Programme Education Objectives (PEOs)

Our program will create graduates who:

1. Will be recognized as a creative and an enterprising team leader
2. Will be a flexible, adaptable and an ethical individual
3. Will have a holistic approach to problem solving in the dynamic business environment.

Course Objectives

- CO1
- For a given trade bloc scenario the student will be able to explain the advantages and disadvantages of regional economic integration and economic and political integration.
- CO2
- Under the given macroeconomic circumstances the student will be able to justify various tariff and non tariff barriers imposed by different countries.

Contd...

- CO3
- For a given policy period the student will be able to assess the trends in India's foreign trade and identify the provisions of EXIM policy which can boost exports.
- CO4
- Ability to identify the roles and judge the importance of the given organizations and schemes such as IMF, UNCTAD, WTO (and GATT), DGFT, EXIM BANK, ECGC, EPC, EPZ, EOU & SEZ involved in promoting international business.

Contd...

- CO5
- For a exchange rate determination, the student will be able to compare the different theories used for rate determination.

- CO6
- For a given country the student will be able to analyze business environmental factors and evaluate the impact of world issues on an organization's international business opportunities.

Introduction to International Business

Semester IV_ Subject_ International Business

INTERNATIONAL

BUSINESS

Learning Objectives

- To explain the concept of globalization
- To elucidate factors influencing globalization
- To discuss global business expansion strategy for emerging market companies
- To explicate the concept of international business
- To delineate motives for international business expansion
- To expound the strategy for managing business in the globalization era

Globalization of Business: A Historical Perspective

In the initial years of human history, there were hardly any formal barriers, such as tariffs or non-tariff restrictions, for the movement of goods or visa requirements for the people. The concept of globalization can be traced back to the phenomenon of a nation-state.

Concept of Globalization

The process of integration of economic, financial, cultural and political systems across the world.

Parameters of Globalization

Economic Globalization

The increasing integration of national economic systems through growth in international trade, investment and capital flows.

Financial Globalization

The liberalization of capital movements and deregulations, especially of financial services that led to a spurt in cross-border capital flows.

Cultural Globalization

Convergence of cultures across the world.

Political Globalization

Convergence of political systems and processes around the world.

Dimensions of Globalization

Globalization of production

Globalization of markets

Globalization of competition

Globalization of technology

Globalization of corporations and industries

Globalization of Work Force

Concept of Distance

Distance in terms of Global Trade is nothing but the challenges which an organization is likely to face and the methodologies to overcome them. Generally there are four types of distances in global trade,

1. Cultural Distance
2. Administrative (Political) Distance
3. Geographic Distance
4. Economic Distance

Cultural Distance

Differences in Languages

Differences in ethnicities

Different religions

Different social norms

Administrative(Political) Distance

Absence of colonial ties

Absence of shared political association

Political hostility

Government policies

Institutional weakness

Geographic Distance

Physical Remoteness

Lack of common border

Lack of access through sea route

Size of the country

Weak communication links

Economic Distance

Differences in consumer income

Differences in cost & quality of,

1.Natural Resources

2.Financial Resources

3.Human Resources

4.Infrastructure

5.Intermediate inputs

6.Information or knowledge

Generic International Strategies

Strategy is all about the alignment and consistency of organizational resources and activities to achieve competitive advantage.

Global strategies depend on-

- Domestic business cycle
- Tapping the growing market for goods   services
- Protecting global market share
- Reducing costs through scope global scale

AAA Global Strategy Framework

These are the three generic approaches to global value creation. These are-

1. Adaptation
2. Aggregation
3. Arbitrage

Adaptation

- Adaptation strategies tries to adapt to the needs of the international markets by altering its one or two components of the business model.
- There are five categories of adaptation.
- A.Variation B.Focus C.Externalization
- D.Design E.Innovation

Adaptation _ Variation

- Involves alteration in product/services and business policies.
- Example :Whirlpool has changed its model of washing machine and a washing machine with smaller washers to suit European markets.
- Star TV Network has started developing & telecast its programs in practically all regional languages to suit Indian viewers needs.

Adaptation _ Focus

- Here the organization focuses on alterations in a particular line of business and its value chain so as to make it suitable for local markets.
- Example : Star TV Network had to change entire programming to adapt to the Indian news cast to satisfy the needs of the Indian audience.

Adaptation _ Externalization

- Achieving growth and sharing the responsibility through franchising and strategic alliances.
- Example: McDonalds achieves the growth through allocating franchise outlets in various countries.

Adaptation _ Innovation

- Innovating through blend of technology and product/services.

- Example : Amazon, which is a superb blend of technology and services for e-commerce business. Which is win-win situation for suppliers as well as the buyers across the globe.

Aggregation

- A strategy which focuses on achievement of economies of scale or scope by creating global efficiencies that involve standardization of value proposition there by aggregating the development & production process together.
- Example: Aditya Birla group acquired Domsjo which had a cutting edge over speciality pulp making and bio-refining. Thereby Aditya Birla group got a control over inputs of Viscose Staple Fibres, which was a substitute for cotton or synthetic fibres.

Arbitrage

- A strategy that exploits the economic distances between the operating country and the parent country there by setting supply chain partners in the operating country.
- Example: Wal-Mart sells products worldwide which are sourced from China, there by earning profits out from the price differences.

Factors Influencing Globalization

Movers of Globalization

- Economic liberalization
- Technological breakthrough
- Multilateral institutions
- International economic integrations
- Move towards free marketing systems
- Rising research & development costs
- Global expansion of business operations
- Advents in logistics management
- Emergence of the global customer segment

Factors Restraining Globalization

- Regulatory controls
- Emerging trade barriers
- Cultural factors
- Nationalism
- War and civil disturbances
- Management myopia

Reasons for Support of Globalization

- Maximization of Economic Efficiencies
- Enhancing Trade
- Increased Cross-border Capital Movement
- Improves Efficiency of Local Firms
- Increases Consumer Welfare

Criticism of Globalization

- Developed versus Developing Countries: Unequal Players in Globalization:
- Widening Gap between the Rich and the Poor
- Wipes out Domestic Industry
- Leads to Unemployment and Mass Lay-offs
- Brings in Balance of Payments Problems
- Increased Volatility of Markets
- Diminishing Power of Nation States
- Loss of Cultural Identity
- Shift of Power to Multinationals

International Business_Defined

- **International Business:** All those business activities which involves cross border transactions of goods, services, and resources between two or more nations

- **Global Business**: Conduct of business activities in several countries using a highly co-ordinated and single strategy across the world.

