**UNIT – III**

**WORLD FINANCIAL ENVIRONMENT:**

The focus of global financial stability risks has been shifting to emerging market economies and their potential to contribute to destabilizing adjustments in financial markets. Volatility has picked up in global financial markets, following a lengthy period of very low volatility and compressed risk premia. Concerns about the prospects for economic growth in China, against the backdrop of a significant run-up in debt in recent years, helped trigger the downward revaluation of global equity prices and higher financial market volatility. These concerns weighed on investors' expectations for growth in a number of emerging market economies, particularly commodity exporters given lower commodity prices. Higher debt, fiscal pressure and political instability have been compounding factors for some emerging markets. With the first US Federal Reserve policy interest rate increase since 2006 in prospect in the period ahead, the risk remains that this combination of factors could trigger a sharp reprising in markets where for several years investors have been searching for yield. Recent price movements in some financial markets, including in advanced economies, have, on occasion, been amplified by short periods of market dislocation, underlining concerns that liquidity risk might be underpriced by some investors.

The global banking sector has continued to improve its resilience, which should help mitigate the risks to broader financial system stability arising from these developments. In the major advanced economies, bank profitability has been supported by further improvements in asset quality, particularly in the United States. In the euro area, near-term concerns about Greece have abated following the rescue package agreement reached in August. Gradual improvements in economic conditions in most euro area economies have supported bank profits, although there continues to be slow progress in reducing the large stock of non-performing loans. Key banking indicators in emerging markets have generally remained sound to date, including in more vulnerable markets; however, some banking systems face very challenging operating environments, which could entail a future weakening of asset performance.

## Emerging Market and Non-Japan Asia Financial Systems

### China

China has been an engine of growth for Australia and the world in the post-crisis period, yet financial stability risks have been building. Credit grew rapidly alongside strong asset price growth and there was apparent over-investment in some sectors of the Chinese economy such as real estate and heavy industry.

Debt provision spilled beyond the heavily regulated banking system to the more opaque shadow banking sector. If economic growth continues to slow from the very strong pace in recent years, any past excesses may be exposed.

Risks in China are particularly prominent for highly leveraged firms, including some firms in the oil and gas industries that are exposed to a decline in energy prices and construction firms that have raised significant foreign currency denominated bond funding in recent years. Similarly, many local governments have large debts, and land sales account for a sizeable share of their revenues. Links between the formal banking sector and the shadow banking sector could be another channel for risks to emerge and amplify a macroeconomic downturn.

Policy challenges from the heavily controlled financial system in China have become more evident, highlighting the difficulty the authorities face in promoting financial liberalization while supporting financial stability and economic growth. Recent developments in the Chinese stock market associated with leveraged investors, and the measures adopted to address them, provide an example of such challenges. Chinese equity prices have fallen by around 35 per cent from their June 2015 peak, after rising by 150 per cent over the previous year. Initial price falls were contained by a range of policy actions by the Chinese authorities, which included direct purchases of shares. Price falls continued as policymakers reportedly stepped back from these efforts, though prices have been more stable in recent weeks.

The policy challenges facing the Chinese authorities were further underscored by the volatility in international financial markets that followed the People's Bank of China's announcement of reforms to make the renminbi (RMB) exchange rate more market determined. While this policy is likely to be beneficial for macroeconomic stability, the reform's announcement prompted widespread concern about the potential for further depreciation of the RMB and added to near-term pessimism over Chinese economic conditions and private capital outflows.

Since the previous Review, the Chinese authorities have continued to implement a range of measures to ameliorate financial risks and reduce some market restrictions. For example, a debt swap program has allowed local governments to use lower-yield bonds to refinance existing borrowings raised off-balance sheet via financing vehicles. A range of measures have also been implemented to address other distortions that have encouraged growth of the shadow banking sector. Official data suggest that these measures – which include restricting banks' interbank investments, further liberalizing interest rates and insuring bank deposits – have helped slow growth in off-balance sheet lending in China.

Despite ongoing policy challenges, the Chinese authorities have supported growth and financial stability to date, and in many ways remain well placed to continue to do so. They have many levers given the ongoing large role of the state in the economy and the heavily regulated financial system. Capital account controls limit the potential for pressure to arise from foreign creditors, and foreign exchange reserves are large, despite falls in recent months. The measured central government fiscal position is also very strong, though the overall public sector fiscal position is considerably less so given the build-up in debt among local governments and state-owned enterprises.

The main financial risks to the rest of the world from an economic downturn in China are likely to be indirect, through the implications for world trade volumes, commodity markets and the associated effect on sentiment in financial markets. Direct financial links are much less significant because China's capital account is still relatively closed. That said, there are growing direct financial linkages with the rest of the world that could reverberate in particular jurisdictions in the event of difficulties in China: these include large exposures to China by banks located in Hong Kong and Chinese banks' lending overseas, particularly if overseas lending by other Asian banks were to slow as well.

### Banking system in China

The profitability of Chinese banks continued to decline in the first half of 2015, though the banks reportedly remain highly profitable overall. State-owned and joint stock commercial banks, which account for 60 per cent of banking system assets, continued to be more profitable than many smaller Chinese commercial banks. The moderate decline in aggregate profitability reflected lower growth in both net interest income and non-interest income, as well as increased provision expenses. The outlook for profitability remains pressured by expectations of a further deterioration in banks' asset quality in conjunction with slower rates of credit growth and the potential for net interest margins to narrow if the liberalizations of interest rates increases price competition for funding.

Though Chinese banks continue to report low non-performing loan (NPL) ratios, these ratios and associated loan-loss expenses have risen as economic growth has slowed. Loans to the manufacturing and the wholesale & retail trade sectors have primarily driven these increases; loans to these sectors appear to be less well collateralized than other categories of lending.

Several factors have raised concerns that Chinese banks' asset quality could deteriorate more markedly: existing corporate leverage is high and there are signs that economic activity has slowed further recently. In addition, the share of loans classified as ‘special mention’ – where there are some doubts surrounding repayment but loss is not yet expected – has picked up. A sizeable share of bank lending is to the construction industry. Relevant to collateral values in this segment, national property prices in the residential property market have risen in recent months, primarily in the largest cities, which has partly unwound earlier declines. The pace of annual growth in land prices slowed through 2014, but has shown signs of improvement over 2015.

Large Chinese banks' capital ratios increased marginally during the six months to June 2015, supported by preference share offerings by two of the large banks. Large Chinese banks' Common Equity Tier 1 (CET1) capital ratios also increased over the half year and currently range between 9.2 and 12.2 per cent of risk-weighted assets, compared to the end-2015 transitional CET1 regulatory minimum of 7.3 per cent and global systemically important bank (G-SIB) surcharge of 1 per cent (where applicable). The aggregate CET1 capital ratio for the broader banking system was stable at 10.5 per cent over the half year. As of June 2015, each of the five largest Chinese banks was reported to be compliant with the Liquidity Coverage Ratio on a fully phased-in basis.

### Other emerging market and non-Japan Asia financial systems:

For emerging markets more broadly, capital inflows have been strong in the years following the global financial crisis, supported by low interest rates in the advanced economies, relatively strong economic growth and high commodity prices.  However, portfolio capital inflows have slowed significantly and appear to have reversed for some economies more recently. This has occurred alongside interrelated concerns about economic growth prospects in China, weaker domestic growth outlooks, commodity price falls and expectations that the US Federal Reserve would soon increase its policy interest rate for the first time since 2006.

These developments have been reflected in sharp depreciations of several emerging market currencies, especially for economies that are reliant on commodity exports and/or where there is political instability, such as Brazil, Russia and Turkey. Equity prices have generally fallen in these economies, and for some corporate bond spreads have widened significantly.

The shift in capital flows and lower economic growth expectations have raised concerns about vulnerabilities associated with emerging market corporate sector leverage, which has increased significantly in some economies since the financial crisis. While most emerging market corporate debt has continued to be intermediated by banks, corporations have increasingly sourced funding directly from markets, partly because financing conditions in global markets have been so favorable in recent years. This pattern reversed in the September quarter, when corporate bond issuance dropped sharply across most emerging markets.

Some of the increase in emerging market corporate borrowing in recent years reflects financial deepening in these economies and available evidence suggests currency and rollover risks – which have been associated with past financial crises – may be low in aggregate. While bond issuance by emerging market corporations has increased – especially in Asia – the ratio of foreign currency bond issuance to nominal GDP has been broadly stable. In addition, an increasing share of debt funding has been raised via long-term bond issuance, which may have lengthened aggregate maturity profiles and reduced rollover risk.

Nevertheless, corporations in some sectors – such as construction and energy – and in some countries – such as Brazil, India, Indonesia and Turkey – have increased their foreign currency borrowings in recent years. Depending on whether and how they hedged, the profits of some corporations might come under pressure because of domestic currency depreciations and slower economic growth. More generally, increased exposures of advanced economy investors to emerging market corporations and sovereigns in recent years may be a channel through which financial stresses in emerging markets spill over to advanced economies.

In the low-yield environment, residential property prices have appreciated considerably over recent years in a number of economies, including Brazil, Malaysia and Taiwan. More recently, however, price growth has moderated in these economies. Housing prices in Hong Kong have risen especially quickly, partly as a result of the accommodative monetary policy setting associated with its fixed exchange rate system. In response to a further increase in prices – particularly for residential apartments – and a historically high household debt-to-GDP ratio, the Hong Kong Monetary Authority tightened macro prudential policies in February. While growth in loan approvals has decelerated somewhat since these measures were implemented, housing price growth remains rapid.

### Banking systems in other emerging and non-Japan Asia markets

Weaker economic growth and the build-up in debt imply that banking systems in emerging markets face a more challenging near-term operating environment, but key banking indicators remained sound in the first half of 2015 even across the more vulnerable emerging markets, such as Brazil and Turkey. Russian banks continue to be pressured by a combination of rouble depreciation, contracting economic activity, economic sanctions and rising NPLs.

Key banking indicators in East Asian economies generally remained sound in the first half of 2015. Most large banks in the region remained highly profitable, despite some moderation in the profitability of banks in Indonesia, Malaysia and Thailand associated with increased loan-loss expenses and slower growth in net interest income. Korean banking system profitability continued to recover in the six months to June 2015 following significant losses for some banks in 2013, but remains pressured by lower non-interest income and higher provisioning expenses than east Asian peers. All banking systems in Asia continue to report low aggregate NPL ratios, and aggregate capital ratios are well above regulatory minimums.

## Advanced Economy Financial Systems

Since the previous Review, heightened concerns about growth in China and other emerging market economies has led to a broad reassessment of risk in financial markets, causing a moderate tightening in financial conditions in the advanced economies. In advanced economy equity markets, where valuations had been relatively high by historical standards, prices are around 10–15 per cent lower than their recent peaks. Similarly, corporate bond spreads have widened to be around historical averages, with spreads widening further for lower-rated bonds.

Monetary conditions in the major advanced economies are expected to be very accommodative for some time, even though economic conditions in these economies have generally improved and the US Federal Reserve is expected to start raising its policy interest rate in the period ahead. For example, sovereign bond yields remain around historically low levels, though they have increased slightly since the previous Review. Thus, although investors appear to have become more discerning about risk, search for yield behaviour continues to be supported by accommodative monetary policy and is evident in a range of asset markets where prices remain elevated.

Low interest rates support economic growth and economic risk taking but, if persistent, can encourage investors to increase financial risks in an attempt to maintain expected nominal returns. For example, term premia in US Treasury securities are estimated to have fallen to be around zero, indicating that investors are receiving minimal compensation for bearing the risk that interest rates do not evolve as expected – which is larger for a given maturity when yields are low. Low yields can be particularly challenging for insurance firms and defined benefit pension plans, which typically rely on financial asset returns to meet their long-term liabilities.

The low-yield environment has been reflected in buoyant activity in a range of markets. Commercial real estate prices have increased in a number of countries in recent years to be near or above pre-crisis peaks, and credit standards appear to have eased for commercial property lending in the United States. Residential real estate prices have also increased in many advanced economies over recent years, such as Germany, Sweden and the United Kingdom. Corporate bond issuance in major advanced economies has also remained solid in the period since the previous Review, including for sub-investment grade issuers. A significant share of proceeds appears to have been used to fund mergers and acquisitions and share buybacks, rather than new investments.

The strong pace of bond issuance reflects the growing importance of financial intermediation through markets and asset managers, rather than banks, in the post-crisis period as banks' business models and the regulatory environment in which they operate have changed. This has focused attention on the potential for a sell-off in bond markets to have disruptive effects on the broader economy, possibly exacerbated by rapid redemptions by bond fund investors and a structural decline in bond market liquidity in recent years.

The structural decline in bond market liquidity is mostly attributable to reduced market-making activities by banks, and is reflected in a range of indicators including the declining share of trading assets on the balance sheets of the G-SIBs. The decline in market making by banks reflects regulations that were designed to shift some risks from banks to end investors, as well as changes in financial institutions' own risk preferences. Both of these factors are expected to add to overall financial system resilience.

While equity market volatility picked up in recent months, bond markets were relatively stable, even as outflows accelerated from some bond funds. However, concerns persist about broader market resilience to large shocks. Challenges in equity markets on 24 August, and prior episodes of bond market turbulence, such as the ‘flash rally’ in US Treasuries on 15 October 2014, have shown that the implications of developments such as growth in exchange-traded funds and algorithmic trading may not be fully understood.

In the euro area, immediate concerns associated with Greece were allayed when agreement over a third bail-out package was reached. In contrast to the situation in 2011, market reactions to uncertainty prior to the agreement were muted. For example, Greek sovereign bond spreads rose but widening in other peripheral European sovereign bond spreads was limited relative to what was observed during previous episodes. This reflected a number of factors that have reduced channels for contagion including significantly lower private-sector exposures to Greece, increased support from the European Central Bank (ECB), and further advances in the European framework for financial regulation.

