibility enables courts to interpret contracts or disputes involving novel trade arrangements or technologies, even in the absence of explicit laws.

### **3. Importance of Custom and Usage**

Common Law originally evolved from customs and practices observed in medieval England. Even today, commercial customs and trade usages play a

significant role in shaping legal obligations, especially in areas like international trade, shipping, and insurance.

Courts often recognize customary practices in a particular trade or region when interpreting contracts. For example, the usage of trade in the international shipping industry may determine the responsibilities of the buyer and seller under a maritime contract, even if not explicitly stated in writing.

#### **4. Flexibility and Adaptability**

A major strength of the Common Law system lies in its flexibility. Since it is based on judicial decisions rather than fixed codes, it can evolve with time. Courts can reinterpret old rules in light of new developments, ensuring that the law remains relevant to changing economic, technological, and social conditions.

For instance, the emergence of e-commerce, digital payments, and cyber contracts has been accommodated within Common Law jurisdictions without requiring complete legislative overhaul—thanks to judicial adaptability.

This feature makes Common Law systems particularly attractive for global business operations where rapid adaptation to new issues is essential.

#### **5. Limited Role of Legislation**

Although statutes and acts passed by legislatures exist in Common Law countries, they are supplementary rather than all-encompassing. Judges interpret and fill the gaps left by legislation through case law.

For example, while the United Kingdom's Sale of Goods Act provides general guidelines on commercial transactions, much of the practical interpretation—such as what constitutes a “breach of contract” or “reasonable time for delivery”—comes from court decisions.

This means that in business disputes, judicial interpretation often carries more weight than written law.

#### **6. Adversarial System of Trial**

Common Law countries typically follow an adversarial system of justice, where the court acts as an impartial referee between the parties. Each side presents

its case, evidence, and arguments through lawyers, and the judge or jury determines the outcome based on facts and applicable precedents.

This contrasts with the inquisitorial system found in Code Law countries, where the judge takes an active role in investigating the case.

The adversarial approach promotes fair hearing, cross-examination, and transparency, which are highly valued in international commercial litigation and arbitration.

### **7. Case Law as a Source of Guidance**

In Common Law systems, case reports and judicial opinions are recorded and published as legal references. Lawyers and judges frequently cite previous cases (case law) to support arguments or judicial reasoning.

This vast library of case law provides a rich source of guidance for future cases and helps lawyers predict outcomes. International corporations use this feature to assess legal risks and design contracts that comply with established legal precedents.

### **8. Emphasis on Individual Rights and Property Protection**

Common Law systems traditionally emphasize individual rights, freedom of contract, and protection of property. These values have made Common Law jurisdictions favorable environments for entrepreneurship and international trade.

For instance, in countries like the United States and the United Kingdom, strong judicial protection of contractual and property rights has encouraged foreign investment and commercial innovation. The recognition of intellectual property, corporate rights, and contract enforcement is a key strength of the Common Law tradition.

### **9. Influence on International Business Law**

The principles of Common Law have significantly shaped modern international business law. Institutions such as the International Chamber of Commerce (ICC) and international trade agreements often incorporate Common Law concepts like good faith, breach of contract, and due diligence.

Many multinational corporations prefer to conduct contracts under Common Law jurisdictions (e.g., English law or New York law) because of their clarity, global acceptance, and predictable dispute resolution mechanisms.

### **10. Examples of Common Law Countries**

Countries that follow the Common Law system include:

United Kingdom

United States

India

Canada

Australia

New Zealand

Singapore

Hong Kong

These countries often serve as hubs for international trade, finance, and arbitration—further reinforcing the global influence of Common Law principles

### **3.2.4 Difference between Criminal and civil procedure codes:**

**Meaning of Civil Procedure Code (CPC) and Criminal Procedure Code (CrPC),**

**Civil Procedure Code (CPC), 1908:**

The Civil Procedure Code lays down the procedures and rules followed by civil courts in India for adjudicating civil cases such as property disputes, contracts, family matters, and compensation claims. It provides the framework for filing suits, presenting evidence, and executing decrees.

**Criminal Procedure Code (CrPC), 1973:**

The Criminal Procedure Code prescribes the procedure for the investigation, inquiry, trial, and punishment of offenses under criminal law. It governs how criminal cases are initiated, investigated by the police, tried in court, and how penalties are imposed or appealed.

### Key Differences between Civil and Criminal Procedure Codes

Basis of Difference	Civil Procedure Code (CPC, 1908)	Criminal Procedure Code (CrPC, 1973)
1. Nature of Wrong	Deals with private wrongs or disputes between individuals.	Deals with public wrongs or offenses against the state/society.
2. Objective	To enforce rights, recover damages, or obtain relief (compensation, injunction, etc.).	To punish the offender and maintain public order.
3. Parties Involved	Plaintiff (who files the case) and Defendant (against whom it is filed).	State (prosecution) and Accused (person charged with offense).
4. Type of Case	Civil cases — e.g., property disputes, breach of contract, divorce, etc.	Criminal cases — e.g., theft, murder, fraud, assault, etc.
5. Initiation of Proceedings	Case initiated by an individual filing a plaint.	Case initiated by the state or police through FIR or complaint.
6. Burden of Proof	Based on <i>preponderance of probabilities</i> (less strict standard).	Based on <i>proof beyond reasonable doubt</i> (very strict standard).
7. Outcome / Result	Results in judgment, decree, or order — usually compensation or injunction.	Results in conviction, acquittal, or sentence (fine, imprisonment, etc.).
8. Role of State	State acts as a neutral authority	State acts as a party to the

	through the judiciary.	case (prosecution).
<b>9. Compromise</b>	Parties can compromise or settle the dispute outside court.	Compromise possible only in compoundable offenses with court permission.
<b>10. Appeals</b>	Appeal can be made to a higher civil court.	Appeal can be made to higher criminal courts depending on offense gravity.
<b>11. Arrest / Detention</b>	No arrest or detention involved in civil proceedings.	Arrest and detention are integral to criminal proceedings.
<b>12. Legal Outcome</b>	Restores rights or compensates for loss.	Imposes punishment or penalty for wrongdoing

### 3.2.5 Implications of Code and Common Law on International Business

Code (civil) law and common law have major implications for international business, especially regarding contracts, intellectual property, dispute resolution, and compliance. Understanding the differences is essential for firms operating across legal systems, as each framework influences contract structure, risk management, and enforcement mechanisms.

#### Code Law Implications

Code law is based on comprehensive written statutes and legislative codes, particularly prevalent in continental Europe, Japan, and parts of Latin America.

Business contracts in code law countries tend to be detailed and explicit, listing all possible contingencies, and agreements often require formal registration for enforceability.

Judicial decisions rely strictly on the letter of the law, giving judges limited flexibility and leading to more predictable but sometimes rigid outcomes.

Intellectual property protection usually demands registration, providing clear ownership but requiring more administrative effort for international businesses.

### Common Law Implications

Common law, practiced in the UK, US, Australia, and former British colonies, emphasizes precedent, judicial interpretation, and adaptability to new situations.

Contracts in common law jurisdictions are often less detailed since prior case law guides interpretation, but legal disputes may emphasize the intent of the parties.

Ownership may be established through use rather than registration, adding flexibility but possible ambiguity for companies expanding globally.

Dispute resolution tends to be adversarial, with precedent playing a key role, and international commercial agreements often favor common law for its adaptability.

### International Business Considerations

Multinationals must adapt contracts and business practices to comply with the relevant jurisdiction's law to avoid enforceability and liability issues, especially when choosing governing law for cross-border agreements.

A sound legal strategy often includes arbitration and mediation for dispute resolution, as cross-border litigation can invoke complex differences in code and common law systems.

Firms should consult legal experts familiar with target country laws to manage risks in areas such as intellectual property registration, employment regulations, and taxation.

Understanding these fundamental legal differences enables international businesses to create resilient strategies, mitigate risks, and maximize opportunities across diverse legal landscapes

### **Let's Sum Up**

This section focuses on the two dominant legal systems that shape global business practices — Code Law (Civil Law) and Common Law. Code Law systems, found in countries like France, Germany, and Japan, rely on comprehensive written codes that clearly define legal principles and procedures. Common Law systems, followed in countries such as the United Kingdom, the United States, and India, depend largely on judicial precedents and case law. For international businesses, understanding these systems is critical, as they determine how contracts are written, interpreted, and enforced. In Code Law countries, contracts must be exhaustive and detailed, while in Common Law jurisdictions, past judgments and interpretations influence decisions. Recognizing the distinction between these systems helps firms draft contracts that are legally valid and enforceable in the respective countries.

### **Check your Progress Quiz – 3.2**

1. Which of the following best describes a Code Law system?

- A) Based on judicial precedents
- B) Based on written legal codes and statutes
- C) Based on customary practices only
- D) Based on religious law

**Answer: B) Based on written legal codes and statutes**

2. The Common Law system originated in:

- A) France
- B) Germany
- C) England
- D) Rome

**Answer: C) England**

3. In a Common Law system, the principle of stare decisis means:

- A) Judges ignore past decisions
- B) Past judicial decisions are binding on future cases
- C) Laws are written in codes
- D) Judges cannot interpret laws

**Answer: B) Past judicial decisions are binding on future cases**

4. One key difference between Code Law and Common Law is that:

- A) Code Law relies heavily on precedent, Common Law does not
- B) Common Law is codified, Code Law is not
- C) Common Law allows judges to interpret and make law, Code Law does not
- D) There are no major differences

**Answer: C) Common Law allows judges to interpret and make law, Code Law does not**

5. How does Code Law affect international business contracts?

- A) Contracts can be very brief and general
- B) Contracts rely on previous judgments
- C) Contracts must be detailed and comprehensive
- D) No written contracts are required

**Answer: C) Contracts must be detailed and comprehensive**

6. Which of the following countries follows the Common Law system?

- A) France
- B) Germany
- C) Japan
- D) United States

**Answer: D) United States**

### **SECTION 3.3.1 – MEANING AND NATURE OF INTERNATIONAL BUSINESS CONTRACT**

In today's globalized economy, businesses engage in trade and investment activities that cross national borders. These transactions—whether for the sale of goods, licensing, joint ventures, or services—require a clear and legally binding understanding between parties from different countries. This understanding takes the form of an international business contract.

An international business contract serves as the legal foundation for cross-border commercial relationships. It outlines the terms and conditions under which the parties agree to perform their respective obligations, such as the delivery of goods, payment, quality standards, and dispute resolution mechanisms. Because such contracts operate across multiple legal systems, they must be carefully drafted to reflect international laws, trade practices, and jurisdictional rules.

#### **Meaning of International Business Contract**

An international business contract (also known as a cross-border contract or foreign trade agreement) is a legally enforceable agreement between two or more parties located in different countries for conducting international commercial transactions.

It specifies:

The rights and obligations of each party.

The terms of trade, such as delivery, payment, and risk transfer.

The applicable law and jurisdiction in case of disputes.

The mode of dispute settlement, which may include arbitration, mediation, or litigation.

In essence, an international business contract is an instrument of certainty, designed to prevent misunderstandings and conflicts in international transactions where cultural, linguistic, and legal differences may otherwise cause confusion.

For example, if an Indian exporter sells machinery to a German buyer, the contract will define the product specifications, price, delivery schedule, payment method, insurance, applicable law (say, English law), and mechanism for dispute resolution (such as ICC arbitration in Paris).

### **Nature of International Business Contract**

The nature of an international business contract is more complex than that of a domestic contract because it involves different legal jurisdictions, trade customs, currencies, and political environments. The following characteristics explain the distinctive nature of such contracts:

#### **1. Cross-Border Element**

The most fundamental nature of an international contract is that it involves parties from different countries. The transaction may include export-import of goods, technology transfer, franchising, or foreign investment. Because of this cross-border

nature, the contract must comply not only with domestic laws but also with international conventions and trade regulations such as:

The United Nations Convention on Contracts for the International Sale of Goods (CISG, 1980)

Uniform Customs and Practice for Documentary Credits (UCP 600)

INCOTERMS (International Commercial Terms) set by the ICC

This multi-jurisdictional aspect makes international contracts legally sensitive and globally relevant.

## **2. Diversity of Legal Systems**

Parties to an international contract may belong to countries following different legal systems—such as Common Law (e.g., UK, USA, India) or Code Law (e.g., France, Japan, Germany). These differences affect contract interpretation, enforcement, and remedies for breach.

For instance, in Common Law countries, contracts are interpreted largely by judicial precedents and the doctrine of freedom of contract, while in Code Law countries, the written statutory provisions play a dominant role.

Therefore, parties must agree in advance on the applicable law that governs their contract (known as the choice of law clause).

## **3. Detailed and Comprehensive Nature**

Since the parties operate under different jurisdictions and may not have the same understanding of trade practices, international business contracts are usually detailed and comprehensive.

They cover all aspects of performance—price, quality, inspection, packing, insurance, documentation, and remedies for non-performance.

This comprehensiveness helps prevent ambiguity and provides a legal framework for dispute resolution. The more detailed the contract, the less room there is for conflicting interpretations in court or arbitration.

#### 4. Dependence on International Conventions and Model Laws

International contracts are influenced by globally accepted model laws and conventions designed to standardize commercial practices. Some key instruments include:

CISG (1980) – governs international sale of goods.

UNIDROIT Principles of International Commercial Contracts – provides guidelines for fair and uniform interpretation of commercial agreements.

UNCITRAL Model Law on International Commercial Arbitration (1985) – facilitates arbitration of cross-border disputes.

By referencing these frameworks, businesses ensure that their contracts align with internationally recognized norms, making enforcement easier across jurisdictions.

#### 5. Risk Allocation and Payment Provisions

International contracts must clearly define how risks are shared between the buyer and seller—such as loss or damage during transit, currency fluctuations, or delays.

They also specify the method of payment (e.g., advance payment, letter of credit, or documentary collection), guided by INCOTERMS rules which standardize risk transfer points and responsibilities.

For instance, under the FOB (Free on Board) term, the seller's responsibility ends when goods are loaded onto the shipping vessel, and risk passes to the buyer thereafter.

#### 6. Involvement of Multiple Laws

An international business contract may be simultaneously governed by:

Contract law of the chosen jurisdiction,

International trade law,

Foreign exchange regulations,  
Customs and import/export control laws, and  
Maritime or transport laws.

This multi-layered legal involvement requires careful drafting and expert legal review to ensure compliance with all applicable regulations.

## **7. Choice of Law and Jurisdiction Clause**

Every international contract contains a choice of law clause specifying which country's legal system will apply, and a jurisdiction clause identifying where disputes will be resolved.

For example, an Indian exporter and an American importer might agree that English law governs the contract, and any dispute will be settled through arbitration in Singapore. Such clauses are crucial because they determine how and where the rights of parties will be protected.

## **8. Use of Arbitration and Mediation**

Due to the high cost and complexity of international litigation, most contracts prefer arbitration or mediation as the mode of dispute settlement.

Institutions like the International Chamber of Commerce (ICC), London Court of International Arbitration (LCIA), and Singapore International Arbitration Centre (SIAC) provide neutral platforms for resolving cross-border business disputes efficiently and confidentially.

## **Significance of International Business Contracts**

International business contracts serve as the legal backbone of global trade and investment. Their significance can be summarized as follows:

They create legal certainty in cross-border dealings.

They protect the interests of parties from different legal backgrounds.

They prevent disputes by clarifying rights and obligations.

They provide legal recourse in case of breach or non-performance.

They support international trade growth by building trust and reducing risks.

Without formal and enforceable contracts, international trade would be exposed to unpredictable risks, misunderstandings, and legal disputes.

### **SECTION 3.3.2 – ELEMENTS OF A VALID INTERNATIONAL CONTRACT**

For an international business contract to be legally enforceable, it must fulfill certain essential elements recognized under both domestic and international law. These elements ensure that the agreement reflects a genuine meeting of minds between parties from different countries and that it can withstand scrutiny in a court of law or an international arbitration tribunal.

While international contracts share many foundational principles with domestic contracts, their cross-border nature introduces additional complexities, such as differences in legal systems, languages, and enforcement mechanisms. Therefore, a valid international contract must comply with universal contract principles as well as international legal standards such as those found in the United Nations Convention on Contracts for the International Sale of Goods (CISG, 1980) and UNIDROIT Principles.

#### **1. Offer and Acceptance**

The foundation of every valid contract is the offer made by one party and its acceptance by another.

**Offer:** An offer is a definite proposal made by one party (the offeror) to another (the offeree) with the intention that it becomes binding upon acceptance.

In international trade, an offer must clearly specify the product, price, quantity, delivery terms, and payment conditions. For example, an Indian exporter may offer to sell 500 tones of steel to a German importer at USD 600 per tones FOB Mumbai.

Acceptance: Acceptance must be unconditional, absolute, and communicated to the offer or within a reasonable time. In international transactions, acceptance often takes place through electronic communication, such as emails or telex.

Under CISG Article 18, acceptance becomes effective when it reaches the offeror, unless the parties agree otherwise. Thus, offer and acceptance together create a meeting of minds (*consensus ad idem*) — a key requirement for a valid international contract.

## 2. Intention to Create Legal Relations

A valid international contract must reflect the intention of both parties to enter into a legally binding agreement.

In domestic contexts, social or moral agreements (e.g., family promises) are not enforceable because there is no such intention. However, in international business, commercial dealings are presumed to have legal intent.

For example, when a Japanese company signs a supply agreement with a French firm, both intend that the terms are legally enforceable under applicable law.

In the international context, this intention is reinforced through formal written documents, signature requirements, and clauses indicating governing law and dispute resolution. The inclusion of these legal clauses demonstrates the parties' clear intent to be bound by the contract's terms under recognized international legal frameworks.

## 3. Lawful Consideration

Consideration refers to something of value that each party agrees to exchange — it could be money, goods, services, or a promise to perform or refrain from an act.

In an international business contract, the consideration is usually payment for goods or services, but it can also take the form of technology transfer, franchise rights, or intellectual property licensing.

For example, a U.S. company may pay a royalty to an Indian firm for licensing patented technology. The payment (money) and the technology (intellectual property) constitute valid considerations. However, the consideration must be lawful — it cannot involve prohibited goods (e.g., narcotics, banned arms, or illegal trade). Under UNIDROIT Principles, the contract is invalid if its purpose or performance is contrary to public policy or international law.

#### **4. Capacity of Parties**

The parties entering into an international contract must have the legal capacity to do so. Capacity refers to the legal competence of individuals or entities to enter into a binding agreement.

In cross-border business, this includes:

Individuals: Must be of legal age and sound mind.

Companies or corporations: Must be legally incorporated and authorized to conduct international transactions under their national laws.

For instance, if a foreign subsidiary of a multinational company lacks board approval for entering into a contract, the agreement could later be declared void.

Therefore, before signing an international contract, it is standard practice to verify the legal status, authority, and power of signatories through documentation like board resolutions, powers of attorney, or corporate certificates.

#### **5. Lawful Object and Purpose**

A valid international contract must have a lawful object, meaning its purpose must not violate domestic or international law.

Contracts that involve illegal activities — such as smuggling, corruption, trade with sanctioned countries, or violation of export-control regulations — are void and unenforceable.

For instance, a contract between a European company and an entity in a country under UN trade sanctions would be illegal under international law.

Moreover, the object must comply with international public policy, ethical business standards, and human rights obligations.

Thus, legality of the object ensures that the contract contributes to legitimate international trade and not to activities that undermine global governance.

## 6. Free Consent

Consent is valid only if it is freely given, without coercion, fraud, undue influence, or misrepresentation.

Under international contract law, consent can be vitiated by:

Misrepresentation (false statements about goods or services),

Fraud (intentional deception),

Duress or coercion (threats to compel agreement),

Undue influence (exploitation of a dominant position).

For instance, if a company from a developing country is forced to sign a contract under economic duress by a powerful multinational, the contract may be invalidated in arbitration or court. Thus, free and informed consent is crucial to ensure fairness and equality between international contracting parties.

## 7. Certainty and Possibility of Performance

The terms of an international business contract must be certain, clear, and capable of being performed.

Ambiguous or indefinite terms can render a contract void due to uncertainty.

For example:

“Delivery to be made at a suitable time” is vague.

“Delivery to be made within 45 days of order confirmation at Port of Singapore” is precise and enforceable.

Additionally, the contract must involve acts that are physically and legally possible. A contract to export goods banned by either country’s government, or to perform an act prohibited by international sanctions, is void ab initio (void from the beginning).

## **8. Compliance with Formalities**

In international business, certain formalities must be followed to make a contract valid and enforceable.

Written documentation (most international contracts must be in writing).

Signatures of authorized representatives.

Witnessing and notarization, in some jurisdictions.

