Global Marketing Management
Prof. Zillur Rahman
Department of Management Studies
Indian Institute of Technology - Roorkee

Module - 1
Lecture - 5
Global Economic Environment - Part III

Welcome to this course on Global Marketing Management. And we are talking about the second section in this course. This second section deals with the Global Marketing Environment. Remember that Global Marketing Environment is made up of several different environments. 1 important environment that makes up Global Marketing Environment is the Global Economic Environment.

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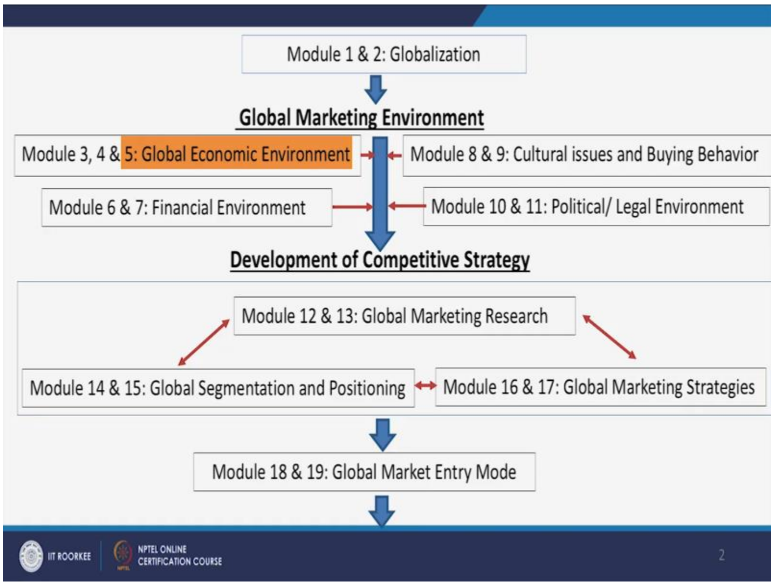

Module 3, 4 and 5 are related to Global Economic Environment. In module 3, we have seen the different type of economic systems that are there. Then, we have also seen that how integrated the world economy is. And lastly, we have seen the various stages in market development. In module 4, we have seen the evolution of the global trading arrangements.

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In module 5, we will talk about the regional trading arrangements and multinational corporation. Let us quickly recall, why do countries trade? So, besides many other reasons, 1 plain, simple and primary reason is that, all countries that trade are better off at the end of the day. And also, I would like you to recall from module 2, various theories of international trade which also suggest the same thing.

But then, the question is why do not countries trade? If everybody will be at the advantage then why do not countries trade? Let us take the same example that we have talked about in module 4. There are 2 countries, Brazil and Argentina. Both of them knows that if they, if Brazil imports from Argentina, then there will be a lot of benefits. And Argentina also knows that if they import from Brazil, there will be lots of benefit.

But, why do not then they trade? For a plain simple reason. Brazil thinks that if it reduces the barriers from Argentina, lots of Argentinian goods will come into Brazil. And what if Brazil does not reciprocate by reducing the barriers. Then, Brazil would be at a loss. And similarly, Argentina also thinks the same thing. So, this is why this is so happening? This is primarily happening because of the trust deficit.

There is no trust between these 2 countries. Second important reason why these countries are not able to trade is that, a person, let us assume that we are talking of 2 countries, India and Thailand. When an Indian export to Thailand, we want to have Indian rupee in return. While the Thai people has, have Thai baht to give to us. And similar is a situation with Thailand also. So, there has to be a system whereby the value of currency can be transferred from 1 currency to another currency.

So, as we have seen in module 4, several institutions have come into place including WTO. And that we have talked about in module 4. And also, IMF and the World Bank that we will talk about in the financial environment, these institutions, they have come up to established a basic amount of trust between countries, 1. And then, to establish a monetary system. International monetary system whereby, the value of money can be transferred from 1 currency to another currency.

So, in fourth module, we have seen that WTO of how global trading arrangements, cooperative trading arrangements have come up from International Trade Organization to general agreement on tariffs and trade and to World Trade Organization. Now, there are several benefits of World Trade Organizations that we have seen in module 4. And at the same time, there are several disadvantages also.

1 basic disadvantage of WTO is that, it is a very big body and small issues when they are taken up to WTO, they can become very complex. Now, what happens then. Because there are so many members, a simple issue; for example, in India, Indian government gives lots of advantages to females. For example, the income tax rate for females is less and also the interest rate that they pay on the loans that they take from banks is less.

Now, a person in Argentina or Argentina government may think that this is not the right way to do things. And then, they may take it up at WTO. Now, this issue becomes complex because there are lot there are so many countries involved. And it means that, the trade will not happen. To overcome this kind of problem, countries now, they have started a via-media whereby the trade, international trade or trade between countries can still happen. And those arrangements are called as regional economic arrangements. Now, WTO defines regional trade arrangement as reciprocal trade arrangement between 2 or more countries.

