UNIT 1 INTRODUCTION TO INTERNATIONAL BUSINESS ENVIRONMENT

Structure

1.0 OBJECTIVES

After going through this unit, you should be able to:

- explain the meaning, nature and relevance of international business environment
- describe the domestic, foreign and global dimensions of international business environment
- analyse geographic, economic, financial, socio-cultural, political, legal and ecological components of a foreign country's environment
- discuss implications of each components of international business environment.

1.1 INTRODUCTION

Business is defined as a set of activities relating to industry and commerce. When these activities are performed on an international level, these can be termed as international business. Basic functions, processes and techniques of international business are essentially the same as those involved in domestic business. What is different is the environment within which these functions are performed and processes are carried out. While doing business within one's own country, one is familiar with most of the environmental factors and is readily able to cope with them. But the task of managing international business is not that easy. Because of operating in environments which are unfamiliar and different from the domestic environment, one needs to be extra careful and vigilant to these environmental differences. These variations may need adaptation for business success. In this unit, you will learn the meaning, nature and relevance of the international business environment. You will further learn in detail the geographical, economic, financial, socio-cultural, legal and ecological aspects of global business environment.

1.2 CONCEPT AND RELEVANCE OF INTERNATIONAL BUSINESS ENVIRONMENT

Simply speaking, environment refers to one's milieu or surrounding. In the context of a business firm, environment can be defined as various external actors and forces that surround the firm and influence its decisions and operations. The two major characteristics of the environment as pointed out by this definition are: one these actors and forces are external to the firm, and secondly these are essentially uncontrollable. The firm can do little to change them. It has to rather learn to live with them.

1.2.1 Micro and Macro Environments

In order to gain a better understanding, let us have a look at two important classifications of environment. One classification is the micro and macro environments.

Micro environment can be defined as the actors in the firm's immediate environment which directly influence the firm's decisions and operations. These include: suppliers; various market intermediaries and service organisations such as middlemen, transporters, warehouses, advertising and marketing research agencies, business consulting firms and financial institutions; competitors, customers and general public. While the customers constitute firm's market, suppliers and market intermediaries help providing the firm with inputs and assist in production and marketing processes. Competitors and general public also influence the way a firm conducts its business.

Macro environment, on the other hand, consists of broader forces which affect the firm as well as other actors in the firm's micro environment. These include factors such as geographic, economic, financial, socio-cultural, political, legal, technological and ecological forces. Firms need to continuously monitor changes in these environmental forces and devise strategies to cope with them.

1.2.2 Domestic, Foreign and Global Environment

Another way of understanding various factors constituting international business environment is to divide the various factors into three broad groups: domestic, foreign and global environments. This classification is based on the location at which environmental actors and forces exist and operate. Look at Figure 1.1 where a schematic presentation of these three levels of environment alongwith their components has been shown.

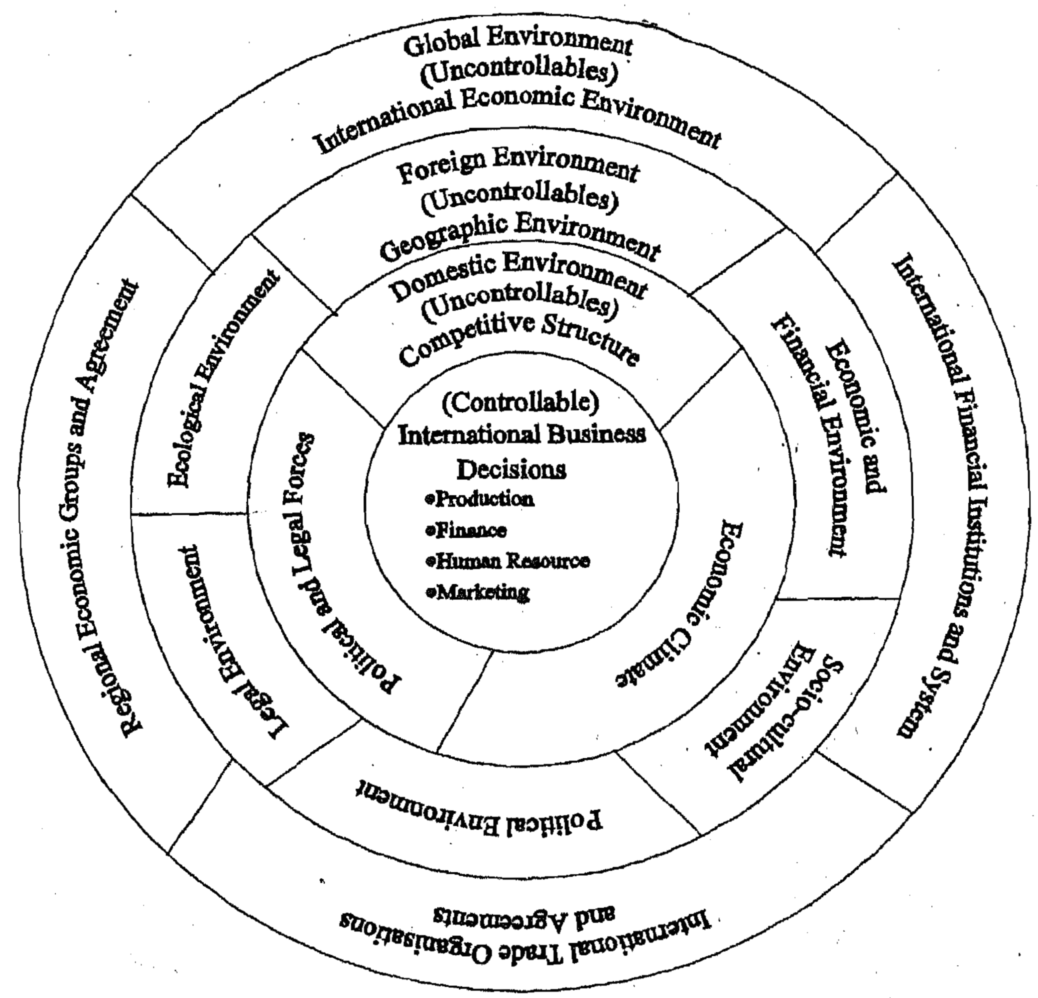
In the figure, innermost circle represents firm's business strategy and decisions with regard to production, finance, marketing, human resources and research activities. Since these strategies and decisions are made by the firm, they are called controllables. Firm can change them but within the constraints of various environmental factors.