Nevertheless, longer-term challenges to the Greek Government and banking system remain, and deposit withdrawals and international transfers continue to be restricted. It is unclear if Greece can implement all of the extensive commitments in the agreement or what their economic impacts might be; a slow recovery would exacerbate vulnerabilities in the banking system and reduce the Greek Government's ability to reduce its debt to a more sustainable level. Greek banks remain burdened by a large volume of NPLs, are undercapitalized and continue to be reliant on Emergency Liquidity Assistance funding from the ECB. Up to €25 billion of the €86 billion rescue package has been earmarked for Greek bank resolution and recapitalization, which will include the bail-in of senior bondholders. The recapitalization of Greek banks is likely to occur before year-end, after the conclusion of asset quality reviews and stress tests in October, but before the Single Resolution Mechanism becomes fully operational on 1 January 2016.

Although broader euro area financial market contagion from recent developments in Greece was limited, if difficulties were to again arise, confidence in the euro area could be undermined and risk in financial markets reassessed more broadly. More generally, the euro area remains susceptible to financial stress because the gradual economic recovery and low inflation continue to weigh on bank profits and the debt-servicing capacity of highly indebted sovereigns.

### Bank profitability

Profitability of the major banking systems increased somewhat in the six months to June, primarily in the United States and the euro area where profits were supported by improving asset quality and stronger credit growth; profitability was generally stable in other banking systems. Returns on equity remain below pre-crisis levels in most countries, however, because equity funding has increased and returns on assets are lower. Returns on assets have been weighed down by factors including compressed net interest margins associated with low interest rates and flat yield curves, litigation expenses and, mainly for some euro area banks, stubbornly high levels of NPLs. These factors continue to dampen the outlook for bank profitability, which is reflected in low share price to book value ratios. Bank share prices have fallen in the major advanced economies since the previous Review, generally in line with, or by less than, broader equity price falls.

### Asset performance and exposures

NPLs continue to vary widely across jurisdictions and are a factor explaining some of the variation in bank profitability and valuations. For most jurisdictions outside the euro area, loan-loss provisions amongst large banks have returned to be around pre-crisis levels. The decline in provisions has been associated with improving asset performance, with NPL ratios continuing to decline over the first half of 2015. However, these ratios remain above pre-crisis levels in most jurisdictions.

In the United States, further declines in NPL ratios for residential real estate loans continued to underpin asset quality improvements, which have been supported by better economic conditions and a small pick-up in credit growth. NPL ratios continued to fall in the euro area – most notably in Ireland and Spain – but remain high in most euro area countries compared with both pre-crisis levels and relative to other banking systems. The aggregate NPL ratio in the United Kingdom has declined to be at its lowest level since 2008, though the pace of improvement has slowed more recently.

Some international banks have significant exposures to emerging markets. As a proportion of global consolidated assets, banks headquartered in the United Kingdom have the largest exposures to Asia, most notably to China and Hong Kong. Japanese banks also have large exposures to this region and have been actively expanding their overseas activities recently. Exposures to emerging markets outside of Asia are generally smaller.

As discussed in the previous Review, banks in the advanced economies do not appear to have large direct exposures to the energy sector and commodity producers, so their profitability seems unlikely to be adversely affected by the falls in commodity prices. Nonetheless, lower commodity prices could indirectly reduce bank profitability in commodity-exporting economies if economic growth were to slow in these countries. Some banks in the United States and Canada are reported to have undertaken actions to mitigate the risk of losses associated with loans to oil and natural gas producers, including reducing credit lines, tightening credit standards and restructuring existing loans.

### Capital

The majority of large banks in the advanced economies increased their CET1 ratios over the first half of 2015. This was mainly achieved through an increase in retained earnings, though a modest increase in CET1 issuance and a fall in risk-weighted assets in the United Kingdom also contributed. All of the G-SIBs that report fully phased-in Basel III CET1 ratios continued to exceed the minimum Basel III targets including the capital conservation buffer and G-SIB surcharge, even though full phase-in does not occur until 2019. Issuance of Additional Tier 1 (AT1) and Tier 2 capital declined somewhat over the first half of 2015, although this followed very strong issuance in the second half of 2014; under Basel III, banks have been required to report non-risk weighted leverage ratios since 1 January 2015, which can be met with CET1 or AT1 capital. Most G-SIBs in the major advanced economies report leverage ratios that are either close to meeting, or exceed, the fully phased-in Basel III and supplementary requirements.

### Funding and liquidity

Bank funding conditions generally remained favorable in the first half of 2015, despite a modest widening in bond spreads and increased deposit competition in the euro area. The volume of bank bond issuance has slowed somewhat, with maturities continuing to exceed issuance in the euro area; in the major banking systems, balance sheets continue to be increasingly funded with deposits and, to a lesser extent, equity.

The phase-in of the Liquidity Coverage Ratio (LCR) commenced in most of the major banking systems during 2015. The LCR requires banks to hold a sufficient amount of high-quality liquid assets to cover expected net cash outflows over a 30-day stress period. Banks have generally been active in positioning their balance sheets to meet the new liquidity requirements ahead of regulatory deadlines; most G-SIBs in the major advanced economies already report LCRs that exceed the fully phased-in Basel III requirements. As discussed in previous Reviews, some banks have achieved this, in part, by reducing deposits of large institutional customers, which are treated less favorably under the new liquidity requirements.

### Credit conditions and lending standards

Lending standards in some of the major advanced economies continued to ease in the first half of 2015, with banks citing increased competition as the primary driver. Across the major markets, improving economic conditions and accommodative monetary policies, in conjunction with easier lending standards, have supported moderate increases in loan demand and credit growth. Lending surveys in the United States, euro area and Japan noted in particular further easing’s in household lending standards.

Though growth in domestic bank lending has recently picked up in Japan, overseas lending continues to be the key driver of the expansion of the large Japanese banks' loan portfolios. The Bank of Japan has continued to highlight foreign currency liquidity risk arising from Japanese banks' overseas operations – a significant proportion of foreign currency lending is funded via short-term money markets – as well as increased interest rate risk mainly associated with Japanese banks' accumulation of euro-denominated bonds with long maturities.

In the United Kingdom, buy-to-let (investor) mortgage lending has continued to grow more rapidly than lending to owner-occupiers. With little available evidence that underwriting standards of major UK lenders have fallen, the Bank of England's Financial Policy Committee (FPC) has judged that there is no immediate case for additional prudential measures specifically for the buy-to-let mortgage market. However, the FPC has said that it remains alert to the potential risks that the sector could pose to broader UK financial stability, both through credit risk to banks and the potential amplification of movements in housing prices, especially given already high levels of household debt. The FPC was granted Powers of Direction over mortgage lending for owner-occupied properties earlier in 2015 and HM Treasury is expected to consult on FPC Powers of Direction for buy-to-let lending later in 2015.

### New Zealand

Australia's major banks have significant operations in New Zealand, making its banking system of particular interest. The housing and dairy sectors continue to be key areas of focus for New Zealand financial stability.

For some time, the Reserve Bank of New Zealand (RBNZ) has been concerned about rapid housing price inflation given already elevated levels of mortgage debt relative to household income. While housing price inflation slowed significantly following the implementation of restrictions on high loan-to-value ratio (LVR) lending in late 2013 and increases in the official cash rate in 2014, house price growth in Auckland has subsequently picked up sharply. The RBNZ attributes this to ongoing supply constraints, increased demand driven by high net immigration, stronger investor participation and low mortgage interest rates; the RBNZ has cut interest rates by a cumulative 75 basis points in the period since the previous Review. In May, the RBNZ announced that most mortgages on investment properties in the Auckland Council area will soon be required to have maximum LVRs of 70 per cent. Banks will also be expected to hold additional capital against all investor housing loans in New Zealand. The stated aims of these policies are to moderate the cyclical role of residential investors in the Auckland housing market and to strengthen the resilience of banks against any future housing market downturn.

The RBNZ has also raised concerns about the fall in dairy incomes associated with lower international milk prices. The dairy sector is both important to the New Zealand economy and highly indebted. Lending to the dairy sector accounts for around 10 per cent of New Zealand bank lending, with around half of all dairy sector debt held by one-tenth of dairy farmers. International milk prices have fallen by around 50 per cent since their 2013 peak and are below the estimated industry average break-even point. The RBNZ estimates that one quarter of New Zealand dairy farmers had negative cash flow in the 2014–15 season. To date, dairy land prices have held up, but a scenario where both agricultural land prices and income are falling would place highly leveraged farmers under significant pressure.

**Cross-national Cooperation and Agreements**

**Approaches to economic integration may be:**

• Bilateral integration-two countries cooperate closely, usually in the form of tariff reductions.

• Regional integration-a group of countries located in the same geographic proximity decide to cooperate, i.e. the European Union.

• Global integration-countries worldwide cooperate through the WTO.

* trade disputes between the U.S and Europe
* disputes over agricultural subsidies by the industrial countries, services trade, and investment rules
* Industrial ( especially the U.S. Canada, EU and Japan) vs. developing countries led by Brazil and India.
* Companies need to determine where to produce products.
* Companies need to determine what their entry strategy will be.
* Companies need to balance the commonness of the EU with national differences.
* Economic Integration.
* Major Regional Trading Groups

### The World Trade Organization

* European Union
* North American Free Trade Agreement
* The Americas: CARICOM, MERCOSUR, CAN, LAIA
* ASEAN
* APEC
* The African Union

### European Union

### Some major issues facing the WTO

### How to Do Business with the EU: Implications for Corporate Strategy

### North American Free Trade Agreement

### Regional Economic Integration

* + Includes Canada, the United States, and Mexico.
  + Went into effect on January 1, 1994.
  + Involves free trade in goods, services, and investment.
  + Is a large trading bloc but includes countries of different sizes and wealth.

### Major Types of Economic Integration

* Free trade area—no internal tariffs.
* Customs union—no internal tariffs plus common external tariffs.
* Common market—customs union plus factor mobility.

• U.S.-Canadian trade is the largest bilateral trade in the world.

• The United States is Mexico’s and Canada’s largest trading partner.

The World Trade Organization is the major body for - reciprocal trade negotiations - enforcement of trade agreements

* Predecessors
* Organizational Structure
* The Single European Act
* Monetary Union
* Expansion
* Bilateral Agreements.

**Effects of Integration**

### Regional Economic Integration in the Americas

* The Caribbean Community CARICOM
* MERCOSUR
* The Andean Community (CAN)
* Latin American Integration Association (LAIA)

### NAFTA Rational

### Rules of Origin and Regional Content

### Impact of NAFTA

### Economic Integration in Central America and the Caribbean

### Regional Economic Integration in Asia

### Calls for Closer Cooperation

* Asia Pacific Economic Cooperation (APEC)
* Challenges to Solidity
* Lack of binding treaties
* Goal of “Open Regionalism”
* Trade liberalization to non-APEC countries on an unconditional, MFN, or reciprocal basis

### Other Forms of International Cooperation

### Future: Will the WTO Overcome Bilateral and Regional Integration Efforts are.

* Static Effects
* Dynamic Effects
* Trade Creation
* Trade Diversion
* Economies of Scale
* Increased Competition
* Rules of origin-goods and services must originate in North America to get access to lower tariffs.
* Rules of Regional Content-50 % of the net cost of most products must come from the NAFTA region

### How to Do Business with NAFTA: Implications for Corporate Strategy

### Latin American Economic Integration

* The United Nations
* Nongovernmental Organizations (NGOs)
* Global Compact
* Regional integration might actually help the WTO achieve its objectives
* NAFTA and the EU will continue to develop stronger linkages and expand
* Regional integration in Africa will continue at a slow pace due to the existing political and economic problems there Organization of Petroleum Exporting Countries (OPEC)
* Commodities-raw materials or primary products that enter into trade, such as metals or agricultural products.
* Many commodity agreements now exist for the purpose of:
  + Discussing issues
  + Disseminating information
  + Improving product safety

**TARIFF & NON-TARIFF BARRIERS:**

Introduction: This paper examines tariff and non-tariff policies that restrict trade between countries in agricultural commodities. Many of these policies are now subject to important disciplines under the 1994 GATT agreement that is administered by the World Trade Organization (WTO).

The paper is organized as follows. First, tariffs, import quotas, and tariff rate quotas are discussed. Then, a series of non-tariff barriers to trade are examined, including voluntary export restraints, technical barriers to trade, domestic content regulations, import licensing, the operations of import State Trading Enterprises (STEs), and exchange rate management policies. Finally, the precautionary principle, an environment-related rationale for trade restrictions, and sanitary and phytosanitary barriers to trade are discussed.

**Tariffs and Tariff Rate Quotas**

Tariffs, which are taxes on imports of commodities into a country or region, are among the oldest forms of government intervention in economic activity. They are implemented for two clear economic purposes. First, they provide revenue for the government. Second, they improve economic returns to firms and suppliers of resources to domestic industry that face competition from foreign imports.

Tariffs are widely used to protect domestic producers’ incomes from foreign competition. This protection comes at an economic cost to domestic consumers who pay higher prices for import-competing goods, and to the economy as a whole through the inefficient allocation of resources to the import competing domestic industry. Therefore, since 1948, when average tariffs on manufactured goods exceeded 30 percent in most developed economies, those economies have sought to reduce tariffs on manufactured goods through several rounds of negotiations under the General Agreement on Tariffs Trade (GATT). Only in the most recent Uruguay Round of negotiations were trade and tariff restrictions in agriculture addressed. In the past, and even under GATT, tariffs levied on some agricultural commodities by some countries have been very large. When coupled with other barriers to trade they have often constituted formidable barriers to market access from foreign producers. In fact, tariffs that are set high enough can block all trade and act just like import bans.

A tariff-rate quota (TRQ) combines the idea of a tariff with that of a quota. The typical TRQ will set a low tariff for imports of a fixed quantity and a higher tariff for any imports that exceed that initial quantity. In a legal sense and at the WTO, countries are allowed to combine the use of two tariffs in the form of a TRQ, even when they have agreed not to use strict import quotas. In the United States, important TRQ schedules are set for beef, sugar, peanuts, and many dairy products. In each case, the initial tariff rate is quite low, but the over-quota tariff is prohibitive or close to prohibitive for most normal trade.