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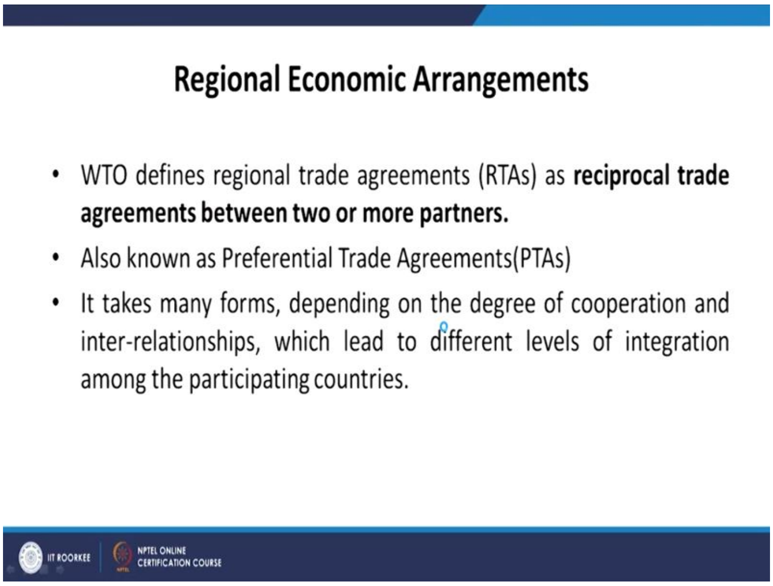

So, 2 or more countries, generally they are closely located. They enter into agreement of, agreement to increase trade by reducing tariff and non-tariff barriers. So that, at the end of the day, these 2 countries are at a advantage. Now, these regional economic arrangements are also called as preferential trade agreements. And these agreements can take several forms depending upon the kind of integration or interrelationship that exist between these nations.

So, what happens in this regional economic arrangements of preferential trade agreements is that, the partners they give special treatment to each other and they may discriminate against the other members. About 300 preferential trade agreement have been notified by the World Trade Organization.

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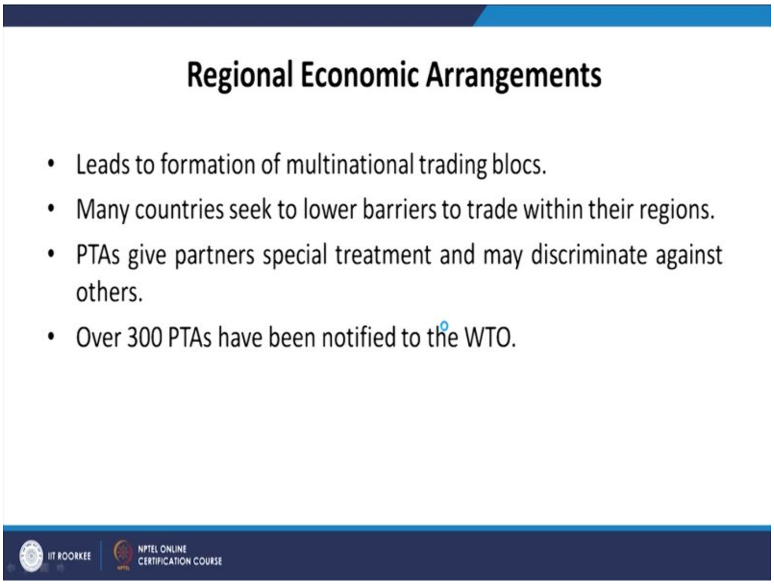

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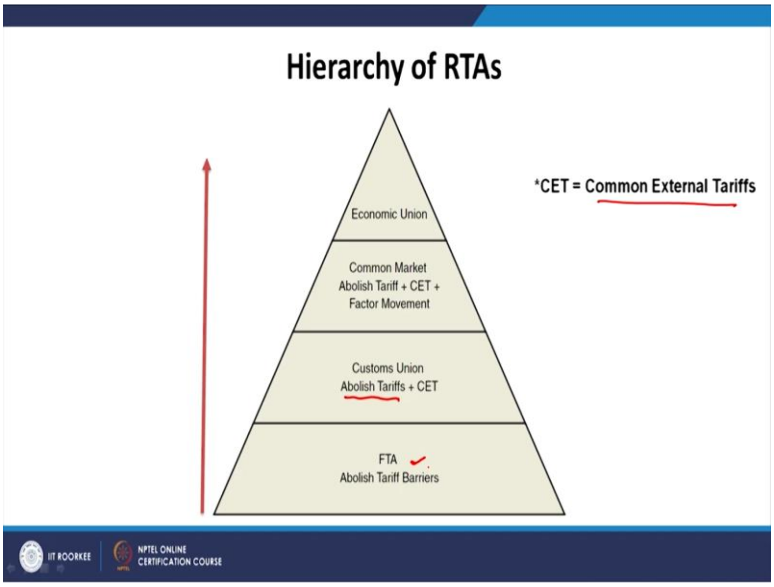

Now, look at this triangle. This is the hierarchy of regional trade agreement or preferential trade agreement. At the base of this triangle are FTA that is Free Trade Arrangements. So here, what happens is, the 2 countries or the 3 countries, they decide to abolish tariff barriers. This is the first level of integration. As the trade happens over a period of time, the economic arrangements and the integration, it increases.

And then, it goes on up to the, to the next level which is called as custom union. In custom union, you see that what happens, you are abolishing tariffs, 1. And then, you also have Common External Tariffs. In FTA there were no Common External Tariffs. Here, there are common external tariffs. I will explain the difference in a moment. As you move off, there are common markets. In common markets, common markets are custom union + factor moment.

Factors are factors of production. So, land, labor, capital and technology. It becomes easier for people and money to move from one country to another. And at the last and the highest level of integration is economic union. Now, let us see about each of them in detail. So, these are the 5 different types of regional economic arrangement.

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The last one and the most highly integrated one is called as political union. For example, union between the West Germany and the East Germany. Now, see what happens in a free trade area. 2 or more countries agree to abolish tariff, 1.

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So, this is important. They agree to abolish tariff and other barriers. So, they agree to abolish tariff and non-tariff barriers to trade amongst themselves. And at the same time, they continue independent trade policies with countries outside this arrangement. So, India will have a different kind of tariff structure with other countries. And if we have a FTA with Sri Lanka, Sri Lanka will have its own different kind of tariff arrangement with other countries.