Stamping or registration, as required by law.

Adherence to international trade rules such as INCOTERMS, UCP 600 (for letters of credit), and CISG.

Electronic contracts (e-contracts) are also recognized under the UNCITRAL Model Law on Electronic Commerce, provided they meet authentication and consent standards.

Proper formalities ensure that contracts are legally valid and can be enforced in case of disputes.

## **9. Mutuality of Obligation**

A valid international contract must impose reciprocal obligations — both parties must be bound to perform.

For example, in a contract for sale of goods:

The seller must deliver goods as per agreed specifications and schedule.

The buyer must pay the agreed price within the payment period.

If one party has no obligation, the contract becomes void for lack of consideration or mutuality.

This principle ensures that international contracts are based on fairness and mutual benefit, which are essential in global business relationships.

### **10. Compliance with Governing Law and Jurisdiction**

Every international contract must specify the governing law (which country's laws apply) and jurisdiction (where disputes will be resolved).

These clauses prevent confusion and conflicting interpretations when disputes arise.

**Governing Law:** This Agreement shall be governed by and construed in accordance with the laws of England and Wales.

**Jurisdiction:** Any dispute shall be referred to arbitration under the ICC Rules in Paris.

Such clauses align with global standards and make enforcement easier under international conventions like the New York Convention (1958) on enforcement of foreign arbitral awards.

### **3.3.3 TYPES OF INTERNATIONAL BUSINESS CONTRACTS**

International business contracts take many forms depending on the nature of cross-border dealings. Each type serves a distinct commercial purpose and follows different legal rules, though all share the basic contractual elements already discussed.

#### **1. International Sale of Goods Contract**

This is the most common type and forms the backbone of global trade. It governs the sale, purchase and delivery of goods between parties located in different countries

Key contents include description of goods, price, delivery terms (using INCOTERMS 2020), insurance, inspection rights, payment terms, and dispute settlement.

These contracts are regulated by the United Nations Convention on Contracts for the International Sale of Goods (CISG, 1980) which harmonizes rules on offer, acceptance, risk transfer, and remedies.

## **2. Licensing Agreement**

A licensing contract allows one party (the licensor) to grant another (the licensee) the right to use intellectual property such as patents, trademarks, or technology.

In international trade, licensing enables technology diffusion without ownership transfer. For instance, an American software firm may license its product to a distributor in India.

Key clauses include territory, duration, royalties, confidentiality, and quality control.

International conventions such as the Paris Convention (1883) and the TRIPS Agreement (1995) govern aspects of intellectual property licensing.

## **3. Franchise Agreement**

A franchise contract is a specialized license granting the franchisee the right to use the franchisor's brand, business model, and operating system.

Global brands like McDonald's or Subway operate through franchise contracts that specify training, quality standards, royalty payments, and termination procedures.

Such contracts must comply with both domestic franchising laws and international IP laws.

## **4. Joint Venture Agreement**

A joint venture (JV) is a contract between two or more parties from different countries to undertake a specific business project by sharing resources, risks, and profits.

For example, Toyota (Japan) and Kirloskar Group (India) formed Toyota Kirloskar Motors Ltd. JV agreements define capital contribution, management control, profit sharing, and exit mechanisms. They are often influenced by foreign-investment regulations and bilateral investment treaties (BITs).

### **5. Agency and Distribution Agreements**

International companies often appoint agents or distributors abroad to market their products. Agency contracts involve an agent who acts on behalf of the principal and earns a commission.

Distribution contracts involve a distributor who buys goods and resells them independently. The distinction affects taxation, liability, and termination rights.

These contracts must comply with competition laws and consumer-protection laws in the importing country.

### **6. Turnkey, Construction, and Service Contracts**

In large-scale infrastructure or industrial projects, exporters enter into turnkey contracts, under which they design, construct, and deliver a fully operational facility to the buyer.

Examples include oil refineries, power plants, or airports. International rules such as the FIDIC Conditions of Contract provide standardized clauses for such agreements.

### **7. Investment Contracts**

Investment contracts govern the terms under which foreign investors participate in host-country ventures.

They define protection against expropriation, tax incentives, repatriation of profits, and dispute-resolution clauses.

These are often backed by Bilateral Investment Treaties (BITs) and the ICSID Convention.

### **3.3.4 LEGAL PROVISIONS GOVERNING INTERNATIONAL CONTRACTS**

#### **1. Domestic Legal Provisions**

Each country's contract law governs agreements made or executed within its jurisdiction.

In India, the Indian Contract Act (1872) defines offer, acceptance, consideration, and breach.

The Sale of Goods Act (1930) and Foreign Exchange Management Act (1999) regulate trade and payment terms.

National laws on arbitration (Arbitration and Conciliation Act 1996) and Companies Act 2013 affect business transactions.

#### **2. International Legal Sources**

CISG (1980): Harmonizes international sale of goods.

UNIDROIT Principles of International Commercial Contracts (2016): Provide model rules emphasizing good faith, hardship, and interpretation standards.

UNCITRAL Model Laws: Guide electronic commerce and arbitration.

INCOTERMS 2020 (ICC): Define delivery obligations, cost, and risk allocation.

New York Convention (1958): Facilitates recognition and enforcement of arbitral awards.

#### **3. Mandatory Clauses in International Contracts**

Every enforceable international contract should include:

Governing Law Clause – specifies which country's law applies.

Jurisdiction Clause – states where disputes will be heard.

Force Majeure Clause – excuses performance due to uncontrollable events.

Arbitration Clause – commits parties to arbitration rather than litigation.

Confidentiality Clause – protects sensitive business information.

#### **4. Regulatory Framework and Institutions**

The World Trade Organization (WTO), International Chamber of Commerce (ICC), and International Monetary Fund (IMF) issue rules and guidelines influencing contract formation, payment systems, and dispute resolution.

Regional trade agreements (e.g., EU, ASEAN, NAFTA/USMCA) also contain legally binding provisions that affect cross-border contracts.

### **3.3.5 DISPUTE SETTLEMENT MECHANISMS**

(Arbitration, Mediation, and Litigation)

International business inevitably involves conflicts due to differing laws and expectations. To maintain commercial certainty, various dispute-resolution mechanisms exist.

#### **1. Arbitration**

Arbitration is the most common and preferred method for international commercial disputes. A private, consensual process where parties appoint neutral arbitrators to make a binding decision. Confidential, flexible, enforceable worldwide (via the New York Convention 1958).

Institutions: International Chamber of Commerce (ICC, Paris), London Court of International Arbitration (LCIA), Singapore International Arbitration Centre (SIAC), International Centre for Settlement of Investment Disputes (ICSID).

Process: Submission → Arbitrator Appointment → Hearings → Award → Enforcement.

Example: A dispute between an Indian exporter and a German importer may be settled under ICC rules in Paris.

#### **2. Mediation / Conciliation**

Mediation is a non-binding, voluntary process where a neutral third party (mediator) assists parties in negotiating a mutually acceptable solution.

It preserves business relationships and reduces costs. Under the UNCITRAL Model Law on International Commercial Conciliation (2002) and India's Arbitration and Conciliation Act 1996 Part III, mediation is increasingly recognized. It is best suited for long-term partnerships and contractual misunderstandings rather than outright breaches.

### 3. Litigation

Litigation refers to resolving disputes through national courts. Although courts provide formal judgments, litigation in international cases is time-consuming, expensive, and complicated by conflicts of law, jurisdictional issues, and enforcement difficulties.

However, litigation remains necessary when arbitration clauses are absent or invalid, or where criminal or regulatory issues are involved. Courts often rely on private-international-law principles to determine applicable law and jurisdiction.

### 4. Hybrid Mechanisms

Some contracts use multi-tier dispute-resolution clauses combining mediation followed by arbitration if mediation fails. This approach promotes amicable settlement before formal proceedings.

#### 3.3.6 ENFORCEMENT OF FOREIGN JUDGMENTS AND AWARDS

The effectiveness of any dispute-resolution process depends on whether its outcome can be recognized and enforced in another country.

#### Enforcement of Foreign Arbitral Awards

The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) is the cornerstone instrument.

It obligates member states (currently over 160) to recognize and enforce arbitral awards made in other contracting states, subject to limited defenses such as public policy violation or procedural irregularity.

In India, enforcement is governed by Sections 44–52 of the Arbitration and Conciliation Act 1996 for “foreign awards.”

Once recognized, such awards are enforceable as a decree of a domestic court.

### **Enforcement of Foreign Judgments**

Foreign court judgments can be enforced under:

Bilateral treaties on reciprocal enforcement.

Section 13 and 44A of the Indian Code of Civil Procedure 1908, which allow enforcement of judgments from “reciprocating territories” (e.g., UK, Singapore, UAE).

Courts verify that the foreign judgment was passed by a competent court, is final and conclusive, and does not contravene domestic public policy.

### **Recognition Without Treaty**

In absence of a treaty, a party may sue on the foreign judgment in domestic courts as a fresh cause of action. The court then examines merits and fairness before granting enforcement.

### **Challenges in Enforcement**

Despite treaties, practical difficulties remain:

Differences in procedural law and public-policy exceptions.

Political or diplomatic tensions between countries.

Difficulty locating assets of the losing party abroad.

Hence, international contracts often include arbitration clauses precisely because arbitral awards are easier to enforce globally than foreign court judgments.

### Recent Developments

The Hague Judgments Convention (2019) seeks to simplify global recognition of civil and commercial judgments.

Many countries, including India, are updating arbitration laws to align with UNCITRAL Model Law for speedier enforcement.

### Let's Sum Up

This section discusses the structure, significance, and components of international business contracts. These contracts form the foundation for cross-border trade by outlining the rights and obligations of the parties involved. Common types include sales agreements, joint ventures, licensing, and technology transfer contracts. To be effective, contracts must contain essential clauses such as those relating to delivery, payment, force majeure, dispute resolution, and governing law. International conventions like the United Nations Convention on Contracts for the International Sale of Goods (CISG) and UNIDROIT Principles provide standardized guidelines that help reduce legal ambiguities. The International Chamber of Commerce (ICC) also plays a key role by formulating Incoterms and arbitration rules. A well-drafted international contract ensures clarity, minimizes risks, and provides a legal safeguard for both parties in global business transactions.

### Check your Progress – Quiz – 3

1. An international business contract is primarily characterized by:

- A) Domestic parties only
- B) Cross-border transactions between different countries
- C) Verbal agreements only
- D) Government-to-government trade only

**Answer: B) Cross-border transactions between different countries**

2. Which of the following is NOT an element of a valid contract?

- A) Offer and Acceptance

- B) Free Consent
- C) Illegal Object
- D) Lawful Consideration

**Answer: C) Illegal Object**

3. The CISG governs:

- A) International contracts for services
- B) International contracts for the sale of goods
- C) Domestic sale of goods
- D) Only agency contracts

**Answer: B) International contracts for the sale of goods**

4. In international contracts, the INCOTERMS rules are issued by:

- A) United Nations
- B) World Trade Organization
- C) International Chamber of Commerce (ICC)
- D) European Union

**Answer: C) International Chamber of Commerce (ICC)**

5. Which dispute settlement method involves a binding decision by an independent arbitrator?

- A) Mediation
- B) Conciliation
- C) Arbitration
- D) Litigation

**Answer: C) Arbitration**

6. Which convention facilitates the enforcement of international arbitral awards?

- A) Vienna Convention

- B) New York Convention (1958)
- C) Rome I Regulation
- D) Paris Convention

**Answer: B) New York Convention (1958)**

7. Which type of international contract allows a company to replicate its business model abroad?

- A) Licensing Agreement
- B) Franchise Agreement
- C) Joint Venture Agreement
- D) Distribution Agreement

**Answer: B) Franchise Agreement**

8. Which mechanism is typically non-binding and focuses on negotiation?

- A) Arbitration
- B) Mediation
- C) Litigation
- D) Adjudication

**Answer: B) Mediation**

9. In international business contracts, which principle ensures clarity on which country's law applies?

- A) Principle of Reciprocity
- B) Choice of Law Clause
- C) Doctrine of Frustration
- D) Public Policy Clause

**Answer: B) Choice of Law Clause**

10. Enforcement of foreign judgments generally depends on:

- A) Verbal agreements between parties
- B) Domestic company registration
- C) Treaties or reciprocal arrangements between countries
- D) UN General Assembly approval

**Answer: C) Treaties or reciprocal arrangements between countries**

### **3.4.1 MEANING OF INTERNATIONAL PAYMENT TERMS**

International payment terms are the conditions under which payment is made in international trade, with common methods including cash in advance, letters of credit, documentary collections, open account, and consignment. Each method carries different levels of risk and security for both the buyer and the seller, with cash in advance offering the most security for the seller and open account presenting the highest risk to the seller.

#### **Essentials Elements of a Valid Contract:**

- \* Proposal or Offer and acceptance
- \* Consideration – lawful consideration with a lawful object
- \* Capacity of parties to contract – competent parties
- \* Free consent
- \* An agreement must not be expressly declared to be void.
- \* Writing and Registration if so required by law
- \* Legal relationship
- \* Certainty
- \* Possibility of performance
- \* Enforceable by law

#### **i. Offer and Acceptance**

The contract involves an offer (or more than one offer) to another party, who accepts the offer. For example, in a contract for the sale of a piano, the seller may offer the piano to the buyer for \$1,000.00. The buyer's acceptance of that offer is a necessary part of creating a binding contract for the sale of the piano. Please note

that a counter-offer is not an acceptance, and will typically be treated as a rejection of the offer.

For example, if the buyer counter-offers to purchase the piano for \$800.00, that typically counts as a rejection of the original offer for sale. If the seller accepts the counter-offer, a contract may be completed. However, if the seller rejects the counter-offer, the buyer will not ordinarily be entitled to enforce the prior \$1,000.00 price if the seller decides either to raise the price or to sell the piano to somebody else.

### **ii. Mutual Consideration (The mutual exchange of something of value)**

In order to be valid, the parties to a contract must exchange something of value. In the case of the sale of a piano, the buyer receives something of value in the form of the piano, and the seller receives money.

While the validity of consideration may be subject to attack on the basis that it is illusory (e.g., one party receives only what the other party was already obligated to provide), or that there is a failure of consideration (e.g., the consideration received by one party is essentially worthless), these defences will not let a party to a contract escape the consequences of bad negotiation. For example, if a seller enters into a contract to sell a piano for \$100, and later gets an offer from somebody else for \$1,000, the seller can't revoke the contract on the basis that the piano was worth a lot more than he bargained to receive.

### **iii. Legal Capacity**

Not all people are completely free to enter into a valid contract. The contracts of the groups of people listed below involve problematic consent and are dealt with separately, as follows: people who have a mental impairment; young people (minors); bankrupts; corporations (people acting on behalf of a company); and prisoners.

### **iv. Free Consent**

Entering into a contract must involve the elements of free will and proper understanding of what each of the parties is doing. In other words, the consent of each of the parties to a contract must be genuine. Only where the essential element

of proper consent has been given is there contract which is binding upon the parties. The ultimate consequences of establishing that no proper consent was given to enter the contract are matters dealt with when considering remedies for breach of contract.

**Proper consent may be affected by any of the following matters:** mistake; false statements; duress; and undue influence, un-conscionability.

**v. An Agreement must not be Expressly Declared to be Void** law will not enforce all contracts. There are some categories of contract to be wary of. Where a contract is illegal, this may affect its enforceability. Contracts that are illegal by statute will be regulated as to enforceability by the statute; thus the statute will need to be read and interpreted. Contracts absolutely prohibited by statute will be void, whether the parties know of the illegality or not. However, where one party performs an otherwise legal contract in a manner that breaches legislation, the other party, if having no knowledge of the facts giving rise to the illegality, can still enforce the contract or recover damages for breach of it. They may also recover money or other property transferred under the contract.

Contracts made void by statute are treated differently; while they remain valid contracts, the courts will not enforce them. Again, the precise extent of the enforceability of, or the recovery of any money paid under, a void contract will depend on the particular statute. Certain types of contracts are illegal at common law, because they are contrary to the public good. These include contracts: to commit a crime, a tort or a fraud; which are sexually immoral; which prejudice public safety, including good relations with other states or countries; which prejudice the administration of justice; which tend to promote corruption in public life; and to defraud the revenue. Illegally formed contracts are generally void and unenforceable by either party at common law. Therefore, property or money transferred cannot be recovered.

#### **vi. Writing and Registration if so required by Law**

Before entering into a contract, various statements will often be made by one party in order to encourage or induce the other party to enter into the contract. A dispute may later arise as to which of the statements made should be considered a

part, or a term, of the contract, and which should be taken as merely pre-contract talk, and therefore not a part or term of the contract. Parties to a contract are bound only by its terms, not by any peripheral statements that may have been made. To avoid these problems it is better to put all these into writing.

The courts can look at evidence of intention by one or other of the parties that the statement should be part of the contract. For example, the longer the interval is between the making of the statement and the reaching of the final agreement and contract, the less likely it is that the statement will be considered to be a term of the contract. The fact that the maker of the statement had a special knowledge or skill compared with the other party, will make the statement more likely to be a term. Where the agreement was subsequently reduced to writing and the statement was not included, it is less likely to be a term. If an agreement is eventually put into writing, then the statement is more likely to be a term of the contract. The general rule is that a party is bound by all the terms set out in a contractual document if they have signed it. This applies whether or not they have read the terms or understood them. The exceptions to the general rule are mistakes as to the nature of the document and false statements. When documents are registered rights and obligations of parties are further reinforced.

### **vii. Legal Relationship**

Intention to create legal relations is one of the necessary elements of a contract. The courts must be satisfied that the parties had intended their agreement to have legal consequences.

### **viii. Certainty**

Certainty in English contract law set out rules for how judges will interpret, sever or put contracts into effect. If the terms of the contract are uncertain or incomplete, the parties cannot have reached an agreement in the eyes of the law. An agreement to agree does not constitute a contract, and an inability to agree on key issues, which may include such things as price or safety, may cause the entire contract to fail. However, a court will attempt to give effect to commercial contracts where possible, by construing a reasonable construction of the contract.

Courts may also look to external standards, which are either mentioned explicitly in the contract or implied by common practice in a certain field. In addition, the court may also imply a term; if price is excluded, the court may imply a reasonable price, with the exception of land, and second-hand goods, which are unique.

#### **ix. Possibility of Performance**

Contracts based on impossibility of performance are not valid. The contracts must be capable of being performed.

#### **x. Enforceable by Law**

A contract in order to be valid must be enforceable by law which element distinguishes agreement and contract. It is enforceable by law if it is a contract otherwise it is an agreement. The aggrieved party should be able to obtain relief through law in the event of breach of contract. An agreement can also be inferred from correspondence exchanged between the parties.

### **3.4.2 TYPES OF INTERNATIONAL PAYMENT METHODS**

There are different methods of payment for international purchase. There are problems as well. Let us first deal with payment modes like letter of credits, cash, draft, sight/nuisance bills, open account, etc.

Instruments of Payment: A brief account of different terms of payment is presented below.

#### **i. Letter of Credit**

A document issued by a bank (issuing bank) stating its commitment to pay someone a stated amount of money on behalf of a buyer so long as the seller meets very specific terms and conditions. Letters of credit are more formally called documentary letters of credit.

Before payment, the bank responsible for making payment on behalf of the buyer verifies that all documents are exactly as required by the letter of credit. If a United States exporter is unfamiliar with the credit risk of the foreign bank, or if there is concern about the political or economic risk associated with the country in which

the bank is located, it is advised that a letter of credit issued by a foreign bank be “confirmed” by a U.S. bank. This means that the U.S. bank adds its pledge to pay to that of the foreign bank. Letters of credit that are not confirmed are called “advised” letters of credit. The local Department of Commerce district office or an international banker will help exporters determine whether a confirmed or advised letter of credit is appropriate for a particular transaction.

### Types of Letter of Credit

There are several types of LCs serving different needs and conditions. These are briefed below.

- \* **Irrevocable (unconfirmed)** - A letter of credit that cannot be amended or cancelled without prior mutual consent of all parties to the credit. Such a letter of credit guarantees payment by the bank to the seller/exporter so long as all the terms and conditions of the credit have been met. This is the most popular form of letter of credit.
- \* **Revocable (confirmed)** - A letter of credit that can be cancelled or altered by the drawee (buyer) after it has been issued by the drawee’s bank. Revocable letters of credit are rarely used because of security concerns.
- \* **Transferable**- A letter of credit that can be redirected at the seller’s request. These are used when an export broker is involved. Once all conditions on the letter of credit are met, the broker’s bank receives the payment, takes out his commission, and completes the transaction as negotiated.
- \* **Sight** - A letter of credit that requires payment to be made upon presentation of documents.
- \* **Time Draft**- A letter of credit that states payment is due within a certain time (usually 30, 60, 90, or 180 days). Changes made to a letter of credit are called amendments. The fees charged by the banks involved in amending the letter of credit may be paid either by the buyer or the seller, but the letter of credit should specify which party is responsible. Since changes are costly and time-consuming, every effort should be made to get the letter of credit right the first time.