The next circle represents **domestic environment** and it consists of factors such as competitive structure, economic climate, and political and legal forces which are essentially uncontrollable by a firm. Besides profound effect on the firm's domestic business, these factors exert influence on the firm's foreign market operations. Lack of domestic demand or intense competition in the domestic market, for instance, have prompted many Indian firms to plunge into international business. Export promotion measures and incentives in country have been other motivating factors for the firms to internationalise their business operations. Since these factors operate at the national level, firms are generally familiar with them and are able to readily react to them.

The third circle represents **foreign environment** consisting of factors like geographic and economic conditions, socio-cultural traits, political and legal forces, and technological and ecological facets prevalent in a foreign country. Because of being operative in foreign market, firms are generally not cognisant of these factors and their influence on business activities. The firm can neglect them only at the cost of losing business in the foreign markets. The problem gets more complicated with increase in number of foreign markets

in which a firm operates. Differences exist not only between domestic and foreign environments, but also among the environments prevailing in different foreign markets. Because of environmental differences, business strategies that are successful in one nation might fail miserably in other countries. Foreign market operations, therefore, require an increased sensitivity to the environmental differences and adaptation of business strategies to suit the differing market situations.

Figure 1.1 International Business Environment



The upper most circle, viz., circle four, represents the **global environment**. Global environment transcends national boundaries and is not confined in its impact to just one country. Global environment exerts influence over domestic as well as foreign countries and comprises of forces like world economic conditions, international financial system, international agreements and treaties, and regional economic groupings. World-wide economic recession; international financial liquidity or stability; working of the international organisations such as World Trade Organisation (WTO), International Monetary Fund (IMF), World Bank and the United Nations Conference on Trade and Development (UNCTAD); Agreement on Textiles and Clothing (ATC); Generalised System of Preferences (GSP); International Commodity Agreements; and initiatives taken at regional levels such as European Union (EU), North American Free Trade Association (NAFTA) and Association of South East Asian Nations (ASEAN) are some of the examples of global environmental forces having world-wide or regional influences on business operations.

1.2.3 Relevance of International Business Environment

As stated earlier, environment plays a vital role in the conduct of business operations. Especially in the context of international business, environment assumes critical importance as no two countries have similar environments and demand different business strategies to cope with differing business conditions. As the environment affects firms' strategic as well as tactical decisions, it becomes imperative for the firm to have in-depth knowledge of the domestic, foreign and global environments.

legal and political environments would be as important as the economic environment. Let us now learn these environmental components in detail.

1.4 GEOGRAPHIC ENVIRONMENT

Geography is an important component of the foreign environment and refers to a country's climate, topography, natural resources and people. Everyone engaged in international business must have some knowledge of geographic features of the foreign country as these influence the nature and characteristics of a society. It also affect demand pattern of the people living in the country. Geography is a major contributory factor to the development of business systems, trade centres and routes.