Explicit import quotas used to be quite common in agricultural trade. They allowed governments to strictly limit the amount of imports of a commodity and thus to plan on a particular import quantity in setting domestic commodity programs. Another common non-tariff barrier (NTB) was the so-called "voluntary export restraint" (VER) under which exporting countries would agree to limit shipments of a commodity to the importing country, although often only under threat of some even more restrictive or onerous activity. In some cases, exporters were willing to comply with a VER because they were able to capture economic benefits through higher prices for their exports in the importing country’s market.

**Issues**

In the Uruguay round of the GATT/WTO negotiations, members agreed to drop the use of import quotas and other non-tariff barriers in favor of tariff-rate quotas. Countries also agreed to gradually lower each tariff rate and raise the quantity to which the low tariff applied. Thus, over time, trade would be taxed at a lower rate and trade flows would increase.

Given current U.S. commitments under the WTO on market access, options are limited for U.S. policy innovations in the 2002 Farm Bill vis a vis tariffs on agricultural imports from other countries. Providing higher prices to domestic producers by increasing tariffs on agricultural imports is not permitted. In addition, particularly because the U.S. is a net exporter of many agricultural commodities, successive U.S. governments have generally taken a strong position within the WTO that tariff and TRQ barriers need to be reduced.

**Non-Tariff Trade Barriers**

Countries use many mechanisms to restrict imports. A critical objective of the Uruguay Round of GATT negotiations, shared by the U.S., was the elimination of non-tariff barriers to trade in agricultural commodities (including quotas) and, where necessary, to replace them with tariffs -- a process called tarrification. Tarrification of agricultural commodities was largely achieved and viewed as a major success of the 1994 GATT agreement. Thus, if the U.S. honors its GATT commitments, the utilization of new non-tariff barriers to trade is not really an option for the 2002 Farm Bill.

**Domestic Content Requirements**

Governments have used domestic content regulations to restrict imports. The intent is usually to stimulate the development of domestic industries. Domestic content regulations typically specify the percentage of a product’s total value that must be produced domestically in order for the product to be sold in the domestic market (Carbaugh). Several developing countries have imposed domestic content requirements to foster agricultural, automobile, and textile production. They are normally used in conjunction with a policy of import substitution in which domestic production replaces imports.

Domestic content requirements have not been as prevalent in agriculture as in some other industries, such as automobiles, but some agricultural examples illustrate their effects. Australia used domestic content requirements to support leaf tobacco production. In order to pay a relatively low import duty on imported tobacco, Australian cigarette manufacturers were required to use 57 percent domestic leaf tobacco. Member countries of trade agreements also use domestic content rules to ensure that nonmembers do not manipulate the agreements to circumvent tariffs. For example, North American Free Trade Agreement (NAFTA) rules of origin provisions stipulate that all single-strength citrus juice must be made from 100 percent NAFTA origin fresh citrus fruit.

Again, as is the case with other trade barriers, it seems unlikely that introducing domestic content rules to enhance domestic demand for U.S. agricultural commodities is a viable option for the 2002 Farm Bill.

**Import Licenses**

Import licenses have proved to be effective mechanisms for restricting imports. Under an import-licensing scheme, importers of a commodity are required to obtain a license for each shipment they bring into the country. Without explicitly utilizing a quota mechanism, a country can simply restrict imports on any basis it chooses through its allocation of import licenses. Prior to the implementation of NAFTA, for example, Mexico required that wheat and other agricultural commodity imports be permitted only under license. Elimination of import licenses for agricultural commodities was a critical objective of the Uruguay Round of GATT negotiations and thus the use of this mechanism to protect U.S. agricultural producers is unlikely an option for the 2002 Farm Bill.

**Import State Trading Enterprises**

Import State Trading Enterprises (STEs) are government owned or sanctioned agencies that act as partial or pure single buyer importers of a commodity or set of commodities in world markets. They also often enjoy a partial or pure domestic monopoly over the sale of those commodities. Current important examples of import STEs in world agricultural commodity markets include the Japanese Food Agency (barley, rice, and wheat), South Korea’s Livestock Products Marketing Organization, and China’s National Cereals, Oil and Foodstuffs Import and Export Commission (COFCO).

STEs can restrict imports in several ways. First, they can impose a set of implicit import tariffs by purchasing imports at world prices and offering them for sale at much higher domestic prices. The difference between the purchase price and the domestic sales price simply represents a hidden tariff. Import STEs may also implement implicit general and targeted import quotas, or utilize complex and costly implicit import rules that make importing into the market unprofitable.

Recently, in a submission to the current WTO negotiations, the United States targeted the trade restricting operations of import and export STEs as a primary concern. A major problem with import STEs is that it is quite difficult to estimate the impacts of their operations on trade, because those operations lack transparency. STEs often refuse to provide the information needed to make such assessments, claiming that such disclosure is not required because they are quasi-private companies. In spite of these difficulties, the challenges provided by STEs will almost certainly continue to be addressed through bilateral and multilateral trade negotiations rather than in the context of domestic legislation through the 2002 Farm Bill.

**Technical Barriers to Trade**

All countries impose technical rules about packaging, product definitions, labeling, etc. In the context of international trade, such rules may also be used as non-tariff trade barriers. For example, imagine if Korea were to require that oranges sold in the country be less than two inches in diameter. Oranges grown in Korea happen to be much smaller than Navel oranges grown in California, so this type of "technical" rule would effectively ban the sales of California oranges and protect the market for Korean oranges. Such rules violate WTO provisions that require countries to treat imports and domestic products equivalently and not to advantage products from one source over another, even in indirect ways. Again, however, these issues will likely be dealt with through bilateral and multilateral trade negotiations rather than through domestic Farm Bill policy initiatives.

**Exchange Rate Management Policies**

Some countries may restrict agricultural imports through managing their exchange rates. To some degree, countries can and have used exchange rate policies to discourage imports and encourage exports of all commodities. The exchange rate between two countries’ currencies is simply the price at which one currency trades for the other. For example, if one U.S. dollar can be used to purchase 100 Japanese yen (and vice versa), the exchange rate between the U.S. dollar and the Japanese yen is 100 yen per dollar. If the yen depreciates in value relative to the U.S. dollar, then a dollar is able to purchase more yen. A 10 percent depreciation or devaluation of the yen, for example, would mean that the price of one U.S. dollar increased to 110 yen.

One effect of currency depreciation is to make all imports more expensive in the country itself. If, for example, the yen depreciates by 10 percent from an initial value of 100 yen per dollar, and the price of a ton of U.S. beef on world markets is $2,000, then the price of that ton of beef in Japan would increase from 200,000 yen to 220,000 yen. A policy that deliberately lowers the exchange rate of a country’s currency will, therefore, inhibit imports of agricultural commodities, as well as imports of all other commodities. Thus, countries that pursue deliberate policies of undervaluing their currency in international financial markets are not usually targeting agricultural imports.

Some countries have targeted specific types of imports through implementing multiple exchange rate policy under which importers were required to pay different exchange rates for foreign currency depending on the commodities they were importing. The objectives of such programs have been to reduce balance of payments problems and to raise revenues for the government. Multiple exchange rate programs were rare in the 1990s, and generally have not been utilized by developed economies.

Finally, exchange rate policies are usually not sector-specific. In the United States, they are clearly under the purview of the Federal Reserve Board and, as such, will not likely be a major issue for the 2002 Farm Bill. There have been many calls in recent congressional testimony, however, to offset the negative impacts caused by a strengthening US dollar with counter-cyclical payments to export dependent agricultural products.

**The Precautionary Principle and Sanitary and Phytosanitary Barriers to Trade**

The precautionary principle, or foresight planning, has recently been frequently proposed as a justification for government restrictions on trade in the context of environmental and health concerns, often regardless of cost or scientific evidence. It was first proposed as a household management technique in the 1930s in Germany, and included elements of prevention, cost effectiveness, and ethical responsibility to maintain natural systems (O’Riordan and Cameron). In the context of managing environmental uncertainty, the principle enjoyed a resurgence of popularity during a meeting of the U.N. World Charter for Nature (of which the U.S. is only an observer) in 1982. Its use was re-endorsed by the U.N. Convention on Bio-diversity in 1992, and again in Montreal, Canada in January 2000.

The precautionary principle has been interpreted by some to mean that new chemicals and technologies should be considered dangerous until proven otherwise. It therefore requires those responsible for an activity or process to establish its harmlessness and to be liable if damage occurs. Most recent attempts to invoke the principle have cited the use of toxic substances, exploitation of natural resources, and environmental degradation. Concerns about species extinction, high rates of birth defects, learning deficiencies, cancer, climate change, ozone depletion, and contamination with toxic chemicals and nuclear materials have also been used to justify trade and other government restrictions on the basis of the precautionary principle. Thus, countries seeking more open trading regimes have been concerned that the precautionary principle will simply be used to justify nontariff trade barriers. For example, rigid adherence to the precautionary principle could lead to trade embargoes on products such as genetically modified oil seeds with little or no reliance on scientific analysis to justify market closure.

Sometimes, restrictions on imports from certain places are fully consistent with protecting consumers, the environment, or agriculture from harmful diseases or pests that may accompany the imported product. The WTO Sanitary and Phytosanitary (SPS) provisions on technical trade rules specifically recognize that all countries feel a responsibility to secure their borders against the importation of unsafe products. Prior to 1994, however, such barriers were often simply used as excuses to keep out a product for which there was no real evidence of any problem. These phony technical barriers were just an excuse to keep out competitive products. The current WTO agreement requires that whenever a technical barrier is challenged, a member country must show that the barrier has solid scientific justification and restricts trade as little as possible to achieve its scientific objectives. This requirement has resulted in a number of barriers being relaxed around the world. It should be emphasized that WTO rules do not require member countries to harmonize rules or adopt international standards -- only that there must be some scientific basis for the rules that are adopted. Thus, any options for sanitary and phytosanitary initiatives considered in the 2002 Farm Bill must be based on sound science and they do not have to be harmonized with the initiatives of other countries.

**WTO – REGIONAL BLOCKS**

**Introduction:** Regional trade agreements (RTAs) have risen in number and reach over the years, including a notable increase in large plurilateral agreements under negotiation. Non-discrimination among trading partners is one of the core principles of the WTO; however, RTAs, which are reciprocal preferential trade agreements between two or more partners, constitute one of the exemptions and are authorized under the WTO, subject to a set of rules.

**Meaning:** Although the term used in the WTO is “regional”, this subject includes bilateral free trade agreements between countries or groups of countries that are not in the same region. These agreements have become so widespread that most WTO members are now also parties to one or more of them, and their scope, coverage and number are still growing.

**Importance:** It is estimated that more than half of world trade is now conducted under agreements of this kind. They are found in every continent. Among the best known are the European Union, the European Free Trade Association (EFTA), the North American Free Trade Agreement (NAFTA), the Southern Common Market (MERCOSUR), the Association of Southeast Asian Nations (ASEAN) and its ASEAN Free Trade Area (AFTA), and the Common Market of Eastern and Southern Africa (COMESA).

From its inception, GATT — and now the WTO — has allowed member countries to conclude customs unions and free-trade areas, as an exception to the fundamental principle of non-discrimination set out in the most-favored-nation.

Conditions for **trade in goods** within these agreements were set in GATT Article 24. Essentially, a regional trade agreement should aim to boost trade between its member countries and not to raise barriers against the trade with other WTO members. During the 1986–94 Uruguay Round negotiations, Article 24 was clarified to some extent and updated.

Preferential trade arrangements on goods between developing-country members are regulated by an “**Enabling Clause**” dating from 1979. These arrangements are not subject to examination by the Committee on Regional Trade Agreements but are notified to the Committee on Trade and Development.

**Non-reciprocal preferential agreements** generally involve selected developing and developed countries. WTO members that have signed an agreement of this kind have to seek a waiver from WTO rules. Among the best known examples of such agreements are the US-Caribbean Basin Economic Recovery Act and the Cotonou Agreement signed by the EC and the ACP countries to replace the Lomé Convention.

Non-reciprocal schemes under the Generalized System of Preferences — when developed countries allow imports from developing countries to enter duty-free or at low duty rates — are regulated by the “Enabling Clause”.

## Work in the Regional Trade Agreements Committee:

In February 1996, the WTO General Council set up a single committee to oversee all regional trade agreements, replacing separate working parties, each dealing with a separate agreement. The Regional Trade Agreements Committee also looks at the broader, systemic implications of the agreements for the multilateral trading system, the relationship between them, and encourages adequate reporting by countries that have signed these agreements.

Up to July 2005, over 300 regional trade agreements had been notified to the WTO and before it to GATT. Of these, 128 agreements notified under GATT Article 24, 21 agreements under the Enabling Clause and 31 under GATS Article 5 are still in force today. The committee has currently under examination more than 150 agreements.

The Regional Trade Agreements Committee has developed procedures to examine the agreements, including compiling information. These procedures are for assessing whether each agreement is consistent with WTO provisions. However, since there is no consensus among WTO members on how to interpret the criteria for assessing this consistency, the committee now has a lengthening backlog of uncompleted reports. In fact, consensus on consistency with Article 24 has been reached in only one case so far: the customs union between the Czech Republic and the Slovak Republic after the break up of Czechoslovakia.

As the number of regional agreements increases, so does the need to analyze whether the WTO’s rules on these agreements need to be clarified further. WTO members differ on whether regional agreements help or hinder the multilateral trading system — whether they function as “building blocks” or “stumbling blocks”. One view is that the regional agreements strengthen the multilateral system because they can move faster, and because they can help integrate developing countries into the world economy. Other countries believe that the WTO’s rules should be revised— and not just reinterpreted — so that the two systems can work together better, particularly since the number of agreements has increased, and their membership has increasingly overlapped.

## What’s at stake?

Issues raised by the regionalism debate are complex.

Some are primarily **legal**. For example, GATT Article 24 requires that a regional trade agreement should cover “**substantially all the trade**” in goods between its members. Similarly, GATS Article 5 calls for a “**substantial sectoral coverage**” in services. But there is no agreement among members on what this means, and in practice many agreements leave out large and sensitive areas such as agriculture and financial services. This poses difficulties for assessing whether the agreements are consistent with WTO rules.

