Model answer
Course: MBA
Semester: I
Subject: International Business Environment and Management
EXAM: DECEMBER 2014
Section A : Short Answer Questions

Ans 1.

1. When more units of a good or a service can be produced on a larger scale, yet with (on average) less input costs, economies of scale (ES) are said to be achieved. Alternatively, this means that as a company grows and production units increase, a company will have a better chance to decrease its costs. According to theory, economic growth may be achieved when economies of scale are realized.

2. A corporation that has its facilities and other assets in at least one country other than its home country. Such companies have offices and/or factories in different countries and usually have a centralized head office where they co-ordinate global management. Very large multinationals have budgets that exceed those of many small countries.

3. Franchising is a continuing relationship in which a franchisor provides a licensed privilege to the franchisee to do business and offers assistance in organizing, training, merchandising, marketing and managing in return for a monetary consideration. Franchising is a form of business by which the owner (franchisor) of a product, service or method obtains distribution through affiliated dealers (franchisees).

4-Totalitarianism or totalitarian state is a concept used by some political scientists in which the state holds total authority over the society and seeks to control all aspects of public and private life wherever possible.

5. In geocentric orientation, the firms accept a worldwide approach to marketing and its operations become global. In global enterprise, the management establishes manufacturing and processing facilities around the world in order to serve the various regional and national markets through a complicated but well co-ordinated system of distribution network. When a firm adopts polycentric approach to overseas markets, it attempts to organize its international marketing activities on a country to country basis. Each country is treated as a separate entity and individual strategies are worked out accordingly. Local assembly or production facilities and marketing organisations are created for serving market needs in each country

7. Inflation is defined as a sustained increase in the general level of prices for goods and services. It is measured as an annual percentage increase. As inflation rises, every dollar you own buys a smaller percentage of a good or service. To avoid the inflation in the international market there are many factors that has to be observed and complied with the business.

8. A mixed economy is one in which there exists a mixture of free enterprise and government control. In some areas of a mixed economy, the government may even have a monopoly. Most of the developed countries of the world have a mixed economy. The mixture of two different economic philosophies can imply a variety of consequences for a country, some of which are seen as beneficial, while others are neutral or detrimental. Mixed economies are also known as dual economies.

9. Comparison between Tariff Barriers and non Tariff Barriers

• The purpose of both tariff and non tariff barriers is same that is to impose restriction on import but they differ in approach and manner.

• Tariff barriers ensure revenue for a government but non tariff barriers do not bring any revenue. Import Licenses and Import quotas are some of the non tariff barriers.

• Non tariff barriers are country specific and often based upon flimsy grounds that can serve to sour relations between countries whereas tariff barriers are more transparent in nature.

10. The objectives of the WTO are spelled out in the preamble to Marrakesh Agreement. In a nutshell, these are:

1. To ensure the reduction of tariffs and other barriers to trade.
2. To eliminate discriminatory treatment in international trade relations.
3. To facilitate higher standards of living, full employment, a growing volume of real income and effective demand and an increase in production and trade in goods and services of the member nations.
4. To make positive effect, this insures developing countries especially the least developed secure level of share in the growth of international trade that reflects the needs of their economic development.
5. To facilitates the optimal use of the world's resources for sustainable development.
6. To promote an integrated, more visible and durable trading system incorporating all the resolutions of the Uruguay Round's Multi literal trade negotiations.

Section B: Long Answer Question

Ans2.

International Business comprises all commercial transactions (private and governmental, sales, investments, logistics, and transportation) that take place between two or more regions, countries and nations beyond their political boundaries.

There are many Problems in International Business. The restraining forces slow down the progress of companies that take up International Business. The restraining forces are:

1. First Main Problem in International Business is Culture: The culture of the nation and the companies should have international vision. The long term perspective of companies should be to move wherever market opportunities are good. The inward looking culture makes companies to remain local.
2. Another main problem in International Business is Market Competition in Host Country : If best global companies enter the markets, the competition goes intense and accordingly inefficient companies have to close their shops.
3. Another main problem in International Business is Costs: The competition calls for marketing quality products at competitive prices. If prices are high the market rejects the products.
4. One of the main problems in International Business is National Controls: The nation builds barriers for outside country manufacturers by increasing trade barriers. Trade barriers will be direct by way of high customs duties. Indirect barriers will be licensing procedures, quota system, inspection, certification and tedious paper work.
5. Another main problem in International Business is Nationalization: Due to Ideological differences some nations do not trade with nations of their dislike.
6. Another main problem in International Business is War and Terrorism: The political uncertainties and war like situation are blockages to growth of trade.