Different climatic conditions (viz., rain, snowfall, wind, temperature, humidity, etc.,) give rise to demand for different types of products. It is largely due to climatic differences that people differ in their housing, clothing, food, medical and recreational needs. Many a time needs are same, and the same products are demanded. But because of the climatic and topographic differences, products need adaptation or modifications to suit local conditions. Rolls Royce cars from England, for instance, required extensive body work and renovations in Canada because the salted sand, spread over streets to keep them passable throughout four or five months of virtually continuous snow in Canada, caused rusting and corrosion in the fenders and door panels and oil system also developed leaks.

Geographic conditions also affect a firm's plant location decision. A firm prefers to set up its manufacturing plant in a country which has favourable climatic conditions, possesses suitable topography (i.e., surface features such as hills, plains, river and sea) and where raw materials, energy and labour are cheaply and abundantly available. Foreign country's nearness to other markets and its strategic location on major trade routes are other equally important considerations.

Firms' distribution and logistic strategies are directly influenced by geographic conditions in the foreign markets. Re-order points and safety level stocks are kept generally higher for those countries or places which are not easily accessible and can be cut off suddenly and heavily due to bad weather.

Location of a country on the world map is an equally important consideration. It affects its trade prospects with other countries. Landlocked countries such as Bolivia, Zambia and Zimbabwe are not only costly to reach but are also difficult to penetrate as trading with these countries depend upon their relations with neighbouring countries through which goods have to cross.

Consumer demand for many a low priced and essential product is directly related to the number of people living in a country. It is primarily due to large populations that the countries like China and India have become the targets of the multinational corporations which are vying with one another to gain a foothold in these markets. To arrive at a correct estimate of the market size, however, one needs to take into account other factors also such as population growth, population density and population distribution by age, income, location and occupation. Taken together, these variables provide better estimates of the present and future market potentials and also help in providing information relevant for communication, distribution, product quality and pricing decisions.

1.5 ECONOMIC AND FINANCIAL ENVIRONMENT

Among all the uncontrollables, economic environment is perhaps the most important factor. An analysis of economic environment enables a firm to know how big is the market and what its nature is. Answers to these questions in turn determine whether a firm should enter a given foreign market, and if yes, what strategies it should use to successfully run its business operations. Closely related to the economic environment is the financial environment which affects a firm's capital structure,investment decisions and accounting practices.

Various dimensions one needs to consider while attempting an economic and financial analysis include : foreign country's level of economic development, income, expenditure pattern, infrastructure including financial institutions and system, inflation, foreign investment in the country, commercial policy, balance of payments account, accounting systems and practices, and integration of the foreign country's foreign exchange, money and capital markets with the rest of the world. Let us learn these economic and financial environment in detail.

1.5.1 Economic Environment

Economic environment is the most important indicator of the global market analysis. Let us discuss the major economic indicator influencing the foreign market decisions.

Economic Development: Economic development is directly related to the development of marketing in a country. Countries characterised by high levels of economic development not only have high demand for a variety of products, but also have better infrastructure and more developed marketing systems. Competition is also high in these countries. In the less developed countries, on the other hand, not only demand is low, but infrastructure is also poor. It, therefore, becomes quite difficult and more expensive to do business in such nations.

Income: Income is an important indicator of the country's level of development and also its market size. Gross national product (GNP) and per capita income are among the major measures of income. While sales of most of the industrial goods and capital equipment generally correlate with GNP, demand for consumer products depends on per capita income.

Besides income, one should acquire information about the sectoral distribution of the GNP as it is an important determinant of kinds of goods in demand in a foreign country. If the majority of a country's GNP comes from agriculture, it implies that the country is agriculture based and it shall have a good demand for agricultural inputs such as seeds, fertilisers, pesticides and agricultural machinery and tools. An industrial nation with relatively higher dependence on manufacturing, on the other hand, shall have a good market for raw materials, plant and machinery, and also for a variety of consumer durables and non-durables.

Though per capita income is a useful measure, it is not a full-proof measure of the country's development and prosperity. What is more relevant is the distribution of income. While in the developed countries income distribution is relatively more even, it is highly skewed in the developing countries. Since only a small portion of the population accounts for 60 to 70 per cent of the country's GNP and the rest are poor in the developing countries, market for high priced product and non-essential products is limited only to select rich people.

Expenditure Pattern: Data on expenditure patterns are useful in judging as to how the money is spent on different items and which products receive more weightage.