Other issues are more **institutional** in nature. They highlight possible discrepancies between the regional agreements’ rules and those of the WTO. The focus in negotiations has shifted over time from tariff reductions to rules and regulations, both at the regional and at the multilateral level — for instance, rules on anti-dumping, subsidies, or product standards. Some recent regional agreements include provisions not covered by the WTO at all, such as investment or competition policies.

Finally and most importantly, there is the **economic dimension**. Today, this goes far beyond the effects of tariff preferences on members and non-members of regional agreements. Rather, this is now a question of the regional agreements’ impact on the shape and development of world trade itself — given their large and increasing number and their overlapping membership. Over the next few years, this will be one of the most important challenges facing trade policymakers in all continents.

## The Doha Declaration

The relationship between regionalism and multilateralism has become a critical systemic issue, reflected in the WTO Regional Trade Agreements Committee’s increasing backlog of unconcluded reports and its lack of consensus on the broader question of the consistency between regional agreements and WTO rules.

At the Doha Ministerial Conference in November 2001, WTO members agreed to give a political push to this question and to negotiate a solution, giving due regard to the role that these agreements can play in fostering development.

The ministerial declaration mandates negotiations aimed at “clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements. The negotiations shall take into account the developmental aspects of regional trade agreements”.

## Since then: the Rules Negotiating Group

While the Regional Trade Agreements Committee has continued its examination of specific agreements, members decided that the Doha mandate should be fulfilled through a specific negotiating channel. A **Rules Negotiating Group** was set up in 2002 to clarify and improve disciplines on implementation on dumping, subsidies and countervailing measures, fishery subsidies, and regional trade agreements.

The negotiating group’s work has progressed substantially. Identifying the issues could be completed quickly because they had already been debated extensively in the Regional Trade Agreements Committee.

Good progress on procedural issues.

The Group has made good progress on developing draft procedures that would promote greater “transparency” of RTAs. In September 2005, the Group was working on a draft text from the chairman, containing elements on the early notification of the RTAs, and improving the information provided by members on their agreements. The Secretariat is expected to play an increasing role in presenting factual reports on individual agreements, as a way to make the review of regional agreements more efficient and coherent. As an experiment, the Committee on RTAs used a Secretariat factual report in its examination of the Chile-Korea Free Trade Agreement in July 2005 to the general satisfaction of delegations.

Outstanding issues in this area include how to deal with RTAs presently under examination in the RTA Committee, and whether the new procedures would apply to RTAs notified under the Enabling Clause.

**Issues to do with the trading system.**

Discussions on “systemic issues” have gained momentum with the recent tabling of several proposals. However, divergent positions continue to be expressed on issues such as:

* how to interpret the phrase “substantially all the trade”
* regulations that could restrict trade such as rules of origin under preferential schemes
* how regional agreements relate to development
* the primacy of the multilateral trading system and the negative effect regional agreements can have on other countries.

## For Hong Kong

The negotiating group has no intermediate deadlines in the area of RTAs. However, the Group has agreed on an intensive work programme aimed at submitting a draft transparency agreement to ministers and to advancing as far as possible discussions on the systemic issues.

## What Are Mergers and Acquisitions – M&A?

Mergers and acquisitions (M&A) is a general term used to describe the consolidation of companies or assets through various types of financial transactions, including mergers, acquisitions, consolidations, tender offers, purchase of assets and management acquisitions. The term M&A also refers to the desks at [financial institutions](https://www.investopedia.com/terms/f/financialinstitution.asp) that deal in such activity.

#### What's an Acquisition?

## The Essence of Merger: The terms "mergers" and "acquisitions" are often used interchangeably, although in actuality, [they hold slightly different meanings](https://www.investopedia.com/ask/answers/021815/what-difference-between-merger-and-acquisition.asp). When one company takes over another entity, and establishes itself as the new owner, the purchase is called an acquisition. From a legal point of view, the [target company](https://www.investopedia.com/terms/t/targetfirm.asp) ceases to exist, the buyer absorbs the business, and the buyer's stock continues to be traded, while the target company’s stock ceases to trade.

On the other hand, a merger describes two firms of approximately the same size, who join forces to move forward as a single new entity, rather than remain separately owned and operated. This action is known as a "merger of equals." Both companies' stocks are surrendered and new company stock is issued in its place. Case in point: both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, Daimler Chrysler, was created. A purchase deal will also be called a merger when both [CEOs](https://www.investopedia.com/terms/c/ceo.asp) agree that joining together is in the best interest of both of their companies.

## The Action of Acquisition: Unfriendly deals, where target companies do not wish to be purchased, are always regarded as acquisitions. Therefore, a purchasing deal is classified as a merger or an acquisition, based on whether the purchase is friendly or hostile and how it is announced. In other words, the difference lies in how the deal is communicated to the target company's [board of directors](https://www.investopedia.com/terms/b/boardofdirectors.asp), employees and [shareholders](https://www.investopedia.com/terms/s/shareholder.asp). [Nestle](https://www.investopedia.com/articles/markets/122215/top-4-companies-owned-nestle.asp), for instance, has performed a variety of acquisitions lately.

## Types of Mergers & Acquisitions

**Here is a list of transactions that fall under the M&A umbrella:**

**Merger**: In a [merger](https://www.investopedia.com/terms/m/merger.asp), the boards of directors for two companies approve the combination and seek shareholders' approval. Post merger, the acquired company ceases to exist and becomes part of the acquiring company. For example, in 2007 a merger deal occurred between Digital Computers and Compaq, whereby Compaq absorbed Digital Computers.

**Acquisition**: In a simple acquisition, the acquiring company obtains the majority stake in the acquired firm, which does not change its name or alter its legal structure. An example of this transaction is Manulife Financial Corporation's 2004 acquisition of John Hancock Financial Services, where both companies preserved their names and organizational structures.

**Consolidation:** [Consolidation](https://www.investopedia.com/terms/c/consolidation.asp) creates a new company. Stockholders of both companies must approve the consolidation. Subsequent to the approval, they receive common [equity](https://www.investopedia.com/terms/e/equity.asp) shares in the new firm. For example, in 1998, Citicorp and Traveler's Insurance Group announced a consolidation, which resulted in Citigroup.

### Tender Offer: In a [tender offer](https://www.investopedia.com/terms/t/tenderoffer.asp), one company offers to purchase the outstanding stock of the other firm, at a specific price. The acquiring company communicates the offer directly to the other company's shareholders, bypassing the management and board of directors. For example, in 2008, Johnson & Johnson made a tender offer to acquire Omrix Biopharmaceuticals for $438 million. While the acquiring company may continue to exist — especially if there are certain dissenting shareholders — most tender offers result in mergers.

### Acquisition of Assets: In an acquisition of assets, one company acquires the assets of another company. The company whose assets are being acquired must obtain approval from its shareholders. The purchase of assets is typical during bankruptcy proceedings, where other companies bid for various assets of the bankrupt company, which is liquidated upon the final transfer of assets to the acquiring firms.

### Management Acquisition: In a management acquisition, also known as a [management-led buyout](https://www.investopedia.com/terms/m/mbo.asp)(MBO), a company's executives purchase a controlling stake in another company, making it private. These former executives often partner with a financier or former corporate officers, in an effort to help fund a transaction. Such M&A transactions are typically financed disproportionately with debt, and the majority of shareholders must approve it. For example, in 2013, Dell Corporation announced that it was acquired by its chief executive manager, Michael Dell.

### KEY TAKEAWAYS

* The term mergers and acquisitions (M&A) refer to the process of one company combining with another.
* In an acquisition, one company purchases the other outright. The acquired firm does not change its legal name or structure but is now owned by the parent company.
* A merger is the combination of two firms, which subsequently form a new legal entity under the banner of one corporate name.
* M&A deals generate sizable profits for the investment banking industry, but not all mergers or acquisition deals close.
* Post-merger, some companies find great success and growth, while others fail spectacularly.

## The Structure of Mergers

Mergers may be structured in multiple different ways, based on the relationship between the two companies involved in the deal.

* [**Horizontal merger**](https://www.investopedia.com/terms/h/horizontalmerger.asp)**:**Two companies that are in direct competition and share the same product lines and [markets](https://www.investopedia.com/terms/m/market-power.asp).
* [**Vertical merger**](https://www.investopedia.com/terms/v/verticalmerger.asp)**:**A customer and company or a supplier and company. Think of a cone supplier merging with an ice cream maker.
* [**Congeneric mergers**](https://www.investopedia.com/terms/c/congeneric-merger.asp)**:**Two businesses that serve the same consumer base in different ways, such as a TV manufacturer and a cable company.
* **Market-extension merger:**Two companies that sell the same products in different markets.
* **Product-extension merger:** Two companies selling different but related products in the same market.
* [**Conglomeration**](https://www.investopedia.com/terms/c/conglomerate.asp)**:**Two companies that have no common business areas.

Mergers may also be distinguished by following two financing methods--each with its own ramifications for investors.

* **Purchase Mergers:**As the name suggests, this kind of merger occurs when one company purchases another company. The purchase is made with cash or through the issue of some kind of debt instrument. The sale is taxable, which attracts the acquiring companies, who enjoy the tax benefits. Acquired assets can be written-up to the actual purchase price, and the difference between the book value and the purchase price of the assets can [depreciate](https://www.investopedia.com/terms/d/depreciation.asp) annually, reducing taxes payable by the acquiring company.
* **Consolidation Mergers:** With this merger, a brand new company is formed, and both companies are bought and combined under the new entity. The tax terms are the same as those of a purchase merger.

## Details of Acquisitions

Like some merger deals, in acquisitions, a company may buy another company with cash, stock or a combination of the two. And in smaller deals, it is common for one company to acquire all of another company's assets. Company X buys all of Company Y's assets for cash, which means that Company Y will have only cash (and debt, if any). Of course, Company Y becomes merely a shell and will eventually [liquidate](https://www.investopedia.com/terms/l/liquidation.asp) or enter other areas of business.

Another acquisition deal known as a "[reverse merger](https://www.investopedia.com/articles/stocks/09/introduction-reverse-mergers.asp)" enables a private company to become publicly-listed in a relatively short time period. Reverse mergers occur when a private company that has strong prospects and is eager to acquire financing buys a publicly-listed shell company, with no legitimate business operations and limited assets. The private company reverses merges into the [public company](https://www.investopedia.com/terms/p/publiccompany.asp), and together they become an entirely new public corporation with tradable shares.

## Valuation Matters: Both companies involved on either side of an M&A deal will value the target company differently. The seller will obviously value the company at the highest price as possible, while the buyer will attempt to buy it for the lowest possible price. Fortunately, a company can be objectively valued by studying comparable companies in an industry, and by relying on the following metrics:

1. **Comparative Ratios:**The following are two examples of the many comparative metrics on which acquiring companies may base their offers:
2. [**Price-Earnings Ratio**](https://www.investopedia.com/terms/p/price-earningsratio.asp)**(P/E Ratio):**With the use of this ratio, an acquiring company makes an offer that is a multiple of the earnings of the target company. Examining the P/E for all the stocks within the same industry group will give the acquiring company good guidance for what the target's P/E multiple should be.
3. [**Enterprise-Value-to-Sales Ratio**](https://www.investopedia.com/terms/e/enterprisevaluesales.asp)**(EV/Sales):**With this ratio, the acquiring company makes an offer as a multiple of the revenues, again, while being aware of the [price-to-sales ratio](https://www.investopedia.com/terms/p/price-to-salesratio.asp) of other companies in the industry.
4. [**Replacement Cost**](https://www.investopedia.com/terms/r/replacementcost.asp)**:** In a few cases, acquisitions are based on the cost of replacing the target company. For simplicity's sake, suppose the value of a company is simply the sum of all its equipment and staffing costs. The acquiring company can literally order the target to sell at that price, or it will create a competitor for the same cost. Naturally, it takes a long time to assemble good management, acquire property and purchase the right equipment. This method of establishing a price certainly wouldn't make much sense in a service industry where the key assets – people and ideas – are hard to value and develop.
5. [**Discounted Cash Flow**](https://www.investopedia.com/terms/d/dcf.asp)**(DCF):** A key valuation tool in M&A, discounted cash flow analysis determines a company's current value, according to its estimated future cash flows. Forecasted free cash flows (net income + depreciation/amortization - capital expenditures - change in working capital) are discounted to a present value using the company's [weighted average costs of capital](https://www.investopedia.com/terms/w/wacc.asp) (WACC). Admittedly, DCF is tricky to get right, but few tools can rival this valuation method.

**UNIT – IV**

# Foreign Exchange and the Global Capital Markets

**Introduction:** This chapter explores currencies, foreign exchange rates, and how they are determined. It also discusses the global capital markets—the key components and how they impact global business. Foreign exchange is one aspect of the global capital markets. Companies access the global capital markets to utilize both the debt and equity markets; these are important for growth. Being able to access transparent and efficient capital markets around the world is another important component in the flattening world for global firms. Finally, this chapter discusses how the expansion of the global capital markets has benefited entrepreneurship and venture capitalists.

In order to buy goods from around the world, Walmart has to deal extensively in different currencies. Small changes in the daily foreign currency market can significantly impact the costs for Walmart and in turn both its profitability and that of its global suppliers.