Components of International Business

- **International Trade:** Exports of goods and services by a firm to a foreign-based buyer (importer)

- **International Marketing:** It focuses on the firm-level marketing practices across the border, including market identification and targeting, entry mode selection, and marketing mix and strategic decisions to compete in international markets.

- **International Investments:** Cross-border transfer of resources to carry out business activities.
-
- **International Management**: Application of management concepts and techniques in a cross-country environment and adaptation to different social-cultural, economic, legal, political and technological environments.

Reasons for International Business Expansion

- ***Market-Seeking Motives***
  - Marketing opportunities due to life cycles
  - Uniqueness of product or service
- ***Economic Motives***
  - Profitability
  - Achieving economies of scale
  - Spreading R&D costs
- **Strategic Motives**
  - Growth
  - Risk spread

Differences Between Domestic and International Business

- Economic Environment
- Socio-Cultural Environment
- Legal Environment
- Political Environment
- Competition
- Infrastructure
- Technology

Managing Business in the Globalization Era

- Global strategies adopted by business enterprises may include:

• Global conception of markets

•Multi-regional integration strategy

•Changes in external environment of multinational firms

•Changes in internal environment

Unit II

POLICY FRAMEWORK

FOR

INTERNATIONAL TRADE

Significance of Foreign Trade Policy

- Exportability and importability of a firm's goods are often determined by trade policies of the countries involved.

- Policy incentives help exporters increase their profitability through foreign sales
- The host country’s trade and FDI policies often influence entry decisions in international markets.

Strategic Options for Trade Policy

Inward looking strategy (import substitution):

Outward looking strategy (export-led growth):

Incentivizing the exports

Demand vs. Supply Side Policy Measures

Demand side initiatives:

Leveraging the upcountry demand for our products

Supply side initiatives:

Improving the logistics Operations to fulfill this demand profitably.

Instruments of Trade Policy

Various methods employed to regulate trade which include tariffs, non-tariff measures, and financial controls.

Tariffs

Official constraints on import of certain goods and services levied in the form of customs duties or tax on products moving across borders.

Classification of Tariff Instruments

On the basis of direction of trade: import vs. exports tariffs

On the basis of purpose: protective vs. revenue tariffs

On the basis of time length : tariff surcharge vs. countervailing duty

On the basis of tariff rates : specific, ad-valorem, and combined

On the basis of production and distribution points:

- Single stage sales tax:
- Value added tax (VAT)
- Cascade tax
- Excise tax

Turnover tax

Non-Tariff Measures

Contrary to tariffs, which are straightforward, non-tariff measures are non-transparent and obstruct trade on discriminatory basis.

Major Non-tariff Policy Instruments

- Government participation in trade
- Customs and entry procedure
- Quotas
  - Absolute quota
  - Tariff quotas
  - Voluntary quotas
- Other trade restrictions

India’s Foreign Trade Policy

India’s foreign trade policy is **formulated** and implemented mainly by the Ministry of Commerce and Industry, but also in consultation with other concerned ministries, such as Finance, Agriculture, and Textiles, and the RBI.

DGFT under the Department of Commerce is responsible for the **execution** of the Foreign Trade Policy.

India's Foreign Trade Policy

It is published in four volumes:

Foreign Trade Policy

Handbook of Procedures Volume I

Handbook of Procedures Volume II

(Schedule of DEPB _Duty Entitlement Pass Book Rates)

ITC (HS) Classification of Export and Import Items (Indian Trade Clarification –Harmonized System)

Export Prohibitions and Restrictions

Under the foreign trade policy, ***export prohibitions*** are maintained for environmental, food security, marketing, pricing and domestic supply reasons, and to comply with international treaties.

Restrictions on exports on account of security concern through multilateral agreements are contained in the SCOMET list. (Special Chemicals, Organisms, Materials, Equipment and Technologies)

Concessions Provided to *Importers* By the Government of India

1.EPCG Scheme
(Export Promotion Capital Goods)

Scheme for concession on import duty on Capital Goods Imported for Producing goods for exports

To be repaid to Govt. in 12 years

2.Advance Authorization.

: It allows duty-free import of physical inputs

- Advance authorization can be issued for:
  - Physical exports (including exports to SEZs)
  - Intermediate supplies, and
  - Deemed exports

3.Duty Free Import Authorization (DFIA) Scheme

It offers exemptions in respect of customs duty, additional duty, education cess, and anti-dumping or safeguard duties in force for inputs used in export production.

4. Duty Entitlement Passbook (DEPB) Scheme (Customs Duty Free Imports)

Under the scheme, merchant or manufacturer exporters are entitled to duty-free import (basic customs duty component only) of inputs used in manufacture of goods, as a specified percentage of f.o.b. value of exports made to freely convertible currencies.

5.Promotional Measures for Deemed Exports

Transactions in which goods supplied do not leave the country and payments for such supplies is received either in Indian rupees or in free foreign exchange

6. Duty Drawback

Duty Drawback is a rebate which is admissible under Customs Act, 1962 for re-exports of goods on which import duty has been paid for imported material used in the manufacture of exports .

7. Schemes for Concessional Imports for Gems and Jewellery

The Gems and Jewellery Sector is characterized by import of goods in rough or raw form of diamonds and semi-precious stones and gold and silver for value addition and conversion to finished products.

Incentives Provided By The Government To Promote Exports

Export Incentives

These are the protective cover given to the firms engaged in exports from other constraints of economy.

1.Export Oriented Units (EOUs)

Introduced in 1981, the EOU scheme is complementary to EPZ scheme. It offers the same production regime but an EOU can be located anywhere in India.

2.Software Technology Parks (STPs) / Electronic Hardware Technology Parks (EHTPs)

In order to facilitate export-oriented production of computer software and hardware, units can be set up under the STPs/ EHTPs schemes, respectively.

3.Bio-Technology Parks (BTPs)

In order to promote bio-technology exports, the DGFT notifies Bio-Technology Parks on the recommendation of the Department of Biotechnology.