An important characteristic of this free trade area is rules of origin. It restricts transshipment of goods from the country with the lowest tariffs to another country. Now, you see what happens is that, there is this country, let us say it is India, assume let assuming that it is India. And then, there is another country, let us say it is Sri Lanka. Now, India and Sri Lanka they enter a free trade agreement with each other and they have reduced their tariff and non-tariff barriers for trade between these 2 countries.

But India will have a different kind of tariff structure with the rest of the world, while Sri Lanka at the same time will have a different kind of tariff structure with the rest of the world. This rule of origin means that any product that originates in India will get this preferential treatment and it can be sold in Sri Lanka and vice versa. But, the problem here is that, if suppose coal attracts 10% duty to get imported into India, while it attracts 20% duty to gets get imported into Sri Lanka.

What happens is that coal gets imported to India. They pay 10% duty. And then, because now it has come into India, it this, it becomes the rule of origin is applicable to it and it comes into India. So, it becomes, its origin become Indian. And then, it gets exported to Sri Lanka under 0 tariff. So, here the problem is that, Sri Lanka is at a loss because it was supposed to import coal from other countries at a 20% interest rate 20% duty.

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So, to over, these are the various types of free trade areas. 1 free trade area is North America Free Trade Area. That was established in 1994. There are 3 member countries, Canada, United States and Mexico.

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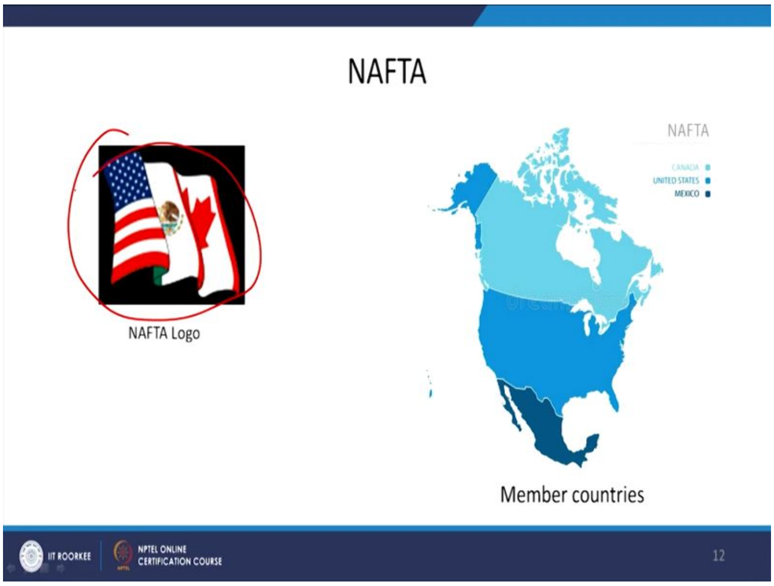

This is the logo of NAFTA.

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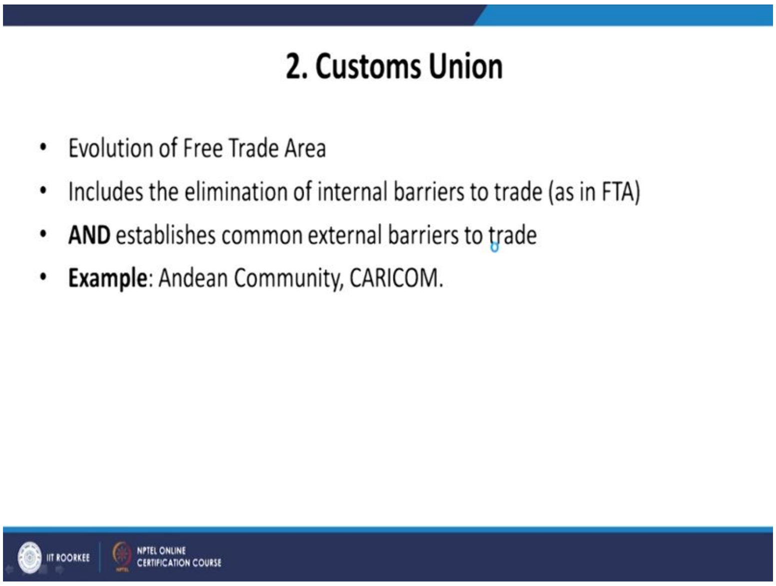

Next level of integration is customs union. Now, it is, at the first level we had the free trade area. Then over a period of time, the economic integration increased. And now, they had common external barriers to trade. So, if coal from India, coal in India is attracting 10% duty. Then it, this will happen the same here in Sri Lanka. So, that is what it means. Example: Andean Community and CARICOM.

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This Andean Community includes Bolivia, Colombia, Ecuador and Peru. So, they have abolished foreign exchange financial and fiscal incentives and export subsidies. And they have established Common External Tariffs.

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The next level of integration is common market. Now, keep in mind that now, we have now a term which is called as market, that is common market. That includes elimination of internal barriers to trade as in a free trade area and establishes a common external barrier to trade as in customs union and allows for free movement of factors of production. So, it is, common market is a free trade area plus a customs union plus a free flow free movement of factors of production. So, this is what a common market is. And there are several examples of common market. Mercosur, South African common market and SICA.