An exporter is usually not paid until the advising or confirming bank receives the funds from the issuing bank. To expedite the receipt of funds, wire

transfers may be used. Bank practices vary, however, and the exporter may be able to receive funds by discounting the letter of credit at the bank, which involves paying a fee to the bank for this service.

Exporters should consult with their international bankers about bank policy on these issues.

### **3.4.3 LEGAL FRAMEWORK GOVERNING INTERNATIONAL PAYMENTS**

International payments operate under a structured legal framework to ensure transparency, security, and compliance.

International Conventions

UNCITRAL Model Law on International Credit Transfers (1992)

UN Convention on the Assignment of Receivables in International Trade (2001)

Domestic Laws

Foreign Exchange Management Act (FEMA), 1999 (India)

Banking Regulation Acts of respective countries.

Banking Guidelines

Rules issued by central banks (e.g., RBI, Federal Reserve).

ICC's UCP 600, URC 522 (for collections), and URDG 758 (for guarantees).

Foreign Exchange Control Regulations

Set restrictions and reporting norms for international remittances.

### **3.4.4 ROLE OF INTERNATIONAL CHAMBER OF COMMERCE (ICC) AND INCOTERMS**

**International Chamber of Commerce (ICC):**

Founded in 1919, Paris.

Develops global trade rules, standards, and dispute resolution frameworks.  
Publishes INCOTERMS (International Commercial Terms).

Issues UCP 600, URC 522, and URDG 758.

Promotes arbitration and dispute resolution through the ICC International Court of Arbitration.

### **INCOTERMS (2020):**

Define responsibilities of buyers and sellers in international trade regarding transport, risk, and cost division.

Common INCOTERMS Examples:

EXW (Ex Works): Buyer bears all transport costs.

FOB (Free on Board): Seller responsible until goods are on board.

CIF (Cost, Insurance, and Freight): Seller covers cost and insurance up to destination port.

DAP (Delivered at Place): Seller responsible until delivery at buyer's location.

### **Legal Significance:**

Standardizes trade terms internationally.

Prevents misunderstandings and contract disputes.

## **3.4.5 FOREIGN EXCHANGE REGULATIONS AND FEMA PROVISIONS**

Foreign Exchange Management Act (FEMA), 1999 (India):Regulates foreign exchange dealings and promotes orderly development of the forex market.Administered by RBI under the Ministry of Finance.

Regulation of Current and Capital Account Transactions – ensuring compliance with RBI guidelines.

Authorized Dealers (AD) – Banks authorized to deal in foreign currency.

Export and Import Regulations – Timely realization and repatriation of export proceeds.

Foreign Investment – FDI and ODI policies under FEMA.

Anti-Money Laundering Measures – Preventing illegal forex activities.

**Objective:**

Facilitate external trade and payments.

Maintain stability of the rupee.

Ensure transparency in cross-border transactions.

### **3.4.6 RISK MANAGEMENT AND LEGAL ISSUES IN INTERNATIONAL PAYMENTS**

International payments are exposed to several financial and legal risks.

**Types of Risks:**

Credit Risk: Non-payment by importer.

Exchange Rate Risk: Fluctuations in currency values affect payment value.

Political Risk: Governmental instability or restrictions on fund transfer.

Legal Risk: Contractual disputes or differing jurisdictional laws.

Operational Risk: Documentation errors, fraud, or non-compliance.

Risk Management Techniques:

Use of Letters of Credit (L/Cs) and bank guarantees.

Forward and Futures Contracts for currency hedging.

Export Credit Insurance through ECGC (Export Credit Guarantee Corporation of India).

Arbitration Clauses in contracts for dispute resolution.

Legal Issues:

Compliance with anti-money laundering laws.

Sanctions and embargo restrictions.

Documentation errors leading to breach of contract

### Let's sum up

This section focuses on various payment methods used in international trade and the legal mechanisms that secure them. Payments between exporters and importers involve higher risk due to distance, differing legal systems, and exchange controls. The main methods include advance payment, open account, documentary collection, consignment, and the widely used Letter of Credit (L/C). The Letter of Credit, governed by UCP 600 issued by the ICC, provides a secure payment mechanism by involving banks as intermediaries. It guarantees that the exporter will be paid once the specified documents are presented and verified. The choice of payment method depends on factors such as trust, political stability, and creditworthiness of the parties involved. Hence, appropriate payment terms not only ensure financial security but also strengthen business relationships across borders.

### Check your Progress – Quiz -3.5

1. International payment terms primarily define:

- A) Tariff rates
- B) The time and method of payment between exporter and importer

- C) Shipping routes
- D) Government taxes

Answer: B) The time and method of payment between exporter and importer

2. Which payment method provides maximum security to the exporter?

- A) Open Account
- B) Consignment
- C) Advance Payment
- D) Documentary Collection

Answer: C) Advance Payment

3. Under a Letter of Credit (L/C), payment is made:

- A) Only when goods are sold by importer
- B) Upon presentation of compliant documents
- C) After one year of shipment
- D) Without any conditions

Answer: B) Upon presentation of compliant documents

4. The UCP 600 rules are issued by:

- A) World Trade Organization
- B) International Chamber of Commerce (ICC)
- C) United Nations
- D) World Bank

Answer: B) International Chamber of Commerce (ICC)

5. Which INCOTERM places the maximum obligation on the seller?

- A) EXW
- B) CIF
- C) FOB
- D) FCA

Answer: B) CIF

6. The Foreign Exchange Management Act (FEMA), 1999 is implemented by:

- A) Ministry of Finance
- B) Reserve Bank of India (RBI)
- C) Export Credit Guarantee Corporation (ECGC)
- D) SEBI

Answer: B) Reserve Bank of India (RBI)

7. In the Documents Against Payment (D/P) method:

- A) Buyer pays before shipment
- B) Buyer receives documents after payment
- C) Buyer receives documents before payment
- D) Payment is made after 6 months

Answer: B) Buyer receives documents after payment

8. The main advantage of arbitration or mediation in payment disputes is:

- A) Government involvement
- B) Confidential, quicker, and cost-effective resolution

- C) Always decided by local courts
- D) No written agreement needed

Answer: B) Confidential, quicker, and cost-effective resolution

9. Exchange rate fluctuation is an example of:

- A) Operational Risk
- B) Credit Risk
- C) Foreign Exchange Risk
- D) Political Risk

Answer: C) Foreign Exchange Risk

10. Under FEMA, exporters in India must:

- A) Retain foreign currency indefinitely
- B) Repatriate export proceeds within a prescribed time
- C) Make payments through foreign agents only
- D) Submit payments to SEBI

Answer: B) Repatriate export proceeds within a prescribed time

### **3.5.1 MEANING AND DEFINITION OF CIVIL AND CRIMINAL PROCEDURE CODES**

#### **Meaning**

Procedure codes are laws that prescribe the process and mechanism for enforcing substantive laws — civil or criminal — through the courts. They define how

justice is administered, ensuring uniformity, fairness, and efficiency in legal proceedings.

### **Civil Procedure Code (CPC, 1908):**

The Code of Civil Procedure (CPC), 1908 is a comprehensive law that governs the process of adjudicating non-criminal disputes, such as those related to contracts, property, or commercial transactions.

It provides the framework for filing suits, presentation of evidence, trial, judgment, and execution of decrees.

#### **Definition:**

According to legal interpretation, CPC is a procedural law that regulates how civil cases are initiated, conducted, and decided by civil courts in India.

### **Criminal Procedure Code (CrPC, 1973):**

The Criminal Procedure Code (CrPC), 1973 is the main legislation governing criminal trials and the administration of criminal justice in India. It prescribes procedures for investigation, inquiry, trial, and punishment of offenses, ensuring the protection of the accused and victims alike.

#### **Definition:**

CrPC is a comprehensive procedural statute that outlines the process through which criminal laws (mainly the Indian Penal Code, 1860) are enforced by courts and law enforcement agencies.

### **3.5.2 Key Provisions of Civil Procedure Code (CPC, 1908)**

The CPC is divided into two parts:

Part I: Sections (1–158) — Substantive procedural rules.

Part II: Orders and Rules — Supplementary procedural guidelines.

**Key Provisions:**

**Jurisdiction of Courts (Sections 9–21):** Defines the authority of civil courts to hear civil cases. Civil courts have jurisdiction over all suits of a civil nature unless barred by law.

**Institution of Suits (Order IV):**

A civil suit begins with a plaint, followed by a written statement by the defendant.

The court issues a summons to the defendant to appear and answer the claim.

**Pleadings (Orders VI–VIII):**

Pleadings are the formal written statements of the parties — plaint and written statement — outlining claims and defenses.

**Framing of Issues and Hearing (Order XIV & XV):**

The court identifies disputed issues of law or fact before trial.

**Judgment and Decree (Sections 33–34):**

The judgment states the court's reasoning; the decree is the formal expression of that decision.

**Execution of Decrees (Order XXI):**

Provides for enforcement of court decrees and orders — through attachment, sale, or arrest if necessary.

**Appeals, Reviews, and Revisions (Sections 96–115):**

Allows parties to challenge or seek review of judgments before higher courts.

**Interim Orders and Injunctions (Order XXXIX):**

Courts can issue temporary orders to preserve property or prevent injustice pending final decision.

**Relevance to International Business:**

CPC provisions are crucial in enforcing foreign judgments, settling international commercial disputes, and ensuring that foreign entities receive procedural fairness when involved in Indian courts.

### **3.5.3 Key Provisions of Criminal Procedure Code (CrPC, 1973)**

CrPC provides the machinery for enforcement of criminal law and ensures fair investigation and trial of criminal cases.

Classification of Criminal Courts (Sections 6–19):

Defines the hierarchy — High Courts, Sessions Courts, Judicial Magistrates, and Executive Magistrates.

Cognizable and Non-Cognizable Offenses (Section 2):

Cognizable: Police can arrest without a warrant (e.g., murder, theft).

Non-Cognizable: Warrant required (e.g., defamation, public nuisance).

Investigation and Arrest (Sections 154–176):

Section 154: Filing of First Information Report (FIR).

Police investigate, collect evidence, and produce accused before a magistrate.

Bail Provisions (Sections 436–450):

Distinguishes between bailable and non-bailable offenses.

Ensures liberty while safeguarding the judicial process.

Trial Procedures (Sections 225–265):

Lays down different trial procedures for sessions cases, warrant cases, and summons cases.

Judgment and Sentencing (Sections 353–365):

Judgment must be pronounced in open court and recorded in writing.

Sentences include fine, imprisonment, or other penalties.

Appeals, Revisions, and Transfers (Sections 372–406):

Provides the right to appeal or seek revision of judgments to prevent miscarriage of justice.

Compounding of Offenses (Section 320):

Allows certain offenses to be settled amicably between the complainant and accused.

Provisions for International Cooperation (Sections 105A–105L):

Facilitates reciprocal arrangements for assistance in criminal matters, such as extradition and evidence gathering — vital for transnational crimes and corporate frauds.

Relevance to International Business:

CrPC helps in prosecuting international economic crimes (money laundering, smuggling, cybercrime, corruption) and ensuring that foreign nationals and companies comply with local criminal laws.

### 3.5.4 Difference Between Criminal and Civil Procedure Codes

Basis	Civil Procedure Code (CPC, 1908)	Criminal Procedure Code (CrPC, 1973)
Nature of Law	Deals with <b>private rights and obligations</b> between individuals or organizations.	Deals with <b>offenses against the State or society</b> at large.
Purpose	To <b>resolve disputes</b> and provide compensation or injunction.	To <b>punish offenders</b> and maintain law and order.
Parties Involved	Plaintiff (complainant) vs. Defendant.	State (prosecution) vs. Accused.
Outcome	Decree or Order (e.g., payment of damages).	Conviction or Acquittal (e.g., imprisonment or fine).

<b>Burden of Proof</b>	Based on <b>preponderance of probabilities.</b>	Based on <b>proof beyond reasonable doubt.</b>
<b>Initiation of Proceedings</b>	By <b>filing a plaint</b> by an aggrieved person.	By <b>FIR or complaint</b> registered by police or magistrate.
<b>Appeals</b>	Appeals under Sections 96–100 of CPC.	Appeals under Sections 372–394 of CrPC.
<b>Execution</b>	Through decree enforcement (attachment, sale, etc.).	Through sentencing and imprisonment.
<b>Example</b>	Breach of contract, property dispute.	Theft, fraud, money laundering.
<b>Relevance to Business</b>	Ensures contract enforcement, arbitration, and commercial dispute settlement.	Ensures corporate compliance, penal liability, and fraud prevention.

### Let's Sum Up

This section elaborates on the mechanisms available for resolving disputes in international business and the institutions that support legal harmony worldwide. Disputes may arise due to breach of contract, non-payment, or violation of trade terms. The common methods for dispute resolution include litigation (court proceedings), arbitration, and mediation. Arbitration is often preferred for its neutrality, speed, and confidentiality, and is governed by international conventions like the New York Convention (1958). Organizations such as the International Chamber of Commerce (ICC), World Trade Organization (WTO), and United Nations Commission on International Trade Law (UNCITRAL) play significant roles in creating uniform trade laws and providing arbitration frameworks. Through these mechanisms, businesses can settle conflicts fairly and continue their global operations with confidence and legal certainty.

### Check Your Progress – Quiz 3.5

1. The Civil Procedure Code (CPC) was enacted in:

A) 1860

B) 1908

C) 1973

D) 1950

**Answer: B) 1908**

2. The Criminal Procedure Code (CrPC) came into force in:

A) 1860

B) 1908

C) 1973

D) 2000

**Answer: C) 1973**

3. The main objective of the Civil Procedure Code is to:

A) Punish offenders

B) Maintain public order

C) Enforce civil rights and resolve private disputes

D) Conduct police investigations

**Answer: C) Enforce civil rights and resolve private disputes**

4. The primary document filed to start a civil case is called:

A) FIR

B) Plaint

C) Charge Sheet

D) Warrant

**Answer: B) Plaint**

5. Which section of CPC deals with the principle of Res Judicata?

- A) Section 2
- B) Section 9
- C) Section 11
- D) Section 21

**Answer: C) Section 11**

6. The process of registering a criminal case usually begins with:

- A) Filing a Plaint
- B) Filing an FIR
- C) Issuing a Summon
- D) Writing a Complaint to Civil Court

**Answer: B) Filing an FIR**

7. In a criminal case, the party representing the government is known as:

- A) Plaintiff
- B) Prosecutor
- C) Defendant
- D) Appellant

**Answer: B) Prosecutor**

8. The burden of proof in criminal cases lies on:

- A) Accused

- B) Complainant
- C) Prosecution
- D) Judge

**Answer: C) Prosecution**

9. Civil cases are decided on the basis of:

- A) Proof beyond reasonable doubt
- B) Preponderance of probabilities
- C) Direct evidence only
- D) Confession by accused

**Answer: B) Preponderance of probabilities**

10. One major difference between CPC and CrPC is that:

- A) Both deal with criminal offences
- B) CPC involves the State as a party in all cases
- C) CrPC deals with offences punishable by law, while CPC deals with civil rights
- D) CPC came after CrPC

**Answer: C) CrPC deals with offences punishable by law, while CPC deals with civil rights**

### **Unit Summary**

This unit has explored the legal framework of international business, covering the nature and complexities of legal systems governing global trade, the distinction between code (civil) and common law traditions and their implications for business, the structure and key provisions of international business contracts, payment terms and associated legal issues in cross-border transactions, and the procedural

difference between civil and criminal codes (particularly in Indian context). By understanding these elements, businesses operating internationally can anticipate legal risks, choose appropriate contract terms (governing law, payment, dispute resolution), adapt to different legal systems, and manage both contract enforcement (civil) and regulatory/compliance risk (which may involve criminal procedure). A solid grasp of the legal environment is hence foundational for successful and lawful international operations

### **Glossary**

**Arbitration:** A private legal process for resolving disputes.

**INCOTERMS:** International commercial terms defining trade responsibilities.

**FEMA:** Indian law regulating foreign exchange.

**WTO:** World Trade Organization governing global trade rules.

**Common Law:** Law based on judicial precedents.

**Legal Framework:** System of rules governing cross-border business.

**CISG:** UN Convention on Contracts for the International Sale of Goods.

**Code Law:** Law based on written codes and statutes.

**Common Law:** Law based on judicial decisions and precedents.

**Letter of Credit (L/C):** Bank instrument guaranteeing payment to exporter.

**Arbitration:** Private dispute resolution mechanism outside courts.

**Force Majeure:** Clause excusing parties from liability during unforeseen events.

**UNCITRAL:** UN Commission on International Trade Law.

**UCP 600:** ICC rules governing Letters of Credit.

### **Self-Assessment Questions**

#### **SHORT ANSWER QUESTIONS (5 Marks Each)**

1. Explain the nature and significance of the legal framework in international business.
2. Differentiate between Code Law and Common Law.

3. What are the essential clauses of an international business contract?
4. Describe various modes of payment in international trade.
5. What is the role of international organizations like ICC and WTO in legal regulation?

### **LONG ESSAY QUESTIONS (8–10 Marks Each)**

1. Discuss the complexities of the international legal environment and their impact on global trade.
2. Compare and contrast Code Law and Common Law systems and explain their implications for business contracts.
3. Explain the structure and key provisions of an international business contract with examples.
4. Describe different payment methods in international trade and evaluate their risks.
5. Examine the dispute settlement mechanisms and the role of international institutions like UNCITRAL and ICC.

### **CASE STUDY**

Case: Letter of Credit Dispute in Export Transaction

An Indian exporter shipped machinery to a UK buyer under a Letter of Credit (L/C). The exporter presented documents within the time limit, but the issuing bank refused payment due to a minor discrepancy in the invoice description.

Legal Issue: Whether the bank can refuse payment due to minor discrepancies?

Resolution:

Under UCP 600, banks deal with documents, not goods. Even minor discrepancies can justify refusal. Exporters must ensure document compliance with L/C terms.

L/C provides security but requires precision.

International trade depends heavily on documentation accuracy.

### **REFERENCES AND SUGGESTED BOOKS**

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## UNIT IV

### Unit IV: Multi-Lateral Agreements and Institutions

Multi-Lateral Agreements and Institutions: Economic Integration – Forms: Free Trade Area, Customs Union, Common Market and Economic Union-Regional Blocks: Developed and Developing Countries-NAFTA- EU-SAARC, ASEAN-BRICS- OPEC- Promotional role played by IMF-World Bank and its affiliates- IFC, MIGA and ICSID – ADB-Regulatory role played by WTO and UNCTAD.

## SECTION 4 MULTI - LATERAL AGREEMENTS AND INSTITUTIONS

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## **SECTION 4.1: CONCEPT AND FORMS OF ECONOMIC INTEGRATION**

### **4.1.1 MEANING AND CONCEPT OF ECONOMIC INTEGRATION**

A multilateral agreement is a trade agreement established between three or more countries with the intention of reducing barriers to trade, such as tariffs, subsidies, and embargoes, that limit a nation's ability to import or export goods. They are considered the best method of encouraging a truly global economy that opens markets to small and large countries on an equitable basis.

In general, trade agreements between nations are either bilateral, involving only two nations, or multilateral. By their very nature, requiring concessions by several countries that have traditionally used trade barriers to protect certain industries or domestic goods, multilateral agreements are much more difficult to negotiate than bilateral agreements.

#### **Examples of Multilateral Agreements**

Multilateral agreements are usually negotiated between countries that share a geographic region, and some of the most well-known regional agreements are the North American Free Trade Agreement (NAFTA) and the Central American-Dominican Republic Free Trade Agreement (CAFTA). However, multilateral agreements can also be international in nature, with perhaps the most successful international trade agreement being the General Agreement on Trade and Tariffs (GATT), negotiated between 153 countries following the end of World War II.

There is a debate as to their effectiveness. For instance, those in favor of multilateral agreements point to the economic benefits they provide smaller countries with emerging markets, while those against them claim that they provide multinational companies increased control over the individual sovereignty of nations.