4.Assistance to States for Developing Export Infrastructure and Other Allied Activities (ASIDE)

Under the scheme, assistance is given to State Govts.for setting up new export promotion parks and zones and complementary infrastructure, such as road links to ports, container depots, and power supply.

5.Free Trade Zones (FTZ) and 6.Export Processing Zones (EPZs)

The FTZs and EPZs, set up as special enclaves, separated from the Domestic Tariff Areas (DTA) by fiscal barriers, are intended to provide an internationally competitive duty-free environment for export production, at low costs which enables their products to be competitive in the international market.

Since May 1994, the government has permitted development of EPZs by private, state or the joint sector.

7.Special Economic Zones (SEZs)

Introduced in April, 2000, the scheme aims to provide an internationally competitive and hassle-free trade environment for export production. An SEZ is designated duty-free enclave to be treated as foreign territory for trade operations and duties and tariffs. Units for manufacture of goods and rendering of services may be set up in SEZs.

8.Agri-export Zones (AEZs)

The concept of the AEZs was floated with a view to promote agricultural exports from India and providing remunerative returns to the farming community in a sustained manner. State governments are required to identify AEZs and also evolve a comprehensive package of services provided by all state government agencies, state agriculture universities and all institutions and agencies of the Union Government for intensive delivery in these zones.

9.Other Export Promotion Measures

Marketing assistance for export promotion:

Market Development Assistance (MDA): In order to facilitate exporters to explore the overseas markets and to promote their exports, the MDA Scheme provides assistance to exporters for participation in export promotion seminars, trade fairs, and buyer-seller meets in India and abroad.

Market Access Initiative (MAI): The Scheme provide financing assistance to public and private sector organizations to finance their marketing activities for the thrust products in the pre-identified markets.

10.Served from India Scheme:

Under the scheme, all service providers are entitled to duty credit scrip equivalent to 10 per cent of free foreign exchange earned during the preceding year.

11. Towns of Export Excellence (TEE)

The scheme aims at recognizing towns that have come up as industrial clusters with considerable exports so as to maximize their potential and assist them to promote exports.

12. *Vishesh Krishi* and *Gram Udyog Yojana* (Special Agriculture and Village Industry Scheme)

The scheme aims to promote the agricultural produce, minor forest produce, village industries' products, and forest-based products by way of providing duty credit scrips so as to compensate high transport costs.

13.Focus Market Scheme (FMS)

This scheme aims to offset high freight cost and other externalities by allowing duty credit scrips for strategic markets.

14.Focus Product Scheme (FPS)

In order to promote incentives for export of select products that have highly employment potential in rural and urban areas, the scheme allows duty credit scrips for notified product categories such as value added leather products and leather footwear, handicrafts items, handloom products, value added fish and coir products and some additional focus products.

15.High Tech Products Export Promotion Scheme

In order to promote exports of High-tech products from India, the scheme provides Duty Credit scrips.

16. Policy Initiatives and Incentives by the State Governments

Providing information on export opportunities

Preference in land allotment for starting an EOU

Exempting from entry-tax, sales tax or turnover tax on supplies to EOU / EPZ / SEZ units.

WTO and Export Promotion Measures

The multilateral trading system under the WTO trade regime provides a rule based framework as to which subsidies are prohibited, which can face countervailing measures, and which are allowed.

The WTO's Trade Policy Review Mechanism (TPRM)

In order to enhance transparency of member's trade policies and facilitate smooth functioning of the multilateral trading system, the WTO members established the TPRM to review trade policies of member countries at regular intervals.

Unit III

INTERNATIONAL TRADE PROCEDURES AND DOCUMENTATION

Learning Objectives

To outline the framework of international trade transactions

To elucidate the export-import procedures

To explain the INCOTERMS

To explicate the significance of documentation in international trade transactions

To discuss commercial and regulatory documents used in international trade

Significance of International Trade Procedures & Documentation

Over a period of time, international trade transactions evolved a customary and regulatory framework so as to facilitate smooth flow of cargo from exporter to importer and ensure receipt of payment from the importer. In order to carry out cross-country trade, a certain set of procedures are followed with a wide range of documents.

Export-Import Procedures

- Compliance with Legal Framework
- Concluding an export deal
- Arranging Export Finance
- Procuring or Manufacturing of Goods
- Pre-shipment Inspection
- Central Excise Clearance on Goods for Exports
- Packaging, Marking, and Labeling of Goods
- Appointment of Clearing and Forwarding (C & F) Agents
- Arranging Cargo Insurance
- Booking Shipping Space
- Dispatch of Goods to Port
- Port Procedures and Customs Clearance
- Dispatch of Documents to the Exporter
- Sending Shipment Advice
- Presentation of Documents at the Negotiating Bank
- Claiming Export Incentives

Compliance with Legal Framework

Each country has its own legal framework for export import transactions which need to be complied by those entering into international trade. In India, exporters are requested to:

- **Obtaining Import Export Code Number**
- **Registration with Sales Tax and Central Excise Authorities**
- **Registration with Export Promotion Organisation**

Concluding an Export Deal

While concluding an export deal an exporter should negotiate the terms of the deal in detail, including the price, the product description, packaging, port of shipment, and delivery and payment terms.

Process of Concluding an Export Deal

- **Identify and negotiate with importer**
- **Confirm the export deal**
- **Receive an export contract**
- **Examine the export contract thoroughly and ask for amendments, if any**
- **Receive letter of credit**
- **Scrutinize the L/C thoroughly, compare with terms of contract, ask for amendments, if needed**
- **Receive amended letter of credit**

Arranging Export Finance

The exporters may avail packing credit facility from commercial banks, generally at concessional rates to meet their working capital requirements for manufacturing, purchasing, and packaging of goods.

Procuring or Manufacturing of Goods

After receiving the confirmed export order, the exporting firm should make preparation for the procurement or production of goods, which include:

- ❖Send delivery note to factory/purchase department
- ❖Goods manufactured/procured
- ❖Pre-shipment inspection
- ❖Central excise clearance
- ❖Packing, marking or labelling
- ❖Dispatch of goods to the port

Pre-shipment Inspection

At the time of exports before clearing the shipment, Customs authorities require submission of an inspection certificate in compliance with the rules and regulations of the exporting country regarding compulsory quality control and pre-shipment inspection.