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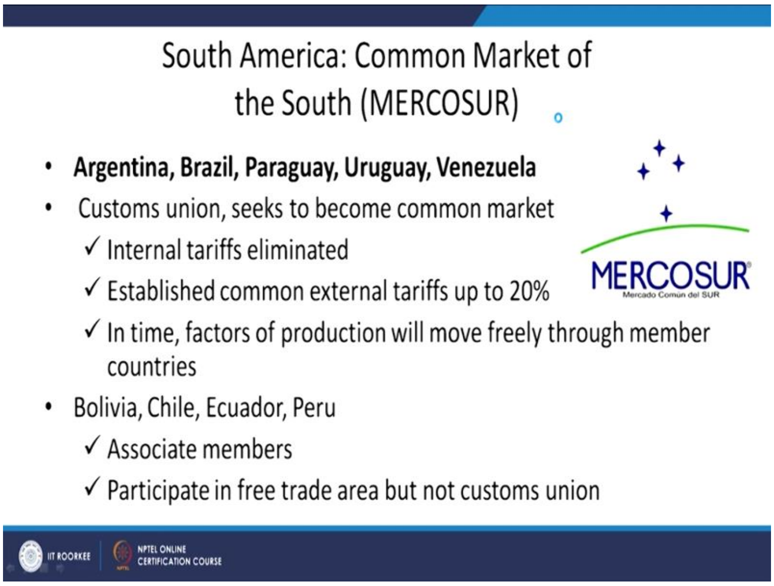

Mercosur means Argentina, Brazil, Paraguay, Uruguay and Venezuela.

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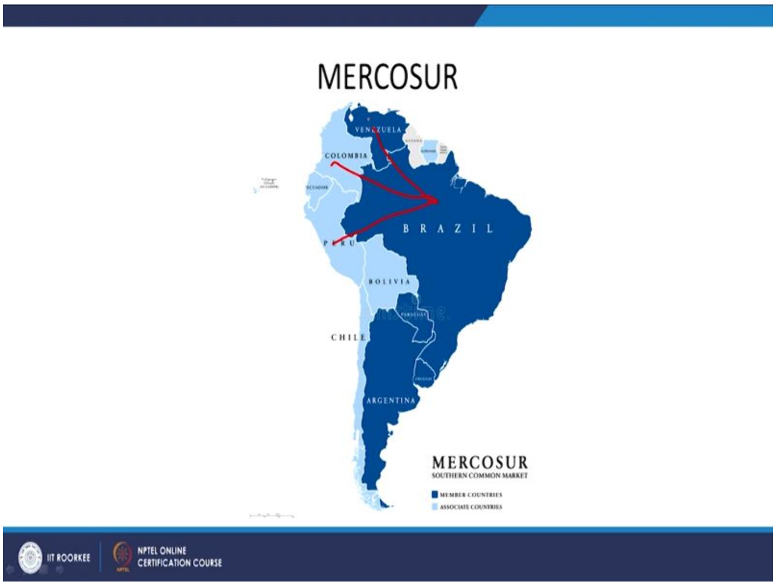

This is the map of Mercosur. So, now you see that, individually the countries may be small except let us say Brazil and Argentina. But then, now it is a big area where trading can be done where movement of men and money can be easier. So, people in Brazil, they can move to Peru or to Columbia or to Venezuela to get jobs and so on.

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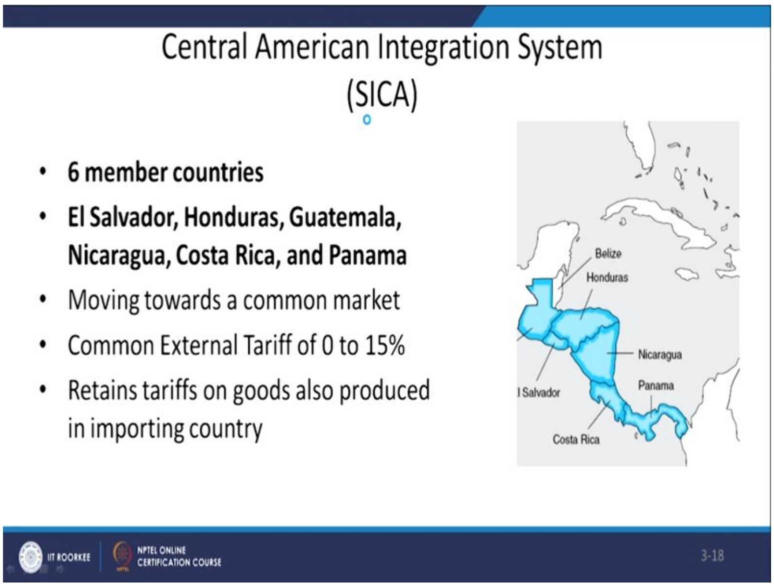

Then, another of this kind of system is Central American Integration System. It has 6 member countries; El Salvador, Honduras, Guatemala, Nicaragua, Costa Rica and Panama. They are now trying to move towards a common market, external tariff of 0 to 5, 15% and retain tariffs on goods also produced in importing countries.

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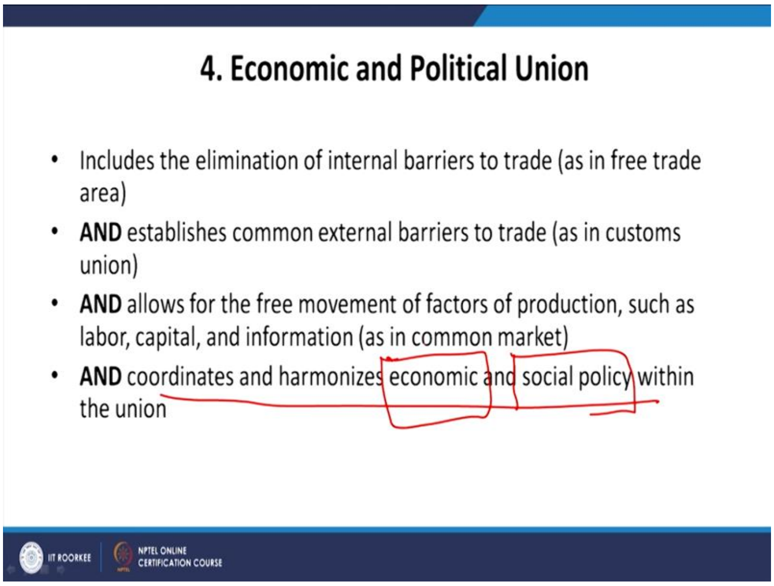

Next level of integration is economic integration and the final level of integration is the political union. So, economic union includes elimination of internal barriers to trade as in free trade area + common external barriers as in custom union; and allows free trade or free moment of factors of production as in common market; and in addition to that, it coordinates and harmonizes economic and social policy within the union.