### **Advantages of Multilateral Trade Agreements**

Liberal economists are perhaps the leading proponents of using multilateral agreements as the ideal way to encourage free and unencumbered global trade. The benefits they point to include:

- **Granting of “favored nation status”** – No nation that is a party to a multilateral agreement can be granted more favorable trading rights than any other party to the agreement. Each country is treated as an equal partner.
- **Best use of a nation’s resources**– Countries can focus on producing only those goods that are deemed valuable by its partners to the agreement, creating efficiencies in the allocation of resources.
- **Exported goods are cheaper**– Reduced tariffs mean that countries exporting their products no longer face artificial barriers to trade.
- **Standardization of regulations**- Companies can more easily navigate trade between signatory countries as a result of agreed upon rules of commerce. In addition, international intellectual property rights can receive greater protection.
- **One agreement versus many**– While multilateral agreements are often complex by their very nature, they actually save countries the time and effort it takes to negotiate separate agreements with every potential trading partner.
- **Emerging markets flourish**– Bilateral agreements tend to favor the powerful. Multilateral agreements level the playing field for all participants, particularly the little guys who have been pushed around for years.

### **Disadvantages of Multilateral Agreements**

Multilateral agreements also have their opponents. Their reasons for seeing these agreements as failing to provide any lasting benefits include:

- \* **Ceding of sovereign rights** – Countries that are partners in a multilateral agreement **give up** degrees of sovereignty over the way they conduct business with other countries, which often is in direct opposition to the democratic principles on which they were founded.
- \* **Some parties win, but some parties lose** – Certain industries within partner countries may be adversely affected by the low cost of imported goods by competing nations.
- \* **Complex and time-consuming negotiations** – Due to the complex nature of an agreement that must be negotiated by several countries with often competing interests, multilateral agreements can take a great deal of time to complete. There is no guarantee that after years of negotiation an agreement will actually be reached.
- \* **Misunderstandings and Misconceptions** - Negotiations during an agreement are often conducted in a confidential manner that breeds mistrust and controversy between corporations, special interest groups, labor organizations, and the media.
- \* **Rise of multi-national corporations** – Smaller businesses often find it difficult to compete with large corporations as traditional borders to trade are erased. This can lead to unemployment in certain industries and lower standards of living as wages are cut in order for these companies to compete.

#### **4.1.2 FORMS OF ECONOMIC INTEGRATION: FREE TRADE AREA, CUSTOMS UNION, COMMON MARKET, AND ECONOMIC UNION**

Economic integration refers to the collaboration of two or more countries to limit or eliminate trade restrictions and encourage political and economic cooperation. It allows global markets to function more steadily with less government intervention, giving countries a chance to make the greatest use of their resources.

Economic integration strives to harmonize economic policies among member nations to promote mutual trade and economic and political interests. It, along with little government interference, creates more business prospects worldwide. As a result, it is a crucial component of regional and global economic developments. International commerce allows countries to make the best use of their resources while also granting their trading partners access to new markets.

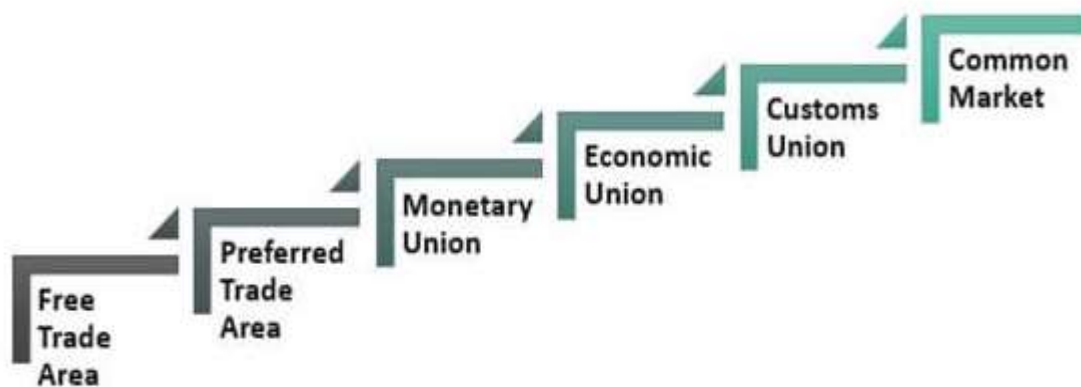
The member countries agree on fiscal rates, monetary policies, and export and import regulations to achieve a stated economic plan. Economic integration maximizes the benefits for all participating economies by setting the terms of involvement and use. Although it emphasizes trading relations, integration can take many other forms.

### How To Measure Economic Integration?

Since regional economic integration is a part of economic development, economic indicators can help measure it, such as:

- \* Trade of products and services
- \* Cross-border capital movements
- \* Labor mobility
- \* Trade union membership
- \* Role of trade unions
- \* Establishment of supranational
- \* Unified economic policies

### Economic Integration Levels



### FREE TRADE AREA

A free trade area (FTA) refers to a specific region wherein a group of countries signs a trade agreement that seals the economic cooperation among them. The FTA's main goals are to bring down barriers in trading, specifically tariffs and import quotas, and encourage the free trade of goods and services among its member countries.

## Advantages of a Free Trade Area

### 1. Increased efficiency

The good thing about a free trade area is that it encourages competition, which consequently increases a country's efficiency, in order to be on par with its competitors. Products and services then become of better quality at a lower cost.

### 2. Specialization of countries

When there is intense competition, countries will tend to produce the products or goods that they are most efficient at. Efficient use of resources means maximizing profit.

### 3. No monopoly

When there is free trade, and tariffs and quotas are eliminated, monopolies are also eliminated because more players can come in and join the market.

### 4. Lowered prices

When there is competition, especially on a global level, prices will surely go down, allowing consumers to enjoy a higher purchasing power.

### 5. Increased variety

With imports becoming available at a lower cost, consumers gain access to a variety of products that are inexpensive.

## CUSTOMS UNION

A customs union is an agreement between two or more neighboring countries to remove trade barriers, reduce or abolish customs duty, and eliminate quotas. Such unions were defined by the General Agreement on Tariffs and Trade (GATT) and are the third stage of economic integration.

Unlike in free trade agreements, a common external tariff is imposed on non-members of the union. When countries outside the union trade with countries in the customs union, they need to make a single payment (duty fee) for the goods that have crossed the border. Once inside the union, they can trade freely with no added tariffs.

## **Purpose of Customs Unions**

The purpose of a customs union is to make it easier for member countries to trade freely with each other. The union reduces the administrative and financial burden of barrier trading and fosters economic cooperation among nations.

However, member countries are not given the freedom to form their own trade deals. The countries in the customs union usually restructure their domestic economy and economic policies in order to maximize their gain from membership in the union. The European Union is the largest customs union in the world in terms of the economic output of its members.

A customs union generates trade creation and diversion that helps with economic integration. Below are the advantages and disadvantages of customs unions.

## **Advantages of Custom Unions**

Customs unions offer the following benefits:

### **1. Increase in trade flows and economic integration**

The main effect of a free-trade agreement is that it increases trade between member countries. It helps improve the allocation of scarce resources that satisfy the wants and needs of consumers and boosts foreign direct investment (FDI).

Customs unions lead to better economic integration and political cooperation between nations and the creation of a common market, monetary union, and fiscal union.

### **2. Trade creation and trade diversion**

The effectiveness of a customs union is measured in terms of trade creation and trade diversion. Trade creation occurs when the more efficient members of the union sell to less efficient members, leading to a better allocation of resources.

Trade diversion occurs when efficient non-member countries sell fewer goods to member countries because of external tariffs. It gives less efficient

countries in the union the opportunity to capitalize on their position and sell more goods within the union.

If the gains from trade creation exceed the losses from trade diversion, that leads to increased economic welfare among member countries.

### **3. Reduces trade deflection**

One of the main reasons a customs union is favored over a free trade agreement is because the former solves the problem of trade deflection. This occurs when a non-member country sells its goods to a low-tariff FTA (free trade agreement) country, which then resells to a high-tariff FTA country, leading to trade distortions. The presence of a common external tariff in customs unions helps avoid problems that arise from tariff differentials.

## **Disadvantages of Customs Unions**

Along with the advantages, customs unions also come with a few drawbacks:

### **1. Loss of economic sovereignty**

Members of a customs union are required to negotiate with non-member countries and organizations such as the WTO. This is necessary to maintain a customs union; however, it also means that individual member countries are not free to negotiate their own deals.

If a country wants to protect an infant industry in its market, it is unable to do so by imposing tariffs or other protective barriers due to the liberal trading policies. Similarly, if a country wants to liberalize its trade outside the union, it is unable to do this due to the common external tariff.

### **2. Distribution of tariff revenues**

Some countries in the union do not receive a fair share of tariff revenues. This is common among countries like the UK that trade relatively more with countries outside the union. Around 20%-25% of the tariff revenue is retained by the member who collects the revenue. It is estimated that the cost of collecting this revenue exceeds the actual revenue collected.

### **3. Complexity of setting the tariff rate**

A common problem faced by customs unions is the complexity of setting the applicable tariff rate. The process is very costly and time-consuming. Member countries often find it hard to forgo the trade of certain goods or services because another country in the union is producing it more efficiently. The problem is usually faced by developing countries and is a major issue that the UK is dealing with during Brexit.

### **COMMON MARKET**

A common market is a formal agreement where a group is formed amongst several countries that adopt a common external tariff. In a common market, countries also allow free trade and free movement of labor and capital among the members of the group. The trade arrangement is aimed at providing improved economic benefits to all the members of the common market.

The most famous example of a common market is the European Common Market, which aims to provide the free movement of goods, capital, services, and labor within the European Union.

#### **Conditions Required to be Defined as a Common Market**

- ✳ To be defined as a common market, the following conditions must be satisfied:
- ✳ Tariffs, quotas, and all barriers regarding importing and exporting goods and services among members of the common market are eliminated.
- ✳ Common trade restrictions such as tariffs on countries outside the group are adopted by all members.
- ✳ Production factors such as labor and capital are able to move freely without restriction among member countries.

If one of the conditions is not satisfied, the resulting market is not a common market. For example, if production factors such as labor and capital are not able to move freely without restriction among member countries, then the arrangement would instead be defined as a customs union.

#### **Benefits of a Common Market**

##### **1. Free movement of people, goods, services, and capital**

In addition to the removal of tariffs among member countries, the key benefits of a common market include the free movement of people, goods, services, and capital. Therefore, a common market is often regarded as a “single market” as it allows the free movement of production factors without the obstruction created by national borders.

## **2. Efficiency in production**

For an economy, a common market facilitates efficiency among members – factors of production become more efficiently allocated, resulting in stronger economic growth. As the market becomes more efficient, inefficient companies eventually shut down due to intense competition.

Companies that remain typically benefit from economies of scale and increased profitability, and innovate more to compete in a more intensely competitive landscape.

## **Costs of a Common Market**

### **1. Less competitive countries may suffer**

The transition to a common market comes with a few drawbacks. For one, companies that have previously been protected and subsidized by the government may struggle to remain afloat in a more competitive landscape. The migration of production factors to other countries may hinder the economic growth of the country and lead to increased unemployment.

### **2. Trade diversion**

Trade diversion occurs when efficient non-members are crowded out of the common market. Furthermore, a country may exhibit depressed wages if it faces an influx of migration of production factors where supply exceeds demand.

## **Real-World Example**

In July 2010, Kenyan President Mwai Kibaki formed the East African Common Market to accelerate economic growth and development in the region. The establishment of a common market in East Africa was an expansion of an existing

customs union, which was created in 2005 and was made up of six countries in eastern Africa: Burundi, Kenya, Rwanda, South Sudan, Tanzania, and Uganda.

The EACM was established to provide the “four freedoms,” with the aim of boosting the region’s economy and increasing productivity. The four freedoms are:

- \* The free movement of goods
- \* The free movement of labor
- \* The free movement of services
- \* The free movement of capital

Following the creation of the EACM in 2010, a protocol was signed in 2013 detailing the plan to further integrate member countries by means of a monetary union. Recently, in 2018, a committee was formed to begin drafting a regional constitution.

## **ECONOMIC UNION**

An economic union is one of the different types of trade blocs. It refers to an agreement between countries that allows products, services, and workers to cross borders freely. The union is aimed at eliminating internal trade barriers between the member countries, with the goal of economically benefitting all the member countries.

The union requires the integration of monetary and fiscal policies, so that member countries coordinate policies, taxation, and government spending related to the agreement. They also use a common currency that comes with fixed exchange rates.

### **Examples of Economic Unions**

**Here are examples of existing economic unions:**

#### **1. European Union (EU)**

The European Union is the world’s largest trade bloc. Importing goods and services from more than 100 countries, it is the biggest import market, as well as the biggest exporter in the world.

The EU's common currency is the euro, which is used by its 28 member states: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

The EU countries coordinate their economic policies, laws, and regulations to address economic and financial issues. One of the union's founding principles is free trade among its members. It is also committed to the liberalization of world trade outside of its borders.

## **2. CARICOM Single Market and Economy (CSME)**

CARICOM Single Market and Economy (CSME) aims to create an economic space for competitive goods and services to establish a foundation for growth and development of the Caribbean community. It is an enlarged market that provides better opportunities to sell products and services, increased competitiveness, and improvement of the lives of people.

## **3. Central American Common Market**

The Central American Common Market is formed by six countries in Central America. They are Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama.

## **4. Eurasian Economic Union (EEU)**

Also called the Eurasian Union, EAEU or EEU, the Eurasian Economic Union is a political and economic union of states in central and northern Eurasia. The treaty that established the union was signed in 2014 by the leaders of Russia, Belarus, and Kazakhstan. The accession treaty of both Armenia and Kyrgyzstan came into force in the following year.

## **5. Gulf Cooperation Council (GCC)**

Also known as the Cooperation Council for the Arab States of the Gulf, the Gulf Cooperation Council (GCC) consists of all the Arab states of the Persian Gulf, excluding Iraq. The council's member states include Bahrain,

Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. The GCC was established in 1981.

### **Economic Union vs. Customs Union**

An economic union is different from a customs union since, in the latter, member countries are allowed to move goods across borders, but they do not share a currency. They are also not allowed to move workers across borders freely.

An economic union is the last step in the process of economic integration, after free trade area, customs union, and common market.

### **More Resources**

CFI is the official provider of the Financial Modeling and Valuation Analyst (FMVA) certification program, designed to transform anyone into a world-class financial analyst.

To keep learning and developing your knowledge of financial analysis, we highly recommend the additional CFI resources below:

- \* Bilateral Agreement
- \* Customs Union
- \* Globalization
- \* Monetary Policy
- \* See all economics resources

### **Let's Sum Up**

Economic integration is the process by which countries coordinate and unify their economic policies to promote free trade and closer economic cooperation. It involves reducing or removing trade barriers such as tariffs and quotas to allow the free movement of goods, services, capital, and labor across borders. Economic integration occurs in stages: a Free Trade Area allows tariff-free trade among members; a Customs Union adds a common external tariff; a Common Market enables free movement of labor and capital; and an Economic Union represents the highest level, combining a common market with unified economic and monetary policies. Together, these stages aim to enhance regional growth, stability, and interdependence among member nations.

**Check your Progress Quiz – 1**

1. Economic integration involves:
 

A) Raising tariffs	B) Reducing trade barriers
C) Restricting imports	D) Isolating markets B
2. The most basic form of economic integration is:
 

A) Common Market	B) FTA
C) Economic Union	D) Customs Union B
3. A Customs Union differs from FTA by:
 

A) No internal tariffs	B) Common external tariff
C) No common policy	D) None B
4. The European Union is an example of:
 

A) Free Trade Area	B) Economic Union
C) Customs Union	D) Common Market B
5. NAFTA was formed between:
 

A) US, Canada, Mexico	B) US, UK, Japan
C) Brazil, Russia, India	D) None A
6. Which is a developing-country regional block?
 

A) EU	B) SAARC	C) NAFTA	D) EFTA B
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7. ASEAN's main focus area is:
 

A) Security	B) Economic and political cooperation
C) Tourism	D) Sports B
8. The term "Trade liberalization" means:
 

A) Reducing trade barriers	B) Increasing subsidies
C) Reducing exports	D) None A
9. The highest level of integration is:
 

A) Customs Union	B) Economic Union
C) FTA	D) Common Market B
10. Regional integration helps in:
 

A) Increasing isolation	B) Expanding markets
C) Reducing cooperation	D) Increasing tariffs B

**SECTION 4.2 REGIONAL TRADE BLOCS AND MULTILATERAL GROUPINGS****4.2.1 INTRODUCTION TO REGIONAL TRADE BLOCS**

A regional trading block is a group of countries within a geographical region that protect themselves from imports from non-members. In general terms, regional trade blocks are associations of nations at a governmental level to promote trade within the block and defend its members against global competition. Defence against global competition is obtained through established tariffs on goods produced by member states, import quotas, government subsidies, onerous bureaucratic import processes, and technical and other non-tariff barriers.

Since trade is not an isolated activity, member states within regional blocks also cooperate in economic, political, security, climatic, and other issues affecting the region.

In terms of their size and trade value, there are four major trade blocks and a larger number of blocks of regional importance. Trading blocs are a special type of economic integration.

#### **There are four types of trading blocs –**

- \* **Preferential Trade Area** – Preferential Trade Areas (PTAs), the first step towards making a full-fledged RTB, exist when countries of a particular geographical region agree to decrease or eliminate tariffs on selected goods and services imported from other members of the area.
- \* **Free Trade Area** – Free Trade Areas (FTAs) are like PTAs but in FTAs, the participating countries agree to remove or reduce barriers to trade on all goods coming from the participating members.
- \* **Customs Union** – A customs union has no tariff barriers between members, plus they agree to a common (unified) external tariff against non-members. Effectively, the members are allowed to negotiate as a single bloc with third parties, including other trading blocs, or with the WTO.
- \* **Common Market** – A ‘common market’ is an exclusive economic integration. The member countries trade freely all types of economic resources – not just tangible goods. All barriers to trade in goods, services, capital, and labor are removed in common markets. In addition to tariffs, non-tariff barriers are also diminished or removed in common markets.

#### **Objectives of Regional Blocks**

- \* **Promoting trade:** Regional trade blocs can promote cross-border trade by removing or lowering tariffs, trade barriers, and administrative obstacles. This creates a more simplified trading environment that can boost economic activity and expand world trade.
- \* **Protecting member interests:**Regional trade blocs can protect the interests of member countries.
- \* **Promoting free trade:**Regional trade blocs can promote free trade, which can increase consumer surplus by lowering prices and increasing choice.
- \* **Promoting good international relations:**Regional trade blocs can help promote good international relations between member countries.
- \* **Addressing environmental challenges:**Regional trade blocs can provide a platform for member countries to work together to establish common environmental standards and regulations. This can help promote sustainable practices and mitigate the negative impact of economic activities on the environment.

### Regional Trading Blocs – Advantages

The advantages of having a Regional Trading Bloc are as follows –

- \* **Foreign Direct Investment** – Foreign direct investment (FDI) surges in TRBs and it benefits the economies of participating nations.
- \* **Economies of Scale** – The larger markets created results in lower costs due to mass manufacturing of products locally. These markets form economies of scale.
- \* **Competition** – Trade blocs bring manufacturers from various economies, resulting in greater competition. The competition promotes efficiency within firms.
- \* **Trade Effects** – As tariffs are removed, the cost of imports goes down. Demand changes and consumers become the king.
- \* **Market Efficiency** – The increased consumption, the changes in demand, and a greater amount of products result in an efficient market.

### Regional Trading Blocs – Disadvantages

The disadvantages of having a Regional Trading Bloc are as follows –

- \* **Regionalism** – Trading blocs have bias in favor of their member countries. These economies establish tariffs and quotas that protect intra-regional trade from outside forces. Rather than following the World Trade Organization, regional trade bloc countries participate in regionalism.
- \* **Loss of Sovereignty** – A trading bloc, particularly when it becomes a political union, leads to partial loss of sovereignty of the member nations.
- \* **Concessions** – The RTB countries want to let non-member firms gain domestic market access only after levying taxes. Countries that join a trading bloc needs to make some concessions.
- \* **Interdependence** – The countries of a bloc become interdependent on each other. A natural disaster, conflict, or revolution in one country may have adverse effect on the economies of all participants

### DEVELOPED AND DEVELOPING COUNTRY

Developed countries are usually industrialized, have high standards of living, and strong economic growth. Developing countries are typically agrarian, have lower standards of living, and have weak economies with slow or nonexistent growth.

**Here are some other differences between developed and developing countries:**

**Infrastructure:** Developed countries have advanced infrastructure, while developing countries have less developed infrastructure.

**Literacy:** Developed countries have high literacy rates, while developing countries have lower literacy rates.

**Life expectancy:** Developed countries have high life expectancy, while developing countries have lower life expectancy.

**Population growth:** Developed countries have low population growth rates, while developing countries have high population growth rates.

**Human capital:** Developing countries may have limited human capital due to inadequate education systems, lack of investment in skills training, and limited access to quality health care.