Central Excise Clearance on Goods for Exports

The exports are free from the incidence of indirect taxes as per internationally accepted practice. Therefore, all goods exported from India are exempt from payment of central excise duties for which exporters have following options:

- **Export of goods under claim for excise duty rebate**
- **Export of goods under bond**

Packaging, Marking, and Labeling of Goods

Proper packaging of export cargo facilitates in minimizing transit and delivery costs and losses. After packaging marking of the packages is done so as to facilitate identification of goods during handling, transportation, and delivery. Labelling contains detailed instructions and is carried out by affixing labels on the packs or by stencils.

Appointment of C & F Agents

Services offered by C&F Agents:

Advising exporters on choice of shipping routes

Reservation of shipping space

Inland transportation at port

Studying provisions of L/C or contract and taking necessary action accordingly

Warehousing insurance

Port, shipping, and customs formalities

Arranging overseas transport service

Rendering assistance in filing claims

Monitoring movements of goods to importer

General advisory services.

Arranging Cargo Insurance

The marine insurance cover is arranged by the exporter based on the conditions of the export contract.

Booking Shipping Space

The shipping space is reserved in the vessel by sending shipping instructions either through the C&F agent or through freight broker who works on behalf of the shipping company.

Dispatch of Goods to Port

On receiving information on reservation of shipping space, the production department makes arrangements for transport of goods to the port of shipment, either by road or rail. The goods are generally consigned to the port town in the name of the C&F agent.

Port Procedures and Customs Clearance

Exporters generally avail the services of C&F agents to comply with procedures for the Customs clearance and other port formalities at the port town.

Dispatch of Documents to the Exporter

Soon after obtaining the B/L from the shipping company, the C&F agent sends the documents to the exporter.

Sending Shipment Advice

Soon after the shipment, the exporter sends a Shipment Advice to the importer intimating the importer about the date of shipment, name of the vessel, and it’s ETA at the port of discharge. The Shipment Advice is accompanied by commercial invoice, packing list (if any), and a non-negotiable copy of B/L so as to enable the importer to take delivery of the shipment.

Presentation of Documents at the Negotiating Bank

The exporter has to present the foolowing documents to the negotiating bank after the shipment:

Bill of Exchange (first and second of original)

Commercial invoice (two or more copies as required)

Full set of 'clean on board' B/L (all negotiable and non-negotiable as required)

GR Form (Duplicate)

Export order/contract

Letter of Credit (Original)

Packing list

Marine insurance policy (two copies)

Consular and/or Customs invoice, if required

Bank certificate (in the prescribed form)

EXIM Policy

FDI

- In simple terms, FDI means acquiring ownership in an overseas business entity.
- Foreign direct investment occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage it.

Importance of FDI for a country

- International trade and foreign direct investment (FDI) are the two most important international economic activities integrating the world economy.

- FDI has become an integral part of firms' strategy to expand international business due to enhancement of Factors of Production.

Source : International Business By Dr.R.M.Joshi,Courtsey Oxford University Press

Foreign Portfolio Investment

- An investment by individuals, firms, or a public body in foreign financial instruments, such as foreign stocks, government bonds, etc.
- In FPI, the equity stake in the foreign business entity is not significant enough to exert any management control.

Raison d'etre For FDI

- Cost of transportation
- Liability of foreignness

Source : International Business By Dr.R.M.Joshi,Courtsey Oxford University Press

Benefits of FDI to Host Countries

- Access to superior technology
- Increased competition
- Increase in domestic investment
- Bridging host countries' foreign exchange gaps

Negative Impacts of FDI

- Market Monopoly
- Crowding-out and unemployment effects
- Technology dependence
- Profit outflow
- Corruption
- National security

Factors Affecting Selection of FDI Destinations

- Cost of capital input
- Wage rate
- Taxation regime
- Cost of inputs
- Cost of logistics
- Market demand

Types of FDI

- **A. On the Basis of Direction of Investment**
- Inward FDI**:** Foreign firms taking control over domestic assets.
- Outward FDI: Domestic firms investing overseas and taking control over foreign assets.

B. On the Basis of Types of Activity

- Horizontal FDI: Overseas investment in a similar activity as carried out in the home country.

- Vertical FDI: Overseas investment so as either to provide inputs for the firm's domestic operations or sell its domestic output abroad.

Conglomerate FDI

- Direct investment overseas aimed at manufacturing products not manufactured by the firm in the home country.

On the Basis of Investment Objectives

- Resource-seeking FDI:

Direct investment overseas so as to gain edge over competitors

- Market-seeking FDI:

Direct investment overseas with sizeable market and growth in order to protect existing markets, counteract competitors, and to preclude rivals from gaining new markets

On the Basis of Entry Modes

Greenfield Investments:

Overseas investment to create new facilities or expansion of existing facilities

Merger & Acquisitions (M&As):

Transfer of existing assets of a domestic firm to a foreign firm that leads to mergers and acquisitions.

On the Basis of Sector

- Industrial FDI:

Investment by a foreign firm in the manufacturing sector.

- Non-industrial FDI:

Investment by a foreign firm in services sector.

On the Basis of Strategic Modes

- Export replacement

FDI is made as a substitute for exports in response to trade barriers of the host country, such as import restrictions and prohibitive tariff structure.

Source : International Business By Dr.R.M.Joshi,Courtsey Oxford University Press

Export Platforms

In order to minimize a firm’s cost of production and distribution, FDI is made so as to utilize the target country to serve the global markets.

Domestic Substitution

- FDI aimed to obtain cheap inputs to support home production.

Policy Framework to Promote FDI

Attracting FDI has become a key part of national development strategies for most countries. Such investments are often viewed to augment domestic capital, employment, and productivity, leading to economic growth.