So, here the important thing is that, in addition to common market, what is there in economic union is that, it coordinates and harmonizes economic and social policy. So, this social component and economic component, it gets into this.

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And this is what we are talking about, European Union. So, they have a independent flag, 1. They have created a signified central bank, there is a single currency, there are common policies on issues such as agriculture, social policy, transportation, competition, mergers and taxation. They require extensive political unity.

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This is what we are talking about, European Union. Let us talk briefly about the history of European Union. Initially, it began with the 1958 Treaty of Rome, to harmonize national laws and regulations so that goods and services, people and money could flow easily across national borders. In 1991, Maastricht Treaty set the stage for transition to and economic union with the central bank and a single currency. So, this common market having a common, having a Central Bank and a single currency, it became the European union.

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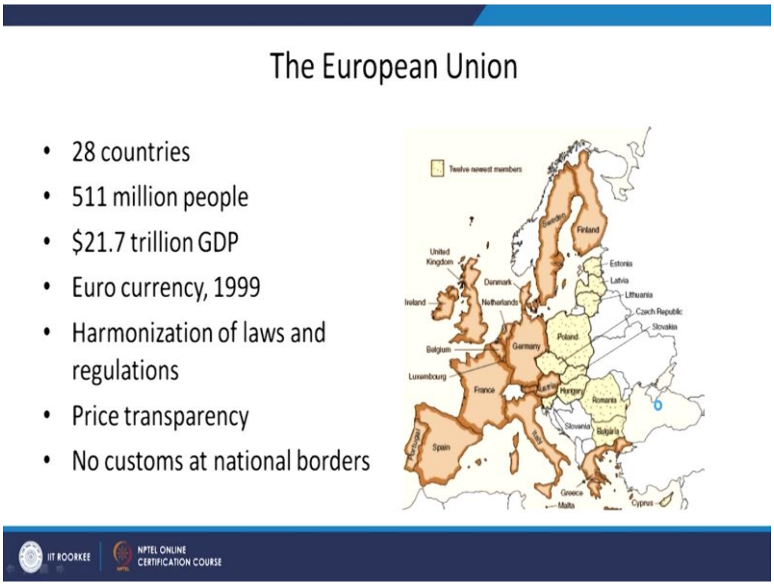

So the, so when the European Union was formed, there were about 28 countries, there were 511 million people and the there was no customs at national borders, harmonization of laws and regulations.

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Then, there is Association of Southeast Asian Nations. That is called as ASEAN. There are 10 member countries; Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam. And their major trading partners are U.S., EU and China. They are geographically closed. They are geographical close by located, but they were historically divided. Another association came into being, that is called as Asia ASEAN + 6. So, that include Japan, China, Korea, Australia, New Zealand and India. So, they are working towards an economic community.

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These are the flags of various ASEAN member countries. You see Philippines and Brunei and Indonesia.

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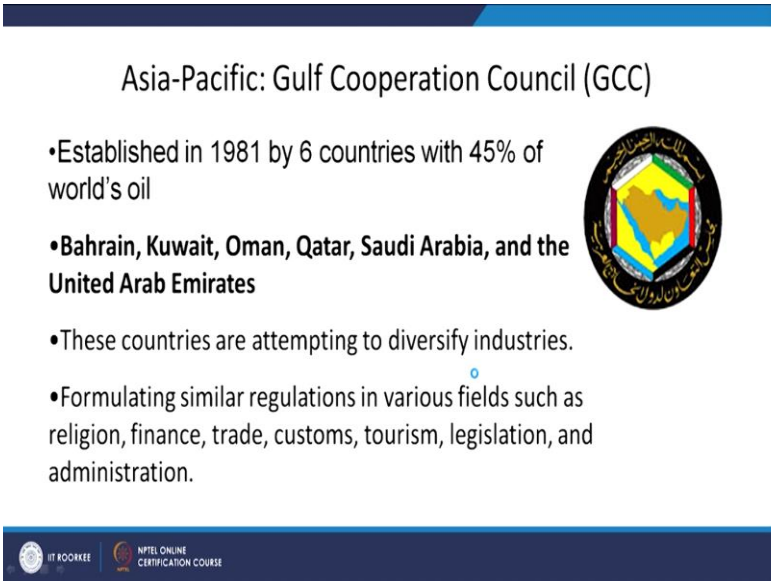

Then in Asia-pacific there is a Gulf Cooperation Council. That was established in 1981 by 6 countries with 45% of world's oil. And we are talking of crude oil. That include, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates. These countries are now attempting to diversify industries, for they have, for they are trying to formulate similar regulations in various fields such as religion, finance, trade, customs, tourism, legislation and administration.