Infrastructure: Infrastructure is another vital dimension of the country's economic environment and is directly related to the country's economic development. Infrastructure refers to various social overheads such as transportation, telecommunications, commercial and financial services like advertising, marketing research, various media, warehousing, insurance, distribution, credit and banking facilities. Absence of adequate infrastructure not only hinders country's development but also affects firms' costs and capacity to reach various market segments. Companies find it difficult to co-ordinate and control their business in countries with poor communication systems.

1.5.2 Financial Environment

Sound financial position of the country coupled by the favourable investment policies reflect strong demand potential. Let us briefly learn important financial indicators.

Monetary and Fiscal Policies: Inflation, interest rate, various kinds of duties and exchange rates are the variables related to the country's monetary and fiscal policies and have a substantial impact on the costs and profitability of business operations. These variables also influence a firm's decision to move funds from one nation to another.

Commercial and Foreign Investment Policies: Each country has its own commercial and foreign investment policies which must be studied in detail to ascertain country's openness to trade and investment with other countries. A proper understanding of these policies can be quite helpful in ascertaining what tariff and non-tariff barriers the particular country uses to protect its domestic industry from foreign competition. The country may plan to minimise the incidence of these trade measures.

Balance of Payments Account: A country's balance of payments account is another major source of information about the country's foreign trade and foreign currency reserves. The current account throws light on the country's exports and imports as well as its major sources of imports and destinations of exports. Capital account reveals stocks of foreign investments, borrowings, lending and foreign exchange reserves. An international firm must be duly aware of exchange controls prevalent in the foreign countries. Countries running deficits in their balance of payment accounts generally impose controls on movement of foreign exchange into and out of their economies. These controls prompts the multinational corporations to resort to transfer pricing mechanism, i.e., overinvoicing of imports and underpricing of exports so as to move out more than permitted funds from such countries.

1.6 SOCIO-CULTURAL ENVIRONMENT

Business is as much a socio-cultural phenomenon as it is an economic activity. Per capita income in two countries may be the same, yet the consumption patterns in these countries may differ. Socio-cultural forces have considerable impact on products people consume; designs, colours and symbols they like; dresses they wear and emphasis they place on religion, work, entertainment, family and other social relations. Socio-cultural environment influences all aspects of human behaviour and is pervasive in all facets of business operations.

Culture can be defined as a "sum total of man's knowledge, beliefs, art, morals, laws, customs and any other capabilities and habits acquired by man as a member of society." It is a distinctive way of life of a group of people, their complete design of living. Culture thus refers to a man's entire social heritage — a distinctive life style of a society and its total value system which is intricately related to the consumption pattern of the people and management philosophies and practices. Look at the box which gives you insight about the socio-cultural environment.

Participative Management Style Backfires!

A production manager who had been sent to Peru from the United States was convinced that he could motivate workers to higher productivity by instituting a more democratic decision making style. He brought in trainers from the home office to teach supervisors how to solicit suggestions and feedback from the workers. Shortly after the new management style was introduced, the workers began quitting their jobs. When asked why, they replied that the new production manager and his supervisors apparently did not know what to do, and were, therefore, asking the workers for advice. Obviously, the company would not last long with that kind of management, and workers, therefore, wanted to quit before the collapse because then everyone would be hunting for a job at the same time.

The case illustrates how differences in workers' attitude toward '*authority*' can lead to serious personnel problems. Latin Americans traditionally regard a manager as a patron (master) - an authoritarian figure who has wide knowledge and experience to manage the job. American manager's participative style led them to believe that he was not knowledgeable and experienced, hence asking for suggestions.

Source: Based on Ball and McCulloch (1988).

Furthermore, within each culture there are many *subcultures* that can have business significance. For instance, in a country like United States distinct subcultures prevail in the South, North-Eastern or midwestern parts. Subcultures are found in all national cultures and failure to recognise them may create impressions of sameness which in reality may not exist. A single national and political boundary does not necessarily mean a single cultural entity. Canada, for instance, is divided between its French and English heritages, although politically the country is one. Because of such distinctive cultural division, a successful marketing strategy among the French Canadians might not effectively work among the English Canadians or vice-versa. Similarly a single personnel policy may not work with workers employed in two different plants if they belong to different subcultural groups and differ in their work habits and underlying motivations.

Elements of Culture

Some of the important elements to understand a country's culture are: language, aesthetics, education, religions and superstitions, attitudes and values, material culture, social groups and organisations, and business customs and practices.