- **FDI is Prohibited in...**
  - Retail trading (Except single brand product retailing)
  - Atomic energy
  - Lottery business
  - Gambling and betting sector
  - Business of chit fund and nidhi company
  - Plantation except tea
  - Trading in Transferable Development Rights (TDR)
  - Activity/ sector not opened to private sector investment

FDI up to 24 per cent allowed

– Manufacture of items reserved for small sector upto 24 per cent

FDI up to 26 per cent allowed

– FM broadcasting
– Up-linking a news and current affairs TV channels
– Defense production
– Insurance
– Publishing of news papers and periodicals

FDI up to 49 per cent allowed

- Broadcasting
  - Setting up hardware facilities
  - Cable network:
  - Direct to Home (DTH):
- Scheduled Air transport services
- Commodity exchanges
- Credit information companies
- Refining in case of PSUs
- Asset reconstruction companies

FDI up to 51 per cent allowed

- Single brand product retailing

- **FDI up to 74 per cent allowed**
  - ISP with gateways, radio-paging, and end-to-end bandwidth
  - Establishment and operation of satellites
  - Private sector banking
  - Telecommunications services
  - Non-scheduled Air transport services, ground handling services

– UPTO 100% FDI is allowed with prior Govt.Approval

– Trading:
– Courier services
– Tea sector, including tea plantation:
– ISP without gateway, infrastructure provider, electronic mail, and voice mail:
– Mining and mineral separation of titanium bearing minerals and ores, its value addition
– Cigars and cigarettes manufacture

UPTO 100% FDI is allowed with prior Govt. Approval_Contd…

- Airports- existing projects with prior government approval beyond 74 per cent
- Up-linking of a non-news and current affairs TV channels
- Investing companies in infrastructure/ services sector (except telecom sector)
- Publishing of scientific magazines, specialty journals and periodicals

Foreign Direct Investment allowed up to

100 per cent under automatic route

1. Agriculture sector

2. Industrial sectors

- Mining
- Manufacturing activities
- Petroleum sector
- Power

Source : International Business By Dr.R.M.Joshi,Courtsey Oxford University Press

Contd…

3.Special Economic Zones and Free Trade Warehousing Zones

4.Industrial Parks

5.Construction development projects

Contd….

- Services
  - Civil aviation
  - Non banking finance companies
  - Trading
- In sectors/ activities not listed above, FDI is permitted up to 100 per cent through automatic route

Components of FDI Flows

FDI is mainly financed by TNCs through

- Equity capital
- Intra-company loans
- Reinvested earnings

Source : International Business By Dr.R.M.Joshi,Courtsey Oxford University Press

FDI Performance Indices

For carrying out cross-country comparison of FDI performance and FDI potential, the UNCTAD’s FDI performance and potential indices serve as useful tools

Inward FDI Performance Index: Measure of the extent to which a host economy receives inward FDI relative to its economy size.

Outward FDI performance index: The ratio of a country's share in global FDI outflows to its share in

the world GDP.

Foreign Direct Investment in Retail Sector

- India is the second largest market in the world after China and it fascinates global retailers to invest. It has opened up FDI upto 51% in retail trade to "single brand products" from Feb, 2006.

Regulatory authorities in INTERNATIONAL Business

Significance of Foreign Trade Policy

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Tarriffs...Contd

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ITC (HS) Classification of Export and Import Items (Indian Trade Clarification –Harmonized System)

Export Prohibitions and Restrictions

Restrictions on exports on account of security concern through multilateral agreements are contained in the SCOMET list. (Special Chemicals, Organisms, Materials, Equipment and Technologies)

Import Promotion Organizations

Many countries are substantially dependent on imports due to limited availability of their resources or imports heavily due to heavy trade surpluses. These countries have set up institutional frameworks to promote imports so as to develop competitive supplier base for its importing firms. Such import promotion organizations also facilitate the foreign exporting firms to explore marketing opportunities and identify importers. Major export promotion organizations include: CBI, JETRO, SIPPO, DIPO etc.

Institutional Framework for International Trade in India

Department of Commerce

- Economic Division
- Trade Policy Division
- Foreign Trade Territorial Division
- Export Product Division
- Export Industries Division
- Export Services Division

Department of Commerce

- **Subordinate offices**
  - Directorate General of Foreign Trade (DGFT)
  - Directorate General of Commercial Intelligence and Statistics (DGCI&S)
  - Directorate General of Anti-Dumping and Allied Duties (DGAD)

Advisory Bodies

- Board of Trade

- Export Promotion Board

EOUs and SEZs

Carpet

Cotton textiles

Handicrafts

Handloom

Indian silk

Synthetic and Rayon textile

Wool and woollens

Powerloom

Commodity Board

Tea Board

Coffee Board

Coir Board

Central Silk Board

All-India Handlooms and Handicraft Board

Rubber Board

Cardamom Board

Tobacco Board

Spices Board

Service Institutions

Indian Institute of Foreign Trade (IIFT)
Export Inspection Council (EIC)
Indian Council of Arbitration (ICA)
India Trade Promotion Organization (ITPO)
India Trade Promotion Organization (ITPO)
National Centre for Trade Information (NCTI)
Export Credit Guarantee Corporation (ECGC)
Export-Import bank of India (EXIM Bank)
Indian Institute of Packaging (IIP)
Federation of Indian Export Organizations (FIEO)

Government Participation in Foreign Trade

For supplementing the efforts of the private sector in the field of foreign trade, the Government of India has set up a number of trading corporations:

- State Trading Corporation (STC)
- Minerals and Metals Trading Corporation (MMTC)
- Spices Trading Corporation Limited (STCL)
- Metal Scrap Trading Corporation (MSTC)

These corporations have provided the essential base for developing and strengthening efforts relating to specific commodities and products and diversifying the country's foreign trade.

States' Involvement in Promoting Exports

The central and state governments have enacted a number of measures to promote exports such as Inter-State Trade Council, States' Cell in Ministry of Commerce and state government departments / organizations.

Inter-State Trade Council

Set up in order to ensure a continuous dialogue between the state governments and Union Territories. It advises the governments on measures for providing a healthy environment for international trade with a view to boost India's exports.

States' Cell in Ministry of Commerce

As an attempt to involve states in export promotion, the Union Government has created a State's Cell under the Ministry of Commerce.

Institutional Infrastructure for Export Promotion by State Governments

The State Level Export Promotion Committee (SLEPC) headed by the Chief Secretary is the apex body at state level promoting exports. It scrutinizes and approves projects and overseas implementation of union government’s scheme on Assistance to States for Development of Export Infrastructure and other activities (ASIDE). Besides most states also promote exports either through their industries department or a separate establishment.