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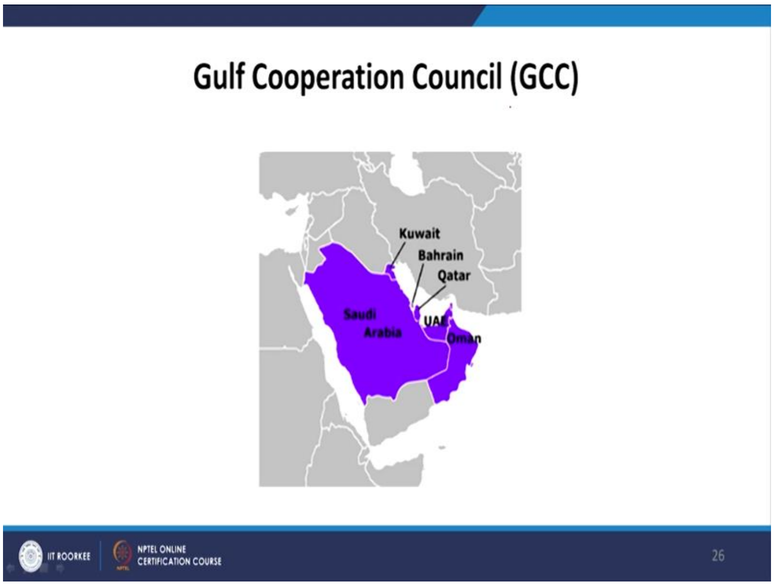

This is what we are talking about. For this is the Gulf Cooperation Council.

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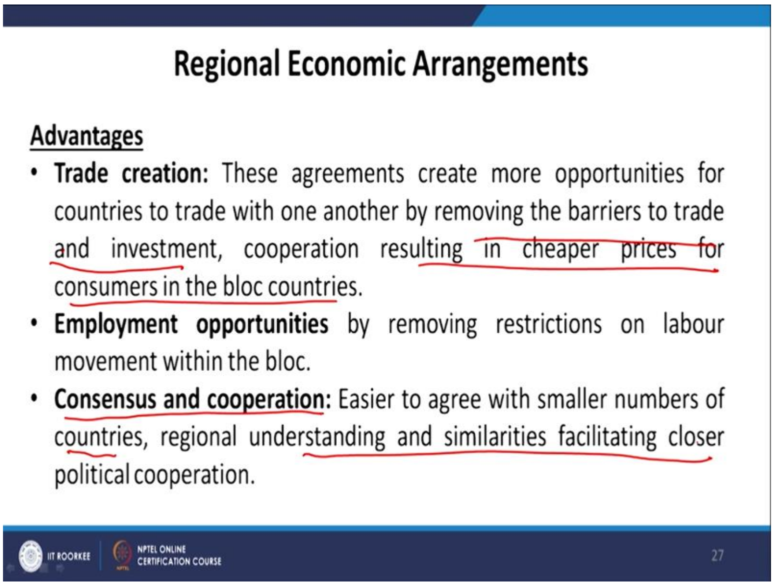

Let us see what, now as we have seen that there are several advantages of WTO and also several disadvantages of WTO. Similarly, there are several advantages of regional economic arrangements and there will obviously be several disadvantage of this kind of arrangement. 1 important advantage of any regional economic arrangement is trade creation. So, these agreements, they create trade for member countries by removing barriers to trade and investments, resulting in cheaper prices for consumers in the bloc country.

So, Indian will buy a phone made in Sri Lanka that comes for a lesser price. A Sri Lankan will buy a television that comes from India, that is made at a lesser price. So, at the end of the day, consumers across these 2 countries, they will be better off. And then, obviously it also creates employment opportunities by removing restrictions on labor movement within the bloc. So, I may like to work in India or I may or a person may like to work in some other country wherever he gets the best salary and wages.

There he will go and he will start work. And then, it also creates consensus and cooperation. Easier to agree with small number of countries. So, that is the biggest advantage. They are easier to agree; a agreement between small number of countries is easier to garner. Regional understanding and similarities facilitate closer political cooperation.

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Disadvantage. Trade diversion: now, when I start buying, Indian start buying mobile phones that are made in Sri Lanka at a lesser price, then what happens to the domestic mobile phone industry. So, that is the problem, 1 problem that is a trade diversion. Increased trade among member countries even with less efficient or more expensive producer, thereby forming new trade barriers with countries outside of the trading bloc.

Employment shifts and reduction: employment country may move production to cheap labor markets. So now, all mobile phones may get, manufacture of all mobile phones may get shifted to Sri Lanka, manufacture of all televisions may get shifted to India. So, therefore, employment also shift. Either people who are, who know how to manufacture mobile phones, either they will move to Sri Lanka or they will have to unlearn how to make mobile phone and learn how to make televisions.

And the biggest problem is that it will, there is a loss of national sovereignty. Nations give up more of their political economic right to determine their own domestic economic policies. For example, India has several regional trading arrangements with several countries and we still have to decide whether and of what use those arrangements are for India. Or are they more suitable more beneficial to our trading partners and not to us. Now, having understood about the regional trading arrangements and the global trading arrangements, etcetera, now we come to a multinational corporation.

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Now, this term, understanding of this term is important, because we have several misconceptions about this term, multinational corporations. Also, most of the world trade that happens is within the multinational corporation. So, this multinational corporation understanding of this concept of multinational corporation is important. According to an international labor organization report, a corporation that controls production facilities in more than 1 country, such facilities having being acquired through the process of foreign direct investment.

So, what it boils it down to is that, a company that has made foreign direct investment to control production facilities in more than 1 country. So, a company has a production facility in more than 1 country that it had invested as the foreign direct investment and come up with that kind of facility. So, that becomes a multinational corporation. Firms that participate in international business, however large they may be, solely by exporting or by licensing technology or not multinational enterprise.

So, a company may be selling, may have offices in 10 different countries and they may be selling their product in 10 different country countries, but they are not termed as multinational corporation. According to this definition, a company when it invest and own production facility in more than 1 country, then it becomes a multinational corporation. And U.S. government defines a multinational corporation. That was defined by International Labor Organization.