### 4.2.2 MAJOR REGIONAL GROUPINGS: NAFTA, EU, SAARC, ASEAN, BRICS, AND OPEC

### **North American Free Trade Agreement (NAFTA)**

The North American Free Trade Agreement (NAFTA) is a treaty entered into by the United States, Canada, and Mexico; it went into effect on January 1, 1994. (Free trade had existed between the U.S. and Canada since 1989; NAFTA broadened that arrangement.) On that day, the three countries became the largest free market in the world; the combined economies of the three nations at that time measured \$6 trillion and directly affected more than 365 million people. NAFTA was created to eliminate tariff barriers to agricultural, manufacturing, and services; to remove investment restrictions; and to protect intellectual property rights. This was to be done while also addressing environmental and labor concerns (although many observers charge that the three governments have been lax in ensuring environmental and labor safeguards since the agreement went into effect). Small businesses were among those that were expected to benefit the most from the lowering of trade barriers since it would make doing business in Mexico and Canada less expensive and would reduce the red tape needed to import or export goods.

#### **Highlights of NAFTA included:**

Tariff elimination for qualifying products. Before NAFTA, tariffs of 30 percent or higher on export goods to Mexico were common, as were long delays caused by paperwork. Additionally, Mexican tariffs on U.S.-made products were, on average, 250 per cent higher than U.S. duties on Mexican products. NAFTA addressed this imbalance by phasing out tariffs over 15 years. Approximately 50 per cent of the tariffs were abolished immediately when the agreement took effect, and the remaining tariffs were targeted for gradual elimination. Among the areas specifically covered by NAFTA are construction, engineering, accounting, advertising, consulting/management, architecture, health-care management, commercial education, and tourism.

Elimination of nontariff barriers by 2008. This includes opening the border and interior of Mexico to U.S. truckers and streamlining border processing and licensing requirements. Nontariff barriers were the biggest obstacle to conducting business in Mexico that small exporters faced.

- \* **Establishment of standards:** The three NAFTA countries agreed to toughen health, safety, and industrial standards to the highest existing standards among the three countries (which were always U.S. or Canadian). Also, national standards could no longer be used as a barrier to free trade. The speed of export-product inspections and certifications was also improved.
- \* **Supplemental agreements:** To ease concerns that Mexico's low wage scale would cause U.S. companies to shift production to that country, and to ensure that Mexico's increasing industrialization would not lead to rampant pollution, special side agreements were included in NAFTA. Under those agreements, the three countries agreed to establish commissions to handle labor and environmental issues. The commissions have the power to impose steep fines against any of the three governments that failed to impose its laws consistently. Environmental and labor groups from both the United States and Canada, however, have repeatedly charged that the regulations and guidelines detailed in these supplemental agreements have not been enforced.
  - Tariff reduction for motor vehicles and auto parts and automobile rules of origin.
  - Expanded telecommunications trade.
  - Reduced textile and apparel barriers.

More free trade in agriculture. Mexican import licenses were immediately abolished, with most additional tariffs phased out over a 10-year period.

- \* Expanded trade in financial services.
- \* Opening of insurance markets.
- \* Increased investment opportunities.
- \* Liberalized regulation of land transportation.
- \* Increased protection of intellectual property rights.

NAFTA stipulated that, for the first time, Mexico had to provide a very high level of protection for intellectual property rights. This is especially helpful in fields such as computer software and chemical production. Mexican firms will no longer be able to steal intellectual property from companies and create a "Mexican" version of a product.

- \* Expanded the rights of American firms to make bids on Mexican and Canadian government procurement contracts.

One of the key provisions of NAFTA provided "national goods" status to products imported from other NAFTA countries. No state, provincial, or local governments could impose taxes or tariffs on those goods. In addition, customs duties were either eliminated at the time of the agreement or scheduled to be phased out in 5 or 10 equal stages. The one exception to the phase out was specified sensitive items, for which the phase-out period would be 15 years.

Supporters championed NAFTA because it opened up Mexican markets to U.S. companies like never before. The Mexican market is growing rapidly, which promises more export opportunities, which in turn means more jobs. Supporters, though, had a difficult time convincing the American public that NAFTA would do more good than harm. Their main effort centred on convincing people that all consumers benefit from the widest possible choice of products at the lowest possible price;-which means that consumers would be the biggest beneficiaries of lowered trade barriers. The U.S. Chamber of Commerce, which represents the interests of small businesses, was one of the most active supporters of NAFTA, organizing the owners and employees of small and mid-size businesses to support the agreement. This support was key in countering the efforts of organized labor to stop the agreement.

### **NAFTA AND SMALL BUSINESS**

Analysts agree that NAFTA has opened up new opportunities for small and mid-size businesses. Mexican consumers spend more each year on U.S. products than their counterparts in Japan and Europe, so the stakes for business owners are high. (Most of the studies of NAFTA concentrate on the effects of U.S. business with Mexico. Trade with Canada has also been enhanced, but the passage of the trade agreement did not have as great an impact on the already liberal trade practices that America and its northern neighbour abided by.)

Some small businesses were affected directly by NAFTA. In the past, larger firms always had an advantage over small ones because the large companies could afford to build and maintain offices and/or manufacturing plants in Mexico, thereby avoiding many of the old trade restrictions on exports. In addition, pre-NAFTA laws stipulated that U.S. service providers that wanted to do business in Mexico had to

establish a physical presence there, which was simply too expensive for small firms to do. Small firms were stuck-; they could not afford to build, nor could they afford the export tariffs. NAFTA levelled the playing field by letting small firms export to Mexico at the same cost as the large firms and by eliminating the requirement that a business establish a physical presence in Mexico in order to do business there. The lifting of these restrictions meant that vast new markets were suddenly open to small businesses that had previously done business only in the United States. This was regarded as especially important for small businesses that produced goods or services that had matured in U.S. markets.

Still, small firms interested in conducting business in Mexico have to recognize that Mexican business regulations, hiring practices, employee benefit requirements, taxation schedules, and accounting principles all include features that are unique to that country. Small businesses, then, should familiarize themselves with Mexico's foundation of business rules and traditions-;not to mention the demographics culture of the marketplace-;before committing resources to this region.

### **THE EFFECTS OF NAFTA**

Since NAFTA's passage, American business interests have often expressed great satisfaction with the agreement. Trade has grown sharply between the three nations who are parties to NAFTA but that increase of trade activity has resulted in rising trade deficits for the U.S. with both Canada and Mexico-;the U.S. imports more from Mexico and Canada than it exports to these trading partners. Critics of the agreement argue that NAFTA has been at least partially responsible for these trade deficits as well as the striking loss of manufacturing jobs experienced in the U.S. over the last decade. But, manufacturing jobs began to decline before the NAFTA agreement. The debate about NAFTA continues.

Isolating the effects of NAFTA within the larger economy is impossible. It is difficult, for example, to say with certainty what percentage of the current U.S. trade deficit-;which stood at a record \$65,677 million at the end of 2005-;is directly attributable to NAFTA. It is also difficult to say what percentage of the 3.3 million manufacturing jobs lost in the U.S. between 1998 and 2004 are the result of NAFTA and what percent would have occurred without this trade agreement. It is not even possible to say with certainty that the increased trade activity among the NAFTA

nations is entirely the result of the trade agreement. Those who favor the agreement usually claim credit for NAFTA for the increased trade activity and reject the idea that the agreement resulted in job losses or the rising trade deficit with Canada and Mexico, (\$8,039 million and \$4,263 million respectively in December 2005). Those who are critical of the agreement usually link it to these deficits and to job losses as well.

What is clear is that NAFTA remains a lightning rod for political opinions about globalization and free trade generally. Opposition to NAFTA has grown and has made it far more difficult, politically, to pass other similar free trade agreements. This was demonstrated clearly in the summer of 2005 when the Central American Free Trade Agreement (CAFTA) was stalled in Congress for lack of support. Two journalists, Dawn Gilbertson and Jonathan J. Higuera, writing in the Arizona Republic at the ten year anniversary of NAFTA, summed things up this way: "The Reality of NAFTA at 10 is this: a still-developing story of winners and losers, split largely by where you work and what you make." The same may be said about the effects of NAFTA on small businesses. For some it has been an opportunity to grow and for others a challenge to be met.

### **THE EUROPEAN UNION (EU):**

The European Union is a unified trade and monetary body of 27 member countries. It eliminates all border controls between members. The open border allows the free flow of goods and people, except for random spot checks for crime and drugs. Any product manufactured in one EU country can be sold to any other member without tariffs or duties.

Practitioners of most services, such as law, medicine, tourism, banking, and insurance, can operate in all member countries. As a result, the cost of airfares, the internet, and phone calls are typically lower than in the United States.

### **Member countries:**

As of 2018, the European Union has 28 members - all European countries. The countries comprising the European Union are Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

However, in 2019, Britain is set to leave the European Union, bringing the total down to 27 countries.

### **The Schengen Area:**

To ensure free passage between countries, the Schengen Area was established for residents of certain countries - including some non-EU countries. Some countries in the Schengen Area are Austria, Belgium, Estonia, Finland, France, Germany, Greece, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, Spain, Czech Republic, Denmark, Hungary, Poland, and Sweden, as well as non-EU countries Iceland, Liechtenstein, Norway and Switzerland. In addition, Bulgaria, Croatia and Romania are pending approval to enter the Schengen Area as well.

For residents in these countries, passage to and from other Schengen Area countries is much easier - not requiring visas or showing passports.

### **Objectives:**

The European Union's main objective is to promote peace, follow the EU's values and improve the wellbeing of nations. The European Parliament and other institutions see to it that these objectives are achieved.

### **The main objectives are:**

- \* **A common European area without borders:** The objective is to create a free and safe Europe with no internal borders. The citizens living in the area enjoy the rights granted by the European Union.
- \* **Internal market:** The objective is to ensure smooth and efficient trade within Europe. Competition between companies is free and fair.
- \* **Stable and sustainable development:** The objective is to ensure Europe's sustainable and steady development. It means balanced economic growth and

stable prices. The European Union seeks to create a competitive market economy which takes into account people's wellbeing and social needs. An important issue is environmental protection. Efforts are made to protect the environment and repair any damage made.

- \* **Scientific and technological development:** The European Union supports the advancement of science and technology and invests in education. Another objective is to achieve a skilled workforce and a high standard of technological production.
- \* **Prevention of social exclusion:** The European Union works hard to prevent social exclusion. It seeks to prevent people from drifting outside the labour market and society. Efforts are made to eliminate poverty. The Union works for equality. Minority rights are protected. Social security is improved. Men and women must be treated equally. Children's rights must be protected and children given a happy childhood. Old people must be looked after and respected.
- \* **Solidarity (unity):** Solidarity between countries and people is promoted in the field of the economy, social quality and regions. The member states must be loyal to one another. It means that states must take responsibility for and be understanding of one another.
- \* **Respect for languages and cultures:** The European Union respects the languages and cultures of the individual countries. National cultures and the common European culture are cherished and developed.
- \* **Common foreign and security policy:** The European Union seeks to promote peace not only in Europe but also elsewhere in the world. It seeks to ensure that peace is maintained in Europe and that people have security. With the common foreign policy, the European Union wants to make sure that the resources of the planet are used sensibly and that the environment is not destroyed. The European Union also wishes to respect other countries and nations. It works for free and fair trade and tries to eliminate poverty. Human rights are important all over the world. The European Union follows the Charter of the United Nations and underlines the importance of common international rules.

### How Is the European Union Governed?

As mentioned earlier, the European Union is governed by three main bodies – (i) the EU Council, (ii) the EU Parliament and (iii) the EU Commission.

The Council's main job is to create and propose new policies and legislation for the European Union; it operates under a different EU president every six months.

The Parliament then debates and passes the laws proposed by the Council, electing members once every five years.

Finally, the Commission enforces and operates the laws for the European Union - the current president of which is Jean-Claude Juncker (until 2019).

Additionally, the European Central Bank services the EU's financial needs and manages things like inflation rates and foreign exchange reserves.

### **What Currency Does the European Union Use?**

Unsurprisingly, the European Union primarily uses the euro as currency, which is reportedly the second most-used currency in the world, under the U.S. dollar. Once established, the euro has replaced many of Europe's leading currencies, including French and Italian currencies like the franc and lira, to name a few. In fact, according to the EU's website, more than 340million EU citizens in 19 countries use the euro as their currency.

However, not all countries have adopted the euro - with Britain famously holding onto the pound. The euro, despite being so commonly held, has a fluctuating value - which exchange traders daily determine in comparison to the U.S. dollar as a standard.

### **THE SOUTH ASIAN ASSOCIATION FOR REGIONAL COOPERATION (SAARC):**

**Year of foundation:** 1985

**Headquarters:** Kathmandu, Nepal

The South Asian Association for Regional Co-operation (SAARC) is an organisation of South Asian nations, which was established on 8 December 1985 when the government of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka formally adopted its charter providing for the promotion of economic and social progress, cultural development within the South Asia region and also for

friendship and cooperation with other developing countries. The Secretariat of the Association was set up in Kathmandu on 17 January 1987.

It is dedicated to economic, technological, social and cultural development emphasizing collective self-reliance. In terms of population, its sphere of influence is the largest of any regional organisation. In April 2007, Afghanistan became its eighth member.

### **OBJECTIVES:**

The objectives of the Association as outlined in the SAARC Charter are:

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

Decisions at all levels are to be taken on the basis of unanimity; and bilateral and controversial issues are excluded from the deliberations of the Association

### **Principles of SAARC**

- \* The SAARC respects the principles of Sovereignty, territorial, political integrity, and independence. Accordingly, they also have no interference in the internal affairs of another member state.

- \* It promotes regional cooperation in the spirit of friendship, trust, and mutual benefits.
- \* Promotion of harmony, stability, and peace among the participating countries.
- \* Moreover, it promotes regional integration among member states through increased economic cooperation, investment, and trade.
- \* Improve connectivity and communication among the member states as well.

### The SAARC Secretariat:

The SAARC Secretariat is based in Katmandu. It coordinates and monitors implementation of activities, prepares for and services meetings, and serves as a channel of communication between the Association and its Member States as well as other regional organizations. The Secretariat is headed by the Secretary General, who is appointed from Member States in alphabetical order for a three-year term by the SAARC Council of Ministers. The Secretary General is assisted by eight Directors on deputation from Member States. The SAARC Secretariat and Member States observe 8 December as the SAARC Charter Day.

### Importance of SAARC in India

The South Asian Association for Regional Cooperation (SAARC) is essential for India in various ways:

- \* **Economic Cooperation:** It allows India to expand its economic ties with other South Asian nations. But primarily through the facilitation of investment and trade.
- \* **Diplomatic Relation:** India uses SAARC to communicate with its neighbours about various diplomatic disputes. It entails resolving conflicts and border disputes.
- \* **Regional Security:** It gives India a platform to interact with its neighbours and advance regional security. In addition, it is beneficial in disaster management, border control, and counterterrorism.
- \* **Connectivity:** It gives India a chance to collaborate with its neighbours to improve connectivity. Moreover, it covers industries like transportation, energy, and telecommunications. This can be especially beneficial for increasing trade and economic integration.

- \* **Cultural Exchange:** It enables India to share its cultural diversity and heritage with its neighbours and the rest of the world.

SAARC is an important regional organisation for India. It provides a platform for improving peace and brotherhood among the member states.

### SAARC Structure

The SAARC structure consists of the following central bodies:

- \* **Council of Ministers:** The foreign ministers of the member nations make up the Council of Ministers. It is in charge of the SAARC's overall policy direction.
- \* **Standing Committee:** The Standing Committee is composed of the foreign secretaries of the member countries. They are accountable for watching the performance of the actions of SAARC.
- \* **Secretariat:** The Secretariat of the SAARC is located in Kathmandu, Nepal. It is headed by a Secretary General appointed by the Council of Ministers. In addition, the Secretariat is in charge of organising and carrying out the activities in search.
- \* **Technical Committees:** There are several technical committees in search. It includes committees on economic cooperation, agriculture, environment, and health. These committees are responsible for implementing the needs and taking care of their areas.
- \* **Specialised Bodies:** The search also has several specialised bodies. It includes a development fund, disaster management, a cultural centre, and others.

## ASEAN

### ASEAN History

ASEAN was established on 8th August 1967 in Bangkok, Thailand with the signing of the Bangkok Declaration (a.k.a ASEAN Declaration) by the founding fathers of the countries of Indonesia, Malaysia, Thailand, Singapore, and the Philippines. The preceding organisation was the Association of Southeast Asia (ASA) comprising of Thailand, the Philippines, and Malaysia.

### ASEAN Purpose

- \* Accelerating economic growth, cultural development, and social progress in the region by joint initiatives in the spirit of partnership and equality to cement the foundation for a peaceful and strong community of SE Asian countries.
- \* Promoting peace and stability in the region by incorporating respect for justice and the rule of law in the relationships between nations and adherence to the United Nations principles.
- \* Promoting active collaboration and mutual assistance in subjects of common interest in social, economic, cultural, administrative, scientific, and technical domains.
- \* Assisting member countries via training and research facilities in the educational, administrative, technical, and professional domains.
- \* Cooperating for better usage of agriculture and industries, trade expansion (including studying the problem of international commodity trade), improving communication and transportation facilities, and improving living standards among the people.
- \* Promoting SE Asian studies.
- \* Exploring more avenues for further cooperation among themselves, and maintaining close and advantageous cooperation with other international groupings of similar objectives.

### **ASEAN Fundamental Principles**

- \* Mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations;
- \* The right of every State to lead its national existence free from external interference, subversion or coercion;
- \* Non-interference in the internal affairs of one another;
- \* Settlement of differences or disputes by peaceful manner;
- \* Renunciation of the threat or use of force; and
- \* Effective cooperation among themselves.

### **ASEAN Headquarters**

- \* The body is headquartered in Jakarta, Indonesia.
- \* Secretary-General: Dato Lim Jock Hoi

- \* Official Languages: Burmese, Filipino, Indonesian, Khmer, Lao, Malay, Mandarin, Tamil, Thai and Vietnamese
- \* Working Language: English

#### **ASEAN-led Forums:**

- \* ASEAN Regional Forum (ARF): It was launched in 1993. It is a twenty-seven-member multilateral grouping that was developed to facilitate cooperation on political and security issues to contribute to regional confidence-building and preventive diplomacy.
- \* ASEAN Plus Three: The consultative group initiated in 1997 brings together ASEAN's ten members, China, Japan, and South Korea.
- \* East Asia Summit (EAS): First held in 2005, the summit seeks to promote security and prosperity in the region and is usually attended by the heads of state from ASEAN, Australia, China, India, Japan, New Zealand, Russia, South Korea, and the United States. ASEAN plays a central role as the agenda-setter.

#### **BRICS**

BRICS is an acronym for 5 emerging economies of the world viz. – Brazil, Russia, India, China, and South Africa. The term BRIC was coined by Jim O'Neil, the then chairman of Goldman Sachs in 2001. The first BRIC summit took place in the year 2009 in Yekaterinburg (Russia). In 2010, South Africa formally joined the association making it BRICS.

The BRICS brings together five of the largest developing countries of the world, representing 41% of the global population, 24% of the global GDP and 16% of the global trade.

It's an emerging investment market and global power bloc.

#### **What is the Structure of BRICS?**

- \* BRICS does not exist in form of organization, but it is an annual summit between the supreme leaders of five nations.
- \* The Chairmanship of the forum is rotated annually among the members, in accordance with the acronym B-R-I-C-S.

- \* BRICS cooperation in the past decade has expanded to include an annual programme of over 100 sectoral meetings.
- \* Where does the Genesis of BRICS Lie?
- \* The acronym "BRICS" was initially formulated in 2001 by economist Jim O'Neill, of Goldman Sachs, in a report on growth prospects for the economies of Brazil, Russia, India and China – which together represented a significant share of the world's production and population.
- \* In 2006, the four countries initiated a regular informal diplomatic coordination, with annual meetings of Foreign Ministers at the margins of the General Debate of the UN General Assembly (UNGA).
- \* This successful interaction led to the decision that the dialogue was to be carried out at the level of Heads of State and Government in annual Summits.

### What is the Timeline?

- \* The first BRIC Summit took place in 2009 in the Russian Federation and focused on issues such as reform of the global financial architecture.
- \* South Africa was invited to join BRIC in December 2010, after which the group adopted the acronym BRICS. South Africa subsequently attended the Third BRICS Summit in Sanya, China, in March 2011.
- \* What are the Main Objectives of BRICS?
- \* The BRICS seeks to deepen, broaden and intensify cooperation within the grouping and among the individual countries for more sustainable, equitable and mutually beneficial development.
- \* BRICS takes into consideration each member's growth, development and poverty objectives to ensure relations are built on the respective country's economic strengths and to avoid competition where possible.
- \* BRICS is emerging as a new and promising political-diplomatic entity with diverse objectives, far beyond the original objective of reforming global financial institutions.