Concessions Provided to *Importers* By the Government of India

1. EPCG Scheme
(Export Promotion Capital Goods)

Scheme for concession on import duty on **Capital Goods** Imported for Producing goods for exports

To be repaid to Govt. in 12 years

Source : International Business By Dr.R.M.Joshi,Courtsey Oxford University Press

2.Advance Authorization.

- It allows duty-free import of physical inputs

- Advance authorization can be issued for:

1.Physical exports (including exports to SEZs) Intermediate supplies, and

2.Deemed exports

3.Duty Free Import Authorization (DFIA) Scheme

It offers exemptions in respect of customs duty, additional duty, education cess, and anti-dumping or safeguard duties in force for inputs used in export production.

4. Duty Entitlement Passbook (DEPB) Scheme (Customs Duty Free Imports)

Under the scheme, merchant or manufacturer exporters are entitled to duty-free import (basic customs duty component only) of inputs used in manufacture of goods, as a specified percentage of f.o.b. value of exports made to freely convertible currencies.

5.Export Oriented Units (EOUs)

Introduced in 1981, the EOU scheme is complementary to EPZ scheme. It offers the same production regime but an EOU can be located anywhere in India.

Source : International Business By Dr.R.M.Joshi,Courtsey Oxford University Press

Free Trade Zones (FTZ) and Export Processing Zones (EPZs)

- The FTZs and EPZs, set up as special enclaves, separated from the Domestic Tariff Areas (DTA) by fiscal barriers
- Are intended to provide an internationally competitive duty-free environment for export production, at low costs which enables their products to be competitive in the international market.
- Since May 1994, the government has permitted development of EPZs by private, state or the joint sector.

Special Economic Zones (SEZs)

Introduced in April, 2000, the scheme aims to provide an internationally competitive and hassle-free trade environment for export production. An SEZ is designated duty-free enclave to be treated as foreign territory for trade operations and duties and tariffs. Units for manufacture of goods and rendering of services may be set up in SEZs.

ECGC_Functions

1.Export Factoring Facility

Export Factoring Facility : ECGC Limited (formerly known as Export Credit Guarantee Corporation of India Limited), is now offering "Export Factoring Facility" for Micro Small & Medium Enterprises (as defined in MSMED Act-2006).

Insurance Cover to Buyers

- Buyer's Credit is a credit extended by a bank in India to an overseas buyer enabling the buyer to pay for machinery and equipment that he may be importing from India for a specific project.
- A Line of Credit is a credit extended by a bank in India to an overseas bank, institution or government for the purpose of facilitating import of a variety of listed goods from India into the overseas country.

Risks Covered By ECGC

1. Political

- The occurrence of war between the country of the overseas party and India.
- The occurrence of war, hostilities, civil war, revolution, rebellion, insurrection or other disturbances in the country of overseas party.
- The operation of law or of an order, decree or regulation having the force of law which in circumstances outside the control of the lender and/or the overseas party, prevents, restricts or controls, the transfer of the sums due to the lender by the overseas party under the Financial Agreement.

Contd…

2. Commercial

The risk of protracted default of the borrower to pay the amounts due under the loan agreement and insolvency of the borrower.

Loss Coverage:

90%

Period of Cover:

As per the agreement.

Obligations Under Risk Coverage

- Seek in principal approval prior to signing of agreement
- Advise disbursement and repayment schedule
- Inform overdue payments
- Filing of claim
- Recovery action after payment of claim and sharing of recovery.

Review Questions

1.FDI is mainly financed by TNCs through
2.FDI is prohibited in-
3.Conglomerate FDI means –
4.ECGC stands for -

Answers

1.Equity capital, Intra company Loans

2. Transferable Development Rights (TDRs)

3. Direct investment overseas aimed at manufacturing products not manufactured by the firm in the home country.

4.Export Credit Guarantee Corporation.

Unit IV

Foreign Exchange Management

Learning Objectives

To elucidate the concept of international monetary systems

To discuss contemporary exchange rate arrangements

To evaluate various theories of exchange rate determination

To discuss foreign exchange market and exchange rate quotations

To explain foreign exchange risks and exposure

To examine various modes of payment

To elaborate various techniques of financing international trade

Significance of International Finance

Globalization has made understanding international finance pertinent even to business enterprises solely operating domestically in order to assess the impact of movements in exchange rates, foreign interest rates, labour costs, and inflation on the costs and prices of their foreign competitors.

International Monetary Systems

A set of rules, regulations, policies, practices, instruments, institutions, and mechanisms that determine exchange rates between currencies.

Gold Standards

Gold specie standard: The currency consists of gold coins with fix gold content

Gold bullion standard: The currency consists of paper notes but a fix weight of gold remains the basis of money. Any amount of paper currency can be converted into gold and vice versa by the country's monitory authority at a fix conversion ratio.

Gold exchange standard: Paper currency can be converted at a fix rate into the paper currency of the other country, which is operating a gold specie or gold bullion standard.

Fixed Exchange Rates

In post Bretton-woods era, a fixed or pegged exchange rate was maintained for a country's currency vis-à-vis gold or the US dollar. Since the price of each currency was fixed in terms of gold, their values with respect to each other were also fixed.

Floating Exchange Rate System

Currency prices are determined by market demand and supply conditions without the intervention of the governments.

Contemporary Exchange Rate Arrangements

Exchange rate arrangements are classified by the IMF on the basis of degree of variability of observed exchange rate and past official actions affecting the exchange rate over the time period.

Floating Exchange Rate System

Allows complete flexibility of exchange rates unlike the rigidity of currency movements under the fixed exchange rate system.

Independent or Free Float

The exchange rates are market-determined and central banks intervene only to moderate the speed of change or to prevent excessive fluctuations without any attempt to maintain it or drive it to a particular level.

Managed Float

Although currencies are allowed to fluctuate on a daily basis with no official boundaries, national governments intervene to prevent their currencies from moving too far in a certain direction.

Pegged Exchange Rate System

Pegging value of home currency to a foreign currency or a basket of currencies and it is allowed to move in line with that currency against other currencies.

Soft Pegs

Conventional fixed peg: The currency fluctuates for at least three months within a band of less than 2 per cent or +/-1 per cent against another currency or a basket of currencies.

Intermediate pegs

Pegs within horizontal bands: Currencies are generally not allowed to fluctuate beyond +_1 per cent of central parity.