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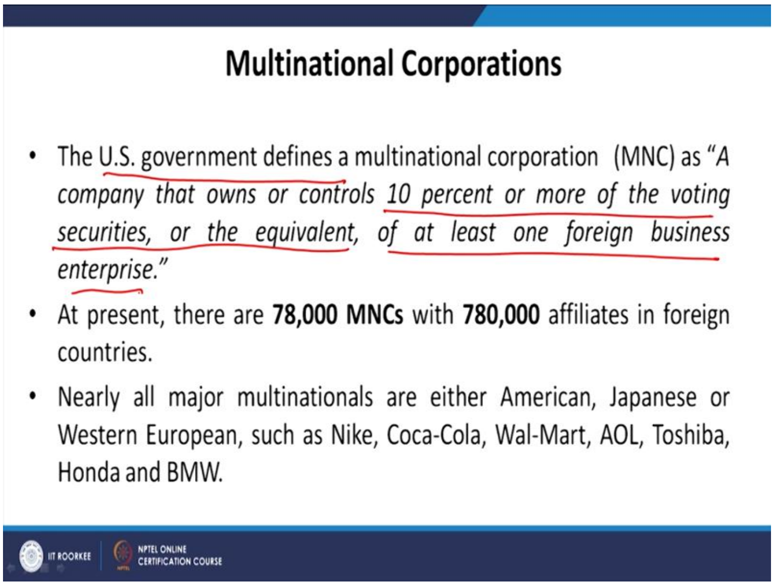

Now, let us see the definition by the U.S. government. It defines a multinational corporation as, a company that owns or control 10% or more of voting securities or equivalent of at least 1 foreign business enterprise. So, you see that there is not a significant difference or between the 2 definitions or the 2 definitions or we can say that the 2 definitions are very similar like.

What U.S. government defines is that a multinational corporation is a company that owns or controls 10% or more of voting securities. And this will come when they have invested, they have done foreign direct investment in at least 1 foreign business enterprise. At present there are 78,000 multinational corporations with 7,80,000 affiliates in foreign countries. And nearly all major multinationals are either American, Japanese or Western European, such as Nike, Coca-Cola, Walmart, America Online, Toshiba, Honda and BMW.

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Currently, factors such as currency movement, capital surpluses, fast growth rates, foreign trade investment barriers have all helped multinational, multinationals from other countries to join cross-border fray. It is not unusual for a startup. Now, in the changed, with changed realities, it is not uncommon, it is not unusual for a startup firm to become global at its inception.

These firms are called as born global. So, the era of a company becoming a domestic company and then be starting exporting and then it becomes a multinational company and then a international company and then a global company, it is gone. Now, a startup can be global in nature. So, these are called as born global. It is now easier than ever for small firms to be in international business through exporting and importing and e-commerce.

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The top 10 largest multinational corporation of the world as of 2016 revenues are: Walmart is 1. So, Walmart is a retailing company, State Grid, Sinopec Group, China National Petroleum, Toyota, Volkswagen, Royal Dutch Shell, Berkshire Hathaway, Apple, Exxon Mobil.

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Apple is the greatest example of multinational enterprise, as it tries to maximize cost advantage. So, it will manufacture their mobile phones anywhere where the cost is the least through for investments in international plants. Another example of multinational corporation is Nestle. Now, you see that Nestle comes from a small company country that is called as Switzerland. It is an example of transnational corporation that execute business and operation decision in and outside of its headquarters.

And then, there is another very good example of multinational corporation the which is Walmart. It has operations in 28 countries including over 11,700 retail stores that employ over 2.3 million people internationally.

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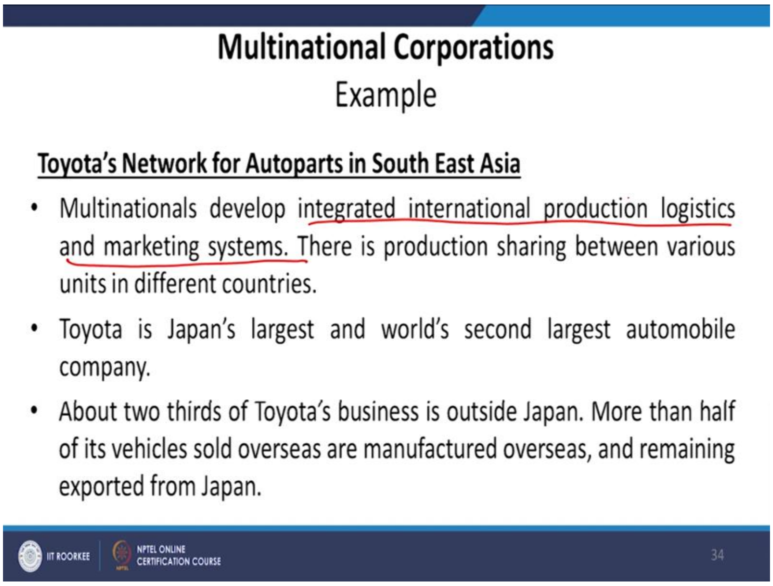

Another example is Toyota network of auto parts in Southeast Asia. Multinationals, they develop integrated international production logistics and marketing system. Keep in mind that multinationals, they develop integrated international production logistics and marketing system. There is production sharing between various units in different countries. Toyota in Japan is Japan's largest and world's second largest automobile company. And about 2 third of Toyota's business is outside of Japan. More than half of its vehicle sold overseas are manufactured overseas and remaining exported from Japan.

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It has established integrated manufacturing systems in all 3 of these main markets, North America, Europe and Asia. They have plants in China, Indonesia, Malaysia, Philippines, Taiwan, Thailand. And look at the diagram on the next slide, that shows integrated production facilities in its, in the various, in different countries.