A company like Walmart needs foreign exchange and capital for different reasons, including the following common operational uses:

1. To build new stores, expand stores, or refurbish stores in a specific country
2. To purchase products locally by paying in local currencies or the US dollar, whichever is cheaper and works to Wal-Mart’s advantage
3. To pay salaries and benefits for its local employees in each country as well as its expatriate and global workforce
4. To take profits out of a country and either reinvest the money in another country or market or save it and make profits from returns on investment

## Currency and Foreign Exchange

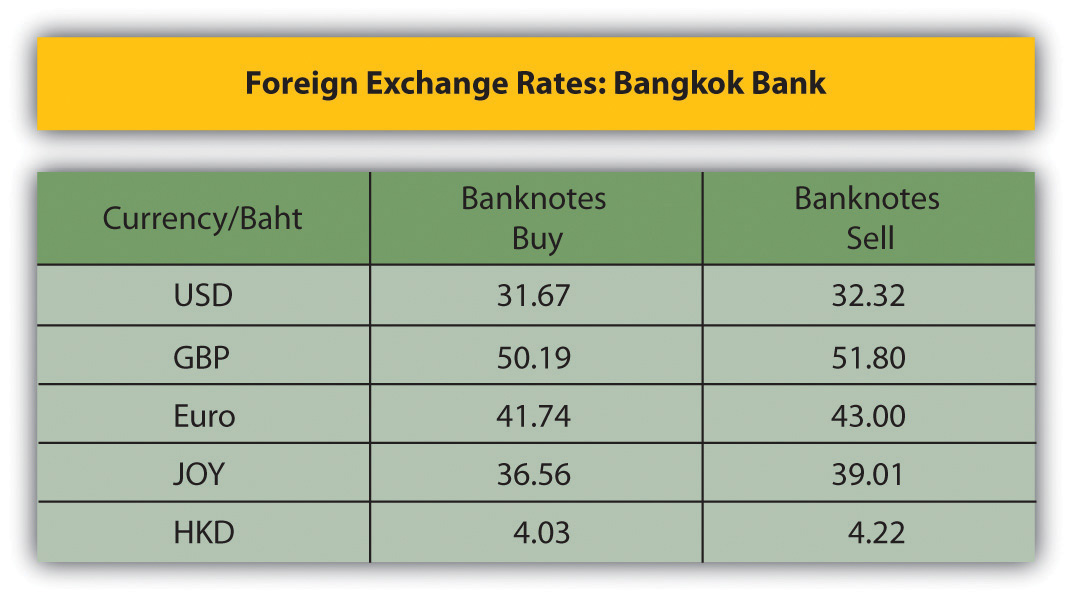
## What Are Currency and Foreign Exchange?

In order to understand the global financial environment, how capital markets work, and their impact on global business, we need to first understand how currencies and foreign exchange rates work.

Briefly, currency is any form of money in general circulation in a country. What exactly is a foreign exchange? In essence, foreign exchange is money denominated in the currency of another country or—now with the euro—a group of countries. Simply put, an exchange rate is defined as the rate at which the market converts one currency into another.

Any company operating globally must deal in foreign currencies. It has to pay suppliers in other countries with a currency different from its home country’s currency. The home country is where a company is headquartered. The firm is likely to be paid or have profits in a different currency and will want to exchange it for its home currency. Even if a company expects to be paid in its own currency, it must assess the risk that the buyer may not be able to pay the full amount due to currency fluctuations.

If you have traveled outside of your home country, you may have experienced the currency market—for example, when you tried to determine your hotel bill or tried to determine if an item was cheaper in one country versus another. In fact, when you land at an airport in another country, you’re likely to see boards indicating the foreign exchange rates for major currencies. These rates include two numbers: the bid and the offer. The bid (or buy) is the price at which a bank or financial services firm is willing to buy a specific currency. The ask (or the offer or sell), refers to the price at which a bank or financial services firm is willing to sell that currency. Typically, the bid or the buy is always cheaper than the sell; banks make a profit on the transaction from that difference. For example, imagine you’re on vacation in Thailand and the exchange rate board indicates that the Bangkok Bank is willing to exchange currencies at the following rates (see the following figure). GBP refers to the British pound; JPY refers to the Japanese yen; and HKD refers to the Hong Kong dollar, as shown in the following figure. Because there are several countries that use the dollar as part or whole of their name, this chapter clearly states “US dollar” or uses US$ or USD when referring to American currency.



This chart tells us that when you land in Thailand, you can use 1 US dollar to buy 31.67 Thai baht. However, when you leave Thailand and decide that you do not need to take all your baht back to the United States, you then convert baht back to US dollars. We then have to use more baht—32.32 according to the preceding figure—to buy 1 US dollar. The spread between these numbers, 0.65 baht, is the profit that the bank makes for each US dollar bought and sold. The bank charges a fee because it performed a service—facilitating the currency exchange. When you walk through the airport, you’ll see more boards for different banks with different buy and sell rates. While the difference may be very small, around 0.1 baht, these numbers add up if you are a global company engaged in large foreign exchange transactions. Accordingly, global firms are likely to shop around for the best rates before they exchange any currencies.

## What Is the Purpose of the Foreign Exchange Market?

The foreign exchange market (or FX market) is the mechanism in which currencies can be bought and sold. A key component of this mechanism is pricing or, more specifically, the rate at which a currency is bought or sold. We’ll cover the determination of exchange rates more closely in this section, but first let’s understand the purpose of the FX market. International businesses have four main uses of the foreign exchange markets.

## Currency Conversion

Companies, investors, and governments want to be able to convert one currency into another. A company’s primary purposes for wanting or needing to convert currencies is to pay or receive money for goods or services. Imagine you have a business in the United States that imports wines from around the world. You’ll need to pay the French winemakers in euros, your Australian wine suppliers in Australian dollars, and your Chilean vineyards in pesos. Obviously, you are not going to access these currencies physically. Rather, you’ll instruct your bank to pay each of these suppliers in their local currencies. Your bank will convert the currencies for you and debit your account for the US dollar equivalent based on the exact exchange rate at the time of the exchange.

## Currency Hedging

One of the biggest challenges in foreign exchange is the risk of rates increasing or decreasing in greater amounts or directions than anticipated. Currency hedging refers to the technique of protecting against the potential losses that result from adverse changes in exchange rates. Companies use hedging as a way to protect themselves if there is a time lag between when they bill and receive payment from a customer. Conversely, a company may owe payment to an overseas vendor and want to protect against changes in the exchange rate that would increase the amount of the payment. For example, a retail store in Japan imports or buys shoes from Italy. The Japanese firm has ninety days to pay the Italian firm. To protect itself, the Japanese firm enters into a contract with its bank to exchange the payment in ninety days at the agreed-on exchange rate. This way, the Japanese firm is clear about the amount to pay and protects itself from a sudden depreciation of the yen. If the yen depreciates, more yen will be required to purchase the same euros, making the deal more expensive. By hedging, the company locks in the rate.

## Currency Arbitrage

Arbitrage is the simultaneous and instantaneous purchase and sale of a currency for a profit. Advances in technology have enabled trading systems to capture slight differences in price and execute a transaction, all within seconds. Previously, arbitrage was conducted by a trader sitting in one city, such as New York, monitoring currency prices on the Bloomberg terminal. Noticing that the value of a euro is cheaper in Hong Kong than in New York, the trader could then buy euros in Hong Kong and sell them in New York for a profit. Today, such transactions are almost all handled by sophisticated computer programs. The programs constantly search different exchanges, identify potential differences, and execute transactions, all within seconds.

## Currency Speculation

Speculation refers to the practice of buying and selling a currency with the expectation that the value will change and result in a profit. Such changes could happen instantly or over a period of time.

High-risk, speculative investments by nonfinance companies are less common these days than the current news would indicate. While companies can engage in all four uses discussed in this section, many companies have determined over the years that arbitrage and speculation are too risky and not in alignment with their core strategies. In essence, these companies have determined that a loss due to high-risk or speculative investments would be embarrassing and inappropriate for their companies.

## Understand How to Determine Exchange Rates

## How to Quote a Currency

There are several ways to quote currency, but let’s keep it simple. In general, when we quote currencies, we are indicating how much of one currency it takes to buy another currency. This quote requires two components: the base currency and the quoted currency. The quoted currency is the currency with which another currency is to be purchased. In an exchange rate quote, the quoted currency is typically the numerator. The base currency is the currency that is to be purchased with another currency, and it is noted in the denominator. For example, if we are quoting the number of Hong Kong dollars required to purchase 1 US dollar, then we note HKD 8 / USD 1. (Note that 8 reflects the general exchange rate average in this example.) In this case, the Hong Kong dollar is the quoted currency and is noted in the numerator. The US dollar is the base currency and is noted in the denominator. We read this quote as “8 Hong Kong dollars are required to purchase 1 US dollar.” If you get confused while reviewing exchanging rates, remember the currency that you want to buy or sell. If you want to sell 1 US dollar, you can buy 8 Hong Kong dollars, using the example in this paragraph.

## Direct Currency Quote and Indirect Currency Quote

Additionally, there are two methods—the American terms and the European terms—for noting the base and quoted currency. These two methods, which are also known as direct and indirect quotes, are opposite based on each reference point. Let’s understand what this means exactly.

The American terms, also known as US terms, are from the point of view of someone in the United States. In this approach, foreign exchange rates are expressed in terms of how many US dollars can be exchanged for one unit of another currency (the non-US currency is the base currency). For example, a dollar-pound quote in American terms is USD/GP (US$/£) equals 1.56. This is read as “1.56 US dollars are required to buy 1 pound sterling.” This is also called a direct quote, which states the domestic currency price of one unit of foreign currency. If you think about this logically, a business that needs to buy a foreign currency needs to know how many US dollars must be sold in order to buy one unit of the foreign currency. In a direct quote, the domestic currency is a variable amount and the foreign currency is fixed at one unit.

Conversely, the European terms are the other approach for quoting rates. In this approach, foreign exchange rates are expressed in terms of how many currency units can be exchanged for a US dollar (the US dollar is the base currency). For example, the pound-dollar quote in European terms is £0.64/US$1 (£/US$1). While this is a direct quote for someone in Europe, it is an indirect quote in the United States. An indirect quote states the price of the domestic currency in foreign currency terms. In an indirect quote, the foreign currency is a variable amount and the domestic currency is fixed at one unit.

A direct and an indirect quote are simply reverse quotes of each other. If you have either one, you can easily calculate the other using this simple formula:

Direct quote = 1 / indirect quote.

To illustrate, let’s use our dollar-pound example. The direct quote is US$1.56 = 1/£0.64 (the indirect quote). This can be read as

1 divided by 0.64 equals 1.56.

In this example, the direct currency quote is written as US$/£ = 1.56.

While you are performing the calculations, it is important to keep track of which currency is in the numerator and which is in the denominator, or you might end up stating the quote backward. The direct quote is the rate at which you buy a currency. In this example, you need US$1.56 to buy a British pound.

Tip: Many international business professionals become experienced over their careers and are able to correct themselves in the event of a mix-up between currencies. To illustrate using the example mentioned previously, the seasoned global professional knows that the British pound is historically higher in value than the US dollar. This means that it takes more US dollars to buy a pound than the other way around. When we say “higher in value,” we mean that the value of the British pound buys you more US dollars. Using this logic, we can then deduce that 1.56 US dollars are required to buy 1 British pound. As an international businessperson, we would know instinctively that it cannot be less—that is, only 0.64 US dollars to buy a British pound. This would imply that the dollar value was higher in value. While major currencies have changed significantly in value vis-à-vis each other, it tends to happen over long periods of time. As a result, this self-test is a good way to use logic to keep track of tricky exchange rates. It works best with major currencies that do not fluctuate greatly vis-à-vis others.

A useful side note: traders always list the base currency as the first currency in a currency pair. Let’s assume, for example, that it takes 85 Japanese yen to purchase 1 US dollar. A currency trader would note this as follows: USD 1 / JPY 85. This quote indicates that the base currency is the US dollar and 85 yen are required to purchase a dollar. This is also called a direct quote, although FX traders are more likely to call it an American rate rather than a direct rate. It can be confusing, but try to keep the logic of which currency you are selling and which you are buying clearly in your mind, and say the quote as full sentences in order to keep track of the currencies.

These days, you can easily use the Internet to access up-to-date quotes on all currencies, although the most reliable sites remain the Wall Street Journal, the Financial Times, or any website of a trustworthy financial institution.

## Spot Rates

The exchange rates discussed in this chapter are spot rates—exchange rates that require immediate settlement with delivery of the traded currency. “Immediate” usually means within two business days, but it implies an “on the spot” exchange of the currencies, hence the term spot rate. The spot exchange rate is the exchange rate transacted at a particular moment by the buyer and seller of a currency. When we buy and sell our foreign currency at a bank or at American Express, it’s quoted at the rate for the day. For currency traders though, the spot can change throughout the trading day even by tiny fractions.

To illustrate, assume that you work for a clothing company in the United States and you want to buy shirts from either Malaysia or Indonesia. The shirts are exactly the same; only the price is different. (For now, ignore shipping and any taxes.) Assume that you are using the spot rate and are making an immediate payment. There is no risk of the currency increasing or decreasing in value. (We’ll cover forward rates in the next section.)

The currency in Malaysia is the Malaysian ringgit, which is abbreviated MYR. The supplier in Kuala Lumpur e-mails you the quote—you can buy each shirt for MYR 35. Let’s use a spot exchange rate of MYR 3.13 / USD 1.

The Indonesian currency is the rupiah, which is abbreviated as Rp. The supplier in Jakarta e-mails you a quote indicating that you can buy each shirt for Rp 70,000. Use a spot exchange rate of Rp 8,960 / USD 1.

It would be easy to instinctively assume that the Indonesian firm is more expensive, but look more closely. You can calculate the price of one shirt into US dollars so that a comparison can be made:

For Malaysia: MYR 35 / MYR 3.13 = USD 11.18For Indonesia: Rp 70,000 / Rp 8,960 = USD 7.81

Indonesia is the cheaper supplier for our shirts on the basis of the spot exchange rate.

## Cross Rates

There’s one more term that applies to the spot market—the cross rate. This is the exchange rate between two currencies, neither of which is the official currency in the country in which the quote is provided. For example, if an exchange rate between the euro and the yen were quoted by an American bank on US soil, the rate would be a cross rate.