Language: Language is an important element of culture and it is through language that most of the communications take place. An international marketer should have a thorough understanding of the language of the market — particularly the semantic differentials and idiomatic nuances which are essential characteristics of all languages of the world. Dictionary translation could be quite different from the idiomatic interpretation of a language. When literal translations are made of brand names or advertising messages from one language to another by people who know the language but not the culture, serious mistakes may occur. When General Motors of the United States literally translated its marketing phrase 'Body by Fisher' into Flemish language, it meant 'Corpse by Fisher'. Similarly, the phrase "Come alive with Pepsi" faced problems when it was translated into German advertisements as "Come out of grave" or in Chinese as "Pepsi brings your ancestors back from the grave". When the American car called 'Nova' was introduced in Puerto Rico, sales were poor until the company realised that the word Nova was pronounced as 'No va' - which literally meant in Spanish "does not go". Sales were better when the name was changed to 'Carbie'.

Aesthetics: Aesthetics pertain to a culture's sense of beauty and good taste, and is expressed in arts, drama, music, folklore, dance and the like. Aesthetics are of special interest to the international business executives for these govern the norms of beauty in a society and are helpful in correctly interpreting meanings of various methods of artistic expressions, colours, shapes, forms and symbols in a particular culture. Colours, for instance, mean different things to different people. The colour of mourning is black in the United States, but it is white in the Far East. Green is restful colour to Americans, but it is disliked by people in Malaysia where it connotes illness and death. Symbols also need to be interpreted correctly. Seven, for instance, signifies good luck in the United States but just opposite in Singapore, Ghana and Kenya. Use of number four should be avoided in Japan because it is pronounced as 'shi' which in Japanese means death. Sensitivity to the aesthetics of a society and their symbolic expressions can greatly help in avoiding socially embarrassing situations and correctly designing the products and messages.

Education: Education is generally understood as formal schooling. But it is better to adopt a broader perspective and define education as any process, formal or informal, through which one learns skills, ideas and attitudes. Education is important as it affects not only the education levels but also the development of mental faculties and various skills. In general, educated people have been found to be more sophisticated, discriminating and receptive to new products and ideas. Availability of educated manpower like skilled labour, technicians and professional is also dependent on the country's education level. Media to be used by a company for promoting its products and services are also dependent on education level prevailing in the country. The conventional forms of printed communications, for instance, do not work in countries where literacy rates are low.

Religions and Superstitions: Religions are a major determinant of moral and ethical values and influence people's attitudes, habits and outlook on life which are reflected in their work habbits and consumption patterns. Dr. Ernest Dichter observed: "In puritanical cultures, it is customary to think of cleanliness as being next to godliness. But in Catholic and Latin American countries, to fool too much with one's body to overindulge in bathing or toiletries, has the opposite meaning. It is that type of behaviour which is considered immoral and improper".

There are numerous religions and faiths in the world, with prominent ones being : Animism, Buddhism, Christianity, Hinduism, Islam and Shinto. Each one has its own morals and codes of conduct. A working knowledge of the religions prevalent in the target markets helps in understanding people's work habbits, underlying motivations and consumption behaviours.

Equally important are the superstitions of the people in a society. People's beliefs in astrology, hand reading, ghosts, lucky days and places are integral part of certain cultures. In some countries, single storey houses are preferred because it is considered bad to have another's foot on ones head. Location of a building and its architecture in many Asian countries is governed by the principles of 'vastushastra' rather than purely geographical and economic considerations.

Attitudes and Values: Besides religions and superstitions, one must be cognisant of attitudes, values and beliefs prevalent in a society. These attitudes and values may relate to consumption level, material possessions, risk taking and change. 'What is important and desirable' differs from society to society and is largely governed by the attitudes and values existing in a society. Americans in general are more receptive to change and risk taking, but people in many societies are averse to change and risk taking. They prefer doing what is traditional and safe. New products are not accepted unless these have the approval of local chiefs or religious leaders.

Material Culture: According to Ball and McCulloch, material culture refers to all man-made objects and its study is concerned with how man makes things and who makes what and why. While the question 'how' relates to technology, other questions 'who', 'what' and 'why' are part of economics.

Technology includes the ways and means applied in making of material goods. It is technical know-how in possession of the people of a society. Choice of technology has its repercussions on the size of investment, scale of operations as well as type and number of workers to be employed. Technology transfer has been a highly controversial issue in the past. Because of supply of obsolete or inappropriate technology, many developing countries have laid down stringent rules and regulations concerning technology imports and payments. Since transfer of new technology is often riddled with workers' resistance to change and public criticisms, multinational corporations are advised to have suitable action plans to counter such opposition.

Economic aspects of material culture, i.e., who, what and why, have already been discussed in Sub-section 1.5.1. It is suffice to say here that these elements influence the level of demand as well as types and quality of goods in demand, and consumption pattern in a society.

Business implications of material culture of a society are obviously many. The goods and services that are acceptable in one market may not be acceptable in another market because of differences in material cultures of two societies. For example, sophisticated electronic appliances widely in demand in the technologically and economically advanced Western countries may not find a market in the less developed countries of Asia, Africa or Latin America.