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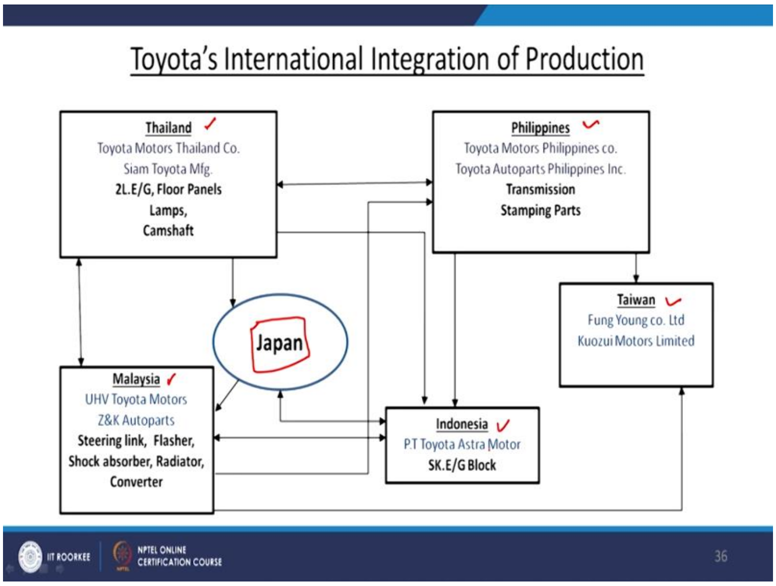

Now, you see that its inter in production facilities are located in Thailand, 1; Philippines, 2; Taiwan, 3; Indonesia, 4; Malaysia, 5. And it is a company that is headquartered in Japan. So, now this, in Thailand they have a company called as Toyota Motors. Thailand corporation and Siam Toyota Manufacturing, they manufacture floor panels, lamps and camshaft. In Philippines, they have Toyota Motor Philippines and Toyota Autoparts Philippines.

And they manufacture transmission and stamping parts. In Taiwan they have these 2 companies. In Indonesia they have another company and in Malaysia they are making a number of things. And then, these things are put together and the automobile is made.

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Advantage of a multinational corporation is that it helps increase investment level and thereby the income and employment in the host country. Vehicle for, they are, they serve as vehicle for transfer technology and sophisticated management techniques, especially to the developing countries. MNCs provide efficient means of integrating national economies. They contribute to inventions and innovations through efficient R and D. And they help increase competition and breakdown domestic monopolies.

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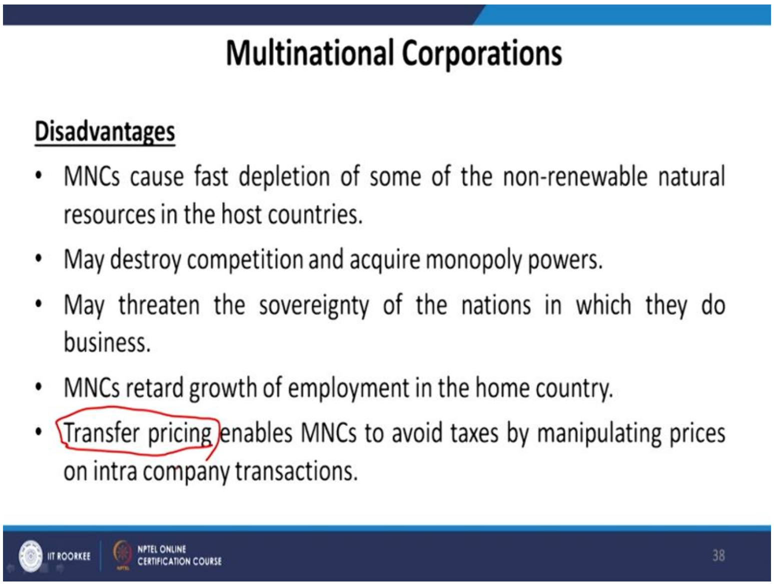

But, at the same time, they also have several disadvantages. Say they, MNCs they cause fast depletion of some of the non-renewable natural resources in the host country. They may destroy competition and they acquire monopoly powers. They may threaten the sovereignty of the nation in which they do business, because they are so big that in a smaller country, the MNC is bigger than the country itself.

And MNC retards growth of employment in the home country. Transfer pricing enables, this is the concept that we will talk about later in this course that transfer pricing; you would be reading about this thing in newspapers every now and then. This is a taxation issue. So, transfer pricing enables MNCs to avoid taxes by manipulating prices on intra-company transactions. These are some of the references from which this lecture is based on.

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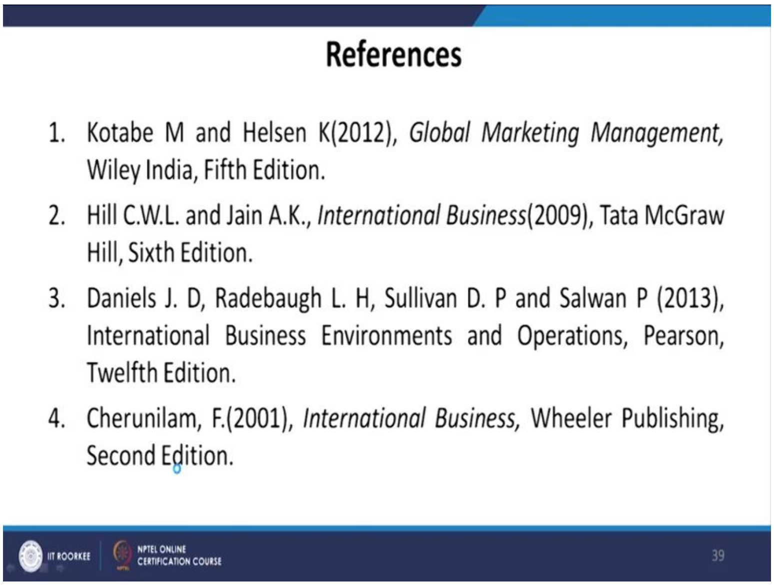

For having a further and deeper understanding, you may go through these references. Thank you.