The most common cross-currency pairs are EUR/GBP, EUR/CHF, and EUR/JPY. These currency pairs expand the trading possibilities in the foreign exchange market but are less actively traded than pairs that include the US dollar, which are called the “majors” because of their high degree of liquidity. The majors are EUR/USD, GBP/ USD, USD/JPY, USD/CAD (Canadian dollar), USD/CHF (Swiss franc), and USD/AUD (Australian dollar). Despite the changes in the international monetary system and the expansion of the capital markets, the currency market is really a market of dollars and nondollars. The dollar is still the reserve currency for the world’s central banks. [Table 7.1 "Currency Cross Rates"](https://saylordotorg.github.io/text_international-business/s11-foreign-exchange-and-the-globa.html#fwk-168388-ch08_s01_s03_s04_t01) contains some currency cross rates between the major currencies. We can see, for example, that the rate for the cross-currency pair of EUR/GBP is 1.1956. This is read as “it takes 1.1956 euros to buy one British pound.” Another example is the EUR/JPY rate, which is 0.00901. However, a seasoned trader would not say that it takes 0.00901 euros to buy 1 Japanese yen. He or she would instinctively know to quote the currency pair as the JPY/EUR rate or—more specifically—that it takes 111.088 yen to purchase 1 euro.

Table 7.1 Currency Cross Rates

| **Currency codes / names** | **United Kingdom Pound** | **Canadian Dollar** | **Euro** | **Hong Kong Dollar** | **Japanese Yen** | **Swiss Franc** | **US Dollar** | **Chinese Yuan Renminbi** |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| GBP | 1 | 0.6177 | 0.8374 | 0.08145 | 0.007544 | 0.6455 | 0.633 | 0.09512 |
| CAD | 1.597 | 1 | 1.3358 | 0.1299 | 0.012032 | 1.0296 | 1.0095 | 0.1517 |
| EUR | 1.1956 | 0.7499 | 1 | 0.09748 | 0.00901 | 0.771 | 0.7563 | 0.1136 |
| HKD | 12.2896 | 7.7092 | 10.2622 | 1 | 0.09267 | 7.9294 | 7.7749 | 1.1682 |
| JPY | 132.754 | 83.2905 | 111.088 | 10.8083 | 1 | 85.65 | 84.001 | 12.6213 |
| CHF | 1.5512 | 0.9732 | 1.2981 | 0.1263 | 0.011696 | 1 | 0.9815 | 0.1475 |
| USD | 1.5807 | 0.9915 | 1.3232 | 0.1287 | 0.011919 | 1.0199 | 1 | 0.1503 |
| CNY | 10.5218 | 6.6002 | 8.8075 | 0.8565 | 0.07934 | 6.7887 | 6.6565 | 1 |
| **Note: The official name for the Chinese currency is renminbi and the main unit of the currency is the yuan.** | | | | | | | | |
| **Source: “Currency Cross Rates: Results,” Oanda, accessed May 25, 2011,** | | | | | | | | |

## Forward Rates

The forward exchange rate is the exchange rate at which a buyer and a seller agree to transact a currency at some date in the future. Forward rates are really a reflection of the market’s expectation of the future spot rate for a currency. The forward market is the currency market for transactions at forward rates. In the forward markets, foreign exchange is always quoted against the US dollar. This means that pricing is done in terms of how many US dollars are needed to buy one unit of the other currency. Not all currencies are traded in the forward market, as it depends on the demand in the international financial markets. The majors are routinely traded in the forward market.

For example, if a US company opted to buy cell phones from China with payment due in ninety days, it would be able to access the forward market to enter into a forward contract to lock in a future price for its payment. This would enable the US firm to protect itself against a depreciation of the US dollar, which would require more dollars to buy one Chinese yuan. A forward contract is a contract that requires the exchange of an agreed-on amount of a currency on an agreed-on date and a specific exchange rate. Most forward contracts have fixed dates at 30, 90, or 180 days. Custom forward contracts can be purchased from most financial firms. Forward contracts, currency swaps, options, and futures all belong to a group of financial instruments called derivatives. In the term’s broadest definition, derivatives are financial instruments whose underlying value comes from (derives from) other financial instruments or commodities—in this case, another currency.

## Swaps, Options, and Futures

Swaps, options, and futures are three additional currency instruments used in the forward market.

A currency swap is a simultaneous buy and sell of a currency for two different dates. For example, an American computer firm buys (imports) components from China. The firm needs to pay its supplier in renminbi today. At the same time, the American computer is expecting to receive RMB in ninety days for its netbooks sold in China. The American firm enters into two transactions. First, it exchanges US dollars and buys yuan renminbi today so that it can pay its supplier. Second, it simultaneously enters into a forward contract to sell yuan and buy dollars at the ninety-day forward rate. By entering into both transactions, the firm is able to reduce its foreign exchange rate risk by locking into the price for both.

Currency options are the option or the right—but not the obligation—to exchange a specific amount of currency on a specific future date and at a specific agreed-on rate. Since a currency option is a right but not a requirement, the parties in an option do not have to actually exchange the currencies if they choose not to. This is referred to as not exercising an option.

Currency futures contracts are contracts that require the exchange of a specific amount of currency at a specific future date and at a specific exchange rate. Futures contracts are similar to but not identical to forward contracts.

## Exchange-Traded and Standardized Terms

Futures contracts are actively traded on exchanges, and the terms are standardized. As a result, futures contracts have clearinghouses that guarantee the transactions, substantially reducing any risk of default by either party. Forward contracts are private contracts between two parties and are not standardized. As a result, the parties have a higher risk of defaulting on a contract.

## Settlement and Delivery

The settlement of a forward contract occurs at the end of the contract. Futures contracts are marked-to-market daily, which means that daily changes are settled day by day until the end of the contract. Furthermore, the settlement of a futures contract can occur over a range of dates. Forward contracts, on the other hand, only have one settlement date at the end of the contract.

## Maturity

Futures contracts are frequently employed by speculators, who bet on the direction in which a currency’s price will move; as a result, futures contracts are usually closed out prior to maturity and delivery usually never happens. On the other hand, forward contracts are mostly used by companies, institutions, or hedgers that want to eliminate the volatility of a currency’s price in the future, and delivery of the currency will usually take place.

Companies routinely use these tools to manage their exposure to currency risk. One of the complicating factors for companies occurs when they operate in countries that limit or control the convertibility of currency. Some countries limit the profits (currency) a company can take out of a country. As a result, many companies resort to countertrade, where companies trade goods and services for other goods and services and actual monies are less involved.

The challenge for companies is to operate in a world system that is not efficient. Currency markets are influenced not only by market factors, inflation, interest rates, and market psychology but also—more importantly—by government policy and intervention. Many companies move their production and operations to overseas locations to manage against unforeseen currency risks and to circumvent trade barriers. It’s important for companies to actively monitor the markets in which they operate around the world.

## The Role of International Banks, Investment Banks, Securities Firms, and Global Financial Firms

The role of international banks, investment banks, and securities firms has evolved in the past few decades. Let’s take a look at the primary purpose of each of these institutions and how it has changed, as many have merged to become global financial powerhouses.

Traditionally, international banks extended their domestic role to the global arena by servicing the needs of multinational corporations (MNC). These banks not only received deposits and made loans but also provided tools to finance exports and imports and offered sophisticated cash-management tools, including foreign exchange. For example, a company purchasing products from another country may need short-term financing of the purchase; electronic funds transfers (also called wires); and foreign exchange transactions. International banks provide all these services and more.

In broad strokes, there are different types of banks, and they may be divided into several groups on the basis of their activities. Retail banks deal directly with consumers and usually focus on mass-market products such as checking and savings accounts, mortgages and other loans, and credit cards. By contrast, private banks normally provide wealth-management services to families and individuals of high net worth. Business banks provide services to businesses and other organizations that are medium sized, whereas the clients of corporate banks are usually major business entities. Lastly, investment banks provide services related to financial markets, such as mergers and acquisitions. Investment banks also focused primarily on the creation and sale of securities (e.g., debt and equity) to help companies, governments, and large institutions achieve their financing objectives. Retail, private, business, corporate, and investment banks have traditionally been separate entities. All can operate on the global level. In many cases, these separate institutions have recently merged, or were acquired by another institution, to create global financial powerhouses that now have all types of banks under one giant, global corporate umbrella.

However the merger of all of these types of banking firms has created global economic challenges. In the United States, for example, these two types—retail and investment banks—were barred from being under the same corporate umbrella by the Glass-Steagall Act. Enacted in 1932 during the Great Depression, the Glass-Steagall Act, officially called the Banking Reform Act of 1933, created the Federal Deposit Insurance Corporations (FDIC) and implemented bank reforms, beginning in 1932 and continuing through 1933. These reforms are credited with providing stability and reduced risk in the banking industry for decades. Among other things, it prohibited bank-holding companies from owning other financial companies. This served to ensure that investment banks and banks would remain separate—until 1999, when Glass-Steagall was repealed. Some analysts have criticized the repeal of Glass-Steagall as one cause of the 2007–8 financial crisis.

Because of the size, scope, and reach of US financial firms, this historical reference point is important in understanding the impact of US firms on global businesses. In 1999, once bank-holding companies were able to own other financial services firms, the trend toward creating global financial powerhouses increased, blurring the line between which services were conducted on behalf of clients and which business was being managed for the benefit of the financial company itself. Global businesses were also part of this trend, as they sought the largest and strongest financial players in multiple markets to service their global financial needs. If a company has operations in twenty countries, it prefers two or three large, global banking relationships for a more cost-effective and lower-risk approach. For example, one large bank can provide services more cheaply and better manage the company’s currency exposure across multiple markets.

One large financial company can offer more sophisticated risk-management options and products. The challenge has become that in some cases, the party on the opposite side of the transaction from the global firm has turned out to be the global financial powerhouse itself, creating a conflict of interest that many feel would not exist if Glass-Steagall had not been repealed. The issue remains a point of ongoing discussion between companies, financial firms, and policymakers around the world. Meanwhile, global businesses have benefited from the expanded services and capabilities of the global financial powerhouses.

For example, US-based Citigroup is the world’s largest financial services network, with 16,000 offices in 160 countries and jurisdictions, holding 200 million customer accounts. It’s a financial powerhouse with operations in retail, private, business, and investment banking, as well as asset management. Citibank’s global reach make it a good banking partner for large global firms that want to be able to manage the financial needs of their employees and the company’s operations around the world.

**UNIT – V**

**GLOBAL COMPETITIVENESS:**

**Introduction:** The International Institute for Management Development defines competitiveness as "a field of economic knowledge which analyzes the facts and policies that shaped the ability of a nation to create and maintain an environment that sustains more value creation for its enterprises and more prosperity for its people."

**Meaning:** The World Economic Forum defines global competitiveness as "the ability of a country to achieve sustained high rates of growth in gross domestic product (GDP) per capita."

## Factors Affecting Global Competitiveness

Business firms abide by the rules and regulations formed by the government. The government assumes a very important role in enhancing competitiveness. Governments must promote trade by reengineering systems and procedures. Governments should be more responsive, reducing bureaucratic red tape.

* **Physical infrastructure** plays a critical role in improving the global competitiveness of a country. This will lead to the smoother movement of people, products, and services, facilitating faster delivery of goods and services.
* The business environment should be as such that it improves **coordination among public-sector agencies**. The best methods include providing support and incentives for R&D activities, HRD and education, encouraging innovativeness and creativity, facilitating the improvement of industrial blocks, and productivity enhancements of SMEs.
* **High total factor productivity** (TFP) is a boon for economic growth. It shows the synergy and efficiency of both capital and HR utilization and promotes national competitiveness.
* **Productivity campaigns** are important because they promote public-awareness and provide mechanisms to use the productivity tools and techniques.
* **Intensifying R&D activities** that contribute to creativity, innovation, and indigenous technological development is also an important factor.
* **Improving the capacities of SMEs** to become increasingly productive suppliers and exporters makes strategic sense.

# Export Management

## Concept of export management

Export business is prevalent around the globe and in recent times it has grown at much faster rate due to globalization process. Export means transaction of products and services from one nation to other following legal rules for trade purposes. Export goods are given to international end users by domestic producers.

Export management is the use of managerial process to the serviceable area of exports. It is basically associated with export activities and type of management that brings harmonization and incorporation of an export business. Export management is concerned with export orders and accomplish objectives to successfully complete in time as per the requirements given by the overseas buyers.

The main purpose of export management is to secure export orders and to make certain for timely delivery of goods as per agreed norms of quality and other specifications including terms and conditions agreed to between the exporter and the importer.

## The nature of export management

Export management can be appraised with reference to functional area of export and the administrative process involved in export management.

## Categorization of Export

The export can be grouped into many sections such as Merchandise Exports, Services Exports, Project Exports, and Deemed Exports.

A merchandise export is related with the export of physical goods, for example, readymade garments, engineering goods, furniture, and works of art. Service Exports denotes to the export of goods that don't exist in physical form, that is, professional, technical or general services.

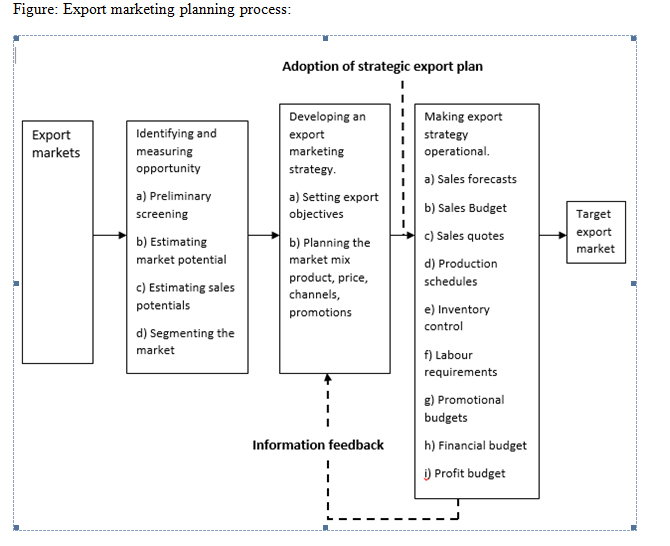
Examples of the exports would include export of computer software, architectural, entertainment or technical consultancy services. Project export means to develop a project by a business firm in a different nation.

It is viewed as systematically evolved work plan devised to achieve a specific objective within a specific period of time.

Deemed Exports refer to those transactions by the recipient of the goods in which the goods are made in India.

The necessary condition is that such goods are manufactured in India. This category of export has been introduced by the Export Import Policy of the Government of India.