Social Groups and Organisations: A study of social groups and organisations is important as it determines how people relate to one another and organise their activities. The size and cohesiveness of the family, role of men and women in society, and positions of different social classes differ from country to country. Social groups and organisations mould the pattern of living and interpersonal relationships of people in a society. They influence the

behavioural norms, codes of social conduct, value systems, etc., that may be of relevance to the international business managers in their decision making.

Business Customs and Practices: A familiarity with business customs and practices prevalent in different countries is a must to avoid business blunders. An international business manager must have necessary knowledge about how business is conducted and what importance business people in a foreign country attach to work, time, formality, change and achievement. American managers, for instance, are by nature highly work oriented and attach upmost importance to speed and punctuality in business dealings. They are, moreover, highly achievement oriented and fond of new things. But people in other parts of the world do not share these values and beliefs. Japanese, for instance, are also workaholics but they are very slow in decision making. Latin Americans too do not believe in haste and spend considerable time in socialising and developing friendships before coming to business transactions.

A person dealing with people from different cultures should be well aware of differences in the number and nature of stages involved in business negotiations and formalities to be observed in concluding business contracts. While in countries like the United States it is necessary to have final agreement in writing, this practice is not much appreciated in many West Asian countries where oral agreement alone is considered more than sufficient.

Check Your Progress B

1. What is economic environment?

....

....

....

....

2. Distinguish between Current Account and Capital Account.

....

....

....

....

3. Enumerate four elements of culture.

....

....

....

....

4. What is material culture?

....

....

....

....

5. State whether following statements are **True** or **False**.
   i) Different climatic conditions give rise to demand for different types of products.
   ii) Demand for consumer products depends on Gross National Products.
   iii) Per capita income is a fullproof measure of the country's development and prosperity.
   iv) Countries running deficits in their balance of payment accounts generally impose controls on movement of foreign exchange into and out of their economies.
   v) Green connotes illness and death in America.

1.7 POLITICAL ENVIRONMENT

It is rightly said that a foreign business firm operates only as a guest and at the convenience of the host country government. The government reserves the right of allowing a foreign firm to operate in the country as well as laying down the manner in which a foreign firm can conduct business. To gain an insight into a foreign country's political environment, one needs to analyse factors such as current form of government and political party system, role of government in the economy, political encouragement to foreign firms, political stability, and political risks to business.

Form of Government and Political Party System: Government in a foreign country can be either parliamentary or absolutist. While the parliamentary type of government is run by people's representatives selected from time to time, the absolutist government assumes the form of absolute monarchies or dictatorships, and only a select few make policies. In the case of parliamentary government, one needs to know whether it is a single party system or multiparty government system. Single party government is considered to be more stable than the multiparty government.

Political Ideology and Role of Government: Besides political party system, one must have knowledge about the political ideology and government attitudes toward foreign business and investment. In addition to regulatory role, government itself can be directly involved in business. In such cases, government enterprises emerge as dominant players in the market and pose tough competition to the foreign firms. Even supplying goods and services to the government agencies is not hassle free. Because of monopsonic power of the government organisations, it becomes quite arduous to negotiate prices and other terms with them.

Political Stability: Stability of the government and government policies are a major concern for the international firm. Since business decisions, these days involve huge investments and are irreversible, what the foreign firms look in for is politically stable countries. Political instability can result from either change in the type of government, a shift in political parties that form the government or change in the government policies without change in the government or shifts in political parties.

Political Risk: Political risk which is defined as the vulnerability of a project to the political acts of a sovereign government is a big threat to foreign business. The political acts leading to political risks can range from confiscation, expropriation, nationalisation, domestication to restrictions on transfer of funds. **Confiscation** occurs when a foreign investment is taken over by a government without any compensation. **Expropriation** takes place when the government takes over foreign investment but some compensation is paid. The compensation may or may not equate with the market value of a firm. **Nationalisation** affects the entire industry rather than a single company, and involves transferring ownership of the confiscated or expropriated business to a national firm or government entity.

Domestication is a mild form of intervention and involves transfer of control of foreign investment to national ownership to bring the firm's activities in line with national interest. It differs from expropriation in the sense that it is gradual encroachment of the freedom of operation of a foreign operator. Domestication can be either firm initiated, government

initiated or predetermined. Whereas firm initiated and predetermined domestication entail low levels of risk, government initiated domestication is quite risky and is ranked with expropriation.