### What are the Main Areas of Cooperation within BRICS?

- \* **Economic Cooperation:** There are rapidly growing trade and investment flows between BRICS countries as well as economic cooperation activities across a range of sectors.

Agreements have been concluded in the areas of Economic and Trade Cooperation; Innovation Cooperation, Customs Cooperation; strategic cooperation between the BRICS Business Council , Contingent Reserve Agreement and the New Development Bank.

These agreements contribute to realisation of the shared objectives of deepening economic cooperation and fostering integrated trade and investment markets.

- \* **People-to-People exchange:** BRICS members have recognised the need for strengthening People-to-People exchanges and to foster closer cooperation in the areas of culture, sport, education, film and youth.

People-to-People exchanges seek to forge new friendships; deepen relations and mutual understanding between BRICS peoples in the spirit of openness, inclusiveness, diversity and mutual learning.

Such People to people exchanges include the Young Diplomats Forum, Parliamentarian Forum, Trade Union Forum, Civil BRICS as well as the Media Forum.

- \* **Political and Security Cooperation:** BRICS member political and security cooperation is aimed at achieving peace, security, development and cooperation for a more equitable and fair world.

BRICS provides opportunities for sharing policy advice and exchanges of best practices in terms of domestic and regional challenges as well as advancing the restructuring of the global political architecture so that it is more balanced, resting on the pillar of multilateralism.

BRICS is utilised as a driver for South Africa's foreign policy priorities including the pursuit of the African Agenda and South-South Cooperation.

- \* **Cooperation Mechanism:** Cooperation among members is achieved through:

- **Track I:** Formal diplomatic engagement between the national governments.
- **Track II:** Engagement through government-affiliated institutions, e.g. state-owned enterprises and business councils.

- **Track III:** Civil society and People-to-People engagement.

### **What is the Impact of BRICS on Global Institutional Reforms?**

- \* The main reason for co-operation to start among the BRICS nation was the financial crises of 2008. The crises raised doubts over sustainability of the dollar-dominated monetary system.
- \* The BRICS called for the “the reform of multilateral institutions in order that they reflect the structural changes in the world economy and the increasingly central role that emerging markets now play”.
- \* BRICS managed to push for institutional reform which led to International Monetary Fund (IMF) quota reform in 2010. Thus the financial crises had momentarily reduced western legitimacy and briefly let the BRICS countries become “agenda setters” in multilateral institutions.

### **What is the New Development Bank?**

- \* NDB is headquartered in **Shanghai**.
- \* At the Fourth BRICS Summit in New Delhi (2012) the possibility of setting up a new Development Bank was considered to mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies, as well as in developing countries.
- \* During the Sixth BRICS Summit in Fortaleza (2014) the leaders signed the Agreement establishing the New Development Bank (NDB).
- \* Fortaleza Declaration stressed that the NDB will strengthen cooperation among BRICS and will supplement the efforts of multilateral and regional financial institutions for global development thus contributing to sustainable and balanced growth.
- \* NDB’s key areas of operation are clean energy, transport infrastructure, irrigation, sustainable urban development and economic cooperation among the member countries.
- \* The NDB functions on a consultative mechanism among the BRICS members with all the member countries possessing equal rights.

**Major Projects funded by NDB in India:**

- \* It has committed funding to a number of major infrastructure projects in India, including the Mumbai Metro rail, Delhi-Ghaziabad-Meerut Regional Rapid Transit System and many Renewable Energy projects.
- \* The NDB has so far approved 14 Indian projects for an amount of nearly USD 4.2 billion.
- \* In 2020, India announced a 1 billion USD loan pact with NDB to boost rural employment and infrastructure.

**THE ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES (OPEC)****Brief history and members:**

The Organization of the Petroleum Exporting Countries (OPEC) was founded in Baghdad, Iraq, with the signing of an agreement in September 1960 by five countries namely Islamic Republic of Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. They were to become the Founder Members of the Organization.

These countries were later joined by Qatar (1961), Indonesia (1962), Libya (1962), the United Arab Emirates (1967), Algeria (1969), Nigeria (1971), Ecuador (1973), Gabon (1975), Angola (2007), Equatorial Guinea (2017) and Congo (2018).

Ecuador suspended its membership in December 1992, re-joined OPEC in October 2007, but decided to withdraw its membership of OPEC effective 1 January 2020. Indonesia suspended its membership in January 2009, reactivated it again in January 2016, but decided to suspend its membership once more at the 171st Meeting of the OPEC Conference on 30 November 2016. Gabon terminated its membership in January 1995. However, it re-joined the Organization in July 2016. Qatar terminated its membership on 1 January 2019.

This means that, currently, the Organization has a total of 13 Member Countries. The OPEC Statute distinguishes between the Founder Members and Full Members – those countries whose applications for membership have been accepted by the Conference.

The Statute stipulates that “any country with a substantial net export of crude petroleum, which has fundamentally similar interests to those of Member Countries,

may become a Full Member of the Organization, if accepted by a majority of three-fourths of Full Members, including the concurring votes of all Founder Members.”

The Statute further provides for Associate Members which are those countries that do not qualify for full membership, but are nevertheless admitted under such special conditions as may be prescribed by the Conference.

OPEC Country	Joined	Located	Oil Produced (mbpd) 2017	Comments
Algeria	1969	Africa	1.06	
Angola	2007	Africa	1.63	
Ecuador	1973	Central America	0.53	Left in 1992. Rejoined in 2009.
Equatorial Guinea	2017	Africa	0.13	
Gabon	1975	Africa	0.21	Left in 1995. Rejoined in 2016.
Iran	1960	Middle East	3.87	Rose due to <a href="#">nuclear treaty</a> .
Iraq	1960	Middle East	4.47	Increased output to fund <a href="#">Iraq War</a> .
Kuwait	1960	Middle East	2.70	
Libya	1962	Middle East	0.82	Returned to 2013 levels.
Nigeria	1971	Africa	1.54	
Saudi Arabia	1960	Middle East	9.96	Produces 30% of total.
U.A.E.	1967	Middle East	2.97	
<a href="#">Venezuela</a>	1960	Central America	2.03	Funds the failing government.
TOTAL OPEC			32.51	Less than the record 33.44 in 2016.

### Goals of OPEC:

1) OPEC's first goal is to keep prices stable. It wants to make sure its members get a reasonable price for their oil. Since oil is a somewhat uniform commodity, most consumers base their buying decisions on nothing other than price. What's the right price? OPEC has traditionally said it was between \$70 and \$80 per barrel. At those prices, OPEC countries have enough oil to last 113 years. If prices drop below that target, OPEC members agree to restrict supply to push prices higher.

But Iran wants a lower target for prices of \$60 a barrel. It believes a lower price will drive out U.S. shale oil producers who need a higher margin. Iran's break-even price is just over \$50 a barrel. Saudi Arabia needs \$70 a barrel to break even. That price includes exploration and administrative costs.

Saudi Arabia's flagship oil company, Aramco, can pump the oil at \$2 to \$20 a barrel. Saudi Arabia has cash reserves to allow it to operate at lower prices. But it is a hardship the country prefers to avoid. Like other OPEC members, it relies on petrodollars for government revenues.

Without OPEC, individual oil-exporting countries would pump as much as possible to maximize national revenue. By competing with each other, they would drive prices even lower. That would stimulate even more global demand. OPEC countries would run out of their most precious resource that much faster. Instead, OPEC members agree to produce only enough to keep the price high for all members. to explore its shale oil fields. U.S. companies used fracking to open up the Bakken oil fields for production. As a result, non-OPEC supply increased.

2) OPEC's second goal is to reduce oil price volatility. For maximum efficiency, oil extraction must run 24 hours a day, seven days a week. Closing facilities could physically damage oil installations and even the fields themselves. Ocean drilling is difficult and expensive to shut down. It is then in OPEC's best interests to keep world prices stable. A slight modification in production is often enough to restore price stability.

For example, in June 2008, oil prices hit an all-time high of \$143 per barrel. OPEC responded by agreeing to produce a little more oil. This move brought prices down. But the global financial crisis sent oil prices plummeting to \$33.73 per barrel in December. OPEC responded by reducing the supply. Its move helped prices to again stabilize.

3) OPEC's third goal is to adjust the world's oil supply in response to shortages. For example, it replaced the oil lost during the Gulf Crisis in 1990. Several million barrels of oil per day were cut off when Saddam Hussein's armies destroyed refineries in Kuwait. OPEC also increased production in 2011 during the crisis in Libya.

In 2018, it exported 25 million barrels of crude oil a day. That's 54% of the total world exports of 46 mbd. OPEC members hold 82% of the world's proven oil reserves. OPEC's decisions have a significant impact on future oil prices.

The Oil and Energy Ministers from the OPEC members meet at least twice a year to coordinate their oil production policies. Each member country abides by an honor system in which everyone agrees to produce a certain amount. If a nation winds up producing more, there is no sanction or penalty. Each country is responsible for reporting its own production.

In this scenario, there is room for "cheating." A country won't go too far over its quota though unless it wants to risk being kicked out of OPEC.

Despite its power, OPEC cannot completely control the price of oil. In some countries, additional taxes are imposed on gasoline and other oil-based end products to promote conservation. Oil prices are also set by the oil futures market. Much of the oil price is determined by commodities traders. That's the underlying reason why oil prices are so high.

### **Recent Decisions:**

On December 7, 2018, OPEC agreed to cut 1.2 million barrels per day. Members would cut 800,000 bpd. Allies would cut 400,000 bpd. Its goal is to return prices to \$70 a barrel by early fall 2019. In November, average global oil prices had dropped to \$65 bpd. Commodities traders had bid prices down. They believed higher U.S. supplies would flood the market with supply at the same time slowing global growth would cut into demand.

On November 30, 2017, OPEC agreed to continue withholding 2% of global oil supply. That continued the policy OPEC formed on November 30, 2016, when it agreed to cut production by 1.2 million barrels. As of January 2017, it would produce 32.5 mbd. That's still above its average 2015 level of 32.32 mbpd. The agreement exempted Nigeria and Libya. It gave Iraq its first quotas since the 1990s. Russia, not an OPEC member, voluntarily agreed to cut production.

The cut came a year after OPEC had raised its production quota to 31.5 mbpd on December 4, 2015. OPEC was struggling to maintain market share. Its share fell from 44.5% in 2012 to 41.8% in 2014. Its share fell because of a 16% increase in

U.S. shale oil production. As the oil supply rose, prices fell from \$108.54 in April 2012 to \$34.72 in December 2015. That was one of the biggest drops in oil price history.

OPEC waited to cut oil production because it didn't want to see its market share drop further. It produces oil more cheaply than its U.S. competition. The cartel toughed it out until many of the shale companies went bankrupt. That created a boom and bust in shale oil.

#### **4.2.4 CHALLENGES AND LIMITATIONS OF REGIONAL GROUPINGS**

Regional groupings or trade blocs such as NAFTA, EU, ASEAN, SAARC, BRICS, and OPEC play an important role in promoting trade and cooperation among member nations. While these groupings aim to enhance economic integration and mutual benefits, they often face several challenges and limitations that hinder their effectiveness. These issues arise due to differences in economic development, political interests, cultural diversity, and policy priorities of the member countries.

##### **1. Economic Disparities Among Member Nations**

One of the most significant challenges in regional groupings is the uneven level of economic development among member states.

In blocs like SAARC or ASEAN, countries differ widely in GDP, industrial capacity, and technological advancement. These disparities make it difficult to formulate uniform trade policies and distribute the benefits of integration equally. Wealthier nations often dominate the decision-making process, leaving smaller economies with fewer advantages.

##### **2. Political and Ideological Differences**

Regional cooperation requires a strong political commitment from all member nations. However, political instability, ideological conflicts, and differences in governance systems create tensions within blocs.

For example, political disagreements between India and Pakistan have limited the progress of SAARC. Similarly, changes in leadership or foreign policy priorities may shift the focus away from integration goals.

### **3. Trade Barriers and Protectionism**

Although regional groupings aim to reduce trade barriers, protectionist tendencies still exist. Member countries often impose tariffs, quotas, or non-tariff barriers to protect domestic industries. Such actions contradict the spirit of free trade and reduce the overall efficiency of the bloc. For instance, within ASEAN, some nations maintain protectionist policies in sectors like agriculture and energy.

### **4. Unequal Distribution of Benefits**

The gains from regional cooperation are not always shared equally. Economically stronger nations tend to benefit more from liberalized trade and investments. Smaller or less-developed countries struggle to compete, resulting in economic imbalances and dissatisfaction. This inequality can lead to withdrawal or reduced participation from weaker members.

### **5. Bureaucratic and Institutional Inefficiency**

Regional organizations often face challenges due to complex administrative structures and slow decision-making processes. The need for consensus in decision-making can delay crucial economic reforms. Lack of effective enforcement mechanisms makes it difficult to implement agreed-upon policies. For instance, SAARC's initiatives often remain unimplemented due to bureaucratic delays and weak institutional frameworks.

### **6. Limited Intra-Regional Trade**

In many regional blocs, intra-regional trade remains a small portion of total trade.

Member countries may have similar export structures or compete in the same international markets, reducing the scope for mutual trade.

For example, most SAARC nations export similar agricultural and textile products, limiting trade complementarities. This limits the growth potential of the bloc and weakens its economic significance.

### **7. External Economic Dependence**

Developing regional blocs often rely heavily on external trade partners such as the United States, China, or the European Union. This dependency reduces the

motivation for regional self-reliance and integration. External influences may also disrupt regional unity when member countries pursue bilateral agreements outside the bloc.

### **8. Geopolitical and Security Concerns**

Security tensions and border disputes often act as major roadblocks to regional cooperation.

Geopolitical rivalries, such as those between India and China or political instability in the Middle East, hinder integration. Such issues shift attention away from economic development and focus more on strategic or defense concerns.

### **9. Cultural and Linguistic Diversity**

Regional groupings encompass nations with diverse languages, cultures, and religions, which sometimes create communication barriers and misunderstandings.

Differences in social and cultural values can affect business practices, negotiation styles, and policy harmonization. Cultural heterogeneity may therefore slow down the pace of integration.

### **10. Lack of Public Awareness and Support**

Public support is crucial for the success of regional integration. In many countries, citizens are unaware of the benefits of regional cooperation or perceive it as benefiting only elites or large corporations. Political leaders, therefore, face challenges in securing domestic approval for deeper integration measures.

### **Let's Sum Up**

This section highlights how regional blocks and global financial institutions collaborate to promote stability, development, and trade. Organizations like IMF, World Bank, and ADB play a promotional and developmental role, while regional blocks such as EU, ASEAN, and BRICS foster trade and regional cooperation.

### **Check your progress – Quiz – 2**

1. NAFTA was replaced by:  
A) SAFTA                      B) USMCA                      C) EU                      D) BRICS                      B
2. The European Union has how many members?

- A) 19                      B) 27                      C) 15                      D) 30 B
3. SAARC was established in:  
A) 1985 B) 1991 C) 1995 D) 2000A
4. The main focus of ASEAN is:  
A) Political union                      B) Economic cooperation  
C) Defence alliance                      D) Cultural exchange                      B
5. BRICS includes which of the following?  
A) Belgium                      B) Brazil  
C) Bangladesh                      D) Bhutan                      B
6. The headquarters of OPEC is located in:  
A) Geneva                      B) Vienna  
C) New York                      D) Paris                      B
7. IMF mainly helps countries facing:  
A) Oil crisis                      B) Balance of payments problems  
C) Inflation                      D) Deflation                      B
8. IFC is affiliated with:  
A) UNCTAD                      B) World Bank Group  
C) WTO                      D) IMF                      B
9. MIGA provides:  
A) Grants                      B) Insurance against political risk  
C) Loans                      D) Training                      B
10. ADB mainly supports:  
A) European nations                      B) African nations  
C) Asian nations                      D) Latin America                      C

### 4.2.3 ROLE OF REGIONAL BLOCS IN PROMOTING INTERNATIONAL TRADE

### SECTION 4.3 INTERNATIONAL FINANCIAL AND TRADE INSTITUTIONS

#### International Monetary Fund (IMF)

The formation of the IMF was initiated in 1944 at the Bretton Woods Conference. IMF came into operation on 27th December 1945 and is today an

international organization that consists of 189 member countries. Headquartered in Washington, D.C., IMF focuses on fostering global monetary cooperation, securing financial stability, facilitating and promoting international trade, employment, and economic growth around the world. The IMF is a specialized agency of the United Nations.

#### 4.3.1 ROLE PLAYED BY IMF

- \* Foster global monetary cooperation
- \* Secure financial stability
- \* Facilitate international trade
- \* Promote high employment and sustainable economic growth
- \* And reduce poverty around the world
- \* Macro-economic growth
- \* Policy advise & financing for developing countries,
- \* Promotion of exchange rate stability, and an international payment system

#### What Does the IMF Do?

It has three critical missions:

- \* Furthering international monetary cooperation, encouraging the expansion of trade and economic growth,
- \* Discouraging policies that would harm prosperity.
- \* To fulfill these missions, IMF member countries work collaboratively with each other and with other international bodies.

#### 4.3.2 WORLD BANK AND ITS AFFILIATES: IFC, MIGA, AND ICSID

##### WORLD BANK AND ITS AFFILIATES

The World Bank Group is an international partnership comprising 189 countries and five constituent institutions that works towards eradicating poverty and creating prosperity.

The five development institutions under the World Bank Group are:

1. International Bank for Reconstruction and Development (IBRD)
2. International Development Association (IDA)
3. International Finance Corporation (IFC)

4. Multilateral Guarantee Agency (MIGA)
5. International Centre for the Settlement of Investment Disputes (ICSID)

### **INTERNATIONAL FINANCE CORPORATION (IFC)**

The IFC is a sister organization of the World Bank (IDA + IBRD). It is the largest international development institution focused on the private sector in developing countries.

- \* It functions as the private sector arm of the WBG.
- \* It works for economic development by investing in for-profit and commercial projects for poverty reduction and augmenting development.
- \* It also engages in mobilizing third-party resources for projects.
- \* The IFC works with the private sector to boost entrepreneurship and create sustainable businesses.
- \* The IFC provides investment, advice, and asset management offerings.
- \* It lends to businesses and private sector projects.

### **IFC and India**

- \* India is a founding member of the IFC.
- \* Over the past few years, IFC has augmented its portfolio in India, improving profitability and investing in high impact projects.
- \* It is expanding its activities in the LIS (the Low Income States and the NE States) in India.
- \* Improving the investment climate for private sector development and inclusive growth.
- \* Financial inclusion by focusing on microfinance institutions.
- \* Focus on renewable energy and cleaner production methods.
- \* Developing PPP transactions with a focus on social services (health and education) and climate change impact projects.

### **MULTILATERAL INVESTMENT GUARANTEE AGENCY (MIGA)**

MIGA's chief goal is to enhance cross-border investment in developing countries by giving guarantees (political risk insurance and credit enhancement) to lenders and investors.

- \* The agency's guarantees to protect investments against non-commercial risks.
- \* It emphasizes on Fragile and Conflict-affected States.
- \* Political risk insurance products:
  - Coverage against losses due to war, terrorism, and civil disturbance.
  - Coverage against expropriation by governments.
  - Coverage against breach of contract.
  - Protection against losses arising from an inability to legally convert local currency into hard currency.
- \* Credit enhancement – protection when governments fail to honor financial obligations.
- \* India became a member of the MIGA in 1994.

### **INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES (ICSID)**

ICSID engages in international investment dispute settlement.

- \* It settles disputes between investors and governments.
- \* It also settles state-state disputes under investment treaties and free trade agreements and acts as an administrative registry.
- \* The Centre provides for settlement of disputes by arbitration, conciliation, or fact-finding.
- \* It also disseminates information on international law on foreign investment.
- \* India is not a member of the ICSID because it claims that the ICSID's functioning and structure are biased towards the developed countries.
- \* India set up the BRICS Arbitration Centre (BRICS Centre) to address and reinforce international arbitrations with foreign investors. Although this is limited to the BRICS countries, it will be available for all developing countries in the future.