7. One of the main problem in International Business is Short-sightedness of Management: Some management ignores vast business opportunities across national borders. The companies do not wish to go beyond national borders. If a company does not adapt to local conditions it does not survive.
8. One of the main problems in International Business is Organization History: The companies who are contended and like to remain within a nation.
9. Another main problem in International Business is Domestic Forces: The government or social restrictions imposed on commerce and industry become hurdle in a company going global.
10. One of the main problems in International Business is Conflict within companies and within international organization is difference of opinion in strategies to be adopted between different management levels in international business. If support is inadequate the international business proposal fails.

Challenges that businesses may experience when doing international business: -

1- Laws & Regulations: Every country has their own regulations and laws set up and it will be your obligation to know them. Importers and exporters must be aware of international laws. Research should be the first thing you do after deciding to go global with your small/mid size company. Some products may be banned in some countries and even though you may not be aware of these restrictions, your company will end up in trouble if you ship those products.

2- Cost: This is one of the key factors that will drive you and your company towards international business. You must calculate all possible costs that may be incur. How do you get the products delivered in the most economical way? This is the question that you must find the most accurate answer for. At the end of the day if the total cost will be more then your expectation you may reconsider taking the risks of opening your door to international business.

3- Communication Difficulties and Cultural Differences: Your business partners overseas may not speak the languages that you know and this could be another barrier to your business. Successful communication is the key factor in everything in our lives, and if you cannot communicate effectively – how do you expect to sell or buy the correct products in the right amounts? The transactions may not go as smooth as you would ideally like it to be. Let's also not forget obstacles you may experience due to cultural differences.

4- Payment Methods and Currency Rate: These are other obstacles that the small business owner must address before accepting or placing international orders. Countries may have different payment methods that are locally popular, but may not be commonly used internationally. In order to secure your business always selects the safest option for you. The currency exchange rate is also of importance. You must be aware of the currency exchange rates at the time of buying or selling your products.

5- Choosing the Right Shipping Method: How to ship the cargo in a timely, safe and cost effective fashion? Which option would be best for you and your goods: Air, LCL or FCL? These questions may seem complicated if you are new to the shipping industry. When getting started you may want to reduce the risk and work with 3PL's as they have the logistics experience, knowledge, and software a small company does not have, and they cost less than hiring employees with such expertise.

Ans3. Short Notes:

(I) Absolute cost advantage theory of international business has its inception in apparent failure of the Mercantilist Theory to explain International Trade, search began for alternative explanations. Another reason for an alternative explanation was also the fact that using the Mercantilist theories, governments of the day imposed several restrictions on the activities of the merchants.The utilitarian atmosphere of the times on the other hand advocated freedom of choice to individuals in all walks of life including economic and trade related matters. It questioned and advocated for removal of all sorts of restrictions on human behaviour placed either by State or by religion.

Adam Smith's Absolute Advantage Theory was therefore an answer to these issues.

According to this theory Trade between Nations took place if the traders saw an absolute advantage cost advantage in buying a particular good from a foreign country rather than buying the same good domestically.

This can be illustrated through the following example –

	Bread	Cloth
India	100	50
England	50	100

The above table shows units of labour required to produce Cloth and Bread in 2 countries – India and England. India can produce bread with 100 units of labour while England can produce the same quantity of bread with 50 units of labour. Clearly England can produce bread in a more efficient manner than India. India would therefore import bread from England. Further assuming that both countries have the same currency (say $) and same wage rates (say 1 $ per unit of labour) – It can be seen that the cost of production of bread in India would be 100$ while that of producing the same quantity of bread in England would be 50$. It would thus be advantageous for Indians to buy Bread from England at anything less than 100$. The Englishmen will also be happy to sell bread to Indians at anything more than 50$.Thus we see that both countries stand to gain if India imports bread from England.

(II) Capitalistic, Socialistic and Mixed Economy:

Capitalism is an economic system in which trade, industry, and the means of production are largely or entirely privately owned and operated for profit.A system of economics based on the private ownership of capital and production inputs, and on the production of goods and services for profit. The production of goods and services is based on supply and demand in the general market (market economy), rather than through central planning (planned economy). Capitalism is generally characterized by competition between producers. Other facets, such as the participation of government in production and regulation, vary across models of capitalism.Central characteristics of capitalism include capital accumulation, competitive markets and wage labour.In a capitalist economy, the parties to a transaction typically determine the prices at which assets, goods, and services areexchanged. Capitalism was carried across the world by broader processes of globalization such as imperialism and, by the end of the nineteenth century, became the dominant *global* economic system, in turn intensifying processes of economic and other globalization. Later, in the 20th century, capitalism overcame a challenge by centrally-planned economies and is now *the* encompassing system worldwide, with the mixed economy being its dominant form in the industrialized Western world.