Another type of risk relates to a temporary or permanent blocking of funds. Unlike other kinds of risks, a business firm under blockage of funds owns the funds and property rights but it cannot remit the funds or earnings back to home country. This was a common problem faced by Indians during Amin's rule in Uganda. Although the government did not formally make any announcements regarding takeover of property, it became almost impossible for the firms to repatriate their earnings in any form. No doubt black money market operations may exist in any country, it is difficult for such operations to handle large scale of funds involved.

International firms need a proactive approach to deal with political risks. An effective management of risks calls for recognising the existence of various kinds of political types of risks and their consequences, and developing appropriate plans and policies to deal with such risks.

1.8 LEGAL ENVIRONMENT

Every business firm operates within the jurisdiction of legal system. This is true of domestic as well as international firms. But the problem for the international firms is that the laws that they face in their home countries might be different from those encountered in the host countries. Advertising laws in West Germany, for instance, are so strict that is best advised for the international marketer to get himself good legal counsel before framing his advertising strategy in West Germany. Similarly there exist laws in European countries preventing promotion of products through price discounting. These laws are based on the premise that such practices differentiate buyers.

Different laws exist not only in the area of marketing mix variables but also for other business decisions like location of plant, level of production, employment of people, raising money from the market, accounting and taxation, property rights including immovable property and patent and trade marks, cancellation of agreements.

Besides directly influencing firm's business operations, laws affect the environment within which a firm operates in the foreign country. Thus while one country may promote competition within its markets through its legal system, another country might try to protect its industry and thereby restrain competition. In the United States, for instance, anti-trust legislation influences all mergers, take-overs, and business practices which are in restraint of trade. Court's verdicts in this respect are governed by paragraph one of Sherman Act. Gillette, for example, was prevented from taking over Braun A.G. of West Germany which was an electric razor manufacturer on the grounds that it would distort competition.

A major problem with laws in different countries is that the legal systems of the world are not harmonised and are in fact based on contradicting legal philosophies. The legal systems that exist in different countries of the world are antecedents of one of the two legal philosophies ,viz., common law and code law. **Common law** finds it roots in Britain and is practised today in the United States, United Kingdom and Canada. The basis of common law is tradition, past practices and past rulings of higher courts who look upon similar problems within the accepted set of laws. **Code law**, on the other hand, is based on Roman law and is an all inclusive system of written rules that encompass all eventualities. One important business implication of the two legal philosophies is that the judgements awarded in the case of a commercial dispute can be radically different. To illustrate, let us take the interpretation of non-fulfilment of required conditions of a contract under 'act of god'. What constitutes an 'act of god' in code law is not necessarily the same under common law. Thus while strike by workers may be looked upon as an 'act of god' in code law, it will definitely not be a reason for non-fulfilment of the contract under the common law.

In last few decades, efforts have been made to evolve international laws. International laws deal with upholding orders. Originally these laws recognised only nations as entities, but today these laws also incorporate role played by individuals. International laws may be defined as a set of rules and regulations which the nations consider binding upon themselves. This definition brings out two important characteristics of international law. One there is absence of the existence of a comprehensive legal system. There is truly no comprehensive body of law because as stated earlier international commercial law is of recent birth. This has had a direct bearing upon the existing administering authorities. As of today, there are only a few international bodies for administering justice. These include International Court of Justice founded in 1946 and the World Court at Hague. Second characteristic of the international law relates to the fact that no nation can be forced into these rules as stated in the phrase 'consider binding upon them'. Since all nations recognise the sovereignty of the legal systems, international judgements are, therefore, based on the premise of good humanity and not on the basis of any particular country's legal system.

In the absence of laws having jurisdiction over sovereign countries, a major problem faced by the international business firms is which country's laws, viz., host country's or home country's or third country's laws, shall be binding in the case of a dispute. Firms also need to be aware of different modes of the settlement of trade disputes and role of International Chamber of Commerce' Court of Arbitration.

Because the field of international law is wide, in this sub-section we have made only an attempt to highlight some of the major legal issues. A detailed discussion of various legal aspects is provided in Units 14 to 16.

1.9 ECOLOGICAL ENVIRONMENT

Ecology refers to the pattern and balance of relationships between plants, animals, people and their environment. Earlier there was hardly any concern for the depletion of resources and pollution of the environment. Smoke stemming from the chimneys and the dust and grime associated with factories were accepted as a necessary price to be paid for the development. But in recent years, the magnitude and nature of the 'pollution overload' have assumed such alarming proportions that pressures have built up all over the world to do something urgently lest the situation gets out of control. In almost all the countries, there exist today legislations and codes of conduct to preserve the earth's scarce resources and put a halt to any further deterioration in the environment. Business operations of the international firms are no exceptions and have been brought under such regulations. Very recently, the United States government imposed a ban on exports of marine products from countries including India which did not have special devices fitted into fishing trawlers to free the tortoises trapped during fishing expeditions. Similarly, restrictions have been put on garment exports using cloth processed through the use of AZO dyes. Germany today is perhaps the country with most stringent environmental laws in the world.