Crawling Peg: A currency is pegged to a single currency or a basket of currencies, but the peg is periodically adjusted with a range of less than 2 per cent in response to changes in selective macro-economic indicators.

Crawling bands: The currency is adjusted periodically at a fixed rate or in response to changes in selective quantitative macro-economic indicators, with a range of fluctuation of 2 per cent or more. The degree of exchange rate flexibility is a function of the bandwidth.

Hard Pegs

Currency board arrangements: A monetary regime based on an explicit legislative commitment to exchange domestic currency for a specified foreign currency at a fixed exchange rate.

Arrangements with no separate legal tender: Adopting such an exchange rate regimes implies the complete surrender to monetary authorities' independent control over domestic policies. It may be 'formal' or 'informal'.

Dollarization: Replacement of a country's local currency with US dollars.

Foreign Exchange

Any type of financial instrument that is used to make payments between countries, e.g. foreign currency notes, deposits held in foreign banks, debt obligations of foreign governments and foreign banks, monetary gold, and SDRs.

Eurocurrency

A currency deposited in a bank outside the country of its origin. It is used as a generic term rather than being confined to the geographical boundary of Europe. For instance:

Eurodollars: Dollars deposited in banks outside Europe.

Euro Sterling: Sterling Pounds deposited in a bank outside the UK

Euro Mark: Detusche Mark deposited outside Germany

Euro Yen: Yen deposited outside Japan.

Determination of Exchange Rates

Purchasing Power Parity (PPP) Theory

The prices of goods sold in different countries, converted to a common currency should be identical.

Interest Rate Theories

These theories use interest rates in determining exchange rates unlike the price levels used under the PPP theory.

Fisher Effect (FE) Theory

The nominal interest rate ‘r’ in a country is determined by the real interest rate ‘R’ and the expected inflation rate ‘i’ as follows:

$$r = R + i$$

International Fisher Effect (IFE) Theory

The exchange rate movements are caused by interest rate differentials. If real interest rates are the same across the country, any difference in nominal interest rates could be attributed to differences in expected inflation.

Other Determinants of Exchange Rates

In addition to inflation, real income and interest rates, market fundamentals that influence the exchange rates include bilateral trade relationships, customer tastes, investment profitability, product availability, productivity changes and trade policies.

Foreign Exchange Market

The organizational setting within which individuals, businesses, government, and banks buy and sell foreign currencies and other debt instruments. It is an over-the-counter market consisting of a global network of inter-bank traders, primarily the banks connected by telecommunication facilities.

Types of Foreign Exchange Markets

Inter-bank or wholesale market: Trading between the banks where banks can obtain quotes, or they can contact brokers who sometimes act as intermediaries.

Retail market: It consists of travellers and tourists who exchange one currency to another in the form of travellers cheques or currency notes. In retail markets, transaction size of retail foreign exchange market is very small whereas the spread between buying and selling prices is large.

Participants in the Foreign Exchange Market

Traders use forward contract to eliminate or cover the risk of loss on export or import orders that are denominated in foreign currencies.

Hedgers are mostly multinational firms, engage in forward contracts to protect the home currency value of various foreign currency-denominated assets and liabilities on their balance sheets that are not to be realized over the life of the contracts.

Arbitrageurs seek to earn risk-free profits by taking advantage of differences in interest rates among countries. They use forward contracts to eliminate the exchange risk involved in transferring their funds from one nation to another.

***Exchange rate*:** The value of one currency in units of another.

Exchange Rate Quotations

Spot vs. Forward Quote

Spot rate: The price agreed for purchase or sale of foreign currency with delivery and payment to take place not more than two business days after the day the transaction has been concluded.

Forward rate: The price at which the foreign exchange rate is quoted for delivery at a specified later date. The date of maturity of a forward contract is more than two business days in a future whereas the exchange rate is fixed at the time of entering the contract.

Direct vs. Indirect Quotes

Direct quotes: Units of the home currency per unit of a foreign currency.

For instance, Indian Rs. 39.5075 per US $ is a direct quote in India whereas Yen ¥ 106.5050 per US $ is a direct quote in Japan.

*Indirect quote: U*nits of foreign currency per unit of home currency. It may be arrived at by inversing the direct quote as follows:

$$\text{Indirect quote} = 1/\text{direct quote}$$

For instance, US$ 0.0253 per Indian Rupee is an indirect quote in India.

Cross Exchange Rate

Quoting exchange rates of two currencies without using the US dollar as the reference currency.

Bid vs. Ask Quotations

Bid rate: The price that a bank is willing to pay for a foreign currency.

Ask or offer rate: The price at which a bank is willing to sell the currency.

Bid/ask spread = (ask rate- bid rate)/ask rate

Foreign Exchange Risks and Exposure

Trans-national operations of a company require it to deal with multiple exchange rate regimes and cash-flows across countries, making it vulnerable to foreign exchange fluctuations. The impact of foreign exchange fluctuations not only depends on how the firm reacts but also on how the firm's competitors, customers, and suppliers react.

Foreign Exchange Risk

The variance of domestic currency value of assets, liabilities, or operating income attributable to unanticipated changes in exchange rates. Thus, it refers not to the unpredictability of foreign exchange rates but to the uncertainty of the values of a firm's assets, liabilities, and operating income due to unanticipated changes in exchange rates.

Foreign Exchange Exposure

The sensitivity of the real value of assets, liabilities, and operating income to unanticipated changes in exchange rates expressed in its functional currency.

Types of Exposures

Transaction exposure: The effect of exchange rate fluctuations on the value of anticipated cash-flows, denominated in home or functional currency terms, relating to transactions already entered into in foreign currency terms.

Economic exposure: The effect of exchange rate fluctuations on a firm's future operating cash flows.

Translation exposure: Also known as *accounting exposure*, translation exposure arises due to conversion or translation of financial statements of foreign subsidiaries and affiliates denominated in foreign currencies into consolidated financial statements of an MNE in its functional or home currency.

Managing Foreign Exchange Risks

Hedging: The avoidance of foreign exchange risk and covering an open position.

Principal hedging techniques:

Forward Contracts: A commitment to buy or sell a specific amount of foreign currency at a later date or within a specific time period and at an exchange rate stipulated when the transaction is struck. The delivery or receipt of the currency takes place on the agreed forward value date.