Socialism is a social and economic system characterised by social ownership of the means of production and co-operative management of the economyas well as a political theory and movement that aims at the establishment of such a system. Social ownership" may refer to cooperative enterprises, common ownership, state ownership, citizen ownership of equity, or any combination of these. There are many varieties of socialism and there is no single definition encapsulating all of them. They differ in the type of social ownership they advocate, the degree to which they rely on markets or planning, how management is to be organised within productive institutions, and the role of the state in constructing socialism.

The socialist political movement includes a diverse array of political philosophies. Core dichotomies within the socialist movement include the distinction between reformism and revolutionary socialism and between state socialism and libertarian socialism.

In the early 19th century, "socialism" referred to any concern for the social problems of capitalism irrespective of the solutions to those problems. However, by the late 19th century, "socialism" had come to signify opposition to capitalism and advocacy for an alternative post-capitalist system based on some form of social ownership. During this time, German philosopher Karl Marx and his collaborator Friedrich Engels published works criticizing the utopian aspects of contemporary socialist trends and applied a materialist understanding of socialism as a phase of development which will come about through social revolution instigated by escalating and conflicting class relationships within capitalism.

A **mixed economy** is an economic system in which both the private sector and state direct the economy, reflecting characteristics of both market economies and planned economies. Most mixed economies can be described as market economies with strong regulatory oversight and governmental provision of public goods. Some mixed economies also feature a variety of state-run enterprises. The term "mixed economy" arose in the context of political debate in the United Kingdom in the post war period, although the set of policies later associated with the term had been advocated from at least the 1930s. Students could explain elements of mixed economy also.

Ans. 4.

The study of culture has led to generalizations that may apply to all cultures. These include elements such as bodily adornments, courtship rituals, etiquette, and concept of family, gestures, joking, mealtime, customs, music, personal names, status differentiation, and trade customs. The sensitivity and adaptation to these elements by an international firm depends on the firm's level of involvement in the market for example, licensing versus direct investment and the product or services marketed. Naturally, some products and services or management practices require very little adjustment, while some have to be adapted.

Language: Language has been described as the mirror of culture. Language itself is multidimensional by nature. This is true not only of the spoken word but also of what can be called the nonverbal language of international business. Messages are conversed by the words used, by how the words are spoken and through nonverbal means such as gestures body position and eye content.Language capability serves four distinct roles in global busines[8]. Language is important in information gathering and evaluation.

Nonverbal Language: Managers also must analyze and become familiar with the hidden language of foreign cultures. Five key topics time, space, material possessions, friendship patterns, and business agreements offer a starting point from which managers can begin to acquire the understanding necessary to do business in foreign countries. In many parts of the world time is flexible and not seen as a limited commodity people come late to appointments or may not come at all. In Hong Kong it is futile to set exact meeting times, because getting from one place to another may take minutes or hours depending on the traffic situation. Showing indignation or impatience at such behavior would astonish an Arab, Latin American, or Asian. Understanding national and cultural differences in the concept of time is critical for the global business manager.

Religion: In most cultures people find in religion a reason for being and legitimacy in the belief that they are of a larger context. To define religion requires the inclusion of the supernatural and the existence of a higher power. Religion defines the ideals for life, which in turn are reflected in the values and attitudes of societies and individuals. Such values and attitudes shape the behaviour and practices of institutions and members of cultures.

Values and Attitudes: Values are shared beliefs or group norms that have been internalized by individuals. Attitudes are evaluations of alternatives based on these values. The Japanese culture raises an almost invisible yet often unscalable wall against all gaijin. Many middle aged bureaucrats and company officials think that buying foreign products is downright unpatriotic. The resistance therefore is not so much to foreign products is downright unpatriotic. The resistance therefore is not so much to foreign products as to those who produce and market them. Similarly foreign based corporations have had difficulty in hiring university graduates or mid career personnel because of bias against foreign employers.

Manners and Customs: Change occurring in manners and customs must be carefully monitored, especially in cases that seem to indicate a narrowing of cultural differences between people. Phenomena such as McDonald's and Coke have met with success around the world, but this does not mean that the world is becoming westernized. Modernization and Westernization are not at all the same as can be seen in Saudi Arabia. Americans often interpret inaction and silence as negative signs. As a result, Japanese executives tend to expect that their silence can get Americans to lower prices or sweeten the deal. Even a simple agreement may take days to negotiate in the Middle East because the Arab party may want to talk about unrelated issues or do something else for a while. The abrasive style of Russian negotiators and their usual last minute change requests may cause astonishment and concern on the part of ill prepared negotiators. As another example consider the reaction of an American businessperson if a Finnish counterpart were to propose the continuing of negotiations in the sauna.