The concept of industrial progress and development has also undergone paradigm shifts. Corporations today are judged in terms of not only financial returns, but also conservation of environmental resources and reduction in pollution levels. Green technologies, green products and green companies are highly valued in today's global market place.

Check Your Progress C

1. What is political instability?

....

....

....

....

2. Distinguish between confiscation and expropriation.

....

....

....

....

3. What do you mean by domestication?

....

....

....

....

4. What is international law?

....

....

....

....

5. State whether following statements are **True** or **False**.
   i) The absolutist government assumes the form of absolute monarchies or dictatorship.
   ii) Government initiated domestication is not risky.
   iii) Advertising laws are very strict in West Germany.
   iv) In the United States, anti-trust legislation influences all mergers, take-overs and business practices which are in restraint of trade.
   v) Germany has relaxed environmental laws.

1.10 LET US SUM UP

A major difference between domestic and international business is the environment within which business is conducted. While doing business within one's own country, one is familiar with the prevailing environment and is readily able to adjust to it. But problem with doing business in foreign countries is that environments in foreign countries are different and also unfamiliar to a business firm. Because of environmental differences, strategies a firm uses in the home country might not be appropriate in the foreign countries. One, therefore, needs to be extra careful in identifying various environmental forces operating at the home country, host country and global levels; and should examine their influence on production, personnel, financial and marketing operations of the firm. The major foreign environment to be analysed include; geographical, economic, financial, socio-cultural, political, legal and ecological.

1.11 KEY WORDS

Business environment: Various external actors and forces that surround a business firm and influence its decisions and operations.

Micro environment: Actors in the firm's immediate environment such as suppliers, various marketing intermediaries, services organisations, competitors and customers which directly influence a firm's decisions and operations.

Macro environment: Broader geographic, economic, financial, socio-cultural, political, legal and ecological forces in the firm's environment which affect the firm as well as other actors in the firm's micro environment. These forces can operate at the home (i.e.,domestic) country, host (i.e., foreign) country and global levels.

Geographic environment: It refers to a country's climatic conditions; topographic features like size, location, hills, rivers and access to sea; natural resources and people.

Economic and financial environment: It pertains to country's economic and financial features such as level of economic development, income, pattern of expenditure, infrastructure, inflation, commercial and foreign investment policies, monetary and fiscal systems, accounting systems and balance of payments account.

Cultural Environment: Culture is defined as the sum total of man's knowledge, beliefs, art, morals, laws, customs and any other capabilities and habbits acquired by man as a member of the society.

Political risks: Political risks refer to vulnerability of a project to the political acts of a sovereign government.

Ecology : It refers to pattern and balance of relationships between plants, animals, people and their environment.

1.12 ANSWERS TO CHECK YOUR PROGRESS

A 5 i) True; ii) False; iii) False; iv) False; v) True.

B 5 i) True; ii) False; iii) False; iv) True; v) False.

1.13 TERMINAL QUESTIONS

1. Define international business environment. Also differentiate between micro and macro environments.
2. How does the home country environment influence foreign business operations of a firm? Explain.
3. How economic environment affect the business decision of a firm?
4. Discuss important elements of culture and their impact on a firm's international business operations.
5. What is political risk? What are the major types of political risks? Discuss.
6. Why should an international business firm monitor the foreign country's trade, monetary and balance of payments account?

UNIT 2 THEORIES OF INTERNATIONAL TRADE

Structure

2.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the pattern of trade between two countries
- discuss how international trade is mutually beneficial to the trading countries
- explain the classical theory of trade
- describe the neo-classical theories of trade
- describe the modern theory of trade.

2.1 INTRODUCTION

Foreign trade has recently, and particularly after 1991, become an important as well as debatable issue for the Indian economy. The Union budget presented in 1991 introduced a wide range of economic policy reforms related with industry and trade, ushering in an era of economic liberalism in the Indian economy. These reforms were designed to transform a closed and inward-looking economy into an open and outward-looking one by lifting controls on import and export of goods and services and by making rupee convertible. In the years that followed, our trade and industrial production have been growing at fairly high rates. There is no doubt that the liberal approach to economic policy will continue and the previous bias against international trade and investment will remain subdued in the foreseeable future. In this new economic environment the teaching of economics will develop a serious gap if the students are not made aware of the basic principles and concepts of international trade. In this unit, you will learn the concept of absolute and comparative advantage, gains from trade, terms of trade and various theories of internationa trade.