Some of the examples of goods that are considered as Deemed Exports, as given in Export-Import Policy (2002-07) are supply of goods against duty free licenses, Supply of goods to projects financed by multilateral or bilateral agencies/Funds notified by the Department of Economic Affairs, Ministry of Finance, Government of India and supply of goods to the power, oil and gas including refineries.



## Function of Export Manager

Export manager has important role in managing business for international orders. They must be competent to perform export business. The conventional management structures with functional classification such as purchases, marketing, finance, accounts, administration, cannot make certain efficiency in export management through all stages in the export phases.

Therefore, export manager is needed to successfully conduct export business operation. The basic role of an export manager is to bring about synchronization and integration of the export transaction from within the established management structures and concerned external agencies to guarantee timely delivery of goods as per the specifications of purchaser.

The export manager is accountable for the successful completing of the order in terms of time, cost and technical performance. He must provide the guidance necessary to connect the people and groups from dissimilar departments working on the export order, into one team in a managerial organisation and provide the drive necessary to complete the task on time and within cost.

He must have good understanding of the techniques applied in export planning, financial management, inventory management, merchandising, risk management, foreign exchange operations, exchange control, negotiation with banks information systems, communication, personnel management and industrial relations, co-ordination and control. The efficiency of export manager will depend upon the extent of authority delegated to him by the senior management.

## Process of Export Management

When it is decides to develop export business, the primary function is to make good plan to secure an export order. After confirming the order to the consumer, it is necessary to develop an organization structure for it and form competent team of personnel for its implementation. Export Manager has great responsibility to manage all operation in timely manner. The success of the export order depends, on his efficient management and handling of export orders.

He must maintain liaison with the importer, prepare plans for its implementation and issue necessary executive instructions to the export employees. He has also to develop an information system so that there is continuous flow of information on the progress of the order. In case, if progress is not satisfactory and some tasks are not performed as per prescribed schedules, export manager has duty to evaluate the variances and tasks suitable corrective measures, if necessary, for the purpose and ultimately submit report on the progress of work to the top management. The major functions of the export manager in managing orders are: procurement of export order, planning for export order execution, direction for exports, export order execution, importer liaison, export order evaluation, reprogramming, reporting on export order execution.

## Development of Export Strategies

Once a detailed market analysis has been completed, company should develop a method of market entry. The indirect methods of market entry usually need less marketing investment, but company could lose considerable control over the marketing process. Direct exporting may require huge capital investment in marketing, but there is more control over export strategies. Corporate presence is a choice for companies with successful test marketing. In Direct Exporting, Company or individual can access directly to customers and sell them products in foreign markets by establishing an export department within your organization. Selling through company's sales department creates a chance to establish healthy relationship with the abroad market and buyer.

In addition to selling directly to the market, company can penetrate and may also choose to use an export manager to handle other parts of the world. In fact, in some countries, it is not necessary to sell directly to the end-user; company must use a local agent or representative. Other direct exporting options are Manufacturer's Representative or Sales Agents. They are the persons who are responsible for closing the sale and taking orders on a commission basis. They do not take financial responsibility or collect payment for the goods sold, and they assume no risk or responsibility for the product. Foreign Distributor/Importer is another option for exporting who buys the product and is always responsible for payment of the export item. They presume financial risk and generally provide support and service for the product. Distributors often buy to fill their own inventories and typically carry a range of non-competitive, but complementary products. Overseas Retailers are also involved in exporting products.

Indirect Exporting is preferable for complex task and also cover the risk of direct exporting. An Export Management Company functions as an "off-site" export sales department, representing company's product along with a variety of non-competitive manufacturers. The Export Management Company searches for business for company and usually provides the array of services like it performs market research and develops a marketing strategy, locates new and utilizes existing foreign distributors or sales representatives, to put your product into the foreign market, functions as an overseas distribution channel or wholesaler, takes title to the goods and operates on a commission basis. Another indirect exporting option is through Export Trading Company which is analogous to Export Management Companies. The ETC is more likely to take title to the product and pay directly, but like an EMC, they can also act as an export department. Usually, there is less responsibility on the part of the ETC towards the supplier and they tend to be demand driven and transaction oriented. Licensing offers a small business the advantages of rapid entry into foreign markets as well as reducing the capital requirements to establish manufacturing facilities overseas. Other option is Franchise agreements that tend to give the franchiser more control over marketing, since it is the company's reputation and existing market relationship that adds value to the product. Agreements with foreign manufacturers to produce company product, as opposed to exporting to the overseas region is known as contract manufacturing. It is an easy foreign market entry method when your manufacturer is already producing company product for the domestic market.

## Benefits of Exporting

Main benefit of export is the possession which is specific to the firms' international experience, asset and capacity of the exporter to offer distinct product or low cost product with in the values chain.

An assortment of investment risk and market potential is recognized as the site benefit of the particular market combination.

Some companies have lower level of ownership advantage therefore they may not enter into the foreign markets.

In case a company's products and company's ownership equipped with the international advantage and ownership advantage, the entry can be made through low risk model.

Another benefit is that low investment is needed in exporting of goods than the other modes of international trade and development.

In export of products, the managers perform the various operational control however it does not have the option over the control of marketing activities of the company.

The consumer of exported goods is far away from the exporter though the different intermediaries can manage the risk.

## Problems and issues in export management

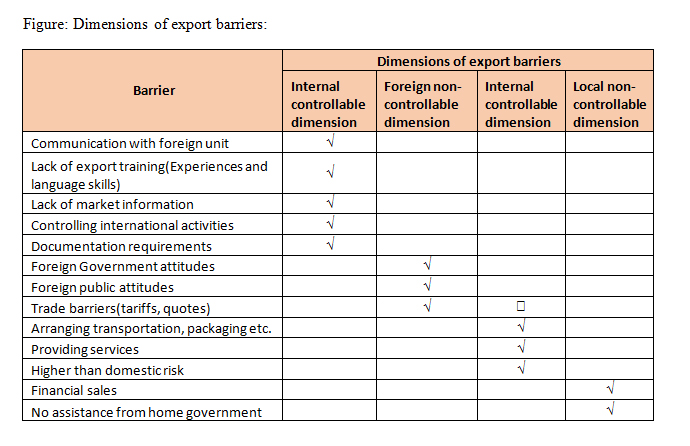
Major barriers of export management include language, high risk, government control, difference in laws, difficulty in payment, custom duty, and lack of information. Other problems of export management are evil effects of foreign trade, economic dependence, disadvantage of agriculture country, international rivalry.

Researchers said that there is high risk in foreign trade instead of internal business because goods are transported to other countries through sea, air in which there is environmental threat and products may be damaged from poor climate, rocks etc.

Usually international trade is under governmental control and licence is must for doing international trade. In export, management, there are differing law in each country therefore traders have to face many problems in conducting business.

Export management become difficult when information flow is not smooth. It is very difficult to assess the financial position of businessman located in other country. It is observed that developed nations get advantage through export business but developing countries may suffer loss as they cannot manufacture goods at rapid rate and managerial process is also not very smooth.

Another problem is dependency on other country for raw material and if imports are stopped due to some reasons, country has to suffer a lot in terms of finance. Export management is not smooth due to low labour productivity, less technological advancement and laziness.



In order to reduce issues of export trade, it is suggested that traders must know various language for good conversation. Export managers must have knowledge of exchange rates. They must modernize the process of foreign trade and standardize the products. In addition to this there are some major disadvantages highlighted in the export of goods such as financial management, communication technology improvements, and customer demand and management mistakes. To reduce the risk of transaction process of exporting the goods and exchange rate fluctuation, it is necessary to have more capacity for managing the financials for coping up the efforts. Presently, customers can directly communicate with the suppliers with the aid of communication technology which has improved the way of purchasing goods. It leads more clearness in transaction and purchasing of goods and vendors are responsible for following the real time demand for submitting the transaction details.

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It is summarized that exporting is common way for manufacturers to do business in foreign market. Success of export management requires the enthusiastic, honest and positive support of all the functional managers in the organisations. Good export management gets the export order completed within the time and as per the budget allocated for particular project.

# Licensing

**Definition**: Licensing is defined as a business arrangement, wherein a company authorizes another company by issuing a license to temporarily access its intellectual property rights, i.e. manufacturing process, brand name, copyright, trademark, patent, technology, trade secret, etc. for adequate consideration and under specified conditions.

The firm that permits another firm to use its intangible assets is the licensor and the firm to whom the license is issued is the licensee. A fee or royalty is charged by the licensor to the licensee for the use of intellectual property right.

**For example**: Under licensing system, Coca-Cola and Pepsi are globally produced and sold, by local bottlers in different countries.

In finer terms, it is the simplest form of business alliance, wherein a company rents out its product based knowledge in exchange for entry to the market.

### Why Licensing?

The overseas company enters into a licensing agreement with another company based in the domestic country, for a specified period of time. The two primary reasons for entering in the licensing agreement are:

* International expansion of a brand franchise.
* Need for commercialization of new technology.

Generally, a firm opts for license its products, when the firm holds that the consumer’s acceptance of the product is high. It helps the licensee to differentiate the product from other products offered by the competitors in the market. Further, it also assists the licensing company in reaching new customers at a low price.

## Benefits and Limitations

In licensing, the licensor gets the advantage of entering the international market at little risk. However, the licensor has little to no control over the licensee, in terms of production, distribution and sales of the product. In addition to this, if the licensee gets success, the firm has given up profits, and whenever the licensing agreement expires, the firm might find that it has given birth to a competitor.

As a prevention measure, there are certain proprietary product components supplied by the licensor itself. Although, innovation is considered as the appropriate strategy so that the licensee will have to depend on the licensor.

On the other hand, the licensee acquires expertise in production or a renowned brand name. It expects that the arrangement will increase the overall sales, which might open the doors to the new market and help in achieving the business objectives. However, it requires a considerable capital investment, to start the operations, as well as the developmental cost is also borne by the licensee.

# Joint Venture

Joint Venture is a business preparation in which more than two organizations or parties share the ownership, expense, return of investments, profit, governance, etc. To gain a positive synergy from their competitors, various organizations expand either by infusing more capital or by the medium of Joint Ventures with organizations.

## Joint Ventures: Joint Ventures can be with a company of same industry or can be of some other [industry](https://www.toppr.com/guides/geography/industries/introduction-to-industry/), but with a combination of both, they will generate a competitive advantage over other players in the market.

In short, when two or more organizations join hands together for creating synergy and gain a mutual competitive advantage, the new entity is called a Joint Venture. It can be a [private company](https://www.toppr.com/guides/business-laws/companies-act-2013/private-companies/), public company or even a foreign company.

In India, many companies underwent joint venture with various foreign companies, which were either technologically more advanced or geographically more [scattered](https://www.toppr.com/guides/business-mathematics-and-statistics/correlation-and-regression/scatter-diagram/). The major joint ventures in India were done in sectors like [Insurance](https://www.toppr.com/guides/business-studies/business-services/insurance/), [Banking](https://www.toppr.com/guides/general-awareness/banking/structure-of-banking-in-india/), Commercial [Transport](https://www.toppr.com/guides/geography/human-environment-settlement-transport-and-communication/settlement-transport-and-communication/) vehicle, etc.

## ****Characteristics of a Joint Venture****

### 1. Creates Synergy

A joint venture is entered between two or more parties to extract the qualities of each other. One company may possess a special characteristic which another company might lack with. Similarly, the other company has some advantage which another company cannot achieve. These two companies can enter into a joint venture to generate synergies between them for a greater good. These companies can work on economies of large scale to give cost advantage.

### 2. Risk and Rewards can be shared

In a typical joint venture agreement between two or more organization, may be of the same country or different countries, there are many diversifications in culture, technology, geographical advantage and disadvantage, target audience and many more factors to overcome. So the risks and rewards pertaining to the activity for which the joint venture is agreed upon can be shared between the parties as decided and entered into the legal agreement.

### 3. No Separate Laws

As for joint venture, there is no separate governing body which regulates the activities of the joint venture. Once they are into a corporate structure, then the Ministry of Corporate Affairs in association with Registrar of Companies keep a check on companies. Apart from that, there is no separate law for governing joint ventures.

## ****Advantages of Joint Venture****

### 1. Economies of Scale

Joint Venture helps the organizations to scale up with their limited capacity. The strength of one organization can be utilized by the other. This gives the competitive advantage to both the organizations to generate economies of scalability.

### 2. Access to New Markets and Distribution Networks

When one organization enters into joint venture with another organization, it opens a vast market which has a potential to grow and develop. For example, when an organization of United States of America enters into a joint venture with another organization based at India, then the company of United States has an advantage of accessing vast Indian markets with various variants of paying capacity and diversification of choice.

At the same time, the Indian company has the advantage to access the markets of the United States which is geographically scattered and has good paying capacity where the quality of the product is not compromised. Unique Indian products have big markets across the globe.

### 3. Innovation

Joint ventures give an added advantage to upgrading the products and services with respect to technology. Marketing can be done with various innovative platforms and technological up gradation helps in making good products at efficient cost. International companies can come up with new ideas and technology to reduce cost and provide better quality products.

### 4. Low Cost of Production

When two or more companies join hands together, the main motive is to provide the products at a most efficient price. And this can be done when the cost of production can be reduced or cost of services can be managed. A genuine joint venture aims at this only to provide best products and services to its consumers.

### 5. Brand Name

A separate brand name can be created for the Joint Venture. This helps in giving a distinctive look and recognition to the brand. When two parties enter into a joint venture, then goodwill of one company which is already established in the market can be utilized by another organization for gaining a competitive advantage over other players in the market.

For example, a big brand of Europe enters into a joint venture with an Indian company will give a synergic advantage as the brand is already established across the globe.

### 6. Access to Technology

Technology is an attractive reason for organizations to enter into a joint venture. Advanced technology with one organization to produce superior quality of products saves a lot of time, energy, and resources. Without the further investment of huge amount again to create a technology which is already in existence, the access to same technology can be done only when companies enter into joint venture and give a competitive advantage.