### 4.3.3 ROLE OF ASIAN DEVELOPMENT BANK (ADB) IN GLOBAL DEVELOPMENT

#### ASIAN DEVELOPMENT BANK (ADB)

- \* Asian Development Bank (ADB) was established in the year 1966, with head office at Manila (Philippines). It has 67 members from the Asia Pacific region. This bank was modeled on the lines of the world bank.
- \* Japan holds the largest share in ADB with 15.677%, followed by U.S.A (15.567%), China (6.473%), and India (5.812%).
- \* The aim of the ADB is social development by reducing poverty in the Asia Pacific with inclusive growth, sustainable growth, and regional integration. This is carried out through an 80% investment in the public sector.
- \* ADB invests in infrastructure, health, public administration system, helping nations to reduce the impact of climate change and to manage natural resources.

#### Asian Development Bank (ADB) & India

India started availing of ADB's assistance in 1986. The aim of Asian Development Bank is to support India in the following fields:

- \* Industrial competitiveness
- \* Jobs creation
- \* Growth acceleration of low-income states
- \* Environmental and climate change challenges

#### Recent development between ADB & India:

- \* ADB and India have signed a loan of \$206 million to strengthen urban services in 5 Tamil Nadu cities
- \* Asian Development Bank (ADB) has listed its 10-year masala bonds worth Rs 850 crore on the global debt listing platform of India INX
- \* Asian Development Bank (ADB) had prepared a Conceptual Development Plan (CDP) for Vizag-Chennai Industrial Corridor (VCIC)
- \* ADB has offered to provide USD 4 million to member countries to contain coronavirus outbreaks.

- \* The Asian Development Bank (ADB) will provide Rs 100 crore loan to hospital chain Medanta for healthcare services and medical equipment to fight the COVID-19 pandemic. The project will support the purchase of personal protective equipment, basic hygiene products, and patient care equipment such as ventilators and beds.

#### **4.3.4 REGULATORY ROLE OF WTO AND UNCTAD IN INTERNATIONAL TRADE**

##### **REGULATORY ROLE PLAYED BY WTO**

###### **Progressive opening and regulation of markets**

The WTO's mission is to open markets gradually while ensuring that rules are respected. The origin of the organization dates back to the end of World War II when the idea of peaceful cooperation among peoples was emerging. In 1947, a number of countries decided to open up their markets on the basis of common principles, and founded the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT). In the current round of trade negotiations, the WTO is seeking to make further advances in equitable trade.

###### **The WTO acts as conductor, tribunal, monitor and trainer**

###### **1. Orchestra conductor**

International trade is governed by very precise rules developed by the WTO's members. Countries must apply these rules when trading with one another. The WTO acts as the orchestra conductor, ensuring that rules are respected. The WTO was founded in 1995, but its origins date back to 1947 and the creation of the GATT. Since then, WTO members have adapted these rules to keep up with new developments. For example, services have developed considerably since the 1980s, and have now become one of the most important economic sectors. As a result, WTO members established rules governing international trade in services. Adapting or changing the principles of international trade means reaching consensus among WTO members through a round of negotiations. The latest round - the ninth since 1947 - was launched in 2001 (see "How do trade negotiations work?" above)

## 2. Tribunal

One of the main roles of the WTO is to settle disputes between its members. The WTO plays the role of trade tribunal, where members may file complaints against other members who failed to abide by the principles of international trade. There are three stages to dispute settlement. To begin with, the disputing countries try to settle their differences by themselves. If that fails, the case is decided by a panel made up of three experts, which issues a ruling. That ruling may be appealed. Once a definitive ruling has been issued, the losing party must comply. If it does not, it is liable to sanctions. Since 1995, over 400 complaints have been filed by WTO members.

## 3. Monitor

The WTO regularly reviews the trade policies of its members. These reviews assess whether WTO members are abiding by WTO rules and measure the impact of their domestic policies on international trade. The purpose of these reviews is not so much to solve problems as to prevent them from occurring in the first place.

## 4. Trainer

The WTO provides training programmes for government officials from developing countries - for example, ministry staff or customs officials. The WTO currently spends about 35 million Swiss francs annually on these programmes. Africa is the main beneficiary, followed by Asia and Latin America. In 2011, approximately 26 per cent of training activities took place in Africa.

**How do trade negotiations work?** Before defining the principles of international trade, WTO members have to negotiate them. Every eight to ten years or so, they launch a new round of trade negotiations. They begin by defining the subjects to be included. For example, the current round, known as the Doha Round, has 20 dishes on the negotiation menu, including agriculture, the environment, fisheries, development, etc. The meal is prepared by 157 chefs (the 157 WTO members). Given the number of dishes and chefs involved, producing the meal is a lengthy and difficult process, and it is not surprising that it can be a long time before the family can sit down to enjoy it.

**REGULATORY ROLE PLAYED BY UNCTAD**

The United Nations Conference on Trade and Development (UNCTAD) helps countries at the national, regional, and international levels develop trade policies, regulations, and institutions that promote development. UNCTAD's work can include:

- \* **Trade policy and negotiations:** Helping developing countries understand trade policy issues and negotiations, and ensure that outcomes reflect their developmental concerns
- \* **Competition and consumer protection:** Helping countries protect consumers from abuse and curb regulations that stifle competition
- \* **Trade, environment, and climate change:** Managing issues at the intersection of trade, the environment, and climate change
- \* **Digital technologies:** Helping countries increase access to digital technologies
- \* **Entrepreneurship and innovation:** Promoting entrepreneurship and innovation
- \* Value chains: Helping local firms move up value chains
- \* **Ports and maritime transport:** Developing capacity building and online guidance tools to help countries prepare and enhance the resilience of ports and maritime transport.

**Let's Sum Up**

The WTO acts as a global regulator ensuring fairness and predictability in trade through binding agreements. UNCTAD, on the other hand, acts as an advisory and developmental body, focusing on the concerns of developing nations. Together, they maintain a balance between liberalization and equity in international trade.

**Check your Progress – Quiz – 3**

1. WTO was established in:  
A) 1947                      B) 1991                      C) 1995                      D) 2000                      C
2. WTO replaced:  
A) GATT                      B) UNCTAD                      C) IMF                      D) World Bank                      A
3. WTO headquarters is in:



**Economic Union** Integration of economic and monetary policies

**IMF** International Monetary Fund – supports monetary stability

**WTO** World Trade Organization – regulates global trade

**UNCTAD** United Nations Conference on Trade and Development

**BRICS** Coalition of emerging economies

**INCOTERMS** International Commercial Terms standardizing trade practices

## 4.8 SELF-ASSESSMENT QUESTIONS

### Short essay Questions

1. Explain the concept and types of economic integration.
2. Discuss the objectives of SAARC and ASEAN.
3. Write short notes on IMF and its functions.
4. Differentiate between WTO and UNCTAD.
5. Explain the role of regional blocks in international trade.

### Long essay Questions

1. Describe the forms of economic integration with examples.
2. Explain the role of IMF, World Bank, and ADB in promoting international development.
3. Discuss the importance of WTO in global trade regulation.
4. Evaluate the achievements and challenges of regional economic cooperation among developing nations.
5. Analyze the impact of multilateral trade institutions on developing economies.

## 4.9 Case Study

### The Role of WTO in India's Trade Policy

India's accession to the WTO in 1995 marked a turning point in its economic liberalization. WTO membership required India to reduce import tariffs, remove quantitative restrictions, and align intellectual property laws with the TRIPS Agreement.

This opened the economy to global competition, boosting exports in services (especially IT) while challenging domestic industries in agriculture and manufacturing.

**WTO policies can spur competitiveness and growth, but developing countries must balance liberalization with protection for vulnerable sectors.**

#### **4.10 References and Suggested Books**

International Business: Competing in the Global Marketplace – Charles W.L. Hill & G. Tomas M. Hult, McGraw-Hill Education, 13th Edition, 2023.

International Business Environment: Text and Cases – Francis Cherunilam, Himalaya Publishing House, 2022.

Global Business Today – Charles W.L. Hill, McGraw-Hill Education, 12th Edition, 2022.

International Economics: Theory and Policy – Paul Krugman & Maurice Obstfeld, Pearson Education, 11th Edition, 2022.

The WTO and Developing Countries – Hoekman, Bernard M., Edward Elgar Publishing, 2020.

International Institutions and Global Governance – Thomas G. Weiss, Routledge, 2021

## UNIT V

**UNIT V: Multinational Companies (MNCs) and Host Countries**

Multinational Companies (MNCs) and Host Countries: MNCs – Nature and characteristics. Decision Making-Intra Firm Trade and Transfer Pricing – Technology Transfer- Employment and labour relations- Management Practices- Host Country Government Policies-International Business and Developing countries: Motives of MNC operations in Developing Countries (Discuss case studies)-Challenges posed by MNCs.

### SECTION 5 MULTINATIONAL COMPANIES (MNCS) AND HOST COUNTRIES

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## SECTION 5.1 NATURE, CHARACTERISTICS, AND DECISION-MAKING OF MNCS

### 5.1.1 MEANING AND NATURE OF MULTINATIONAL COMPANIES (MNCS)

A multinational corporation (MNC), also known as a multinational company, is a large corporation that operates in more than one country, often with production facilities, sales offices, and subsidiaries worldwide.

#### NATURE OF MULTINATIONAL COMPANIES

- \* **Huge Assets and Turnover:** Because of operations on a global basis, MNCs have huge physical and financial assets. This also results in huge turnover (sales) of MNCs. In fact, in terms of assets and turnover, many MNCs are bigger than national economies of several countries.
- \* **International Operations Through a Network of Branches:** MNCs have production and marketing operations in several countries; operating through a network of branches, subsidiaries and affiliates in host countries.
- \* **Unity of Control:** MNCs are characterized by unity of control. MNCs control business activities of their branches in foreign countries through head office

located in the home country. Managements of branches operate within the policy framework of the parent corporation.

- \* **Mighty Economic Power:** MNCs are powerful economic entities. They keep on adding to their economic power through constant mergers and acquisitions of companies, in host countries.
- \* **Advanced and Sophisticated Technology:** Generally, a MNC has at its command advanced and sophisticated technology. It employs capital intensive technology in manufacturing and marketing.
- \* **Professional Management:** A MNC employs professionally trained managers to handle huge funds, advanced technology and international business operations.
- \* **Aggressive Advertising and Marketing:** MNCs spend huge sums of money on advertising and marketing to secure international business. This is, perhaps, the biggest strategy of success of MNCs. Because of this strategy, they are able to sell whatever products/services, they produce/generate.
- \* **Better Quality of Products:** A MNC has to compete on the world level. It, therefore, has to pay special attention to the quality of its products.

### 5.1.2 CHARACTERISTICS OF MNCS

- \* **Global presence:** MNCs have a substantial presence in multiple countries, ranging from a few to dozens of nations, allowing them to diversify their revenue streams and minimise risks associated with operating in a single market.
- \* **Cross-border operations:** These companies engage in cross-border trade, investment, and production, enabling them to benefit from differences in resources, costs, and consumer preferences among various countries.
- \* **Centralised management:** Despite operating in different countries, MNCs maintain centralised management structures, ensuring consistency in branding, strategies, and decision-making processes.
- \* **Transfer of knowledge and technology:** MNCs often transfer technology, skills, and best practices across their global operations, contributing to knowledge sharing and skill enhancement in host countries.

### 5.1.3 Decision-Making Process in MNCs

Decision-making in MNCs refers to the process of choosing appropriate strategies, policies, and actions that align with global objectives while considering local conditions and constraints.

#### Nature

It involves multi-level and multi-country coordination.

Requires balancing global integration with local responsiveness.

Often influenced by cultural, political, and legal environments of host countries.

#### Types of Decisions in MNCs

**Strategic Decisions** Long-term, top-level decisions taken by headquarters. Global expansion, mergers, entry into new markets.

**Tactical Decisions** Mid-level managerial decisions. Pricing, marketing strategy, production schedule.

**Operational Decisions** Day-to-day decisions by subsidiaries. Staffing, procurement, logistics.

#### Decision-Making Models in MNCs

Model Approach      Nature of Control

**Centralized Model** Decisions made by HQ.      High control, uniform strategy.

**Decentralized Model**      Decisions made by subsidiaries.      Greater autonomy, local adaptation.

**Hybrid Model** Shared decision-making between HQ and subsidiaries.      Balance between control and flexibility.

#### Factors Influencing Decision-Making in MNCs

Cultural Differences – national culture impacts communication and risk-taking.

Government Regulations – legal compliance in multiple jurisdictions.

Economic Environment – inflation, taxation, and exchange rate variations.

Organizational Structure – determines hierarchy and authority.

Technology and Information Flow – digital systems facilitate faster decisions.

### **Challenges in Decision-Making**

Time Zone and Distance Barriers

Information Asymmetry between HQ and subsidiaries

Conflict of Interests (global vs. local goals)

Communication Barriers (language, culture)

Ethical Dilemmas in cross-border operations

### **5.1.4 INTRA FIRM TRADE**

**Intra-industry trade** is the trade of similar goods that are part of the same industry between two nations.

The **intra-industry trade index**, also known as the Grubel-Lloyd Index measures the intra-industry trade of a specific good.

Intra-industry trade provides the consumers in each economy with a wider selection of goods. Just because two goods are of the same type, does not mean they are identical. With these differences come differing preferences. Two people might both use laptops, but where one person prefers a MacBook, the other swears by ASUS. Intra-industry trade makes it possible for consumers to have both goods available to them regardless of what country they live in.

Developed nations like the United States, Japan, China, Canada, and countries in the European Union, engage in intra-industry trade across several industries. Developed nations are more likely to engage in this type of trade because

of the similarity of their production capabilities. Developed nations can produce similar goods but it would not be efficient for every nation to produce all the goods that it needs just because it can. Engaging in intra-industry trade with nations that can produce similar goods, allows each nation to specialize where they have a comparative advantage.

For example, if the US produces harvest machinery better than China, but China produces logging machinery better, China should specialize in logging machinery, and the US in harvest machinery, rather than both nations producing both. Both China and the US import and export machinery, but they trade different types. The need for efficiency and specialization helps drive this intra-industry trade.

### **Types of Intra-Industry Trade**

The two types of intra-industry trade are:

- horizontally differentiated trade
- vertically differentiated trade

Let's look into the types of intra-industry trade. The first type is horizontal trade where two similar goods are of the same standard and price range.<sup>1</sup> Horizontal intra-industry trade allows the consumer to have a wider variety of goods to choose from. For example, the US produces many types of fruit from oranges and limes to peaches and grapes, but it imports mangoes, bananas, and avocados. Although some might prefer one fruit over the other, they are generally considered to be in the same standard category and are priced similarly depending on the season. When nations engage in horizontal intra-industry trade the quality of the goods as well as their price range is going to be very similar.

The second type of intra-industry trade is vertically differentiated trade where the goods are of the same type but are of different quality and/or price levels.<sup>1</sup> An example of vertically differentiated intra-industry trade would be Italy producing and exporting expensive high fashion clothing while importing fast fashion that was manufactured in China. The goods that are being imported and exported belong to the same clothing industry but they are of varying quality and price.

## SECTION 5.2 TECHNOLOGY TRANSFER, EMPLOYMENT, AND MANAGEMENT PRACTICES

### 5.2.1. TRANSFER PRICING

Transfer pricing can be defined as the value which is attached to the goods or services transferred between related parties. In other words, transfer pricing is the price that is paid for goods or services transferred from one unit of an organization to its other units situated in different countries (with exceptions).

#### Transactions Subject to Transfer Pricing

The following are some of the typical international transactions which are governed by the transfer pricing rules:

- \* Sale of finished goods
- \* Purchase of raw material
- \* Purchase of fixed assets
- \* Sale or purchase of machinery etc.
- \* Sale or purchase of intangibles
- \* Reimbursement of expenses paid/received
- \* IT enabled services
- \* Support services
- \* Software development services
- \* Technical Service fees
- \* Management fees
- \* Royalty fees
- \* Corporate Guarantee fees
- \* Loan received or paid

#### Purposes of Transfer Pricing

The key objectives behind having transfer pricing are:

- \* Generating separate profit for each of the divisions and enabling performance evaluation of each division separately.

- \* Transfer prices would affect not just the reported profits of every centre, but would also affect the allocation of a company's resources (Cost incurred by one centre will be considered as the resources utilized by them).

### **Case Study: How Google Uses Transfer Pricing**

Google runs a regional headquarters in Singapore and a subsidiary in Australia. The Australian subsidiary provides sales and marketing support services to users and Australian companies. The Australian subsidiary also provides research services to Google worldwide. In FY 2012-13, Google Australia earned around \$46 million as profit on revenues of \$358 million. The corporate tax payment was estimated at AU\$7.1 million, after claiming a tax credit of \$4.5 million.

When asked about why Google did not pay more taxes in Australia, Ms. Maile Carnegie, the former chief of Google Australia, replied that Singapore's share in taxes was already paid in the country where they were headquartered. Google reported total tax payments of US \$3.3 billion against revenues of \$66 billion. The effective tax rates come to 19%, which is less than the statutory corporate tax rate of 35% in the US.

### **5.2.2. TECHNOLOGY TRANSFER**

Technology transfer (or tech transfer), in the context of research institutions, is the process by which new inventions and other innovations created in those institutions' labs are turned into products and commercialized. This is typically done in two ways: through licensing patented intellectual property to corporations, and the creation of start-up companies, which also often license the IP created by faculty.

#### **The what, who, how, and why of technology transfer**

- \* What many people don't realize is just how many products and technology advances we take for granted originated in university and federal laboratories, then ultimately reached the marketplace in large part through technology transfer efforts.
- \* Gatorade and Google are two often-cited examples, but there are thousands of others that have impacted virtually every scientific field and every walk of

life: life-saving drugs and medical devices, alternative energy solutions, computer hardware and software, new modes of transportation, blockchain technologies, artificial intelligence, vaccines, robotics, cybersecurity, environmental solutions, agricultural innovations, aerospace, and countless others.

- ✧ A key role of technology transfer professionals is to protect the intellectual property associated with these valuable innovations so that they can be licensed and commercialized, and brought to the marketplace for society's benefit.

### **Process of Technology Transfer**

- ✧ working with attorneys to secure patent and other intellectual property rights,
- ✧ assessing the commercial potential of new inventions,
- ✧ marketing available technologies to potential licensees and partners,
- ✧ educating researchers on commercialization principles and strategies,
- ✧ assisting with faculty start-up creation and development,
- ✧ securing funding for early-stage research and start-ups
- ✧ negotiating partnerships and license agreements,
- ✧ organizing business plan and start-up competitions,
- ✧ helping to build innovation ecosystems and support structures that promote innovation and economic development,
- ✧ Creating programs that encourage both student and faculty to innovate in labs and maker spaces and engage in entrepreneurship so they can participate in bringing those innovations to the marketplace.

### **Tech transfer best practices**

Successfully technology transfer has benefits for universities, companies, regional and national economies, and society at large.

- ✧ For universities it can bring revenues that can be plowed back into research, as well as recognition of its scientists and their innovations – which in turn can help with faculty recruitment and grant funding.
- ✧ For companies, benefits include the ability to tap into research advances without spending on internal R&D, and introducing new products that can drive the success of their businesses forward.

- \* For regional and national economies, technology transfer is a key factor in growth through innovation, creating new ventures and stronger industries that create more jobs.
- \* And for society at large, the benefits are incalculable in terms of lives saved, improved health, a cleaner environment, and countless technical advances that bring not only new capabilities but that drive local, regional, national, and global economies forward through innovation.

### 5.2.3 EMPLOYMENT AND LABOUR RELATIONS

Employee and Labour Relations describe the relationship between employees, and between the employer and the employees. They include the contractual, practical, and emotional connection between the managers and their workforce.

According to organizational psychology, there are certain unwritten 'psychological contracts' that are derived from the relations between an organization and its members. These contracts are purely individual beliefs in a reciprocal obligation between the employees and the organization. When these contracts are breached on the part of the company, they can be fatal for the employee and labor relations.

#### Benefits of Employee and Labor Relations

1. **Commitment to the Organization:** A pleasant work environment is a good incentive for an employee to be loyal to their work. When the employees feel connected to their employers and have a good understanding of them, they make efforts to do their tasks well. An individual that is committed to their organization would spread a good word about it among their community that brings in experienced and skilled workers to the company. It improves the brand image that is profitable in terms of the customer experiences as well.
2. **Improvement in Employee Motivation:** Good relations within the company motivate the employees to work hard. If they feel satisfied with their environment and achievements, they are inclined to make efforts to improve themselves. Motivated employees turn out to be great team members, encouraging their peers to do better. Appreciations from their leaders and colleagues also make the employees feel motivated towards their tasks.