Future Contracts: Standardized contracts that trade on organized futures markets for a specific delivery dates only.

Options: An agreement between a holder (buyer) and a writer (seller) that gives holder the right, but not the obligation, to buy or sell financial instruments at a time through a specified date.

Types of Foreign Currency Options

Call option gives the holder the right to buy foreign currency at a pre-determined price.

Put option gives the holder the right to sell foreign currency at a pre-determined price.

Swap

Agreement to exchange one currency for another at a specified exchange rate and date. Currency swaps between two parties are often intermediated by banks or large investment firms.

Global Cash Management

Using a centralized system, a *Cash Management Centre* (CMC) is established that nets out receivables against payables and only the net cash flows are settled among different units of the MNE.

Multilateral netting considerably reduces the total number of currency conversions and results in significant savings on transaction costs.

Modes of Payment in International Trade

Advance Payment

The payment is remitted by the buyer in advance, either by a draft mail or TT (telegraphic transfer). Generally, such payments are made on the basis of a single receipt and its approval by the importer.

Documentary Credit

Documentary Collection: The payment collection mechanism that allows exporters to retain ownership of the goods or reasonably ensures their receiving payments.

It is governed by Uniform Customs and Practices of Documentary widely known as UCPDC 600.

Documentary Credit with Letter of Credit (L/C)

A documentary credit represents a commitment of a bank to pay the seller of goods or services a certain amount provided s/he presents stipulated documents evidencing the shipment of goods or performance of services within a specified period.

Types of L/C

Irrevocable: The issuing bank irrevocably commits itself to make payment if the credit terms as given in the L/C are satisfied

Revocable: Such L/C can be revoked any time without consent of or notice to the beneficiary.

Confirmed: The confirming bank (generally a local bank in exporter's country), commits itself to irrevocably make payment on presentation of documents.

Unconfirmed: The issuing bank asks the corresponding bank to advise about the L/C without any confirmation on its part.

Sight: The beneficiary receives payment upon presentation and examination of documents.

Term credits: These are used as financing instruments for the importer.

Acceptance credit: The exporter draws a Time Draft, either on the issuing or confirming bank or the buyer or on another bank depending upon the terms of credit.

Deferred payment credit: The bank issues a written promise to make the payment on due date upon presentation of the documents.

Revolving: The amount involved is reinstated when utilized, i.e., the amount become available again without issuing another L/C and usually under the same terms and conditions.

Back to Back: *U*sed when exporter uses the L/C as a cover for opening a credit in favour of the local suppliers.

Documentary Credit without L/C

Documents are routed through banking channels that also acts as seller's agent alongwith Bill of Exchange.

Such drafts may be either *sight* or *usance*.

Sight draft (document against payment): The importer can take physical possession of the goods only when s/he has made the payment before getting documents from the bank.

Usance or time draft (document against acceptance): The importer gets documents by the bank on his/her acceptance of the payment obligations and can subsequently takes title of the goods before the payment is released.

International Trade Finance

Access to adequate finance at competitive rates is crucial to successful completion of an export transaction. Finances are required to complete an export trade cycle right from receiving the export order till the realization of final payment from the importer. Export credit is extended both at pre-shipment and post-shipment stages.

Types of International Financing Alternatives

Banker's Acceptance: It is time draft or Bill of Exchange drawn on and accepted by a bank. By 'accepting' the draft, the bank makes an unconditional promise to pay the holder of the draft the specified amount of money on maturity.

Discounting: Exporters can convert their credit sales into cash by way of 'discounting' the draft even if it is not accepted by the bank. The draft is discounted by the bank on its face value minus interest and commissions 'with' or 'without' recourse.

Accounts Receivable Financing: Banks often provide loans to the exporter based on its credit worthiness secured by an assignment of the accounts receivables. The exporter is responsible for repaying the loan to the bank even if the importer fails to pay the exporter, for whatever reasons. Usually the period of such financing is one to six months.

Factoring: It is widely used in short-term transactions as a continuous arrangement. It involves purchase of export receivables by the factor at a discounted price, i.e., generally 2 per cent to 4 per cent less than the full value. However, the discount depends upon a number of other factors such as the type of product, terms of the contract, etc.

Forfeiting: It refers to the exporter relinquishing his or her rights to a receivable due at a future date in exchange for immediate cash payment at an agreed discount, passing all risks and responsibility for collecting the debt to the forfeiter. Forfeiting is particularly used for medium-term credit sales (1 to 3 years).

Letters of Credit (L/C): In a L/C the issuing bank undertakes a written guarantee to make the payment to the beneficiary, i.e., the exporter, subject to the fulfillment of its specified conditions.

Terms credit is often used as financing instrument for the importer who gets delivery of the goods without making payment to the importer.

Counter-Trade: It is used to combine trade-financing and price setting in one transaction. Counter-trade finances imports in form of reciprocal commitments from countries that have payment problems, especially in hard currencies

Export Finance

As a part of their export promotion strategy, countries around the world offer export credit, often at concessional rates to facilitate exports.

Export credit in India is available both in Indian rupees and foreign currency.

Financing to Overseas Importers

Credit is also extended to overseas buyers to facilitate import of goods from the exporting country, mainly under two forms:

Buyer's credit

Extended by a bank in exporter's country to an overseas buyer enabling the buyer to pay for import of machinery and equipment that s/he may be importing for a specific project.

Line of credit

Extended by a bank in exporting country to an overseas bank, institution or government for the purpose of facilitating import of a variety of listed goods from the exporting country into the overseas country.

Credit Risk Insurance

It provides protection against both political and commercial risks to the exporters who sell their goods against credit terms.

Insurance policies and guarantees extended by export credit agencies, such as ECGC can be used as collateral for trade financing

WTO Compatibility of Trade Finance and Insurance Schemes

WTO sets the framework for the types of subsidies that can be provided by a country for export promotion.

The agreement on Subsidies and Countervailing Measures (SCM) prohibits national governments to provide subsidies that are contingent upon export performance or upon the use of domestic goods over the imported ones. It also constrains government intervention in the area of export financing and insurance.

Reference

Source : International Business

By Dr.Rakesh Mohan Joshi,

Oxford Publishing House