# Effects of Globalization on Human Resources Management

When a business expands its operation into other countries, the impact of globalization on human resource development and management is significant. Companies need to consider a diverse range of practical adjustments to be able to hire, train, retain and support a workforce that's often spread throughout several countries, which often have varying cultural identities. Human Resources departments must adapt their thinking and practices to include cultural differences, foreign regulations and technological developments.

## Globalization of Human Capital

Perhaps the greatest resource available to any company is the workforce it acquires and retains. As a company extends its base to a foreign shore, the impact of that globalization on HR procedures will extend to current workers and also to new employees. The HR department will need to increase support of its current staff, as they transfer overseas to new positions. Assistance with visas, work permits, and housing will be required, as well as training in cultural issues and perhaps language acquisition. New local talent must be acquired and developed, as well. A company's ability to move into new markets, will depend on its ability to fill needs with skilled workers. In some situations, local workers may meet the criteria, but in other situations, they may be more looking for skilled and already-trained employees to be transferred to positions in the new overseas location. In this case, the willingness of workers to become mobile could be a key factor to productivity.

## Corporate and Cultural Differences

Another significant impact of globalization on human resource development is the necessity to consider cultural differences, both in and out of the workplace. Businesses tend to have their own corporate cultures or ways of operating, but there are societal and cultural differences between people as well. Cultural norms within a society affect the workforce and how workers view their jobs, especially in relation to time spent with their family and ideas about employment expectations. Some cultures may also have varying mores about gender roles, particularly concerning the role of women in leadership. While a female in a managerial position is not uncommon in American culture, the same many not hold true elsewhere.

Similarly, a manager brought in from the home office may not be the best person to manage an overseas staff, because they do not understand all the nuances of the local culture and what's considered acceptable business practice. For example, in some countries, the typical work day may be quite different from the traditional 9 to 5 hours. Workers might be accustomed to starting their day earlier in the morning, taking a longer mid-day break for lunch and rest and then returning finishing their work by early evening. A manager who adapts to local culture may find better success among his employees.

## Employment and Tax Laws

Global expansion is also affected by varying tax and labor laws. HR departments need to be prepared to deal with different tax rates, benefit requirements or labor and environmental regulations. These requirements may be in addition to or even in conflict with current corporate policies, so adjustments to maintain compliance with local governments are necessary. HR managers must become experts in issues that not only pertain to their industry, but keep current with issues and government policies within the countries in which their company now operates.

## Long-Distance Communication Challenges

In a small, local business, the HR manager can ask an employee to stop by the HR office to sign a form, discuss an issue with their paycheck or to handle a policy-related issue. When managing employees over great distances and perhaps in several sites spread around the globe, HR departments face a bigger challenge in communicating with their employees. Often, they must rely on technology such as email or conference calling to relay information, thereby eliminating some of the more direct human elements of interaction. Offices are also open during different points in the 24-hour work day, so that even simple issues may take more time to resolve. Although forms and HR management software should be standardized throughout the company, accommodations may have to be made for language differences, as well.

# Globalization with Social Responsibility

**Globalization** is a dynamic set of social processes that is transforming our present social condition of nationality into one of globality, characterised by tight global economic, political, cultural, and environmental interconnections that make most of the currently existing borders and boundaries irrelevant.

The economic dimension of globalisation is highly significant in shaping contemporary societies and organisations through the intensification and stretching of economic interrelations worldwide. Its key components include the deregulation of interest rates, the removal of credit controls, and the privatisation of government-owned banks and financial institutions. Globalisation of financial trading allows for increased mobility among different segments of the financial industry, with fewer restrictions and greater investment opportunities.

The enhanced role of international economic institutions such as the International Monetary Fund (IMF), World Bank, and World Trade Organisation (WTO) enjoy the privilege position of making and enforcing the rules of the global economy. In return for supplying much-needed loans to developing countries these institutions implemented the structural adjustment programs, mainly directed at countries with large foreign debts. It can be observed the impacts that trade liberalisation policies have on industries in the third world.

But globalizations is a multidimensional concept that is not easily reduced to just the economic dimension. The intensification of global economic interconnections is set into motion by a series of political decisions. The political dimension of globalizations refers to the intensification and expansion of political interrelations across the globe. Recent economic developments such as trade liberalisation and deregulation have significantly constrained the set of political options open to states. Thus, global markets frequently undermine the capacity of governments to set independent national policy restrictions.

However, the worldwide intensification of economic and political interaction does not consider in sufficient detail the cultural feasibility of global democracy, which makes the possibility of resistance and opposition just as real as the mutual accommodation and tolerance of differences.

The cultural dimension of globalisation refers to the intensification and expansion of cultural flows across the globe facilitated by the Internet and global media empires that rely on powerful communication technologies to spread their message, giving rise of an increasingly homogenised popular culture underwritten by western culture industry.

**Corporate social responsibility (CSR)** of business activity is strongly influenced by globalisation, particularly through the change and erosion of national political power.  CSR has four kinds of social responsibilities, economic, legal, ethical, and philanthropic. These four components of CSR might be represented as a pyramid with economic responsibilities ‒ and profit motive as the primary incentive ‒ underpinning all other business responsibilities.

Business organisations have also to comply with laws and regulations as the ground rules under which they must operate. These legal responsibilities establish the ground of fair operations and are represented as the next layer on the pyramid. In this way, organisations are expected to perform in a consistent manner with the government and law expectations.

However, society also expects from organisations other activities and practices that are not codified into law. These ethical responsibilities embrace those norms that reflect a concern for what consumers, employees, shareholders and community regard as right, just, and fair (i.e. moral rights), and are represented as the next layer of the CSR pyramid. Thus, corporate behaviour goes beyond mere compliance with laws and regulations.

**Globalization**, as defined in terms of the deterritorialisation of economic activities, is particularly affecting business ethics in three main areas – culture, law, and accountability.

Within the cultural issues, it could be seen how corporations increasingly engage in overseas markets, suddenly finding themselves confronted with new and diverse ethical demands.

Moral values, which were taken for granted in the home market, may get questioned as soon as corporations enter foreign markets.

The legal issues are closely linked with ethics and law. As soon as a company leaves its home territory the legal framework becomes very different. Consequently, managers can no longer simply rely on the legal framework when deciding on the right or wrong of certain business practices.

Finally, globalization leads to a growing demand for corporate accountability where business ethics can respond to the various stakeholders’ claims.

Writing CRS strategies is an important step but implementing them can be a different story as the good intentions do not always come into practice as planned.

**Five strategies for negotiating international business contracts**

When doing business internationally, there are numerous areas for negotiation. What happens if the merchandise is damaged during transportation? What inspections or authorization paperwork is necessary? When will payment be made, in which currency and by what date? What, if anything, will the packaging consist of? What are the regulations related to importing and exporting the product, in all countries involved with the transaction? Negotiation is where these and numerous other questions should be answered. If the contract does not address these questions, or is not clear, they will be answered by applying the law of whatever country or international convention has been chosen to govern the contract. Negotiation is the fulcrum of commercial transactions. When parties consider buying or selling, importing or exporting goods, it is with the intention of gaining something that will benefit their bottom line. These gains are often at the expense of other parties who have their own gains in mind. The final agreement on what will be exchanged is often the result of rounds of negotiations full of concessions: some voluntary and some based on foreign legislation (for example, some countries dictate local owners must retain 51 percent of legal ownership of a venture).

1) Hire a consultant If there is no in-house expertise skilled in the international negotiation arena, retain one to help. If cost is an issue, purchase literature or search online to subscribe to an accredited expert.

2) Choose your team wisely Consider a small, competent team to manage expenses, schedules and communication more effectively, especially if travel is necessary. Also, if there is a language or cultural barrier, be sure to include a translator and/or customary expert as part of your team.

3) Gauge your counterpart’s bargaining power and negotiation style usually one party has substantially more to gain or lose from an international venture. Over or underestimating the balance of bargaining power can result in unnecessary concessions or failed negotiations. Similarly, if you approach negotiations too aggressively and your counterpart is more passive, or if you are technically focused and they are financially focused, the business venture will not seem like a good fit.

4) Meet them in person If at all possible, it is important to meet with prospective parties face-to-face. Be conscientious of cultural norms. Be on time, dress in appropriate attire and demonstrate proper manners and respect. First appearances go a long way in establishing the tone and trust level for further negotiations. Similarly, choosing a neutral site or persuading them to come to your home territory can help you overcome or address cultural biases.

5) Fix the agenda and keep detailed records In addition to being perceived as professional and informed, an agenda (or a checklist) helps keep time, expenses and schedules in check, limits the number of issues that can be overlooked, keeps further rounds on track, and provides reference for future negotiations.

# INTERNATIONAL ASSET PROTECTION

The need for **international asset protection** has never been greater than it is right now. Lawsuits against high-net-worth individuals, high risk professionals, and entrepreneurs continue to proliferate. Government intervention allowing unprecedented control over individual wealth (e.g. The Patriot Act and NSA) has never been higher, and technology only compounds the problem. It has never been easier for a government bureaucrat to identify individual bank accounts, securities, and/or real estate and freeze those assets before any trial takes place.

The government can now make a presumption of guilt and freeze assets. Likewise, civil plaintiffs’ lawyers have lots of tools for discovering what you own and how you own it. These attorneys are highly motivated to take your wealth. International asset protection provides a solution to these problems.

# International Asset Protection

Ignore the world of international asset protection at your own peril. The rest of the world is well accustomed to the concept of using international tools for the protection of wealth. Why aren’t we? The answer is that we’ve grown too comfortable at home. Our view isn’t as worldly as the views of Europeans, South Americans, Asians, and Australians who are constantly crossing borders. We’re happy dealing with local banks and domestic estate planning tools, but complacency has a significant cost.

The truth is that the United States has some of the best financial institutions in the world. That’s why so many people from other countries use the U.S. as their jurisdiction of choice for international asset protection. However, the problem with living in the land of the free and the home of the brave is that we have to give ourselves the option to move beyond the borders of the U.S. if we want the full benefits of international asset protection.

International asset protection is about legally diversifying your wealth. It’s not about secrecy or about hiding your assets (though it does provide A LOT of privacy). Rather, **the aim of international asset protection planning is simply to separate your assets from your risk**.

## International Asset Protection Doesn’t Have to Be International

Great international asset protection doesn’t necessarily have to be international from the start, but an asset protection plan does need to be in place before a lawsuit or other claim is asserted against you. Think of international asset protection planning as preventative medicine and not as a cure for currently pending litigation.

**That means that your asset protection plan can exist completely inside the United States with features that make it (and your wealth) completely and legally transferrable to an offshore jurisdiction even after a lawsuit is filed against you.**

**The benefits of international asset protection include:**

* Privacy – Nobody will know what you have until you tell them.
* Control – The vast majority of my clients never lose control of their assets at any point in time.
* Diversification – If you only risk being sued in the U.S., make sure you have the option to quickly and legally move your assets to another country, where you have no risk of being sued.
* Ironclad protection – So long as your plan is set up as “preventative medicine,” it is the strongest form of protection available.

## Once Your Plan Has Gone International

After a “triggering event” (e.g. potentially catastrophic lawsuit) has occurred and you’ve ported your asset protection plan to an international jurisdiction, the first thing you’ll want to know is “Will my money be safe offshore?” The answer is yes. None of my clients have ever lost money placed into foreign banks or assets held by the offshore trust companies we work with. Very simply, concern over foreign financial institutions is misplaced, and international asset protection is safe.

Once you’ve chosen to avail yourself of international asset protection laws, you’ll have your choice of banks. You can use any of the following:

* A bank in the jurisdiction of your international asset protection plan (most likely the **Cook Islands, Nevis, or Belize**);
* Banks located in major non-U.S. financial centers;
* Financial institutions located in the Cayman Islands (the world’s fifth largest banking center);
* European banks (many Swiss private banks are capitalized at 50% tier 1 capital ratios compared to U.S. banks which are almost always below 20%);
* Banks in the Far East (e.g. Hong Kong or Singapore).

**Multilateral Settlement of Accounts**

A system of mutual payments used in foreign trade, credits, investments, and nontrade payments that involve three or more parties.

Various forms of multilateral settlement of accounts are employed in the international payment practices of both capitalist and socialist countries. The leading such form in the capitalist countries under present-day conditions is settlement in freely convertible currencies.

Multilateral clearing based on the principle of the transferability of sums held on account by the participants in the settlement is one distinctive form of multilateral settlement. The system of “transfer accounts” in pounds sterling, which operated in Great Britain between 1947 and 1958, provides an example of such clearing.

Another form of multilateral clearing practiced by the capitalist countries is the “currency club” examples include the Hague Currency Club and the Paris Currency Club. Participants in this form settle their accounts in partially convertible currencies.

Multilateral settlement of accounts is also used extensively among the socialist countries. Since 1964, accounts among the countries that belong to the Council for Mutual Economic Assistance have been settled in transfer rubles under a system of multilateral settlement of accounts operated through the International Bank of Economic Cooperation.

**MULTILATERAL SETTLEMENTS**

**Make No Payment:** Or more accurately, associate an alternative payment method (which allows the option to make no payment to the subsidiary). For example, if all netting settlements are made by BACS but one subsidiary has net flows greater than the BACS limit, then this subsidiary could have an alternative settlement method allowing wire transfer.

**Matching:** The process of agreeing transactions between participants. Matching is usually completed on invoice number as a key field plus other criteria such as participant code, currency, amount, reference information etc. see also Mismatching.

**Mismatching:** This is a common problem needing to be fixed at many companies. The two versions of any transaction need to be matched and agreed in a tight time scale.

### Month End Reconciliation

### Multi-lateral Netting

### Multilateral Netting

* An arrangement which allows settling of obligations such as payments, for multiple parties, through a central point (see also Intercompany Netting, FX Netting, Balance Netting).

### Multilateral Netting System

* Software that allows the calculation of the amount to offset and is owed to or owed by any one netting participant.

### Multilateral Settlement System

* The software and/or hardware needed to run a multilateral netting process.

**ALL THE BEST!!!**

**BEST OF LUCK!!!**

**THE END.**