3. **Employee Retention:** The employees must be made to feel valued about their skills and their work. Even if they are not satisfied with their work, a healthy work environment is a great incentive for employees to stay in the company. Additional employee benefits such as bonuses, regular appraisals, and up skilling offered by a firm may urge the employees to stay loyal to the company. The cost of recruitment and training can be reduced if companies invest in the retention of employees.
4. **A Healthy Office Culture:** Healthy workplace culture is highly dependent on how the employees are treated in the company. If the employees feel that are not treated equally by their leaders, it may lead to workplace conflicts. Discrimination, harassment, or biased treatment of the employees makes them feel unvalued and insecure about their work. The employees must have a good relationship with their employers concerning their personal and professional lives. Employers can solve workplace conflicts by investigating into conflicts and resolving them in time, fostering their relationships.
5. **Increased Revenue:** Enhanced labor relations result in improved work productivity, and work profits. It also plays an important role in customer retention. When the employees feel satisfied with their work, they pay attention to the needs of the clients, resulting in a positive customer experience. Engaged employees are more committed to their tasks and this growth can bring better outputs and revenues for the company.
6. **Enhanced Focus on Organization Goals:** Employee relations promote their need to achieve the goals of their organization with more vigor. Workers who are familiar with the long-term goals of their company, are more efficient in their tasks and focused on how they need to achieve those goals. Having a sense of purpose motivates them to enhance their skills to accommodate in accordance to the goals.

### Practices that Promote Labor Relations

The best practices that HR professionals can follow to improve their employee and labor relations include:

- \* **Present the Employees with the Company Goals:** Make sure that the workers are aware of what is expected of them, and that they share the

company's vision for the future. Being a part of a larger goal provides them with a sense of importance attached to their work.

- \* **Have Honest Conversation with the Workers:** Communication is the key to having a positive employer-employee relationship. When the employers accommodate the tasks of the employees based on their skills and are present for them in times of crisis, it makes them feel safe and confident about their work in the company.
- \* **Place your Trust in the Employees:** Instead of being aware of every move of your workers, trust them with their work and provide them the liberty to make their decisions. Guide them about what their work is and what is expected of them, to make sure they meet their work objectives.
- \* **Invest in Your Workforce:** One can express their care for their employees by providing them with the right tools and guidance about their work tasks. The companies can invest in their learning and development departments, employee wellness programs, and mentoring programs to improve the skills of their workers.

#### 5.2.4 MANAGEMENT PRACTICES OF MNC'S

- \* **Adopting management ideas:** MNCs adopt and spread management ideas from consultancies, business schools, and industry leaders.
- \* **Building a global employee community:** Human resources (HR) management aims to create a global employee community with a unique company culture and values, despite differences in language, culture, and customs.
- \* **Using strategies:** MNCs may use different strategies to manage and maintain their business abroad, such as global, multi-domestic, transnational, or international.
- \* **Providing customer support:** MNCs can provide customer support from outside a country.
- \* **Analyzing market data:** MNCs can analyze market data in central locations.
- \* **Identifying suppliers:** MNCs can identify preferred suppliers from global databases.
- \* **Using open innovation:** MNCs can use open innovation systems to access local sources of technical knowledge.

- \* **Developing competent managers:** MNCs need managers who can handle challenging situations and estimate the right approach to other markets.
- \* **Adapting to change:** MNCs need to adapt to changes in their environment.
- \* **Developing strategic plans:** MNCs need to develop strategic plans and goals that are responsive to the cultural norms and values of the host country.
- \* **Balancing standardization and localization:** MNCs need to balance standardization and localization of HR, which covers aspects such as staffing, training, performance management, compensation, and labor relations.

### 5.2.5 HOST COUNTRY GOVERNMENT POLICIES

- \* Attracting foreign direct investment (FDI)
- \* Governments can negotiate and sign international investment agreements (IIAs) to make investors feel more comfortable.
- \* Controlling market access
- \* Governments can require MNCs to form joint ventures, appoint government representatives to their boards, or participate in research and development with state-owned customers.
- \* Capturing a firm's surplus
- \* Governments can use ownership restrictions to force joint ventures so they can better understand a firm's private information about its advantages.
- \* Responding to political and economic issues
- \* Governments can intervene in MNCs' domestic operations if they detect issues like international tax manipulation or corruption.

## SECTION 5.3 MNCS AND DEVELOPING COUNTRIES

### 5.3.1 INTERNATIONAL BUSINESS AND DEVELOPING COUNTRIES

Developing countries have become major players in global trade. Their relative weight has grown enormously, mainly due to China's meteoric rise as an exporter. Though they partly reflect surging oil prices, increasing exports from the Middle East and North Africa (MENA), Eastern Europe, and Central Asia have further increased the weight of developing countries in world trade. GDP projections suggest that the share of world trade held by developing countries will expand

further, more than doubling over the next 40 years and reaching nearly 70 percent by 2050.

### **The Rising Weight of Developing Countries in World Trade**

Developing countries are already playing an increasing role in world trade. In 2006, they accounted for 30 percent of world exports, up from 19.5 percent in 1996.2 The share of exports held by the BRIC economies (Brazil, Russia, India, and China) more than doubled, rising from 6 percent to 12.4 percent. China accounted for a significant portion of this rise—its claim of world exports nearly tripled from 2.7 percent to 7.6 percent. On the other hand, India, which also stands out as a large economy, did little to contribute. Its share of world exports remains very low, at little more than 1 percent in 2006.

As oil prices rose, oil exporters also experienced large share increases. MENA's share increased from 1.4 percent to 4.5 percent, while Sub-Saharan Africa (SSA)'s share rose from 0.7 percent to 1.6 percent. Having transitioned into market economies, the Eastern European and Central Asian countries also saw large increases in export shares, matched by even larger increases in imports and rising current account deficits.

In contrast, the export share of industrialized countries fell, with the United States' share decreasing from 13.9 percent to 9.5 percent. Japan's decline was particularly stark; its share fell from 8.6 percent—significantly more than the total share of the BRIC—to 5.4 percent, less than China's share alone.

#### **5.3.1 MOTIVES OF MNC OPERATIONS IN DEVELOPING COUNTRIES**

1. **To feed the LDCs local markets:** The MNEs seek world-wide markets including those in the LDCs. These markets are served through exports in the first instance.

Market defensive local production is undertaken, if the host country policies restrict imports. Examples of this type of operations are virtually all large MNE affiliates in India from Hindustan Lever and Philips to the drug MNEs, such as, Glaxo, Sandoz, Bayer or Pfizer, or engineering giants as Siemens, ASEA Brown Boweri, and so on.

Developing countries with large and expanding markets, like India, Brazil and China, are generally attractive for MNEs to set up manufacturing facilities to tap the local market.

2. **To obtain access to natural resources and raw materials:** Quite a large proportion of MNE investments in the LDCs are in the extractive and primary commodity producing sectors. These operations are designed to secure an access to the natural resources for their worldwide operations. Examples of this type of investments are the British tea plantations in India and Sri Lanka, ITT's copper mines in Chili, Sesa Goa's (an affiliate of IRI, Italy) iron ore mining activities in India, Unilever's palm oil plantations in Malaysia, and Firestone's rubber plantations in Liberia. Such investments are concentrated in natural resource rich countries.
3. **To exploit cheap labour:** Advances in product design, transport and communication facilities enable the MNEs to rationalise production across countries to minimise costs. The labour intensive portion of manufacturing processes are relocated into cheap labour developing countries, while capital intensive portions are retained at the home country bases. This phenomenon is called International division of labour. In this case an MNE affiliate in an LDC is integrated with its parent and associate companies, vertically. Since the early 1970s, there has been a growing evidence of this pattern of MNE operations in the LDCs. Examples include numerous garment and leather goods factories in Thailand, India, Bangladesh and Sri Lanka that produce for the western MNEs like Motorola's semiconductor chip-making facilities in Southeast Asia, and so on.

Relocation of production in the LDCs may not only be to obtain access to unskilled or semi-skilled cheap labour but also to tap cheap skilled technical manpower. For instance, MNEs like Texas Instruments setting up software development plants and Astra (Sweden) setting up a laboratory for biotechnology research in India to tap cheap and abundant supply of skilled manpower. Sometimes, highly polluting industries are relocated in the developing countries to avoid the enormously high pollution abatement costs in the industrialised countries. Examples of this type of investments are many,

and include shifting of asbestos, pesticides and other agrochemical factories by a number of MNEs from the industrialised to the developing countries.

Thus the MNEs' operations in the developing countries could be motivated to tap the domestic market, to obtain access to either natural resources, or cheap (unskilled or skilled) labour and technical manpower, or to avoid high costs of pollution control in the industrialised countries. The MNE activity, in the first case, are oriented to the domestic market of the host country, and are export-oriented in the rest of the cases.

### 5.3.2 CHALLENGES POSED BY MNCS

- \* Cultural differences: MNCs need to integrate their HR practices with the host country's cultural and institutional practices.
- \* Political and legislative environments: Each country has different rules and regulations, and operating across time zones and multiple legislative bodies can be challenging.
- \* Economic and financial constraints: MNCs need to manage geopolitical and economic risks, including currency fluctuations.
- \* Competition: MNCs compete in the global market.
- \* Supply chains: MNCs may have long supply chains.
- \* Workforce retention: MNCs may need to retain their workforce and create an inclusive work experience.
- \* Social connections: MNCs may need to build and maintain social connections between employees in distributed teams to encourage collaboration and knowledge sharing

### 5.3.3 Case Studies of MNC Operations in Developing Economies

#### Case Study 1: Coca-Cola in India – A Case of Environmental and Social Responsibility

Coca-Cola, one of the world's largest beverage companies, re-entered the Indian market in 1993 after liberalization. It expanded rapidly through local bottling plants and strategic acquisitions like Thums Up and Limca. However, its operations

soon came under criticism due to alleged overexploitation of groundwater and pollution.

### **Nature of MNC Operation**

The company set up bottling plants across several Indian states. Its operations relied heavily on water resources, which led to public protests, especially in Plachimada, Kerala, where farmers claimed water scarcity and contamination caused by the plant.

### **Key Issues and Challenges**

Overuse of local groundwater resources.

Lack of community engagement and corporate transparency.

Environmental degradation and allegations of pesticide residues in its beverages.

Failure to align with local sustainability expectations.

### **Impact on the Host Country**

While Coca-Cola generated employment and contributed to India's FDI inflows, its negative social and environmental image hurt its brand reputation. The Kerala plant was eventually shut down due to public protests and government intervention.

### **Lessons and Policy Implications**

This case highlights the importance of corporate social responsibility (CSR) and sustainable resource management. MNCs must respect local environmental regulations, engage in community dialogue, and implement eco-friendly production methods.

### **Case Study 2: Nestlé India – The Maggi Crisis and Regulatory Compliance**

Nestlé India, a subsidiary of the Swiss MNC Nestlé SA, is one of India's leading FMCG companies. In 2015, its popular instant noodle brand Maggi faced a major crisis when the Food Safety and Standards Authority of India (FSSAI) alleged excessive levels of lead and MSG.

### **Nature of MNC Operation**

Nestlé followed global standards in manufacturing and marketing. However, its quality control and regulatory compliance were challenged under Indian law, resulting in a temporary ban on Maggi noodles.

### **Key Issues and Challenges**

Failure to meet Indian food safety standards.

Inadequate crisis communication with consumers.

Reputational damage and revenue loss.

Impact on the Host Country

The incident raised consumer awareness about food safety and forced stronger government monitoring of FMCG products. It also showcased how global brands must adapt to domestic regulatory environments.

Lessons and Policy Implications

MNCs must maintain strict quality assurance, transparency, and compliance with host-country regulations. Rapid and honest crisis management is vital to rebuild public trust.

### **Case Study 3: Samsung in Vietnam – Manufacturing-led Development**

Samsung Electronics invested heavily in Vietnam, turning it into a global manufacturing hub. Its factories in Bac Ninh and Thai Nguyen produce smartphones, chips, and electronics for export.

Nature of MNC Operation

Vietnam provided incentives such as tax breaks and industrial zones. Samsung became one of the country's largest exporters, accounting for nearly 25% of Vietnam's total exports.

#### **Key Issues and Challenges**

Heavy dependence on one MNC for national exports.

Limited transfer of high technology to local industries.

Labor concerns related to low wages and repetitive work.

#### **Impact on the Host Country**

Samsung's presence created hundreds of thousands of jobs, boosted infrastructure development, and enhanced Vietnam's global competitiveness. However, Vietnam's overreliance on a single corporation poses long-term economic risks.

#### **Lessons and Policy Implications**

MNC-led growth must be complemented with domestic capacity-building. Host countries should promote technology transfer, enforce labor standards, and diversify industrial partnerships.

### **Case Study 4: Unilever in Africa – Balancing Profit and Development**

Unilever, headquartered in the UK and the Netherlands, has deep roots in African economies. It produces personal care, food, and hygiene products and operates across countries like Kenya, Ghana, and Nigeria.

**Nature of MNC Operation**

Unilever localizes production, employs thousands of local workers, and runs agricultural sourcing programs. However, it faces criticism for market domination and pricing policies that affect local SMEs.

**Key Issues and Challenges**

Monopolistic tendencies and local competition suppression.  
Ethical concerns in advertising and pricing.  
Pressure to maintain affordability while ensuring profits.

**Impact on the Host Country**

Unilever supports rural employment and women entrepreneurship programs. It has also contributed to local brand development and distribution networks.

**Lessons and Policy Implications**

Sustainable MNC operations require shared value creation, ensuring benefits for both the company and local stakeholders. Governments must regulate fair competition and encourage local entrepreneurship.

**Case Study 5: Shell in Nigeria – The Cost of Environmental Negligence**

Shell has been a dominant oil producer in Nigeria for decades, operating in the Niger Delta region. Its exploration has contributed billions to Nigeria's GDP but also caused environmental damage and social unrest.

**Nature of MNC Operation**

Shell's oil extraction operations led to frequent oil spills, gas flaring, and contamination of water and soil, affecting local communities' health and livelihoods.

**Key Issues and Challenges**

Environmental pollution and lack of accountability.  
Human rights violations and conflicts with local communities.  
Poor compensation and inadequate clean-up efforts.

**Impact on the Host Country**

While Nigeria benefited economically, the Niger Delta region suffered from severe environmental degradation and poverty. The conflict between Shell and local groups like the Movement for the Survival of the Ogoni People (MOSOP) drew global attention.

**Lessons and Policy Implications**

MNCs must implement sustainable environmental practices and uphold human rights. Host governments should enforce environmental protection laws and ensure transparent revenue sharing.

**Case Study 6: Toyota in South Africa – Industrialization and Labor Relations**

Toyota has operated in South Africa since the 1960s, manufacturing cars for both domestic use and export. It is among Africa's leading automobile exporters.

**Nature of MNC Operation**

The company's Durban plant produces thousands of vehicles annually, providing jobs to thousands of workers and contributing to technological training.

**Key Issues and Challenges**

Labor union strikes and wage disputes.

Dependence on imported parts and limited local sourcing.

**Impact on the Host Country**

Toyota's investment enhanced South Africa's manufacturing capabilities and integration into global supply chains. However, industrial disputes sometimes disrupted production.

**Lessons and Policy Implications**

Strong industrial relations, worker training, and local supply chain development are crucial for sustainable industrial growth.

**Let's Sum Up**

Multinational Corporations (MNCs) are large companies that operate in multiple countries through subsidiaries, branches, or joint ventures.

Their main motive for entering developing countries is to maximize profits and expand global presence by accessing new markets, cheap labor, natural resources, and favorable investment conditions. MNCs also seek to benefit from tax incentives, relaxed regulations, and growing consumer demand in these economies.

However, MNCs often pose challenges such as economic dependency, cultural influence, exploitation of resources, repatriation of profits, and unfair competition that can harm local industries. They may also influence domestic policies and create environmental and social issues if not regulated properly.

**Check your Progress quiz – 5.3**

1. The primary motive of MNCs entering developing countries is to:

- A) Support local governments
- B) Promote cultural exchange
- C) Expand markets and maximize profits
- D) Reduce global competition

**Answer: C) Expand markets and maximize profits**

2. Which of the following is a major advantage of MNCs for developing countries?

- A) Exploitation of labor
- B) Technology transfer and job creation
- C) Monopoly control of markets
- D) Repatriation of profits

**Answer: B) Technology transfer and job creation**

3. MNCs often prefer developing countries because of:

- A) High labor costs
- B) Strict trade barriers
- C) Cheap labor and raw materials
- D) Lack of consumers

**Answer: C) Cheap labor and raw materials**

4. One of the main challenges posed by MNCs is:

- A) Encouraging domestic entrepreneurship
- B) Reducing income inequality
- C) Creating economic dependence on foreign firms
- D) Promoting balanced regional growth

**Answer: C) Creating economic dependence on foreign firms**

5. Repatriation of profits means:

- A) Investing profits back in the host country
- B) Sending profits back to the home country
- C) Sharing profits with local workers
- D) Donating profits to local governments

**Answer: B) Sending profits back to the home country**

6. Which of the following is a positive impact of MNCs?

- A) Cultural erosion

- B) Environmental degradation
- C) Employment generation
- D) Monopoly control

**Answer: C) Employment generation**

7. Which of the following MNCs has major operations in developing countries like India and Indonesia?

- A) Toyota
- B) General Motors
- C) Unilever
- D) Both A and C

**Answer: D) Both A and C**

8. A common criticism of MNCs in developing countries is that they:

- A) Encourage fair trade
- B) Use advanced technology responsibly
- C) Exploit natural and human resources
- D) Promote local industries

**Answer: C) Exploit natural and human resources**

9. An example of an MNC contributing to local development through sourcing and partnerships is:

- A) Nestlé working with local farmers
- B) Coca-Cola reducing local water supply
- C) Shell causing oil spills
- D) None of the above

**Answer: A) Nestlé working with local farmers**

10. The best policy approach for developing countries toward MNCs is to:

- A) Ban foreign investment
- B) Leave MNCs unregulated
- C) Encourage MNCs with proper regulation and social responsibility
- D) Allow monopoly control

**Answer: C) Encourage MNCs with proper regulation and social responsibility**

## 5.4 Unit Summary

This unit explored the interaction between MNCs and host countries, focusing on their nature, operations, and impact.

MNCs contribute significantly to global trade through investment, technology, and innovation. Yet, they present challenges such as profit repatriation, exploitation of labour, and policy conflicts. Host governments must balance economic benefits with regulatory oversight to ensure sustainable development. The key to success lies in ethical business practices, transparent governance, and mutual benefit between MNCs and developing economies.

## 5.5. Glossary

**MNC** A company operating in multiple countries with a centralized management structure.

**FDI** Foreign Direct Investment – investment in business operations in another country.

**Transfer Pricing** Pricing of transactions within subsidiaries of the same MNC.

**Technology Transfer** Process of sharing technical knowledge across borders.

**Host Country** Nation receiving foreign investment or business operations.

**Intra-Firm Trade** Trade of goods/services within the same multinational enterprise.

**Labour Relations** Interaction between employers, employees, and unions.

**Profit Repatriation** Transfer of profits from host country to MNC's home country.

**Regulatory Policy** Government rules that control MNC operations.

**Localization Strategy** Adapting business practices to local markets.

## Self-Assessment Questions

### Short Essay-Type Questions

1. Explain the major characteristics and decision-making structure of MNCs.

2. Discuss the concept of intra-firm trade and transfer pricing with examples.
3. Evaluate the role of MNCs in technology transfer and employment generation.
4. Analyze the challenges faced by developing countries due to MNC operations.

## Case Studies

### Case Study 7: Union Carbide in India – The Bhopal Gas Tragedy

Union Carbide (now part of Dow Chemical) operated a pesticide plant in Bhopal, India. In 1984, a gas leak of methyl isocyanate (MIC) killed over 3,000 people instantly and injured over 500,000.

#### Nature of MNC Operation

The company's local management neglected safety protocols and under-invested in maintenance. Emergency systems failed, causing catastrophic damage.

#### Key Issues and Challenges

Corporate negligence and lack of accountability.

Weak regulatory oversight by Indian authorities.

Inadequate compensation for victims.

#### Impact on the Host Country

The tragedy remains a symbol of corporate irresponsibility in developing nations. It exposed weaknesses in industrial safety laws and foreign company regulation.

#### Lessons and Policy Implications

Host countries must ensure strict environmental and labor safety regulations. MNCs must follow global safety standards and maintain ethical accountability

#### Case Study 3: Nestlé in Africa

Nestlé faced ethical criticism over infant formula marketing practices in Africa.

Questions:

What ethical issues arose from Nestlé's marketing strategy?

How should MNCs ensure responsible operations in developing countries?

What role can host governments play in regulating such issues?

**Task**

Prepare a short report (2–3 pages) on any MNC operating in India. Include:

Its investment type (FDI or Joint Venture)

Employment and technology contributions

Challenges faced under Indian regulations

Social or CSR initiatives

**References and Suggested Readings**

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