Material Elements: Material culture refers to the results of technology and is directly related to how a society organizes its economic activity.

Aesthetics: Each culture makes a clear statement concerning good taste as expressed in the arts and in the particular symbolism of colors form and music. What is and what is not acceptable may vary dramatically even in otherwise highly similar markets.

Education: Education either formal or informal plays a major role in the passing on and sharing of culture. Educational levels of a culture can be assessed using literacy rates enrolment in secondary education or enrolment in higher education available from secondary data sources.

Social Institutions: Social institutions affect the ways people to each other. The family unit which in Western industrialized countries consists of parents and children in a number of cultures is extended to include grandparents and other relatives.

Ans 5.

Globalisation means the integration of national economies into the international economy through trade, foreign direct investment, capital flows, migration, and the spread of technology.

- Elimination of tariffs; creation of free trade zones with small or no tariffs
- Reduced transportation costs, especially resulting from development of containerization for ocean shipping.
- Reduction or elimination of capital controls
- Reduction, elimination, or harmonization of subsidies for local businesses
- Creation of subsidies for global corporations
- Harmonization of intellectual property laws across the majority of states, with more restrictions.

- Supranational recognition of intellectual property restrictions (e.g. patents granted by China would be recognized in the United States)

Advantages of Globalization:

- Resources of different countries are used for producing goods and services they are able to do most efficiently.
- Consumers to get much wider variety of products to choose from.
- Consumers get the product they want at more competitive prices.
- Companies are able to procure input goods and services required at most competitive prices.
- Companies get access to much wider markets
- It promotes understanding and goodwill among different countries.
- Businesses and investors get much wider opportunities for investment.
- Adverse impact of fluctuations in agricultural productions in one area can be reduced by pooling of production of different areas.

Disadvantages of Globalization:

- Developed countries can stifle development of undeveloped and under-developed countries.
- Economic depression in one country can trigger adverse reaction across the globe.
- It can increase spread of communicable diseases.
- Companies face much greater competition. This can put smaller companies, at a disadvantage as they do not have resources to compete at global scale.

Globalization has played a major role in export-led growth, leading to the enlargement of the job market in India.

One of the major forces of globalization in India has been in the growth of outsourced IT and business process outsourcing (BPO) services. The last few years have seen an increase in the number of skilled professionals in India employed by both local and foreign companies to service customers in the US and Europe in particular. Taking advantage of India's lower cost but educated and English-speaking work force, and utilizing global communications technologies such as voice-over IP (VOIP), email and the internet, international enterprises have been able to lower their cost base by establishing outsourced knowledge-worker operations in India.

Notable examples of international companies that have done well in India in the recent years include Pepsi, Coca-Cola, McDonald's, and Kentucky Fried Chicken, whose products have been well accepted by Indians at large.

Ans. 6 (a).

Foreign investment was introduced in 1991 under Foreign Exchange Management Act, 1999 (FEMA) is an Act of the Parliament of India "to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India". It was passed in the winter session of Parliament in 1999, replacing the Foreign Exchange Regulation Act (FERA). This act seeks to make offenses related to foreign exchange civil offenses. It extends to the whole of India, replacing FERA, which had become incompatible with the pro-liberalisation policies of the Government of India. It enabled a new foreign exchange management regime consistent with the emerging framework of the World Trade Organisation (WTO).

(b).

Monetary policy- Monetary policy is the process by which the government, central bank, or monetary authority of a country controls (i) the supply of money, (ii) availability of money, and (iii) cost of money or rate of interest to attain a set of objectives oriented towards the growth and stability of the economy.[1] Monetary theory provides insight into how to craft optimal monetary policy. Monetary policy rests on the relationship between the rates of interest in an economy, that is the price at which money can be borrowed, and the total supply of money. Monetary policy uses a variety of tools to control one or both of these, to influence outcomes like economic growth, inflation, exchange rates with other currencies and unemployment. Where currency is under a monopoly of issuance, or where there is a regulated system of issuing currency through banks which are tied to a central bank, the monetary authority has the ability to alter the money supply and thus influence the interest rate (to achieve policy goals). It is important for policymakers to make credible announcements. To achieve low level of inflation, policymakers must have *credible* announcements; that is, private agents must believe that these announcements will reflect actual future policy. If an announcement about low-level inflation targets is made but not believed by private agents, wage-setting will anticipate high-level inflation and so wages will be higher and inflation will rise. A high wage will increase a consumer's demand (demand pull inflation) and a firm's costs (cost push inflation), so inflation rises. Hence, if a policymaker's announcements regarding monetary policy are not credible, policy will not have the desired effect.

Ans. 7.

International Monetary Fund (IMF): General Objectives and Major Functions

A landmark in the history of world economic cooperation is the creation of the International Monetary Fund, briefly called IMF. The IMF was organised in 1946 and commenced operations in March, 1947. The fundamental object of the IMF was the avoidance of competitive devaluation and exchange control that had characterised the era of 1930s. It was set up to administer a "code of fair practice", in the field of foreign exchange and to make short-term loans to member nations experiencing temporary deficits in their balance of payments, to enable them to meet these payments without resorting to devaluation or exchange control, while at the same time following' international policies to maintain domestic income and employment at high levels.

Thus, basically there are three general objectives of the IMF:

(i) The elimination or reduction of existing exchange controls,

(ii) The establishment and maintenance of currency convertibility with stable exchange rates, and

(iii) The widest extension of multi-lateral trade and payments.

In essence the Fund is an attempt to achieve the external or international advantages of gold standard system without subjecting nations to its internal disadvantages, and at the same time maintaining the internal advantages of paper standard while bypassing its external disadvantages.

The following are the major functions of the IMF:

1. It functions as a short-term credit institution.
2. It provides machinery for the orderly adjustments of exchange rates.
3. It is a reservoir of the currencies of all the member countries from which a borrower nation can borrow the currency of other nations.
4. It is a sort of lending institution in foreign exchange. However, it grants loans for financing current transactions only and not capital transactions.
5. It also provides machinery for altering sometimes the par value of the currency of a member country. In this way, it tries to provide for an orderly adjustment of exchange rates, which will improve the long-term balance of payments position of member countries.
6. It also provides machinery for international consultations. In fine, the Fund contributes to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all member nations. The Fund is an autonomous organisation affiliated to the UNO. IMF's constitution

represents a departure in the formation of an international organisation. It is financed by the participating countries, with each country's contribution fixed in terms of quotas according to the relative importance of its prevailing national income and international trade. Thus, the quota assigned to a country is determined by its contribution to the capital of the Fund. The quotas of all the countries taken together constitute the total financial resources of the Fund. Moreover, the contributed quota of a country determines its borrowing rights and voting strength. India being one of the largest quota-holders (600 million dollars) has the honour of having a permanent seat on the Board of Executive Directors. Each member nation of the IMF is required to subscribe its quota partly in gold and partly in its own currency. Specifically, a member nation must contribute gold equal to 25 per cent of its quota or 10 per cent of its gold stock and U.S. dollar holdings, whichever is less. The portion of subscription paid in a nation's own currency is generally paid in the form of deposit balance in favour of the IMF held in the nation's central bank. Thus, the Fund gets a pool of foreign currencies to lend, together with gold enables it to acquire additional amounts of currencies whenever its initial supply of some currencies becomes depleted. The lending operations of the Fund technically take the form of sale of currency. Any member nation running short of foreign currency may buy the required currency from the Fund, paying for it in its own currency. Since each member contributes gold to the extent of 25 per cent of its quota, the Fund freely permits a member to draw up to the amount of its gold contribution. Additional drawings are permitted only after certain careful and strict scrutinizes.

Ans. 8.

(I) Foreign exchange, or Forex, is the conversion of one country's currency into that of another. In a free economy, a country's currency is valued according to factors of supply and demand. In other words, a currency's value can be pegged to another country's currency, such as the U.S. dollar, or even to a basket of currencies. A country's currency value also may be fixed by the country's government. However, most countries float their currencies freely against those of other countries, which keeps them in constant fluctuation.

Main Factors that Influence Exchange Rates

1. Inflation

2. Interest Rates

4. Change in Competitiveness

5. Relative strength of other currencies.

6. Balance of Payments

7. Government Debt.

8. Government Intervention

9. Economic growth / **recession.**

Ans. 9.

Uruguay Round was the 8th round of multilateral trade negotiations (MTN) conducted within the framework of the General Agreement on Tariffs and Trade (GATT), spanning from 1986 to 1994 and embracing 123 countries as "contracting parties". The Round led to the creation of the World Trade Organization, with GATT remaining as an integral part of the WTO agreements. The General Agreement on Tariffs and Trade (GATT) was a multilateral agreement regulating international trade. According to its preamble, its purpose was the "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis."