MINISTRY OF SCIENCE AND HIGHER EDUCATION
OF THE RUSSIAN FEDERATION
SOUTHERN FEDERAL UNIVERSITY

**P. V. Pavlov**

# INTERNATIONAL BUSINESS

Textbook

Rostov-on-Don – Taganrog
Southern Federal University Press
2019

UDC 339.5, 339.7, 339.9
BBC 65.5, 65.2/4

*Published by the decision of the Department of Enterprise Economics Institute of management in Economic, Ecological and Social systems, Southern Federal University (Protocol № 10 of 09.01.2018)*

**Reviewers:**

**Alexey Yu. Arkhipov**, Doctor of Economics, Professor, Head of the Department of International Business, Southern Federal University (105/42, B.Sadovaya Str., 344000, Rostov-on-Don, Russia; e-mail: arkhipov@sfedu.ru);
**Sebastian M. Bakalarczyk**, PhD, Professor, Lodz University of Technology (266 Piotrkovska Str., 90-924 Lodz, Poland; e-mail: sebastian.bakalarczyk@p.lodz.pl);
**Sergey F. Sutyrin**, Honorary Figure of Higher Education, Doctor of Economics, Professor, Head of the Department of World Economy, St. Petersburg State University (7–9, Universitetskaya Emb., 199034, St. Petersburg, Russia; e-mail: s.sutyrin@spbu.ru)

**Pavlov, P. V.**
International Business : textbook / P. V. Pavlov ; Southern Federal University. – Rostov-on-Don ; Taganrog : Southern Federal University Press, 2019. – 294 p.
ISBN 978-5-9275-3129-5

The course “International Business” is aimed to provide the future specialists with theoretical and practical knowledge in the field of organization, management and regulation of international business in the conditions of Russian and world practice.

The textbook is for undergraduate and graduate students majoring in Management, Economics, Customs, as well as employees of commercial enterprises, customs officers and credit institutions, insurance and transport organizations, etc.

Author's edition.

UDC 339.5, 339.7, 339.9
BBC 65.5, 65.2/4

ISBN 978-5-9275-3129-5

CONTENTS

## ABBREVIATIONS

| | | | |
|---|---|---|---|
| **AMA** | American Marketing Association | **JIT** | Just in Time |
| **APEC** | Asia-Pacific Economic Cooperation | **JV** | Joint Venture |
| **ASEAN** | Association of South-East Asian Nations | **LDCs** | Least Developed Countries |
| **B2B** | Business-To-Business | **M&As** | Mergers and Acquisitions |
| **B2C** | Business-To-Customer | **M2B** | Marketing-To-Business |
| **B2G** | Business-To-Government | **MERCOSUR** | Southern Common Market |
| **BQP** | Balance of Payments | **NAFTA** | North American Free Trade Area |
| **C2C** | Consumer-To-Consumer | **NASA** | National Aeronautics and Space Administration |
| **CIS** | Commonwealth of Independent States | **OECD** | Organisation for Economic Cooperation and Development |
| **EAEU** | Eurasian Economic Union | **OPEC** | the Organization of the Petroleum Exporting Countries |
| **EC** | E-commerce | **PJSC** | Public Joint Stock Company |
| **ECOWAS** | Economic Community of Western African States | **PR** | Public Relations |
| **EU** | European Union | **PSAs** | Production Sharing Agreements |
| **FDI** | Foreign Direct Investment | **R&D** | Research and Development |
| **FEA** | Foreign Economic Activity | **SA** | Strategic Alliance |
| **FIG** | Financial and Industrial Group | **SACU** | South African Customs Union |
| **G2B** | Government-To-Business | **SCE** | Supply Chain Execution |
| **GDP** | Gross Domestic Product | **SCP** | Supply Chain Planning |
| **GNP** | Gross National Product | **SWF** | Sovereign Wealth Funds |
| **ICC** | International Chamber of Commerce | **TNCs** | Transnational Corporations |
| **IMF** | International Monetary Fond | **TNI** | Transnationality Index |
| **INCOTERMS** | International Commercial Terms | **UN** | United Nations |
| **IPC** | International Production Company | **UNCTAD** | United Nations Conference on Trade and Development |
| **ISA** | International Strategic Alliance | **WEF** | World Economic Forum |
| **ITP** | International Tax Planning | **WTO** | World Trade Organization |

**The following symbols are used in this Textbook:**
$ - United States dollar(s)
Billion means one thousand million.

# INTRODUCTION

Internationalization of economies has become an important factor determining the current state of the World Economy. The economic interdependence of countries is increasing. Over the past 30 years, the number of countries participating in the World Economy has increased fivefold. The total number of participants in international business operations has increased dramatically. International business is becoming more and more diverse; hence a challenging task to provide adequate training for qualified managers who could work at different national enterprises involved in international economic relations.

This is facilitated by “International Business” course.

“International Business” as a course aims at the following, and facilitates:

– getting acquainted with the main provisions of doing business in foreign countries and regions;

– studying the features of the development of business abroad in comparison with the Russian specific features;

– developing the ability to select the optimal features of doing business on the example of Russian and foreign models.

The “International Business” as a course is aimed to provide for:

– the study of problems arising when enterprises enter foreign markets, and the specificity of building the marketing policy of an enterprise;

– mastering the methods of developing the foreign economic strategy of an enterprise, choosing a country and a foreign partner for international business;

– gaining knowledge about the procedure of entering the world market of Russian enterprises, state regulation of foreign economic activity (FEA), the implementation of foreign exchange operations and international payments, the creation and operation of joint ventures (JVs);

– mastering modern tools and methods of interaction between the subjects of international business and other subjects of the national economy participating in its organization;

– the formation of practical skills for choosing a marketing strategy and the development of the sales policy of an enterprise on the foreign market;

– familiarization with the foreign trade operations peculiarities concerning trading various types of goods and services;

– the study of the main forms of international payments and ways of improving the monetary and financial relations in international business;

– getting acquainted with the main forms and features of business interaction with foreign partners.

While mastering the course of "International Business", students attain the following **knowledge** concerning**:**

– the content of the concept of *international business* and its forms;

– features of legal regulation of domestic and foreign business;

– the main trends in the development of modern international business in comparison with the domestic one;

– the main marketing strategies for entering the foreign market;

– features of promotion of goods in foreign markets;

– procedures for concluding foreign trade transactions;

– features of foreign trade operations in the areas of trade in various types of goods and services in the markets of different countries;

– basic forms of international settlements;

– basic forms and features of business communication with foreign partners.

While mastering the course of "International Business", students attain the following **skills:**

– planning, evaluating, analyzing the international activity of the firm;

– assessing the opportunities of foreign markets;

– planning the strategy for a company's penetration into foreign markets.

– formulating the tasks of the enterprise in world markets;

– justifying the ways of the subjects of international business to enter the international environment;

– considering the problems of doing business and managing it from the point of view of competition in the international environment;

– navigating in sources of the international information and using it in business;

While mastering the course of “International Business”, students also acquire:

– the skills of a comparative analysis of the prospects of domestic and foreign markets;

– concepts used in international business;

– methodology for selecting a foreign market;

– modern tools and methods of interaction of subjects of international business with other subjects of the national economy participating in its organization;

– the principles of pricing, monetary and financial relations in international trade and approaches to their application in practice; the fundamentals of drafting sales contracts that protect the legal and financial interests of the company;

– logistics and international transport, customs regulation, foreign trade cargo.

# TOPIC 1. CONCEPT AND MODERN STATUS OF INTERNATIONAL BUSINESS

## Concept, Causes and Prerequisites for Emergence and Development of International Business

The XX and XXI centuries saw transnationalization, international economic integration of countries, and redistribution of economic influence between developed and developing countries beginning to play a dominant role in enhancing export-import operations. M. Castells defines globalization as an economy capable of operating as a single system in real time on a planet-wide scale.[1] In the course of globalization, the economic boundaries of countries are becoming increasingly blurred, the development of electronic payment systems creates even more favorable conditions for the functioning of world markets and for an increase in trade flows.

With globalization, companies begin to participate in international trade; they become subjects of international business.

There are many definitions of the concept of *international business*.

John D. Daniels and Lee H. Radebaugh give the following definition: "International business includes all business transactions involving two or more countries, whether the transactions are conducted by private or governmental organizations". They define three aspects that motivate firms to do international business: the expansion of sales, the acquisition of resources and the diversification of sales and supply sources.[2]

V.K. Pospelov believes that "... international business means the specific production and economic activities of groups of companies, firms and enterprises with common economic and business interests, which covers two or more states

[1] Castells, M. The Information Age: Economy, Society and Culture, Vol. 1: The Rise of the Network Society: 2nd edition / Blackwell, 2009.

[2] Daniels, J.D., Radebaugh, L.H., Sullivan D.P. International Business Environments and Operations: 15th edition / Pearson, 2015.

or economic activities of the domestic parent company and its foreign affiliates or subsidiaries, and also independent enterprises”. [3]

According to N.L. Shlyk and S.Yu. Titova, “fundamental element of international business is FEA of countries in its various types and forms”. [4]

V.A. Chernenko believes that “international business involves business operations with several partners outside the country. The area of business activity of economic entities is carried out on the world market: the goods market, the services market, the financial market, and the labor market”. [5]

R.Griffin and M.Pustay argue that “international business consists of business transactions between parties from more than one country. Examples of international business transactions include buying materials in one country and shipping them to another for processing or assembly, shipping finished products from one country to another for retail sale, building a plant in a foreign country to capitalize on lower labor costs, or borrowing money from a bank in one country to finance operations in another”.[6]

S.F. Sutyrin and A.I. Pogorletsky proceed from the fact that “... international business today in most cases is an entrepreneurial activity that is simultaneously conducted in the markets of two or more states”. [7]

B.G. Dyakin considers international business as “... one of the main processes in the system of processes occurring in the global economy. ... International business relations as a transformed form of international economic relations distinguish international business, and put it on a par with other

[3] International Business: Textbook / V.K. Pospelov, ed. / INFRA, 2014.
[4] Shlyk, N.L. International Business: The Basics of Modern Development: Textbook / Khabarovsk, 2016.
[5] International Business: Textbook / V.A. Chernenko, ed. / Publishing House of St. Petersburg State University of Service and Economics, 2017.
[6] Griffin, R.W., Pustay, M.W. International Business: a Managerial Perspective: 5th edition / Prentice Hall, 2007.
[7] International Business: Theory and Practice: a Textbook for Bachelors: A Textbook for University Students Enrolled in Economic Fields and Specialties / A.I. Pogorletsky, S.F. Sutyrin, eds. / Urait, 2014.

processes of the world economy, predetermining its unique place, significance and role”. [8]

For a more accurate understanding of the term “international business”, it is necessary to understand the processes occurring in the modern world, primarily with world trade.

Conceptually, the causes of world trade were explained by many scientists. Theories of absolute advantage[9], and comparative advantage[10] have become widely known. Early in the 20th century, the theory of explaining comparative advantages from international trade on the basis of production factors developed by Swedish economists E. Heckscher, B. Ohlin, gained further development in the studies of P. Samuelson and W. Stolper, became popular.[11]

Among contemporaries there are also many scholars who substantiate new original concepts of *international trade*. As an example, we can cite the theory developed by the American economist M. Porter, described in the book “The Competitive Advantage of Nations”.[12] Due to its complexity and logical justification, the theory of the national competitive advantage has aroused much interest, and is characterized as progressive. The study of M. Porter has something in common with technological theories, since he attributes the dominant role in achieving competitive advantage to introducing innovations into production (which does not necessarily have to be the result of a significant technological breakthrough, but can even be expressed as a combination of minor improvements).

If representatives of two different countries participate in business, then they have to deal with two legislative bases: domestic and foreign. If

[8] Dyakin, B.G. International Business. Volume 6. The Processes Occurring in the Global Economy: The Role of International Business. Monograph / TEIS, 2013.
[9] Smith, A. An Inquiry into the Nature and Causes of the Wealth of Nations / The University of Chicago press, 1976.
[10] Ricardo, D. On The Principles of Political Economy and Taxation / London: John Murray, 1817.
[11] Samuelson, P., Stolper, W. Protection and Real Wages // The Review of Economic Studies, 9(1), 1941.
[12] Porter, M.E. The Competitive Advantage of Nations // Harvard Business Review, 68, 1990.

international economic activity of a company is carried out in several states, then we have to deal with several legislative bases, which, of course, requires more attention to business organization and management.

An important difference between international and national business is also the fact that the national entrepreneur acts in a system of coordinates shared by all national producers.

This applies both to business culture and to a certain system of values, which is sometimes called a national mentality. In contrast, in the international business entrepreneur deals with different business cultures and different mentalities. Lack of attention to these aspects can result in failure; the examples in the history of international business are many.

International business involves not only the sale on the foreign market of an increasing share of the company’s products, but also the division of the production process between legal entities and individuals located in different countries, different departments of a company or a company located in different jurisdictions.

Thus, the definition of international business can be formulated as follows: *international business* means the specific production and economic activities of groups of companies, firms and enterprises that have common economic or business interests covering two or more states, or the economic activity of the parent company home countries and its foreign affiliates or subsidiaries and affiliates.

The main factors for the emergence and development of modern international business are the desire to ensure a) preservation of the company’s position in the domestic economy and b) increase in the company’s profits by winning and holding positions in the economy of another country or on the world market. This aspiration is fueled by intense competition, both domestically and internationally.

Among the factors that influence the development of international business, contributing to it or creating certain obstacles, we can note geographical, political, economic, socio-cultural, international factors. Scientific and technical progress also has a tremendous impact.

The geographical factor is especially important when organizing tourist activities. Stable regime and political stability in society are paramount in conducting business operations in another country. In a large country, investment climate and business environment in its individual regions are also of significant importance. Socio-cultural factors are associated with the historical and cultural traditions of peoples, norms and customs of doing business. International factors are closely linked with relations between states. The general situation in world politics and the situation in certain regions of the world in some cases have a decisive influence in choosing the forms and methods of conducting international business.

The most important factor, the impact of which on international business is difficult to predict, is scientific and technological progress, as a result of which a breakthrough occurs in a particular industry or sphere. A vivid example of the impact of scientific and technological progress on the economic and financial situation of a company is strong competitive position of the American company *Apple*. The stock price of this company rose from $ 70 per share at the beginning of 2005 to $ 700 in September 2012, and as of December 31, 2018, it was $ 158. In 2018, *Apple* became the first company to achieve capitalization of $ 1 trillion.[13]

The globalization factor has a huge impact on the development of international business. Moreover, this impact is reciprocal. In the same way as large-scale industry created the world market, the strengthening of transnational corporations (TNCs) in the world economy was one of the factors of its

[13] Interfax Information Agency - https://www.interfax.ru/business/623679.

globalization. On the other hand, it is not by chance that in recent decades the scale of mergers and acquisitions (M&As) has increased. Although the number and value of M&As declined during periods of crisis, the general upward trend in 1985-2011 is obvious. If in 1985-1988 the total volume of M&As did not reach $ 1 trillion, then in 2006 it increased to about $ 6 trillion, and in the third quarter of 2018 the amount of transactions amounted to $ 12.999 trillion.[14]

Despite the development of the globalization process, the world is by no means a single economic space. And this is reflected in the activities of business structures. In particular, according to United Nations Conference on Trade and Development (UNCTAD), in the leading member countries of the Organization for Economic Cooperation and Development (OECD) and even in some of the small countries in this organization, most companies still produce most of their produce within their national borders. Less than a dozen of the largest TNCs in *Fortune Global 500* (see Table 1) are "global" in the strict sense of the word, i.e. make more than 20% of their sales in each of the three leading economic regions of the world – North America, Western Europe and East Asia. Most companies from these regions produce their products using mainly the domestic industrial base. In the case when they supply products abroad or make direct foreign investments, as a rule, they enter the markets located in relative proximity to the national borders of the country where the company is based.

Particularly impressive is the strengthening of the positions of large business entities from the PRC. Chinese enterprises have learned to work combining the speeds of startups with the performance and quality of large companies' products. The fast ones destroy the large ones. The investments of the government and the largest companies of China in robotics and in additive manufacturing (*Foxconn*) plus the unwillingness of labor resources of other countries to work in the production of China are the components of the

[14] Information Agency AK&M - http://mergers.akm.ru.

exponential expansion of the new generation of the Chinese production system.

**Table 1**

**Representation of Companies from Selected Countries in Fortune Global 500 from 2005 to 2018** [15]

| Countries | 2005 | 2008 | 2012 | 2018 |
|---|---|---|---|---|
| Leading Developed Countries | | | | |
| USA | 176 | 153 | 132 | 126 |
| Japan | 81 | 64 | 68 | 53 |
| France | 39 | 39 | 32 | 28 |
| Germany | 37 | 37 | 32 | 32 |
| Great Britain | 35 | 34 | 27 | 20 |
| Emerging Market States | | | | |
| PRC | 16 | 29 | 73 | 111 |
| India | 5 | 7 | 8 | 7 |
| Russia | 3 | 5 | 7 | 4 |
| Brasil | 3 | 5 | 8 | 7 |
| Taiwan | 2 | 6 | 6 | 9 |

The specific reasons that urge a company to participate in international business can be summarized in two large groups:

1. reaction to environmental changes due to increased competition, changes in the political climate, changes in the economic situation in the country and the world;

2. the policy of active development of international markets and the expansion of its presence in the international economic space, generated by the desire to provide more favorable conditions for the growth of the company.

Products, excessive in terms of the capacity of the domestic market, must be sold outside the national territory. It is important to emphasize that in this case, the more actively one or another economic entity enters the external market, the more it can use the economy of scale, gaining additional advantages in price competition. Once again, we note that this is especially significant for

[15] Source: Fortune Global 500 - http://fortune.com/global500/list/; International Business: Theory and Practice: a Textbook for Bachelors: A Textbook for University Students Enrolled in Economic Fields and Specialties / A.I. Pogorletsky, S.F. Sutyrin, eds. / Urait, 2014.

manufacturers from small countries. That is why companies representing, for example, the states of Northern Europe, the largest of which, Sweden, is about 9 million people, are experiencing a more intensive need for internationalization than Japanese or American firms.

*Case 1.* *One of the world's leading household goods retail companies – the Swedish IKEA – was founded in the 1940s in a small village. IKEA's strategy is based on selling high-quality, budget furniture, which is also a good example of Swedish design, to be self-assembled by the consumers. In the early 1960s, after the Swedish market was saturated, IKEA decided to expand by going beyond national borders. IKEA opened its first store outside Sweden in 1963 in Norway, in 1969 – the second one in Denmark. The company went beyond Scandinavia in 1973, opening a store in Switzerland, and then began to enter a new national market every couple of years. In 2018, the first store opened in India. In 2018, international sales accounted for more than 93% of total sales. During the fiscal year of 2018, the total retail sales of IKEA's (Ingka Group of Companies) amounted to 34.8 billion euros. In 2018, the share of online sales of IKEA reached 8%.*[16]

To reflect the company's place in the international business, they use the *Transnationality Index (TNI)*, which is calculated by UNCTAD specialists and is regularly published in the World Investment Reports.[17] The index is a percentage of the *sum of the three indices:*

1. ratio of the volume of foreign assets to the total volume of assets of the company;
2. ratio of the volume of foreign sales to total sales;
3. ratio of the number of employees in foreign enterprises to the total number of employees in the company.

$$TNI = \frac{1}{3}\left(\frac{foreign\ assets}{total\ volume\ of\ assets\ of\ the\ company} + \frac{volume\ of\ foreign\ sales}{total\ sales\ volume} + \right.$$
$$\left. + \frac{the\ number\ of\ employed\ in\ foreign\ enterprises}{total\ number\ of\ employees\ in\ the\ company}\right) * 100\%$$

This final index makes it possible to estimate the degree of the company's participation in the international division of labor between countries and its

[16] Source: International Business: Theory and Practice: a Textbook for Bachelors: A Textbook for University Students Enrolled in Economic Fields and Specialties / A.I. Pogorletsky, S.F. Sutyrin, eds. / Urait, 2014; https://www.ikea.com.

[17] Source: https://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx.

participation in international production.

Thus, the index of *Vodafone* telecommunications company, based in the United Kingdom, was 87.1, while the *Arcelor Mittal* steel company, headquartered in Luxembourg, had 90.5. The TNI of the Swiss foodstuff producer *Nestlé* was even higher (96.9). The number of company's employees is 323,000. It has factories or business operations in almost all countries of the world.

Of course, the majority of large TNCs have this index significantly lower than 90.0, but according to estimates for the top 100 of the largest non-financial private companies, it exceeds 70.0 on average. Consequently, for many of the top 100 of the largest international companies, foreign production becomes the most important, and in some cases it is even the main factor of their development.

*Case 2. According to the corporate accounts for the 2010 fiscal year, all shoes manufactured by the American company Nike were produced outside the United States. In the reporting period, Nike products were manufactured in factories located in 46 countries. The main production volume was accounted for Vietnam, China, Indonesia, Thailand and India, where 37, 34, 23, 2 and 1% of the total production of the company were manufactured, respectively. The total number of workers employed in the production of goods under the Nike brand in 2010 in these countries amounted to 747 thousand people.*

*The American clothing manufacturer The Gap Inc., one of the five largest TNCs in its industry in terms of revenue, manufactures its products in 728 factories located around the world. Most of them, i.e. 611, are also located in the Asian region, with 186 in China. The remaining part of the industry is distributed as follows: 39 factories in Mexico, Central America and the Caribbean, 25 in Africa and the Middle East, 14 in South America, 20 in Europe and only 18 in the USA and Canada.*

Thus, unlike FEA, where the output of operations (as a rule, trade) of a company across national borders is put at the forefront, international business means carrying out production operations in several countries, which are (usually, but not always) separated by customs borders. At the same time, the overseas share of production and sales of an international company may significantly exceed domestic values. The main point in any case remains the conquest and retention of positions by the company in foreign markets.

Business operations of a company participating in international business may consist in spread production of goods (in cooperation with companies or branches of a given company in other countries in the production of the finished product) or foreign trade operations (export and import of goods and services), international investment operations, hiring foreign labor, scientific and technical cooperation in the joint development and (or) production of goods and services.

*Case 3. Calculate the TNI of international companies using the following table and analyze its components.* [18]

| *Company* | *Assets, $ million* | | *Sales, $ million* | | *Employment, pers.* | |
|---|---|---|---|---|---|---|
| | *foreign* | *total* | *foreign* | *total* | *in foreign enterprises* | *total* |
| *Volkswagen* | *453,000* | *506,956* | *226,480* | *260,028* | *612,000* | *642,292* |
| *BP* | *225,000* | *276,515* | *212,000* | *244,582* | *65,300* | *74,000* |
| *Toyota Motor* | *396,000* | *473,133* | *234,000* | *265,172* | *326,800* | *369,124* |
| *Walmart* | *38,000* | *204,522* | *124,300* | *500,343* | *125,600* | *2,300,000* |
| *Sinopec Group* | *14,600* | *346,544* | *58,600* | *326,953* | *34,000* | *667,793* |

## Classification Factors for Doing International Business

When choosing a target external market for international business, it is advisable to determine the primary key factors of the economic environment, namely: which group of countries this country belongs to, what are the levels of the country’s economic development, market size, basic macroeconomic indicators, population purchasing power, quantitative and qualitative characteristics competition, the level of infrastructure development, and the degree of the country’s involvement in international integration processes (participation in integration groups).

Preliminary analysis to select target markets for international entrepreneurial activities involves classifying countries based on their common characteristics.

Currently, there are different classifications for the typology of countries. For the purposes of international business, the most widely used are

[18] Source: Fortune Global 500 - http://fortune.com/global500.

classifications developed by such international organizations as the United Nations (UN), the World Bank, the International Monetary Fond (IMF), each of which groups countries according to their own criteria, i.e. the ones based on the goals and objectives of the organization.

According to the level of economic development, UN offers the following classification of countries: developed countries, developing countries, least developed countries (LDCs) and emerging economies. The World Bank uses different criteria for dividing countries, for example, according to the criterion of gross national product (GNP) per capita it identifies developing countries with low income ($ 1,025 and below) and developing countries with average income, with two sub-groups: with incomes below the average ($ 1,026 - $ 4,035) and incomes above the average ($ 4,036 - $ 12,475), and developed countries, which include high-income countries ($ 12,476). These classifications can serve as an indicator for making decisions about the attractiveness of a country in terms of needs for goods (services), income levels and employment.

As a rule, developed countries, which are characterized by higher purchasing power of the population, have better opportunities for international business. However, the barrier to entry into these markets may be stronger competition and more demanding consumers. Today, interesting opportunities are opening up in a number of countries that are called Emerging Markets (for example, the BRICS countries, including Brazil, Russia, India, China and South Africa). For these countries, a higher profitability of entrepreneurial activity, combined with higher risks, is typical. At the same time, it should be borne in mind that in many developing countries tougher state regulation is possible and large-scale state entrepreneurship, therefore, it is advisable here to consider public-private partnership options.

Based on these indicators, it is possible to develop strategic solutions for the international business activities of a company, including making estimates and a forecast of the company's market share. Knowing which phase of the economic cycle a given country is in will help form an opinion about the state of economic activity, the possible degree of state intervention in private business. In the event of currency inconvertibility, the possible risks of the company are evaluated by the use of profits in the country of entry and transfer abroad.

The analysis of the *country's tax system*, both in terms of the level of taxes and in terms of tax administration, is of great importance for making decisions concerning the organization and conduct of business. It is important to have an idea about other components of state regulation that form the business environment. In the XXI century such an assessment is facilitated by the use of various ratings of countries compiled by international organizations and individual private firms. Among them are the Business Doing Quality Index (World Bank and International Finance Corporation), Corruption Perceptions Index (Transparency International), Competitiveness Index (the World Economic Forum (WEF)), Property Rights Index, Human Development Index (Development Programs UN) and a variety of others.

Note that the above basic economic indicators need to be studied not only statically, but also dynamically, with an assessment of the factors that led to their change in the past, as well as forecast estimates for the future.

It is also advisable to identify industries and fields of activity in the country under study whose representatives will be the main competitors for the company, and, accordingly, determine what type of competitive structures are typical for them (monopolistic competition, oligopoly or monopoly). Next, we study the nationality of the main competitors, the degree of penetration of foreign capital into the relevant industry (field of activity), the behavior of existing and potential competitors, including the forms and methods of competition. This information will be useful to the company for a number of solutions, in particular for choosing the strategy and form of entry into the market of a given country, decisions of product and price policy.

Political and legal *factors of the company's country of origin* can both facilitate and hinder the company's entry into the external market. If a country's foreign economic policy is focused on expanding its integration into the global economy, then the favorable factors will outweigh.

Examples of state support for companies entering the external market can be information support for FEA, concluding bilateral intergovernmental agreements on trade, economic and scientific cooperation, supporting export-oriented production of goods (services), and promoting their expansion to world markets.

At the same time, for a number of reasons, measures of tariff and non-tariff export regulation can be used, entailing restrictions, up to a ban. Such measures include export duties and their size, licensing of export activities, banning the export of a number of strategic goods and technologies. For example, in lean years, Russia imposed a ban on the export of grain.

Similar reasoning can be cited regarding *the assessment of the attractiveness of countries to penetrate their market*.

## International Business Environment

While in the domestic markets of the country of origin, companies can operate in relatively stable, familiar market conditions, with foreign markets they often face unfamiliar, volatile environment that influences decision-making in international business. In order to systematically collect and correctly interpret the information gained on the external market, it is necessary to have a scientific-based method for studying environmental factors of foreign countries. The most successful method is the classification of environmental factors depending on the impact on the international business of the company, i.e. PEST-analysis of the company (Fig. 1).

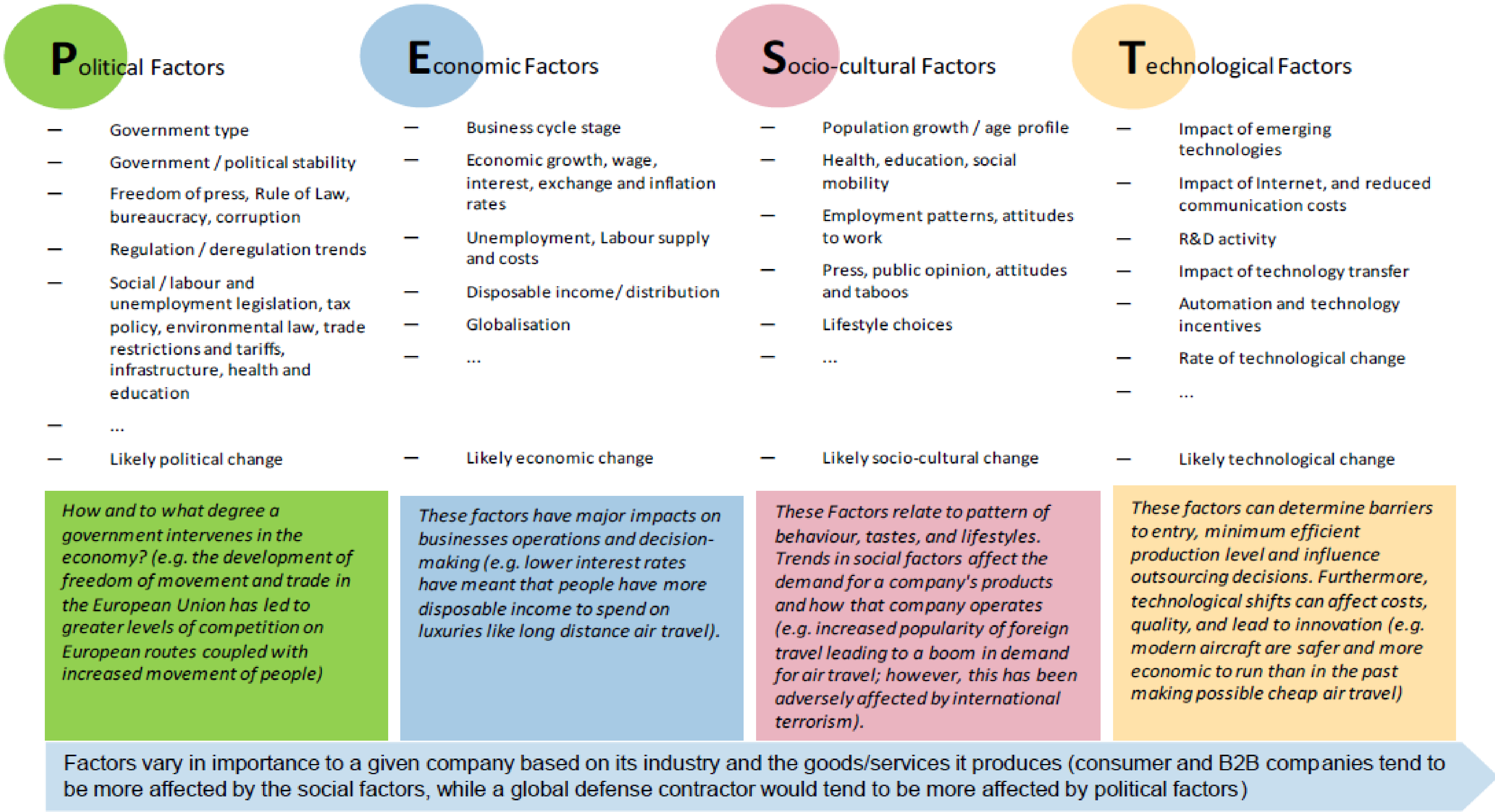


*Fig. 1 – PEST-analysis elements*

The situation on the external market is characterized by the current state of the external market and its development trends which can affect the company's activities. When analyzing the situation on the foreign market, factors can be classified according to the criterion "influence on the company". They are divided into three groups: 1) macro-environment; 2) micro-environment, i.e. external factors; 3) the internal environment of the company – internal factors.

The analysis of the *first group of factors (macro-environment)* should be done very carefully, since the operating conditions of a company can vary considerably from country to country and limit the scope of activities in international business. An assessment of the strategic position in a specific target foreign market should primarily focus on the well-established macro-environment factors that currently exist. However, one should not forget about possible development scenarios when developing long-term strategies in international business.

*The micro-environment is the second group of factors*, and the subject area of the situational analysis; it is a combination of institutions, organizations and individual agents with which the company interacts on the foreign market. At the same time it is important to take into account both the expectations of consumers and the actions of competitors. The degree of influence of the company on the micro-environment depends on the specific situation, characteristics of the market and industry.

*The third group*, which also needs to be studied in a situational analysis, is the group of factors that are "internal" for the company. At this stage of the study, the internal economic conditions are analyzed, which makes it possible to evaluate the strengths and weaknesses of the company in the context of intentions to enter the external market. Undoubtedly, internal factors vary from company to company, both in form and in value. The most important factors are material and financial resources, staff (e.g., qualified personnel) and information resources. A distinctive feature of this group of factors is that they are controlled by the company.

***Political factors.*** Various political risks may threaten the investment forms of entering the foreign market. Political risk is present in any country, but its level and types vary. The main types of political risk are: *property risk* (the property of the company and the lives of employees are at risk); *operations risk* (interference of the receiving state into the company's activities on the territory of this state, e.g. the requirement for the level of localization of production for the company producing cars); *transfer risk* (problems of transferring profit abroad, currency control).

The degree of risk of international entrepreneurial activity in a given country is determined by political stability. The level of political risk is higher in countries with unstable political situation, when a change of power (no matter via elections or resulting from a military coup) may lead to a change in attitude towards foreign companies. As an example, let us cite the nationalization of American oil-producing companies by the government of Hugo Chávez in Venezuela. Other threats: blocking accounts of a foreign company, establishing import quotas (up to a ban on imports, e.g. the USA and Germany to Russia meat imports ban in February 2013), or introducing new taxes (or changing their rates), introducing new customs fees.

The nature of business is influenced by the type of legal system of the host country, especially if it differs from the company's country of origin. The main types of legal systems include customary law, based on the traditions and customs with a large role of the judiciary in the application of law (the USA, Commonwealth countries); civil law, which is based on detailed written laws, summarized in the code (Germany, France, Russia); theocratic law based on religious covenants (for example, Islamic law).

To enter a foreign market, a company needs to know the laws governing the

FEA of both its own country and the countries potentially targeted for its penetration, as well as their internal legislation governing business activities. Very often there are legal differences between the lands (counties) of one country. Thus, in certain states of the USA or in the lands of Germany there are various legal norms that should also be taken into account.

In the event of a conflict between the parties, which are economic entities of two different countries, the question arises, which country's laws should be followed when it is resolved. Even at the stage of signing of an international contract, it is recommended to agree on whose national law partners will be guided in the event of a dispute. If there is no such clause in the contract, then the parties to the conflict must either follow the laws of the country in which the agreement was concluded or the country in which the contract will be executed. International practice shows that usually companies strive to prefer reconciliation and arbitration resolutions in order to resolve disputes more quickly. Arbitration procedures are often negotiated in contracts and usually provide for an impartial Mediator.

***Economic factors.*** Among the positive ones, we note a favorable investment climate, information support, creation of free economic zones, tax incentives. At the same time, import duties, non-tariff restrictions (for example, quotas, phytosanitary control measures, higher standards for products, etc.) may limit the market access factors.

In the modern world, states are connected by an extensive network of mutually beneficial contracts and agreements, which, however, is not yet all-embracing. When planning a business abroad, it is useful to find out whether the target country is related to the country of origin of the company by agreements on waiver of double taxation, mutual support of investments, preferences in trade, etc.

Today, many countries are members of regional integration groupings on various continents, for example, the European Union (EU), North American Free Trade Area (NAFTA), Southern Common Market (MERCOSUR), The Eurasian Economic Union (EAEU), the Economic Community of Western African States (ECOWAS), the South African Customs Union (SACU), and bilateral free trade agreements. Knowing their main characteristics, as well as the content of the agreements on economic issues is important when entering the markets of countries of the integration group. This is important both in case when the company is a representative of a country that is not in this integration group, and if the company's activity extends to two or more countries belonging to the integration grouping.

The international business of the company is influenced by a combination of factors associated with geography, terrain and climate characteristics. In particular, these include such factors as location of the country, climatic features, natural conditions, current state of environment protection.

The remoteness of the target foreign market entails additional transport costs, and sometimes reduces awareness of the specifics of a given country. The latter, in particular, can be explained by the fact that many companies initially enter the markets of countries neighboring the region.

*Natural and geographical factors* have an impact on the settlement of the population in the country, on the number and density of the population in a particular region. These indicators are of interest for assessing the volume and structure of consumer demand. Climatic features will be important for the development of product policies, including specific product parameters, in a number of cases, including decisions on the adaptation of the product, as well as the product mix in general; they are associated with the development of new technologies. *The assessment of the role of technological factors* for international entrepreneurial activity can be carried out in a number of areas.

***Sociocultural factors.*** Concerning entering the consumer goods markets of targeted foreign countries, we need to note that culture manifests itself in the existence of relatively sustainable forms, consumption patterns. For the establishment and development of contacts with foreign partners, the development of communicative policies, cross-cultural communications, it is of interest to look at culture as an aggregate of stable forms of social interaction fixed in norms and values, means of communication often transferred from generation to generation.

*Case 4. In Germany, there are 2.4 million Turks who annually purchase consumer goods worth 80 billion euros. The company Mercedes-Benz has revealed that every fifth Turk car owner drives a Mercedes, compared to only every 17th German who buys this car. In the mid-1990s many young Turks hired as car sellers in Berlin, Cologne, Stuttgart - the areas of Germany where there are many Turks. Car dealerships also organized special zones for Turkish buyers, where you can chat about this and that, including cars, over a cup of tea. As a result of these marketing decisions, the number of cars sold in the "Turkish" segment has significantly increased.* [19]

In the international business of a company, such *elements of culture* as language, religion, norms, customs and traditions can have a special practical value.

The *verbal language* includes a system of phonetic or graphic characters, organized respectively into speech or writing. It is especially important to avoid mistakes when translating trademarks, advertising messages, labels, instructions, etc. *Nonverbal language* includes the concept of *time and distance* when communicating, and also sign language. Thus, a number of cultures are more inclined than others to set deadlines, to follow tight schedules. In particular, punctuality seems to matter much to American businessmen. On the other hand, even a simple agreement may take up to several days in the Middle East. An example of the differences in sign language is the fact that nodding in Japan definitely does not indicate acceptance of the ideas of the interlocutor.

Regarding the factor of *religion* (or beliefs and convictions), we note that

[19] Source: International Business: Theory and Practice: a Textbook for Bachelors: A Textbook for University Students Enrolled in Economic Fields and Specialties / A.I. Pogorletsky, S.F. Sutyrin, eds. / Urait, 2014.

most cultures find their origin in religion. However, the existence of world religions can create the basis for transcultural similarities in Islam, Buddhism or Christianity (for example, religious holidays, ban on the use of certain products).

In every society there is a system of *values, norms, and relations*, transmitted by both formal and non-formal education systems. For example, national cuisine and its flavors, attitudes to the role of women in society. It is known that in Russia older people prefer bitter dark chocolate, while in Germany consumers of all ages prefer milk chocolate.

The second component of the considered block of factors of the external environment includes social factors. Here one can evaluate the structure and role of social institutions that are characteristic of a given country (family, educational institutions, reference groups, parties and movements, clubs and societies). Each of these institutions can influence behavior of customers, their values and lifestyle. Next, it is necessary to note the social structure of the society of a given country, the differences in consumption between classes and social strata that arise from it, as well as in the forms of social interaction.

***Technological factors.*** Assessment of the attractiveness of a country as a target market, as well as the order of its development (strategies for processing external markets) is tightly connected with analyzing information on indicators such as the degree of use in a given country of technologies in manufacturing products and services, the share of high-tech industries in the industry economies, the volume of imports and exports of high-tech products and services, their share in export and import, the share of qualified personnel. This implies the country's need to import new technologies for its own production or import of already finished high-tech products.

The development of new technologies contributes to the expansion of international business, in particular the penetration of the Internet and telecommunications in all areas of activity in all regions of the world. One example is a widely known fact that the availability of databases on target markets makes it much easier to conduct research and forecasting on target markets. Competitive analysis has become easier, as sufficient amount of information on the companies' market activities, their assortment policies is now available on the companies' websites. Financial information for investors can predict the prospective structure of a market and the position of the analyzed company in the market.

*Case 5. Aeroflot Public Joint Stock Company (PJSC) PEST analysis*

| | |
|---|---|
| ***P*** | *Abandonment in favor of Aeroflot of the USSR heritage, royalty transfers for overflight by foreign airlines along the Trans-Siberian air corridor (about $ 100 million per year); the state program for the development of aviation in Russia results in a possible increase in passengers transit from the regions through Moscow; the state subsidizing of air traffic in the Kaliningrad Region and the Far East, with Aeroflot as the recipient of subsidies and the designated carrier; conflicts of interests between the company and the regional authorities in charge of the airports to which Aeroflot seeks to fly (Saratov, Mineralnye Vody)* |
| ***E*** | *Turbulence in the development of the world economy means possible recessions in the air transportation market due to the low dynamics of economic development in the modern post-crisis period (falling consumer incomes, lower demand in tourism and business trips); turbulent conjuncture of world commodity markets results in the possibility of both growth and lower prices for aviation fuel; currency risks mean the need to diversify the company's air fleet with Boeing (prices denominated in USD) and airbuses (prices denominated in euros)* |
| ***S*** | *The aging of the population and the growing conservatism of consumers (which results in increasing loyalty to Aeroflot); labor migrations of the population and the concentration of business and political activity of Russia in Moscow results in servicing passenger flows in the Moscow aviation hub* |
| ***T*** | *The possibility of building high-speed railways in Russia – the risk of competition for passengers with Russian railways on the lines Moscow - St. Petersburg, Nizhny Novgorod, Kazan, Kiev, Riga, Rostov, Sochi; technological refinement to the high performance of the Sukhoi Superjet 100 liner and the launch of the new MS-21 airliner; the possibility of using new foreign air traffic control programs at Sheremetyevo airport to increase the capacity of the company's base airport.* |

At the same time, there are challenges for international business activities related to new technologies. Thus, it is impossible not to ignore the threat of new products (technologies) from competitors, which makes the given company's products obsolescent, shortening the product life cycle. It is necessary to monitor the actions of competitors for the modernization of the product range, not only in their own country, but also abroad.

The problems associated with the emergence of new technologies should include the increasing availability of information not only for the company, but also for competitors. Today, additional efforts are required to protect information.

**Topic 1 Review Questions**

1. What are the main definitions of the concept of *international business*?
2. What are the factors that influence the development of international business?
3. What does *Fortune Global 500* rating show? Who were the leaders of this rating in 2018?
4. How does the UN classify countries by level of their economic development?
5. What factors relate to the business environment of the company?
6. What is the TNI and how is it calculated?
7. Name and describe the main elements of the PEST analysis.

# TOPIC 2. STRATEGIES IN INTERNATIONAL BUSINESS

## Company Strategy and its Implementation Stages

The *strategy* is a set of principles for achieving long-term competitive advantages of the company. The most important among such principles are the following ones:

– profitability (efficiency) of the business entity;

– market leadership, protected by appropriate barriers for potential competitors;

– freedom of action, which implies innovation aimed at creating own rules of the game on the market;

– survival in tough competitive conditions;

– customer loyalty, for which it is necessary to guarantee sufficient attention and custody of the most valued customers of the given company or individual entrepreneur;

– loyalty of the company staff, interested in successful development of business.

In formulating a strategy, there are the following five key stages.

1. defining the mission of the company;
2. defining the environment in which the company operates;
3. setting strategic goals;
4. defining tactics that contribute to the achievement of goals;
5. creating a clear structure of management of the company.

At the *first stage*, when developing a company's mission, there is to be formed understanding of the prerogative of this business, target consumer segments and target markets, as well as available technologies and competitive methods, development plans of the company and its business, the fundamental business philosophy, plans to achieve the desired reputation among the company's customers, employees, shareholders, state and public. The mission involves clarifying goals of the company, understanding of the values available to the company and the choice of its activities.

An international company can have several missions at once, depending on different geographic markets. Examples of missions of the world's leading companies are presented in Annex.

At the *second stage*, when studying the environment in which the company business is conducted, information is collected about all internal and external business conditions, strengths and weaknesses of the company's activity, its possibilities and threats of activity (SWOT-analysis). The results of this analysis are summarized in a SWOT analysis matrix.

At the *third stage*, the strategic goals of the company are defined, which are assigned tasks that must be carried out in accordance with a specific action plan. Strategic goals should be measurable, achievable and time limited.

The tactics of achieving the goals (*fourth stage*) implies a phased approach to the company's actions based on the consistent implementation of relevant plans.

And finally, the general scheme of the company's business management *(fifth stage*) should be subordinate to the strategic goals; it should provide the delineation of duties and areas of competence and responsibility at all levels of management, as well as ensure the minimization of overhead costs associated with management.

International business involves the sale of goods and services not only in the domestic but also in the external market. There may be two options:

1. the domestic company seeks to enter foreign markets with its commodity;
2. the domestic company intends to organize the sale of foreign company's goods on the domestic market.
3. Both of these options involve different strategies or lines of conduct.

*Case 6. Aeroflot PJSC SWOT-analysis* [20]

| | |
|---|---|
| ➢ ***S (Strength)***<br>*The company's strengths as compared to those of competitor are outlined as follows:*<br>• *new fleet;*<br>• *highly qualified staff;*<br>• *developed route network with wide coverage in Russia and abroad;*<br>• *member of Sky Team international air carriers alliance;*<br>• *high punctuality;*<br>• *high recognition and high rating among international companies -air carriers;*<br>• *state support of the airline activities* | ➢ ***W (Weakness)***<br>*Weaknesses of the company, as compared to competitors:*<br>• *the base airport – Sheremetyevo has, in fact, reached its capacity limits;*<br>• *periodic conflicts between air carrier and base airport;*<br>• *passengers' discrimination – owners of Elite Plus level bonus cards from other Sky Alliance airlines on Domestic Aeroflot flights (non-provision of the business hall, lack of priority access plan of embarkation on Sky Priority at most Russian airports);*<br>• *position of a monopolist in the Russian market do not allow competing equitably with other airlines (higher prices for flights where several carriers operate)* |
| ➢ ***O (Opportunities)***<br>*Potential and future prospects for business development estimates:*<br>• *increasing carrying capacity of Sheremetyevo airport after completion third runway or management optimization of air traffic;*<br>• *growth of a modern fleet to increase the number and frequency of transcontinental flights;*<br>• *bankruptcy of a number of Russian and foreign airlines (VIM-Avia, Transaero, KD Avia, Tatarstan Air, Avianova, Moscowy) results in switching passengers to Aeroflot;*<br>• *discovery and acquisition of subsidiary companies (Victory, Aurora, Russia)*<br>• *development of air traffic network.* | ➢ ***T (Threats)***<br>*Attention is drawn to the threat for the company from external and internal environments including relevant competitors' actions:*<br>• *low transport mobility for most people in Russia: a peak of Russian passenger traffic will soon be reached;*<br>• *Aeroflot's monopoly on a number of international and domestic directions may come to an end because of the position of Rosaviation, interested in competition in the industry (in particular, the active development of low cost airlines);*<br>• *lack of highly qualified pilots; rising fuel prices; company cost increase;*<br>• *government lobbying for procurement of midrange Sukhoi Superjet 100 liner that was not the most efficient in its class;*<br>• *failure of a promising new aircraft Boeing 787 Dreamliner, which Aeroflot had planned to buy for their transcontinental routes;*<br>• *delays with the launch of the new Russian airliner MS-21, which the company plans to upgrade its fleet with.* |

[20] Source: https://www.aeroflot.ru/ru-en/about/aeroflot_today.

*Case 7. In the beginning of the Second World War, the German bottling factory Coca-Cola lost supplies of ingredients from the United States, and they decided to produce another drink from food production waste – pomace and milk whey – and called it "Fanta" (short for "fantasy"). After the war the chief manager of this plant, Max Kate, contacted the parent company, Coca-Cola restored their ownership of the factory and did not reject a new drink, which had already gained popularity.*

On the one hand, it is easier to organize the sale of foreign products in the domestic market: a Russian company can assess the potential of the market, conduct an appropriate marketing research, make a corresponding offer to a foreign company, negotiate and, if successful, conclude an agreement on selling its products in the domestic market.

In practice, this strategy also faces challenges. First of all, it is necessary to find out whether the foreign company has the intention to organize the sale of its products in Russia, whether there are other distributors of products of this company in Russia, how strong is the competition among the existing distributors, etc.

It is much more difficult to enter foreign markets with our products. At the preliminary stage it is necessary to study a number of questions. One should keep in mind that the relationship between the manufacturer of the product and the buyer does not end with the sale and purchase of his product. It is no less important to organize after-sales service and, if necessary, the damaged goods servicing and repair.

*Case 8. Since year 1935 the German company Mast-Jagermeister AG has been producing the famous herbal liqueur Jaegermeister which consists of 56 herbs, and supplies it to more than 90 countries. The company logo shows the deer's head. In 1999, the company's management revealed that the target group of the drink has "grown older" - it was now preferred by consumers aged 50+. The company decided to "rejuvenate" the brand: to position it as a youth party drink. In European countries, they showed advertisements featuring two deer Rudi and Rudolph spending time joking with young people in discos. They also offered free herbal liqueur cocktails at the parties. The company changed the design of its Internet homepage and sponsored a number of concerts of famous rock bands. As a result of the promotion campaign liqueur Jaegermeister became associated with such values as composure (self-control), self-confidence and mischief. In two or three years, Jaegermeister became popular among young people, ranking first among the herbal cocktail liqueurs in many countries. Today, its main target customer group is young people.*

## Ways of Entering Foreign Markets

Entering foreign markets can be carried out by various ways, including:

– direct export;

– creation of a JV;

– sale of the right to produce products of the company to an entrepreneur in a foreign country;

– direct investment.

Let us consider each of these methods in more detail.

Access to foreign markets *through direct exports* is applicable to all products, but can be used to export most types of services as well, since the consumption of services, as a rule, occurs at the time of its creation. Therefore, the service provider should, as a rule, be present in a foreign country.

When exporting goods, it is necessary either to create sales (wholesale and retail) organizations in a foreign country, which is not always economically beneficial, or enter into an agreement with a resident company in the foreign country for which the exported goods are imported. Therefore, the company should strive to interest foreign companies in its products, using all available at its disposal marketing resources.

In terms of the company’s costs, direct exports have undeniable benefits, however, the disadvantage of this method is that the exporting firm loses control over the exported goods, which can turn into problems for the brand, if the importing company organizes improper sale and after sales service. Therefore, the exporter of the goods must carry out systematic quality control implemented in the overseas commodity market and after-sales service. To this end relevant terms and conditions may be included in the purchase agreement sales.

In addition to direct exports, there is also export through an intermediary. Intermediaries usually do not fulfill customer orders, but transfer them to the exporter for execution. However, they may assist the exporter in registration of transport or export documentation.

*The second way* is the creation of JVs. JV means cooperation in the form of a new legal entity between two or more natural or legal persons in which each party participates in the division of profits and losses and control over the enterprise. The capital of the JV is formed through joint contributions to the capital of the enterprise. Among the reasons for JVs to be created, there is some interest in establishing a partnership with an enterprise which possesses capabilities and resources (financial, technical, or sales resources).

Unlike interaction between companies in partnerships that involve long-term relationships, a JV is created for the implementation of a specific project. Under Russian law (and the laws of several countries), JVs are independent legal entities. However, since this form of joint economic activity has the features of a partnership, in some cases it is not recognized in foreign practice as a separate legal entity.

Creating a JV allows solving several problems:

– eliminate the factor of possible customs restrictions;

– monitor the quality of products sold;

– get all the necessary information about the foreign market, in particular, about the system of preferences of local buyers, about local laws, norms and customs.

Foreign companies creating JVs with national capital usually introduce new technologies and business practice, while the national partner prepares the necessary documentation and transfers to the new JV established business contacts (see Table 2).

**Table 2**

**Characteristics of JVs**

| | |
|---|---|
| Aim | To ensure the growth of the company's market share or facilitate entrance to new markets. Getting access to the latest technology and know-how, resources, skilled workers to boost profitability |
| Term | Created for a specific period |
| Asset Management | Possible separation of company assets into a separate structure. and selling them to another JV company |
| Risks | Companies participating in a JV carry out risk sharing between JV partners |
| Revenues | Profit is divided according to the share of each participant in the capital of the JV. |

It may also be difficult to develop and make management decisions in a JV. Emerging problems can escalate into intractable conflicts. A striking example of such a conflict is the situation in a JV TNK- BP.

*Case 9. TNK-BP was established in September 2003 on a parity basis by the British company BR and Russian Alpha groups and Access / Renova. But in May 2008 a conflict that arose between the shareholders of the company became public. One of the problems there was disagreement about the company's objectives. The Russian side wanted to diversify its activities with the help of foreign assets, so the company would face the challenge of international expansion. In this case, it would become a competitor of BP on world markets. English partners wanted to use TNK-BP exclusively in Russia. Disagreement over the choice of partners in Russia and abroad resulted in a sharp conflict of shareholders.*

Another way to enter foreign markets is signing *production sharing agreements (PSAs)*. This type of business is used in the mining industry.

*Case 10. In 2012, Gazprom Oil company used its subsidiary Gazprom Neft Middle East V.V. to enter the two new projects for the exploration and development of hydrocarbon reserves in the format of a PSA in Iraq. In the Gamian development project, Gazprom Oil will receive 40%. Canadian company Western Zagros, another party to the PSA with a share of 40%, remains the project operator until the start of the main works under the agreement. In the Shakal block, in which Gazprom Oil's share will be 80%, the company will receive the status of a project operator. The share of the Kurdistan Regional Government in both agreements is 20%.*

*Direct foreign investment* comes not only in the form of PSAs or JVs. Creating a subsidiary in a foreign country from scratch or acquiring the existing company allows it to bypass the customs barriers, since an enterprise created with the help of direct investments receives the status of a resident. It is this consideration that largely explains the fact that Japanese and South Korean companies opened automobile factories in the USA. At the same time, the reaction of the American public was taken into account.

Countries attracting direct investment are counting not only on capital inflows, but also on the transfer of new technologies, know-how, and modern management methods. And if this circumstance is not dominant for developed countries with market economies, then for developing and transitional countries, this consideration is crucial in many cases. For both groups of countries, it is also important that the inflow of direct investment creates jobs. And for countries with a negative balance of foreign trade, investment inflows can improve the balance of payments (BQP).

Licensing is also one of the ways to enter foreign markets. This involves the sale of the right to manufacture their products to a foreign company.

A special and very common *method of licensing* is sale-purchase franchise. The essence of this commercial concession is that one party (the franchisor) gives the other party (the franchisee) the right to a certain type of business using its established business model. For this right, the franchisee pays the franchisor a fee (royalty). In accordance with this transaction, the franchisee receives the right to act on its own behalf, using trademarks and (or) brands of the franchisor. The literature highlights the following signs of franchising.

Franchisee must pay some initial fee for the right to become part of the system; franchisor receives deductions for using its trademark; franchisor provides the franchisee with a business management system.

By transferring the rights of the franchisee, the franchisor imposes obligations on him to run business in accordance with the concept of *the franchisor*. Franchisee gets the right to use the franchisor's trademark, know-how, business methods and technology, procedures and other rights to industrial and /or intellectual property. At the same time, in accordance with the franchise agreement signed by both parties, the franchisor provides the franchisee with technical and business support.

*Case 11. McDonalds is one of the most famous franchises. Only 15% of McDonald's restaurants are owned by the McDonalds corporation itself, the rest are owned by national franchisees. The cost of franchise is $ 40-50 thousand, but it can be significantly higher.*

To do business that does not bring profit (income) is meaningless (the exception, however, is social interests of some by default unprofitable state-owned companies that may prevail over business imperatives of private entrepreneurs: typical examples are environment protection or maintenance of a certain level of income and employment of the local population, regardless of the profitability of the business).

In order to ensure a guaranteed profit, a company operating in a competitive global environment has two main ways:

– to produce all the same as its competitors, but cheaper (including the use of the "economies of scale": saving on costs as a result of a significant increase in production volumes) and better quality;

– to produce unique products that have not yet been mastered by competitors, on which it is possible to set initially high prices, significantly exceeding the real production costs (strategy differentiation).

In addition to focusing on profit, even if the activity of a company in this direction is successful, it is necessary to monitor the entry barriers to the business. The fact is that the size of such barriers serves as an indicator of the competition level in the industry, because production of the simplest products (for example, mobile phones cases or tablet PC cases) or provision of widespread services (making and selling sandwiches or tea and coffee) are available to a large number of entrepreneurs. Accordingly, entry barriers in such a business are small (getting a sewing machine for the production of cases or buying a coffee machine for making coffee will do), so a large number of companies operating on the market in this segment or individual business entities will have to compete quite fiercely for the level of costs (buying supplies and equipment as cheap as possible, saving on rent and staff remuneration), the number of customers served, and reputation. Ultimately, the profit from such a business, where there is fierce competition, turns out to be low.

At the same time, production of, say, airplanes, requires enormous investments in high technologies to guarantee economy and safety, as well as complex, expensive equipment, and trained staff. It also takes decades to earn the good name of the aircraft manufacturing company. At the same time, this is a typical example of a business with the highest level of entry barriers to the industry: after all, for a long time American manufacturer *Boeing* was the only mass producer of wide-body long-haul airliners; competitors were non-existent. As a result, the $ 100 million profits from the sale of each new aircraft allowed *Boeing* to be a highly profitable monopolist in its segment. Only recently has *Boeing*'s monopoly on wide-body long-haul aircraft been broken by European Concern *Airbus* Industry entering into this business (Russian developer and manufacturer of the IL-96 aircraft in this business is not a competitor, because of low capacities for the aircraft production), but the existing duopoly is reliably protected from potential competitors with the highest entry barriers, and these barriers allow *Boeing* and *Airbus* to earn high profits on their products (Fig. 2).

If the company has reached the optimum scale of activity and stable profit, operating solely on the domestic market, it does not make sense to engage in international business. If the company has not yet reached the optimal scale of production of goods (services), it may well be internationalized. However, access to international market for a company can only be justified if the company clearly understands why it needs it, especially with a view of increasing revenues in comparison with activities in the domestic market. Otherwise, the internationalization of activities may end in a great failure.

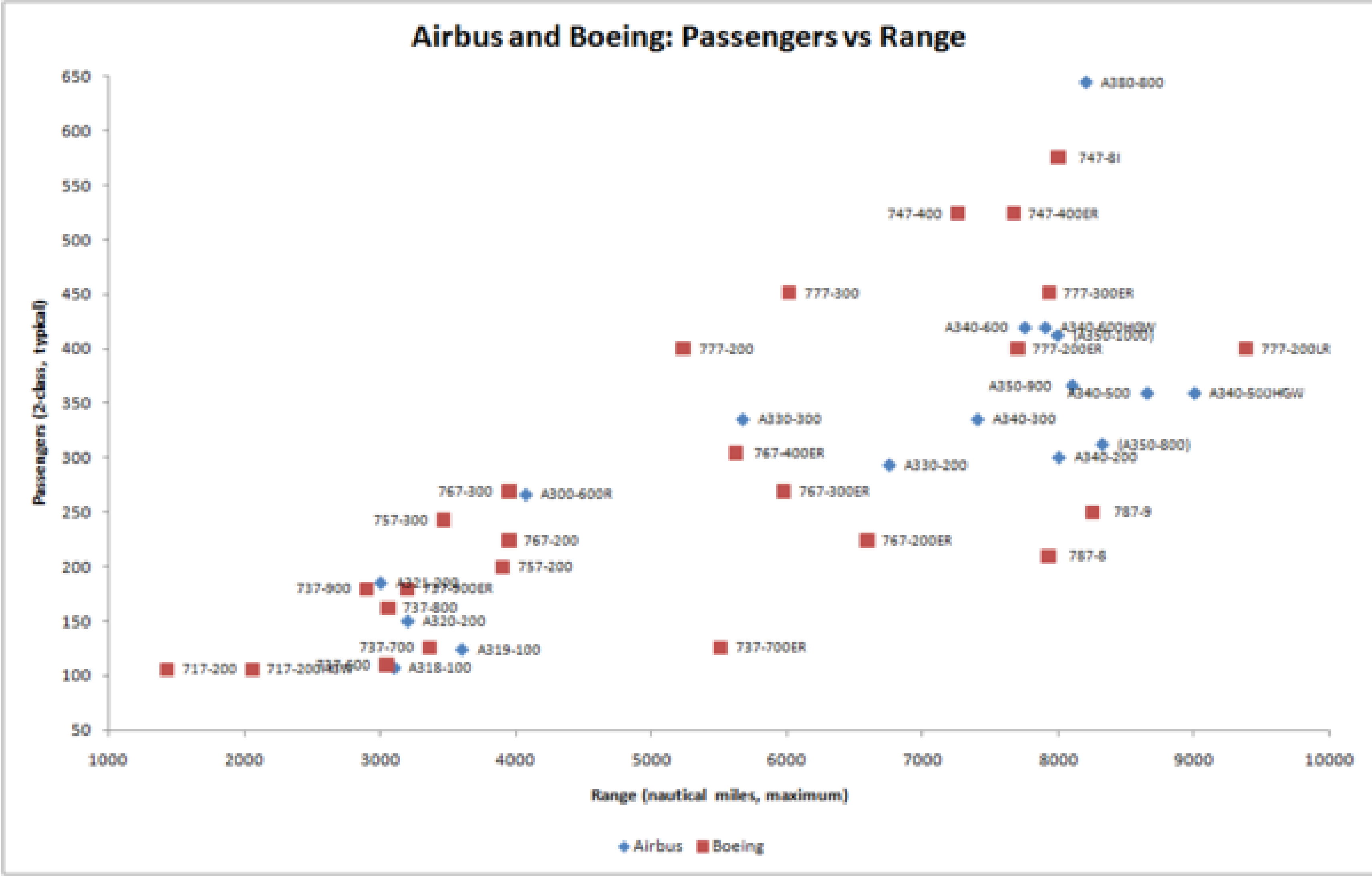


*Fig. 2 – Comparative characteristics of Boeing and Airbus Industry products*

The company’s exit from the national economy can be appropriate primarily because lower production costs will than cover the increase in costs associated with distances. Entering the international level makes sense if three conditions are followed:

1. the local market has reached saturation;
2. internationalization guarantees economy because of scale of the activities;
3. costs associated with internationalization are lower than saving production costs.

Developing a strategic vision for international business has priority value. The economic entity must clearly understand what it is striving for, taking its activity beyond its national jurisdiction, and what new competitive advantages it will be possible to possess. If output growth with view of the costs of internationalization will result in cost reduction and thereby help earn extra profit – it will meet the expectations. It is possible that the decision on internationalization stems from such tasks of international operations as improving customer service or diversifying country risks. It is acceptable. But if internationalization will contribute to growth in sales while reducing profits in comparison with focusing exclusively on the domestic market, then, regardless of goals and objectives the company would have set, they will not justify internationalization.

Setting strategic planning objectives implies that a company or an individual entrepreneur given the international specifics of their operations will be clear about the answers to the following questions:

– what goods or services the company or an individual intends to sell on foreign markets;

– where and how the production of these goods (services) will be carried out;

– where and how the goods (services) produced will be sold;

– where and how the necessary resources for production of goods (services) will be acquired;

– how the company or individual entrepreneur expects to surpass their competitors.

Classification of markets of interest to international operations suggests that potential countries for doing business will be carefully analyzed for entry barriers to relevant national markets, sales market potential, expected additional competitive advantages (moving production may help save on labor costs – for this reason the world production is mostly based in the countries of South East Asia, where wages are low).

Choosing strategic alternatives for acquiring global competitive advantage implies that an economic entity rationally selects for itself the best combinations (bringing the greatest profit):

– countries of operation (taking into account all political and social economic features);

– forms of entering foreign markets (either direct export of goods (services) produced in their jurisdiction, or their production on-site in a foreign country using various organizational and legal statuses);

– business partners, carefully assessing the benefits of acting be oneself or cooperating with other important players in the market;

– labor resources involved in the business (either using own labour, or recruiting new staff in foreign countries as well as in the home jurisdiction).

Choosing the optimal organizational form for doing business is also important; it depends on the nature of the competitive advantage that an economic entity seeks to get. Often this choice is connected with a dilemma: the financial efficiency of production usually requires centralized management of activities, while decentralization of decision making can also be a smart move in international business, especially if local conditions of national markets and related cultural factors are properly taken into account. Determining the required type of organizational structure the most suitable for international operations is not always an easy task.

*Case 12. Japanese car companies have high competitive advantage in the world, especially in terms of ways of organizing production (high performance at a consistently high level of quality). Although Japan is the largest car manufacturer in the world, direct export from the Land of the Rising Sun to foreign countries is significantly hampered by the peculiarities of international trade policies (import duties) and yen rate growth against major world currencies. As a result, exporting cars from Japan by the end of XX century became unprofitable. Therefore, Japanese companies decided to open their own production in countries where they were in high demand. Immediately, two alternatives emerged: either to create a car factory from scratch, or to acquire and integrate local manufacturing companies into the company's structure.*

*Nissan company tried both, and the results were as follows: in the UK, where Nissan plants were built from scratch, productivity and quality levels were even better than in Japan, while in Spain, where Nissan acquired Motor Iberia, production efficiency was low due to the fact that the Spanish workers retained the business culture of the former company, ignoring the higher production standards of the Japanese. As a result, the Spanish division of Nissan was unprofitable and the English one, by contrast, cost-effective. The conclusion that the management of Nissan did was the following: in cases where the company's competitive advantage is primarily in the use of its own working methods and standards, it is better to start business in foreign countries from scratch.*

There are four possible options for implementing an international business strategy within a company operating in foreign markets:

1. the strategy of duplication of the business model (international strategy);
2. multilocal (multinational) strategy;
3. global strategy;
4. transnational strategy.

The *strategy of duplication of the business model (international strategy)* implies the use of the strategy that the company usually uses in its own country in foreign markets. The reason for this choice may be the success in the domestic market, as well as the initial stage of international business, when the company does not have enough experience to take other strategies as a basis. An example of this kind may be the activity of *Daimler-Benz*, initially oriented towards highly profitable consumer segment in Germany and an excellent reputation for its domestic market.

A *multi-local (multinational) strategy* implies the presence of aggregate of relatively independent subsidiaries, each of which serves any national market. In this case, companies have good opportunities to adapt their products, as well as marketing campaign and methods of producing goods (services) for maximum satisfaction of diverse consumer needs. A typical example of such a company is the Swiss *Nestlé*, which has a decentralized structure and widely diversified product line adapted to specific needs of consumers in different countries of the world (for example, in Switzerland and countries of Western Europe production focuses on milk chocolates, preferred by most consumers, and in the Russian market the company is also successfully promoting dark bitter chocolate, much loved by the Russians).

*Global strategy* is typical for companies that perceive the whole diverse world as a single market. In this case, the emphasis is on production and sale of standardized goods (services) that meet the requirements of most consumers around the world. Global companies are characterized by the centralization of management and control, and also taking advantage of the effects of scale (here comes expansion of production and sales, highly efficient structural subdivisions act, united by common marketing and advertising campaign, as well as the unity of production processes). A good illustration of global companies is *Boeing* (one aircraft, let's say, the most popular *Boeing 737*, for airlines representing different countries and continents) or mobile device manufacturers, such as *Apple*, *Samsung*, *Nokia* (one basic phone model and software for various national markets). It is worth mentioning that the main difference of the global strategy from the strategy of duplication of business model (because each of these strategies involves doing business in a single format in any state of the world) is that a global company is not greatly influenced by preferences and practices in the domestic market of the main country of its home base. It offers a global product for global market, determining for itself the best way to meet needs of all consumers in all countries of the world.

Finally, *transnational strategy* combines the advantages of increased efficiency through globalization of operations (as with global companies) and the benefits of delegation of authority to management of local subsidiaries (as in multi-local companies). This problem is solved by an informal approach to centralization or the decentralization of authority and the distribution of responsibility between the most efficient and flexible units. An example of a company using a transnational strategy is *Microsoft*: although the new software products are developed in the USA, the responsibility for their sales are transferred to the field, to the appropriate foreign units, better familiar with the national characteristics of different markets (so along with the basic English version of the Windows program, its versions are released in the main languages of the world, adapted to language features of different countries).

It is obvious that in each case one of these four main strategies will be appropriate. If *Mercedes* cars catch fancy of a demanding high-income German customer, they can also be successfully sold in the luxury car segment in the USA, Russia or China. At the same time, the company *Boeing*, releasing their aircraft, thinks first of all about global customers, without fundamentally distinguishing American airlines among its customers. *Nestlé* company, however, complements dry milk mixes with its own brand of purified bottled water produced on-site in African countries to ensure the safety of the final water-diluted product for African babies. At the same time, higher standards of cleaning piped water and health literacy in Europe or North America make a similar combined *Nestlé* product superfluous: here its components are consumed separately. *Microsoft* is acting quite differently, uniting the developers of its software products in the US base unit, while giving independence of dealers in national markets. Comparative characteristics of the strategic alternatives we considered are presented in the matrix of K. Bartlett - S. Ghoshal (see Table 3).

**Table 3**

**K. Bartlett - S. Ghoshal Matrix**

<table>
<tr><td rowspan="2">The need to increase efficiency by globalization of operations</td><td>High level</td><td>Global strategy<br>The world is a one whole market.<br>The main goal is to create standardized goods (services) that meet the requirements of consumers around the world.</td><td>Transnational strategy<br>Ensuring an optimal combination of the benefits of increased efficiency through globalization of operations and the advantages of adaptation to local conditions</td></tr>
<tr><td>Low level</td><td>Duplication strategy of business model (international)<br>Using core competence or specific advantages achieved in the domestic market as a means of competing in foreign markets</td><td>Multilocal (multinational) strategy<br>A collection of relatively independent subsidiaries, each of which serves a particular domestic market</td></tr>
<tr><td colspan="2" rowspan="2"></td><td>Low level</td><td>High level</td></tr>
<tr><td colspan="2">The need for flexibility and adaptation to local conditions</td></tr>
</table>

Speaking of strategic alternatives in corporate business, another important area should be noted: the possibility of buying a ready business, M&As companies, as well as various joint forms of doing business with several independent legal entities. It is also worth taking into account. Indeed, in a number of cases when a competitor cannot be outraced in an open market rivalry, you can just buy the competitor, especially if it has financial problems. So did the Chinese during the peak period of global financial crisis of 2008–2009, by purchasing assets of American car companies including famous brand Hammer. M&As in the automotive industry are also common, as they allow companies to reach the optimal effective scale of production.

*Case 13. For Skoda, the Czech domestic market was too small, and the company's activity there was of little effect, but, becoming a part of the Volkswagen group, the company's cars gained access to foreign markets, and Skoda managed to take advantage of the scale advantage, becoming profitable. At the same time, alliances give the ability to expand the business, while obtaining additional income. Similarly, becoming a part of the global airline alliance Sky Team, Aeroflot expanded its route network for own clients, and also got hold of* *additional passengers from other airlines of the alliance that have switched to Aeroflot routes convenient for them.*

Specific market entry strategies, including foreign ones, are reflected in several matrices. One of the most famous is Ansoff matrix (see Table 4).

**Table 4**

**Ansoff Matrix**

| **Market** / **Product** | **Existing** | **New** |
|---|---|---|
| **Existing** | Market penetration | Creation (development) of a product |
| **New** | Creation (expansion) of the market | Diversification |

1. *Market penetration strategy* is the simplest and most obvious strategy of promotion of the existing goods to the existing market. The company is already present in this market, so the main tools to implement this strategy are to increase product competitiveness, advertising campaign, and sports competition sponsorship. An example of such a strategy in the US market is *Coca-Cola Company*. In recent years, the annual cost of advertising for this company accounted for about $ 3 billion and tripled since the early 1990s. In 2012, *Coca-Cola* collaborated with the Olympic committees of about 200 countries, sponsored various sports competitions.

*Case 14. Since its founding, Ford's ambition has been to achieve highest production efficiency through process optimization: Ford was the first company to introduce a conveyer car assembly line, everything (color, car models) was unified as much as possible to cut down costs. In the course of company's internationalization, with the growing demand for Ford cars in foreign markets, the company had to make adjustments in the strategy of penetrating the domestic markets of foreign states. So, in the early 1970s Ford Fiera model became very successful in the Philippines market. Ford initially conquered overseas markets by global strategy. So they decided to repeat the success of Ford Fiera sales in Thailand. The company applied the same sales approach, including advertising campaign and pricing guidelines. However, in the Thai market Ford Fiera was a failure: the price of the car turned out to be higher than the prices of competitors for similar brands, while the car itself got a bad reputation because of unreliability. When Ford analyzed the situation, it turned out that competitors were able to offer favorable conditions for the purchase of their cars in a loan that Ford ignored at the time, entering the Thai market on the same approach as used for sales of the car Fiera in the Philippines. Besides, Fiera cars often broke down in Thailand, not because they were of poor quality, but because local consumers usually loaded them two to* *three times of the weight, which was far beyond Fiera capacity. As a result, Ford had to adjust strategy, moving away from the idea of a single product on the same conditions at a single price for all markets to greater sales customization in each country of business. So, global strategy was replaced by transnational strategy, which helped Ford in future.*

2. The *strategy of creating (expanding) the market* includes promotion of existing product to new markets and is particularly widely used by transnational companies.

*Case 15. The tire manufacturing company Bridgestone was founded in 1931 in Japan and initially worked only in the domestic market. Rapid development of automotive industry since the end of World War II inspired Bridgestone, and the company began to explore the international market. The first foreign factory opened in Malaysia, followed by opening of a subsidiary in the USA in 1967. In 1972, the European office of Bridgestone was created in Brussels, and in 1979 a series of aluminum wheels for passenger cars was launched and a technology was developed to recycle old tires into fuel for industrial furnaces.*

*Strengthening the company's position in the international market continued with the acquisition of Bridgestone production facilities in Tennessee (USA) from a tire Firestone company. And in 1988, the entire Firestone company, the second largest tire company in America, was bought by Bridgestone for $ 2.6 billion. This meant acquisition by Bridgestone of the status of a truly global corporation. In 2001, Bridgestone was recognized by global car manufacturers as a leading Run-flat tire producing company (model Potenza RE040 RFT). As a result, car manufacturers BMW and Lexus adopted the RE040 RFT as original equipment for their most prestigious sports models Z8 and SC430. Also in 2001, Bridgestone opens its sixth plant in Europe, in the city of Poznan (Poland). At the beginning of 2002 at the Geneva Bridgestone and Continentale Auto Show a partnership in areas of development and technical improvement of run-flat tires was announced.*

3. The *strategy of creation (development) of the product* is based on the presentation of a product updated in such a way that it results in expansion in product lines of the company. An example of this strategy is modification of the tablet iPad.

4. *Diversification strategy*. A prime example of this strategy was the appearance of the iPad, which became a completely new product. A distinctive feature of the new *Apple* device was not only the original product design and its high-quality embodiment, but also dozens of thousands of applications adapted specifically for iPad. It is believed that the diversification strategy is the riskiest and is justified only when the new direction promises to be more profitable.

In addition to the Ansoff matrix, there is Boston consultative group's matrix, based on the product life cycle model, McKinsey's matrix, developed by

McKinsey Advisory Group in collaboration with General Electric Corporation (it includes nine squares), ADL matrix (based on two variables that reflect the maturity of not goods, but sectors (industry life cycle) and position relative to competitors), as well as a number of other matrices, aimed at reflecting various parties and aspects of strategic management.

## International Production Activity of Companies

International production activity involves the following organizational forms:

– foreign production;

– creation of international associations engaged in joint production activities.

Besides, there is outsourcing of a number of commercial operations to foreign counterparties. Forms of business are determined by two types of agreements: contractual and equity agreements. Their structure will be shown in Table 5.

**Table 5**

**Modern Business Agreements**

| Type of agreement | Subtype | Form |
|---|---|---|
| Contractual | Traditional contractual | Purchase and sale of goods |
| | | Licensing |
| | | Franchising |
| | New progressive forms | Joint Research and Development (R&D) |
| | | Marketing |
| | | Standardization work |
| | | Distribution services |
| | | Production |
| Equity | Without creating a new company | Alliance |
| | Creating a new company | Independent JV or a subsidiary of TNC |

Equity agreements include agreements on the division of companies, M&As. Within the strategic alliances (SAs), a closer relationship is established than with contractual agreements. At the same time, new progressive contractual agreements are an area of SA. The Alliance differs from the contractual agreement by a greater degree of cooperation and does not apply to the division, the M&As of companies. From a legal point of view, the SA is located between progressive contractual agreements and cooperation with the creation of a new company.

***TNCs.*** Currently the main part of international business accounted for by multinationals. They attract to themselves an increased public attention in many countries and cause big fears, because within their “empires” a huge amount of goods capital moves from country to country, labor migrates, as well as the trade and exchange of intellectual property is happening, that affects each of the national economy and politics, and culture.

The significance of TNC in the development of the world economy has generated a large number of its definitions, developed at international government and public organizations level, by academics and businesspeople. The UN defines TNC as an incorporated or unincorporated company, which includes the parent enterprise and its foreign affiliates – subsidiary enterprises, associate enterprises and branches. The sign of control by the parent company is determined by establishing its minimum share in the foreign branch (10% of ordinary shares or votes for the incorporated enterprise or its equivalent for unincorporated enterprise).

Opinions of well-known economists about the nature of TNC do not contradict each other. J. Dunning defined a TNC as an enterprise that makes direct foreign investments and owns or controls the mechanisms for obtaining value added in more than one country. According to D. Blake, TNCs are such economic enterprises – producing, mining, servicing or financial – that are headquartered in one country and organize business in one or more foreign countries.

At the present stage of the evolution of the subjects of international economic relations, TNC is considered a large firm or association of firms from different countries that have assets abroad and can have a significant impact on any sector of the world economy. The production and trading activities of TNC go beyond the limits of one state through the establishment of branches in foreign countries (in the form of structural units without legal independence) and subsidiaries.

Historically, TNCs have undergone several stages in their development, and therefore they can be divided into *five generations*. The first generation of TNC (from their inception to 1918) was mainly engaged in the development and extraction of raw materials in the colonial countries of Asia, Africa, and Latin America, as well as their processing in the countries – the owners of the colonies. TNCs were cartels and syndicates. The second generation of TNC (1918–1939) was engaged in the production of weapons and military equipment to meet the military needs of the leading countries of Europe, America and Japan. These TNCs were formed in the form of trusts.

The third generation of TNCs (1945–1960) was based on scientific and technical achievements in the field of the newest branches of science and industry (atomic energy, electronics, space, instrument engineering, etc.). TNCs at this stage of development were concerns and conglomerates. The fourth generation of TNCs began to form in 1970-1980. It was during this period that the M&As process accelerated, which contributed to the concentration of capital and production in TNCs that most successfully developed large international business. The fifth generation of TNCs is developing at the beginning of the XXI century in conditions of accelerating processes of regional economic integration, especially in Europe (EU), North and South America (NAFTA and MERCOSUR), Asia (Association of South-East Asian Nations (ASEAN), Asia-Pacific Economic Cooperation (APEC)).

According to UNCTAD, by the end of 2007 there were about 79 thousand non-financial TNCs in the world with 790 thousand foreign affiliates. At the beginning of 2009, there were already about 85 thousand and 809 thousand, respectively. At least 650 state-owned TNCs are powerful source of global foreign direct investment (FDI). They own more than 8.5 thousand foreign affiliates, controlling in 2010, about 11% of global FDI. 19 state TNCs in 2010 hit the list of the largest. About 56% of them are from developing countries and countries with economies in transition. However, developed countries also maintain high statistics on the presence of these companies. If initially public TNCs prevailed in the extractive industry, they are now diversified and already have a strong position in the services sector.

The economic performance of foreign TNC units grew in 2011 for all major activities. Throughout the year in foreign branches there were employed about 69 million workers, who generated $ 28 trillion in sales and $ 7 trillion in value added.

The pace of development of the TNC network over 25 years (from 1982 to 2007) is impressive: from 3.8 times (in terms of the number of employees employed in the foreign affiliates of TNC) to 31.2 times (for total assets of foreign affiliated companies).

By transferring capital from surplus countries to deficient countries, TNCs increase the efficiency of investment use and promote growth of total world income. However, the theory of comparative advantage is not fully suitable for explaining the economic effect of their activities for the two reasons listed below.

One of the most important criteria for TNCs is the export component. So, at present, absolute leaders on this criterion are: the British company *British American Tobacco*, which sells over 99.19% of its products abroad, the Swiss company *Roche Group* (98.81%), the American telecommunications corporation

*Liberty Global* (98.48%). Note that in terms of the volume of foreign assets, *British American Tobacco* occupies only 68th position in the ranking of the largest non-financial TNCs, *Roche Group* is rated 55th, *Liberty Global* – 82nd. The Swiss firm *Nestlé*, which for a long time was the leader by this criterion (15th place in the ranking of the largest TNCs), ranked only fourth in 2011 (97.85%).

The evolution of TNCs has led to such an increase in their technological, organizational, resource and marketing capabilities which allows them to realize the functions that determine the development of the world economy as a whole:

– regulation of production and distribution of products on a global scale;

– intensification of the processes of internationalization of economies.

*Case 16. The Indian conglomerate Tata Group is one example of a conglomerate. The company's business is presented in the markets of more than 50 countries. Tata Consultancy Services is the largest software developer in Asia, Tata Global Beverages demonstrates a high rating in the global tea market, Tata Steel is a renowned steel maker in the world, Taj Hotels Resort and Palaces is in the hotel business, Tata Power is an energy company.*

The activity of TNCs allows overcoming numerous barriers through the implementation of transfer supplies using domestic prices, favorable production conditions, taking into account the market situation, optimal resource utilization, strategically targeted profit sharing, etc.

The typical structure of TNCs is international. At the heart of any TNC there is an enterprise. The term "enterprise" here implies a legal entity operating domestically, as part of a corporation, or as an independent business unit. Enterprises may be privately or publicly owned, controlled by private or state institutions, both resident and non-resident. They can be both financial and non-financial institutions.

TNCs become the same equal participants in international economic relations as the states of basis and the host countries. As a result, TNCs in some cases begin to play leading roles in the national economies of the world. Due to their financial strength, the largest corporations squeeze national investors out of the most attractive sectors of the national economy, create severe pressure on domestic producers, often using unfair competition methods. TNCs, expanding their presence, set their standards not only in the sphere of management, but also influence the social identification of the host population.

The activities of TNCs are assessed both in absolute and relative terms. Among the absolute indicators, the most significant are the size of assets, sales, profits, and the number of employees. The largest world's TNCs in terms of revenue are presented in Table 6.

**Table 6**

**The Largest Companies in the World in Terms of Revenue, 2018** [21]

| Rank | Company name | Country | Sector / industry | Revenue, $ mln |
|---|---|---|---|---|
| 1 | Walmart | USA | Total sales | 500 343 |
| 2 | State Grid | China | Power industry | 348 903 |
| 3 | Sinopec Group | China | Power industry | 326 953 |
| 4 | China National Petroleum | China | Power industry | 326 008 |
| 5 | Royal Dutch Shell | Netherlands | Power industry | 311 870 |
| 6 | Toyota Motor | Japan | Automotive industry | 265 172 |
| 7 | Volkswagen | Germany | Automotive industry | 260 028 |
| 8 | BP | Great Britain | Power industry | 244 582 |
| 9 | Exxon Mobile | USA | Power industry | 244 363 |
| 10 | Berkshire Hathaway | USA | Finance | 242 137 |
| 11 | Apple | USA | Technology | 229 234 |
| 12 | Samsung Electronics | South Korea | Technology | 211 940 |
| 13 | McKesson | USA | Healthcare | 208 357 |
| 14 | Glencore | Switzerland | Power industry | 205 476 |
| 15 | United Health Group | USA | Healthcare | 201 159 |
| 16 | Daimler | Germany | Automotive industry | 185 235 |
| 17 | CVS Health | USA | Healthcare | 184 765 |
| 18 | Amazon.com | USA | Technology | 177 866 |
| 19 | EXOR Group | Netherlands | Finance | 161 677 |
| 20 | AT&T | USA | Telecommunications | 160 546 |

[21] Source: Fortune Global 500 - http://fortune.com/global500/list.

As can be seen from the table, the largest non-financial TNCs in terms of revenue represent the power-generating sector and two engineering industries – production of electronic and electrical equipment and automotive industry.

The financial crisis has greatly affected the fuel and energy industry, which has led to a sharp drop in the performance of global companies representing it. More recently, in 2012, the largest company in the world in terms of gross revenues was the energy company *Royal Dutch Shell*, the second largest one was *Exxon Mobil*, a company representing the energy industry, and Russian *Gazprom* was on 15th place.

The number of workers employed in TNCs and their affiliates is an important indicator characterizing the scale of the efficiency of TNCs. According to the estimates of the International Labor Organization, every 20th of the total number of employees in the world is engaged in TNCs. The top 100 TNCs employ over 15 million people.

In *developing countries*, the largest in attracting personnel TNCs place the main number of jobs both abroad and in the country of their main location. The geography of TNCs in developing countries is clearly localized. The 100 largest non-financial structures are based in 16 countries. The bulk of TNCs are concentrated in the PRC (including Hong Kong and Taiwan), Russia, Singapore, South Africa and India. These countries account for 74% of TNCs from the list of the 100 largest. Hong Kong has the largest share – 18%, Taiwan – 12%, Russia – 10%, China and Singapore – 9% each. The degree of active involvement of personnel, in particular foreign personnel, is more related to the specifics of the sectoral affiliation of TNCs than to the home country (the majority of Chinese TNCs are in the list of the largest), foreign assets or indicators of transnationalization. In absolute terms, both scientific and innovative activity of TNCs are determined.

In the early 1990s, the share of funds spent on research and development

(R&D) by the 400 largest TNCs in the world accounted for about 23% of global R&D contributions; by 2001 it had reached 28-30%. TNCs control 90% of private patents. Share of TNCs in global production of innovations far exceeds their share in the financing of R&D and, according to various estimates, is approaching 40-50% of the world.

**Cooperation.** Cooperation refers to the practice of people or greater entities working in common with commonly agreed-upon goals and possibly methods, instead of working separately in competition (Oxford English Dictionary).

Cooperative teams are ones where members are actually working with each other in a supportive capacity. This must be built on a sound foundation of coexistence otherwise the cooperation will be transient. People know whom to turn to for advice. Tasks are typically assigned to and performed by distinct team members (Nexbridge Dictionary).

**International enterprises alliances.** Historically export-oriented companies were looking for partners in the importing countries in order to facilitate market access. To enhance its competitive advantage, as well as to strengthen its position in the markets of other countries enterprises of one or several industries of different countries began to resort to the creation of an alliance. Currently, alliances are considered as one of the most common areas of international cooperation. Alliance is an association of independent companies that, using each other's intellectual and material resources, carry out joint activities instead of operating independently in the market or conducting a merger procedure (Fig. 3).

### Strategic Alliances

- No binding definition
- May be a loose co-operation in order to reach corresponding or common strategic goals (depending on agreement and binding nature of commitment)
- May be relatively firm business combinations where individual units intensively exchange information and/or employees, together pursue R&D or use common supply sources etc.
- Reciprocal investments are also possible, up to reciprocal equity participation

### Joint Ventures (JV)

- No legal definition for term
- Used in various ways and comprises a wide range of agreements where two or more companies agree upon starting a common business or a common business-related activity
- Contractual JV is one form; an agreement solely based on obligatory rights, where there is no hiving-off of collaboration e.g. in form of a project company
- Established in form of a stock or a private company, it is called Equity JV

### Mergers

- Merger of equities of at least two legally independent stock companies in a way that at least one of the companies involved becomes extinct
- May result from a foregoing co-operation or may present itself as an alternative to corporate transactions such as company acquisitions or participatory acquisitions
- With planning a merger, in particular relevant Conversion Law and national and European competition law issues are to be considered

*Fig. 3 – Forms of cooperation*

Motives for joining an alliance, depending on the industry, competitiveness of the parties, etc., may be the following:

– retention and expansion of market share;

– expanding existing markets and entering new markets;

– use of joint activities for subsequent entry into the markets of these countries;

– rational organization of commercial activities, the use of more economical factors of production.

In case of joining the alliance, the companies hope to get the scale effect, access to markets, and to solve issues of professional competence. At the same time, alliances should be perceived as a temporary form of organization of international business that functions for 5-10 years. The relatively short-term nature of their activities is explained, first of all, by the need to match the economic, scientific, technical and political interests of the members of the alliance, as well as consideration of their national socio-cultural differences.

Among alliances, a special place is occupied by SAs. Such an alliance implies a form of international cooperation where members are strategic investors and partners. SAs are based on participation in assets without the formation of a new organization, the creation of functional and informal agreements, licensing agreements and other commercial arrangements.

According to B. Garrett and P. Diussozh, SA is a union of several independent enterprises that intend to engage in a specific type of production or want to complete the project, using each other’s knowledge, materials and other resources, instead of launching production independently not sharing risks with anyone and not trying to defeat competitors, or creating conditions for M&As.

SAs have the same advantages and disadvantages as similar classic structures. Their members retain legal independence and autonomy. They take joint solutions to commercial problems of international or even global scale related to the resolution of difficult competitive situations. At the same time, joint control over the implementation of the tasks is carried out. SAs extend their activities to several areas. Competition is possible in some sectors between the members of the alliance.

Another modern international business organizational form based on cooperation and partnership is JVs. They are firms, most often founded on a parity basis, or may represent a program in which two or more organizations participate. The prerequisites for creating a JV are the match of interests of both parties and the existence of joint experience of joint work on export-import operations. The reasons for creating this union are:

– the implementation of complex and expensive projects;

– lack of sufficient experience for successful activity in the foreign market of at least one of the companies belonging to the JV;

– the desire of small and medium businesses to conclude an agreement with a large company in order to gain access to distribution channels, services of qualified personnel, new technologies.

The initial forms of cooperation are, as a rule, preceded by the creation of JVs. Therefore, the appearance of a JV can be regarded as the result of a long-term international industrial cooperation. JV partners can choose different forms of interaction, depending on the interests of the participants and the relevant rules of law. Two companies located in the same country may try to enter a foreign market. A foreign company can combine their efforts with the efforts of a local company. Companies from two or more countries may establish a JV in a third country. Finally, a JV can be created by a private company and a government structure (state organization) of any country.

In the formation of a JV the study of the legal system of the home country is very important, just as the degree of openness of the economy, the conditions for the importation of capital into a country and export from it. Integration processes taking place in different regions of the world are the most important external factors contributing to creating a JV, and improving the efficiency of its work. For example, within the EU, the development of industries is carried out on the basis of common agricultural, transport and other programs, which has a positive effect on the development of joint business activities of firms from different countries. In the formation of a JV, there are various problems: decisions concerning investment, industrial cooperation, the choice of the legal and management forms, compatibility of business cultures; if operational management is concentrated at one of the parties, and the other party does not exercise control over its actions, then the JV has high risks of disintegration.

A common way to conduct international business has *become international M&As*. In a developed market economy, it is an objective process leading to intrasectoral and intersectoral consolidation of enterprises both within one country and between countries. Consolidation means the acquisition of rights to additional participation in the authorized capital, the acquisition of greater corporate control. The number of participants does not change. The process serves as a link between the forms of partial acquisitions and full acquisitions. A distinctive feature of a partial acquisition is a variable volume of corporate control due to an increase in the company's authorized capital, in particular additional issue, splitting or merging of shares.

*Acquisition* is a process of obtaining corporate control rights unilaterally within the existing organizational forms. With the full acquisition, one takes the rights of the sole participant of the authorized capital, full control over the participant with preservation of its legal independence. A partial acquisition is characterized by the acceptance of rights to participate in the board of directors. Partial acquisition forms are applied either independently of each other or are an intermediate stage of a higher order process, including the degree of control acquired. For example, integration is carried out in the form of participation, and after some time purchase arrangements are reached. This form, taking into account the process of participation already completed, is possible under the condition of conducting an interim consolidation process. In the above case, the integration process can be viewed as two processes (participation and consolidation) or one, i.e. a purchase.

*Case 17. In 2009, Adam Opel GmbH (hereinafter Opel), owned by General Motors, hit financial rocks as a result of the economic crisis. Opel was put up for sale. Sberbank of Russia showed a serious interest in the purchase. Together with Canadian Magna International Inc. (Magna is a diversified manufacturer and supplier of global automotive components) Sberbank submitted a proposal to acquire equity in Opel as part of the program to strengthen its viability. Despite the fact that the terms of the deal were agreed upon, General Motors subsequently refused to sell Opel. Some analysts believe that the real reason for the sale talks was not the desire to sell the company, but the desire to lobby for its restructuring plan at the EU level.*

With *integration*, a merger occurs on the basis of newly created companies. The merger process involves the appearance of a new market participant. The process of merging firms is regulated by law. The merger of assets is characterized by the implementation of a process on the basis of a newly organized company with the transfer by the owners of the participating companies as a contribution to the authorized capital of the rights of control over their companies and the preservation of activities and legal forms of the latter; M&As are often unfriendly when control is established contrary to the interests of the main shareholders.

*Case 18. After being established in 1987 by uniting the leading national beer producers Artois and Piedboeuf, the largest Belgian brewing company Interbrew began to actively expand into the world market of beer. In the 1990s Belgians managed to acquire beer production in the countries of Central and Eastern Europe and Russia, significantly strengthening their position in the local markets of the region. In 2000, Interbrew swallowed the English beer producer Bass and Whitbread, and in 2001 began expanding into the German market, acquiring Diebels. Later several more German breweries found themselves in the portfolio of purchases, in particular Beck & Co, Gilde Group and Spaten-Lowenbrau-Gruppe. The acquisition of the Brazilian American Beverage Companies (AmBev) in 2004 resulted in the creation of the world's largest brewing company InBev.*

*However, management and shareholders of the newly created world leader in the beer market did not stop there. In 2006, InBev bought the Chinese Fujian Sedrin Brewery, which allowed the company to become the third largest beer producer in The Heavenly Empire. And in November 2008, InBev closed a deal to buy the largest American manufacturer at the time Niva AnheuserBush for $ 52 billion. This purchase not only strengthened Anheuser-Busch*

*InBev's leading position in the beer industry, but also allowed it to enter the top five world-leading consumer goods makers with annual revenue of $ 39 billion (2011). Today, the total number of employees of the company is more than 116,000 people; they work at 137 factories of the corporation located in 23 countries of the world. A portfolio of beer brands owned by Anheuser-Busch InBev has more than 200 brands.*

The specificity of modern M&As is the interethnic nature of the integration of production within the framework of TNCs. The assets of large foreign firms are acquired; the merging of giant companies takes place. M&A include small firms too. The highest intensity of M&As is observed in the basic industries: steel, automobile, chemical, oil, aerospace, shipbuilding, etc. Multiple resales of previously acquired firms that do not fit into the organizational structure of the parent company don't provide targeted profits. There goes a liquidation of technologically outdated, inefficient industries. An important feature of international M&As is that changing the nationality of an enterprise takes place without changing its location (Fig. 4).

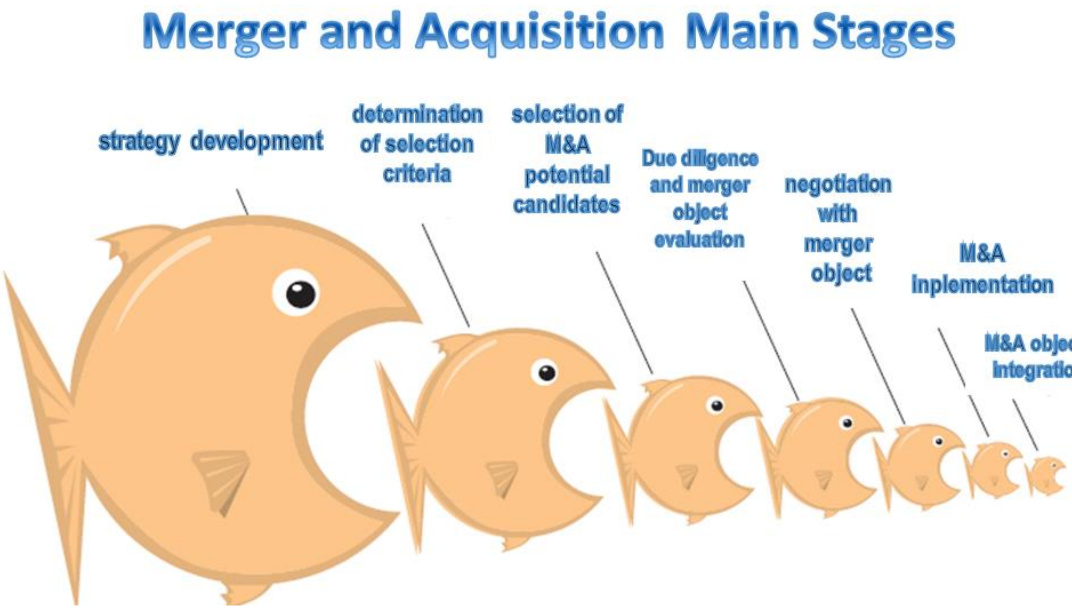


*Fig. 4 – M&As main stages*

*Case 19. The wave of M&As of the automotive multinational companies, as well as the active development of other forms of corporations' international cooperation in recent years indicate that the automotive industry is turning from a set of independent national manufacturers into a complex web of interconnected TNCs, the degree of mutual integration of which continues to increase.*

*Although the share of the largest TNCs (GM, Toyota, Ford, Volkswagen Group, DaimlerChrysler, Nissan, Honda) in the global automotive industry declined in 1998-2005* *from 90 to 85%, it still remains predominant. The volume of cars produced at foreign enterprises by these TNCs increased from 40 to 51%. In the period 1990-2002 there were 35 major M&As registered in the automotive industry. They peaked in 1998-2000, when the Daimler-Chrysler transnational groups (Germany / USA) and Renault-Nissan (France / Japan) were formed. A total of 26 independent national producers were absorbed.*

*The main goal of M&As is survival in a highly aggravated competition in the global market. The merger of companies makes it possible to produce either different car models on the same technological basis using the same components, or the same models, but under different brands (technological mergers). Since 1996, as a result of an alliance between Ford and Mazda, corporations have received the ability to use a common platform for the production of their models. Thanks to this cooperation, Ford sells Mazda cars manufactured in Mexico under its own brand. Volkswagen stands out against the background. The structure of this TNC included six other automakers, herein that in 1986, Volkswagen acquired the Spanish SEAT, and in 1991 the Czech Skoda and the East German plant which had produced Trabant. To improve the production technology of sports models, Volkswagen acquired the English Cosworth Technology in 1998.*

*Image mergers are aimed at expanding the production range by adding prestigious and expensive brands with a rich history and a recognized reputation. These considerations guided Ford when acquiring English Jaguar and Aston Martin, as well as Volkswagen in the takeover of firms producing Bugatti, Lamborghini, as well as Bentley, Rolls-Royce, Porsche. The presence in the range of products of expensive and prestigious brands has a positive effect on the image of the entire corporation and leads to an increase in its sales in general.*

*However, the most common are market M&As, the purpose of which is to increase their presence in new markets for certain TNCs. In this case, it gets the opportunity to use the trademark of the absorbed (or associated company, its production facilities, distribution channels, component suppliers, customer base. There is an opportunity to consolidate efforts in the field of R&D, to optimize management. An example is the collaboration of Renault-Nissan, Daimler-Chrysler.*

*But M&As do not always provide a long-term and desirable synergistic effect. An example is the broken alliance of the English Rover and the German BMW (1994-2000). The GM and FIAT alliance emerged in 2000, a year later it provided savings of 500 million euros through the use of common components, the unification of engines and transmissions for the whole range of cars produced, but it collapsed in 2005.*

*Ford offered Volvo cars for sale in December 2008 and valued the company at $ 2.4 billion. In 2010, Volvo was purchased by a Chinese consortium led by Geely Group. Earlier, Ford had sold Jaguar and Land Rover to the Indian industrial group Tata, and in 2007 transferred the rights for the Aston Martin brand to a consortium of Kuwaiti and European investors. After the sale of luxury European brands, Ford intends to focus on the development of Ford, Lincoln and Mercury brands, which are still popular in the United States and Mexico.*

*Since 1998, General Motors (GM) has deliberately focused on acquiring relatively small (up to 20%) stakes in a number of its competitors, avoiding the problems that arose, during the Daimler Chrysler merger, in particular. The chosen strategy allowed to achieve certain results. When GM's Saab-owned enterprise needed to quickly start producing a new small sized car, Subaru became a partner with model Impreza WRX. The reason for this partnership is that GM owns 20% of Fuji Heavy Industries, which is the owner of Subaru. The new Saab model was created in record-breaking time - 14 months instead of the usual 2-3 years.*

*Since January 2000, Saab Automobile AB passed into full ownership of GM. However, it failed to keep the brand afloat. In 2008, GM announced possible sale of the Swedish automaker. 27 companies expressed interest in acquiring companies, among which were*

*BMW, Renault, a Hyundaj / Kia group, Tata Motors, Geely Automobile, Fiat and Magna International. Priority was given to the Dutch supercar manufacturer Spyker. The sale was completed in 2010, but the Saab assembly line stopped due to debts in April 2011. Currently, Saab is part of National Electric Vehicle Sweden AB, owned by National Modern Energy Holdings Ltd. (British Virgin Islands), Stale Power Group, Qingdao Qingbo Investment Co Ltd. (both from China).*

## Outsourcing

***Outsourcing*** means transferring of business processes to outside contractors (outsourcers) for execution and focusing on profile activities. In this case, the functions transferred to outsourcing may be fragmented or enlarged, i.e. individual elements of the functions can be transferred. Often, some activities become too expensive for a company, and it becomes inexpedient to invest further efforts into coping with them. Then the company can resort to the services of third-party specialized firms.

Mechanisms of international outsourcing have become a significant basis for the development of international productions. This is the main difference between international outsourcing and outsourcing within the framework of the national economy. Domestic outsourcing, developing cooperation on a national basis, does not apply to the formation and development of a new international division of labor.

International outsourcing is developing thanks to the unification of the quality of services, global standardization of business processes, remote monitoring of the production process and due to the development of global communication networks.[22]

The international outsourcing market is one of the fastest growing international markets. Increasing the level of international production specialization and deepening the practice of outsourcing on an international scale are the main driving forces behind the development of world trade in goods. Outsourcing services accelerate the international migration of capital and the

[22] Klimovets, M.V. New Business Model of International Entrepreneurship // Outsourcing, 12, 2016.

advancement of scientific and technical knowledge and know-how; they are the main axis around which the processes of economic integration are expanding. The increase in the rate of international industrial specialization and the introduction of the practice of outsourcing in production and the service sector had a great impact on foreign economic relations in general. The interdependence of the production units of various countries based on the common production and technological tasks – the joint production of one or another final product has increased significantly, and in addition, there has been a rapid growth in international exchange based on production links.

In outsourcing, there are two participants: employer, i.e. the company transferring some function to a third party, and outsourcer (contractor, operator, provider), i.e. the company taking on the execution of the function transferred to it by the customer. At the same time, the roles of these companies within one transaction remain unchanged, the customer in this transaction is always the customer, and the outsource provider is an outsourcer, which can be called classical, or one-way outsourcing.

The following companies apply to outsourcing firms:

– companies that carry out a full cycle (or a large part of it) of the development and production of a product (these include almost all Russian enterprises);

– companies that are mainly engaged in development (such companies have only pilot production and order the production of all parts using the outsourcing system), many of them are market leaders, such as *Cisco, Dell, Compaq* and other firms working in the field of breakthrough technologies;

– companies that use foreign developments and, possessing advanced equipment and the latest technologies, are engaged in production, if necessary, under another brand. These companies also provide outsourcing services. Among them are multinational companies *Flextronics*, *Jabil*, *Selestica*, *Solectron*, *Elcoteq*.

Outsourcing aims at using advanced business technologies and know-how to gain and retain competitive advantages in an ever-increasing competitive struggle.

The economic essence of outsourcing is to build a system of relations between organizations that transfer and take over the implementation of certain types of activities based on long-term agreements.

The practical result of the use of outsourcing is the ability to direct the organization's own resources to perform those functions that constitute its strength, to what the organization can do better than others, providing the external contractor (outsourcer) with the functions that he can perform better than others. Thus the organization can accumulate the latest achievements in the field of science, engineering and technology, ensuring maximum satisfaction of consumer expectations, maximum compliance with market requirements.

Outsourcing can only be considered appropriate if the following conditions are met:

– the outsourcer will do the job more cost-effectively and with better quality;

– this type of activity is not so significant, and its outsourcing could not threaten the capabilities and core competencies of the company;

– it reduces the risk associated with changes in technology and (or) consumer preferences;

– it increases the organizational flexibility and speed of decision-making, reduces the time for developing and launching new products on the market, reduces coordination costs;

– it allows the company to focus on its core business.

Outsourcing can be classified according to the following criteria.

In relation to the profile activity:

– outsourcing of main processes, i.e. outsourcing of processes, including operational management, customer relations, innovation and contribution to the development of society;

– outsourcing of auxiliary processes, i.e. outsourcing of functions for the provision of basic technological processes with electric power, technical equipment, transportation, equipment repair, manufacture of auxiliary devices, etc.

In terms of functions:

– full outsourcing: empowering the outsourcer to take responsibility for the full support of the activity;

– partial outsourcing: transferring to the outsourcing part of the specific tasks of the company;

– operational outsourcing: outsourcing of the functions of entire units.

According to the functions transferred:

– outsourcing tasks: outsourcing of one-off projects, the implementation period of which is clearly specified;

– business process outsourcing: outsourcing of certain functions necessary for running a business, but not the main ones (advertising, storage and processing of information, personnel management, accounting, etc.).

By type of activity including the processes transferred:

– IT outsourcing: partial or full transfer of support, maintenance and upgrading of IT infrastructure into the hands of companies specializing in subscriber services of organizations and having staff of specialists of various qualifications;

– production outsourcing: transfer to an outsourcer of separate operations related to production, development, storage, or the entire production cycle;

– non-production outsourcing: outsourcing of such services as personnel management, reference and service services, etc.

Depending on the type of resources, the following can be distinguished:

– capital outsourcing, which can include production outsourcing and leasing;

– labor outsourcing: the transfer by the enterprise of all organizational issues related to personnel matters to a contractor firm engaged in the selection and recruitment of personnel on a temporary and permanent basis;

– information outsourcing: the customer company entrusts the collection and processing of information, and in some cases, the development of a solution on its basis to a third-party enterprise;

– outsourcing of entrepreneurial abilities: the customer enterprise uses an external intellectual capital, which is the fruit of entrepreneurial skills for conducting its own business activity;

– mixed outsourcing: the customer's enterprise transfers to a third party contractor a function that requires the use of several types of resources.

By the number of partners:

– simple outsourcing: the customer company has a contractual relationship with one service provider;

– joint outsourcing: when there are several outsourcers that perform different in character functions.

Geographically:

– internal outsourcing: the outsourcer and the customer are located in the same country;

– international outsourcing: the outsourcer and the customer are located in different states.

The problem of specialization covers not individual companies, but countries that are in constant interaction with TNCs. The focus of the strategy of leading corporations is to focus on the creation and dissemination of technological innovations of global use, which have promising international markets and integrating innovative systems of individual countries and regions.

The transfer of functions or the whole process to external partners has a number of strategic advantages:

– makes it possible to obtain components or services of higher quality and (or) cheaper;

– improves the company's innovative capabilities through interaction and partnership with world-class suppliers with great intellectual potential and rich innovative experience;

– provides greater flexibility of the company in the event of a sudden change in the market situation or consumer preferences – it is easier and cheaper to find new suppliers with the necessary capabilities and resources than rebuilding the internal activities of the company;

– accelerates the acquisition of resources and skills;

– makes it possible to focus on those operations that are effectively carried out by the company, and those that are strategically expedient to keep under its control.

Nevertheless, outsourcing as a form of business is fraught with a number of risks and has certain disadvantages. Among them are the following:

– the level of professionalism of the outsourcer may not be sufficient to perform work or provide services at the proper level;

– insufficient control can lead to a decrease in the efficiency of processes and an increase in maintenance costs;

– risks of violation of property safety, security and leakage of confidential information as a result of providing uncontrollable access to documents, data and material values of an enterprise;

– an increase in the time of solving problems in emergency situations, associated with unnecessary transmission and coordination;

– lack of knowledge of national and local cultural backgrounds;

– poor acquaintance with the psychology of clients;

– high staff turnover;

– a staff member can timely identify some errors, and sometimes inform a customer about updates, while freelancers usually only detect patterned errors that are less critical.

The disadvantages of outsourcing increase if a certain reasonable limit of its use is exceeded.

*Case 20. Every two of three corporations included in the TOP-100 rating of Fortune magazine use outsourcing to a varying degree. In the domestic American market, the share of outsourcing is 86%. Currently, about 10% of services in the global market are already the subject of international outsourcing. World outsourcing market is estimated at $ 580 billion. The revenues of companies providing services on the outsourcing market on a global scale are growing by 10% per year.*

*The origins of practical outsourcing relate to the period of confrontation between two great managers in the automotive industry – Henry Ford and Alfred Sloan in the 1930s, when it became clear that a number of company functions should be transferred to specialized firms. This especially concerned auxiliary production: service and repair of equipment, tool making, etc. Based on the organization of production of GM, led by A. Sloan, the method of cooperation of highly specialized industries, both inside and outside the company, in a few years provided the conquest of the American car market. An innovation in the Sloan project was the outsourcing methodology applied 70 years before this term appeared in the scientific literature in 1990, in at least two areas of chief's activity: in the organization of company management systems and in the organization of production.*

*In its present form, outsourcing was established only in 1963 by the Electronic Data System (EDS) Company which specializes in information technology outsourcing or IT outsourcing. After many airlines of the world banned Boeing 787 Dreamliner, US newspapers featured articles about serious mistakes made by Boeing's management which had resorted to extensive use of outsourcing to reduce production costs and reduce development time for this type of airplanes. It had been assumed that with the use of outsourcing the development time of the aircraft would be reduced from 6 to 4 years, and the costs from $ 10 billion to $ 6 billion. However, the outcome turned out to be exactly the opposite – the development costs were several $ billion higher, and the backlog was 3 years.*

In general, factors that promoted significant growth in the global outsourcing market can be summarized into the following three groups.

*Technological factors*. The rapid scientific and technical progress of the last few decades in the field of transport, computer technology and communications made the use of more distant resources by enterprises possible and economically feasible due to the accompanying reduction in the cost of related expenses. Qualitative technological changes in the technology of processing, transfer and storage of data played a special role in this process.

*Economic factors.* Economic factors play a significant role in the development of outsourcing, which is due, in particular, to the large difference in labor costs in developed and developing countries. The weight of this group of factors is explained by the fact that the main demand for outsourcing services is imposed by countries with a high level of domestic wages, which occupies the largest share in the cost structure of the provision of services transferred to outsourcing, which causes the customer’s quite natural (for a rational economic entity) desire to optimize them. However, the difference in wages as a factor in the attractiveness of a country for importing services from it by an outsourcing scheme tends to gradually decrease.

*Regulatory factors.* Finally, the third group of factors determining the rapid development of outsourcing as a form of international trade actively practiced by the subjects of the world economy are regulatory factors consisting in overall liberalization and the removal of barriers to trade regulation.

## Topic 2 Review Questions

1. What is "company strategy" and what are its five key stages?
2. What is SWOT analysis and what is it used for? Describe its main elements.
3. List the main ways of entering foreign markets for a company.
4. List characteristic features of the creation and functioning of JVs.
5. Describe licensing as one of the ways to enter foreign markets.
6. Highlight four possible options for implementing an international business strategy within a company operating in foreign markets.
7. What does the Bartlett-Ghoshal matrix show?
8. What is the Ansoff matrix used for?
9. List the main organizational forms of international production activities.
10. What are TNCs and what role do they play in international business?
11. What are the main stages of M&As?
12. Give the concept of *outsourcing* and determine its main purpose.

## Assignment:

Carry out SWOT-analysis and PEST-analysis of one of the following companies:

*1. Samsung*
*2. General Motors*
*3. Toyota*
*4. Tesla*
*5. British petroleum*
*6. Nestlé Food*
*7. Apple*
*8. Industrial and Commercial Bank of China (ICBC)*
*9. Amazon Inc.*
*10. Facebook*
*11. Microsoft*
*12. General Electric*
*13. Johnson & Johnson*
*14. Alphabet Inc.*
*15. Coca-Cola*

## TOPIC 3. MODELS OF INTERNATIONAL BUSINESS

The main ways of entering foreign market are export, license granting, FDI. These methods determine the main models of international activities: export-import, licensing and investment. A comparative analysis of the advantages and disadvantages of these models is given in Table 7.

**Table 7**

**Advantages and Disadvantages of Various Models of Entering the External Market**

| Model / entrance technique | Main advantages | Main disadvantages |
| --- | --- | --- |
| Export-import model / export | Relatively low level of financial risk; the possibility of gradual entry into the market; relatively low political risks | Vulnerability to trade barriers; transport and logistics risks; dependence on local intermediaries |
| Licensed model / licensing | Low level of financial risks; entry into the market without high costs; obtaining information about local markets from the licensee; lack of tariff and non-tariff restrictions | Limited market entry; dependence on the licensee, including in terms of making a profit; the likelihood of a new competitor in the face of the licensee; probability of violation of intellectual property rights |
| Licensed model / franchising | Low level of financial risks; entry into the market without high costs; obtaining information about local markets from the licensee; lack of tariff and non-tariff restrictions; tighter franchisee control compared to licensing | Limited market entry; dependence on the franchisee, including in terms of profit; the likelihood of a new competitor in the face of the franchisee |
| Licensed model / management contracts | The possibility of narrow specialization; concentration of the company's resources depending on its specialization; minimal financial risks | Limiting financial risks to an agreement; unintentional transfer to the partner of experience and working methods |
| Licensed model / turnkey construction projects | The possibility of narrow specialization; concentration of the company's resources depending on its specialization; risk reduction due to limited construction deadlines | Construction risks; financial risks associated with the violation of the construction budget |
| Investment model / direct foreign investment | Implementation of control over the implementation of production operations; making profits due to the coverage of large markets; lack of tariff and non-reef restrictions | The need for large investments; high political risks; complex management system; unstable national legislation on foreign investment |

## Export-Import Model of International Business

The export-import model includes international trade in goods (services). It contains two sides of an international transaction: the buyer (customer) and the seller (the executive). In the process of a transaction, a transfer of property from one side to the other takes place. It can be carried out both directly by the seller and by specialized intermediary firms.

It should be noted that in international commercial practice, *export-import operations* are understood only as operations carried out on a commercial basis, i.e. on the basis of the conclusion and execution of contracts for the sale of goods. Deliveries in the form of humanitarian aid, gifts, etc., carried out on a fee-free basis are, as a rule, not included in the value of exports and imports. They are accounted for separately.

Generally, *export operations* are activities related to the sale and export abroad of goods for transfer to the ownership of foreign counterparties.

*Import operations* refer to the activities associated with the purchase and import of foreign goods for their subsequent sale in the domestic market of their country or export abroad.

Export-import operations are considered to be accomplished if the goods are passed through the state border of the counterparty’s country, which is possible after performing certain formalities and procedures that provide information for statistics. The only basis of international commodity flows statistics is customs records of export-import goods. It also forms the basis of national foreign trade statistics. This explains the need for uniform customs statistics, unification of the concept, standardization of foreign trade documentation.

Export activities may take several forms, among which indirect exporting, direct exporting and intracorporate transfer of goods (services) are the most common. The indirect exporting of goods (indirect exporting) is applied if the company sells its products to a national counterparty, which, in turn, exports them to foreign markets. *Direct exporting* occurs in the case of direct sale of goods to counterparties operating outside the country of the company. Direct export allows companies to gain valuable experience in conducting international commercial transactions, as well as business experience in the countries which it enters. The third form of exporting activity is the intracorporate transfer of goods, the value of which increases due to the increase in the scale of TNC activity. Intracorporate transfer is usually understood as the sale of goods (services) by a company located in one country, to other business units belonging to the same TNC and located in other countries. Intracorporate transfer is an important element of international trade. The share of intracorporate transfer of goods (services) accounts for about 40% of the total US export-import operations.

The mechanisms of export-import operations are determined by the form of export activities. At the same time, the procedures and techniques for preparing international trade transactions with direct connections between counterparties and in the case of indirect exports are similar. The international practice of export-import transactions involves the following three stages:

1) preparation for signing sale contracts;

2) signing of sale contracts;

3) enforcement of sale contracts.

## Licensed Model of International Business

The licensed model is widely used by firms in order to enter foreign markets, since this method does not require large direct costs. Licensing allows companies to take advantage of the location of its production in foreign countries, without assuming ownership of foreign enterprises and without carrying out investment obligations abroad. There are certain features of licensing registration. Since the company has already incurred costs for the formation of licensed intellectual property, passed over under a licensing agreement, companies are not recommended to use licensing to enter the markets of countries where intellectual property rights are not protected. They may have problems with the consideration of conflicts under license agreements in the judicial bodies of these countries.

Despite the large number of ways to enter foreign markets within this model, it includes two commercial operations: international technology exchange and international engineering, which, in turn, include some of their varieties.

*The first commercial operation, the international exchange of technology*, involves the sale of scientific and technical know-how, involving the provision on a commercial basis to a foreign counterparty of the results of scientific and technical activities that have not only scientific but also practical value. *Technology* refers to objects of international exchange of scientific and technical knowledge, which are the results of intellectual work, including: patents, licenses, trademarks, industrial designs, which are part of the so-called industrial property, as well as technical documentation, plans, technical knowledge and experience, united by the concept of *know-how*, and engineering services. The mechanism of foreign trade transactions with objects of copyright is the assignment and acquisition of rights to translate and publish scientific and fiction literature, theatrical performances, the publication of music and the performance of musical works, etc. This also implies the structure of the licensed model for entering the foreign market.

The basis of international trade in patents and licenses is the protection of inventions through patent law, which gives the patent owner a monopoly right to use the invention. The same exclusive rights are granted to owners of other types of industrial property.

A patent grants the owner of an industrial property object (an invention, a utility model, an industrial design) the exclusive right to manufacture, reproduce, and sell patent-protected goods. Therefore, the patent is aimed at improving the efficiency of each business entity, the quality and prospects of the goods produced by it, as well as protecting the product from its reproduction by other competing enterprises. The patent protects its owner not only from local, but also from foreign competitors. If imported goods do not possess a patent clearance, their import is usually prohibited. This turns patents into the most important means of protectionism.

The patent holder may permit to use the rights arising from the patent for a certain time, for a specified remuneration, while retaining the ownership of the article.

In this case, this refers to the purchase and sale of a license to use the invention, carried out on the basis of a license agreement.

*A patent license* is a permit issued by a patent owner (licensor) to another person or firm (licensee) for industrial and commercial use of an invention that has patent protection for a specified period for a certain remuneration. The sale of licenses is economically equivalent to renting an invention as a commodity, since the owner of scientific and technical knowledge transfers the rights to use them for a certain period, retaining the right of ownership to them. Granting licenses to a foreign counterparty to use inventions, technical knowledge and experience, as well as trademarks is called *international licensing*.

International trade practices have accumulated numerous versions of model licensing agreements. They are developed by international organizations, in particular UN commissions, industry associations of industrial firms, and individual firms engaged in licensing activities on an international scale. However, almost every international licensing agreement is unique, due to differences between corporate strategies, levels of competition, product characteristics, and the interests of the licensor and licensee.

In international license agreements, particular attention is paid to the type of license provided and license fees. In the practice of licensed trade, there are three types of licenses: *non-exclusive (simple), exclusive and full*. The basis for such a division is the amount of rights to use the licensor's scientific and technical knowledge.

When selling *a non-exclusive (simple) license*, the licensor permits the licensee to use the invention under certain conditions, while reserving the right to both use it independently and issue similar licenses to the terms of the license to any other interested parties (firms).

*An exclusive license* implies the granting of an exclusive monopoly right to use the invention to a licensee within the defined conditions in a certain territory. At the same time, the licensor refuses to use this invention independently and from selling similar licenses to third parties under the same conditions and in the same territory. Outside the agreed territory and under excellent conditions, the invention may be used by the licensor. When granting an exclusive license, the licensor often makes reservations to the agreement limiting the rights of the licensee. Such a license is called a limited exclusive license.

When a *full license* is sold, the licensee is granted exclusive rights to use it throughout the term of the agreement. For this period, the licensor is deprived of the right to use the invention, both independently and by issuing a license to others. The difference of this transaction from the sale of a patent is that the licensor reserves the title of the owner of the patent and may terminate the license agreement upon the occurrence of certain conditions or upon the expiration of its term and at its discretion use the subject matter of the license.

The second commercial operation, which is a part of the licensed model for entering a foreign market, is *international engineering*. In world practice, the concept of *engineering* in the wider sense is used as the name of the production sphere of entrepreneurial activity related to the creation of industrial enterprises, construction, infrastructure and other facilities, i.e. engineering and consulting activities required by the customer both during the creation of new projects and in the performance of individual independent technical, technological, economic, financial, organizational and other measures. Engineering services are intellectual by nature. Their main goal is to optimize investments during the entire period of their implementation.

Engineering is inseparable from licensed trade. Scientific and technical level of most modern projects is such that engineering services are accompanied, as a rule, by transferring licensing rights to use technology to a customer. In turn, due to the fact that engineering services are an integral part of know-how, licensing entails engineering. Engineering has a great potential impact on the establishment of economic relations and economic activity as a whole. The sale of engineering services creates a demand among buyers for those types of machinery and equipment, the characteristics of which are laid down in recommendations and projects developed by engineering firms, and largely determines the commodity and geographical structure of the global trade in machinery and equipment.

Initially, engineering was limited mainly to providing technical advice, and all construction works were carried out by building contractors. Then there was an outrunning development of engineering and construction services, directly related to the construction of industrial facilities, including turnkey.

## Investment Model of International Business

A distinctive feature of the investment model of the firm's entrance into the external market is the export of capital to another country for facilitating business activities abroad. Therefore, it takes only FDI into account. The rapid growth of FDI is due to the increasing internationalization processes.

The main motives of investment activity are boiled down to a feasibility study of capital allocation for solving basic business problems, for example, using cheap production factors, approaching large sales markets, engaging a wide range of services and goods with a short life cycle in international trade; the creation of infrastructure facilities to facilitate international trade; the possibility of obtaining tax benefits.

The investment model is accompanied by high risks. For their adequate evaluation UNCTAD experts offer three sets of questions that should be answered when making decisions about placing investment capital abroad. The main factors determining the country's attractiveness for investment and influencing the outcome of decisions made by TNCs on the placement of FDIs include:

– the legal framework of the potential recipient country, regulating market access and the organization of foreign investors;

– a high level of economic and political stability in the country;

– state policy in the field of trade regulation, foreign investment and FEA.

In addition, a number of economic indicators should be carefully studied: market capacity, its growth potential, the degree of control over it, the level of inflation, the state of the trade balance.

Currently three types of FDI are used:

1. the creation of a new enterprise (*greenfield*);
2. the acquisition of the existing enterprise (*brownfield*);
3. participation in JVs (*JVs*).

As noted above, currently *brownfield* in the form of cross-border M&As is characteristic of developed countries, FDI in the form of *greenfield* prevail in countries with a lower level of economic development. *Greenfield* and *brownfield* FDIs differ in their impact on the host economy, especially in the initial stages of investment. So, the process of M&As will not be as useful as *greenfield* investments in terms of creating new production capacity, added value, employment. In terms of employment in the host country, the M&As process can have negative consequences.

JVs appear if at least two companies agree on joint activities and the creation of a separate company of joint ownership of capital, divided in established proportion, to maintain the mutual interests of the founders. The statistics for creating such JVs is positive. This is facilitated by radical changes in technology, telecommunications and government policies in different countries. The listed changes allow getting the effect of joint performance on the market, while dividing the risks.

FDIs are accompanied by increased risks. They are primarily manifested in the alienation of the capital of a foreign investor. Currently, there are three ways to alienate investments:

– freezing accounts;
– nationalization or expropriation;
– confiscation.

### International Industrial Cooperation and Joint Enterprise

***International specialization and cooperation of production*** is a specialization of individual countries, firms, associations for the production of certain types of finished products, semi-finished products (or on certain stages of the production process) and cooperation on a contractual basis of legally independent producers from different countries to create certain types of products that have a strictly targeted purpose and constitute the elements of the final product.

Modern international cooperation is the basis of socio-economic and scientific-technical progress of countries, globalization of international relations, regional economic integration, transnationalization, international industrial cooperation. The development of international cooperation involves:

– cooperation, implemented through a contract and not accompanied by the creation of any organizational structures;

– cooperation implemented through international business associations.

In general, manufacturing cooperation includes scientific and technical, industrial, scientific and industrial cooperation:

– scientific and technical cooperation involves cooperation in the field of R&D on the basis of the division of labor between partners;

– industrial cooperation presupposes long-term relationships between economic entities in the production of mass or serial products;

– scientific and industrial cooperation implies sustainable cooperation throughout the cycle of "science – engineering – production".

Taking into account these criteria, international cooperation in the modern world economy is developing in the following forms.

1. Cooperation based on the production of intermediate production is carried out through *contract cooperation* (manufacturing of a certain type of product by a subcontractor company on behalf of the customer enterprise). Contract cooperation is used in the supply of component parts (based on the constituent part (nodal), technological (stepwise) forms of specialization). It is realized through the exchange of components and the assembly of the final product by the partners independently, as well as through the supply of components by one partner to another and the assembly of the final product by one of the partners. International production company (IPC) in the form of the production of components is the most common form of cooperation. Intracorporate constituent part and technological production cooperation is most widely developed within the framework of TNCs in the form of production and technical links between the parent company and its foreign branches (numerous assembly enterprises of electronics, automotive, instrument making, etc.). *Boeing* and *Airbus* companies followed this model (Fig. 5.1, 5.2).

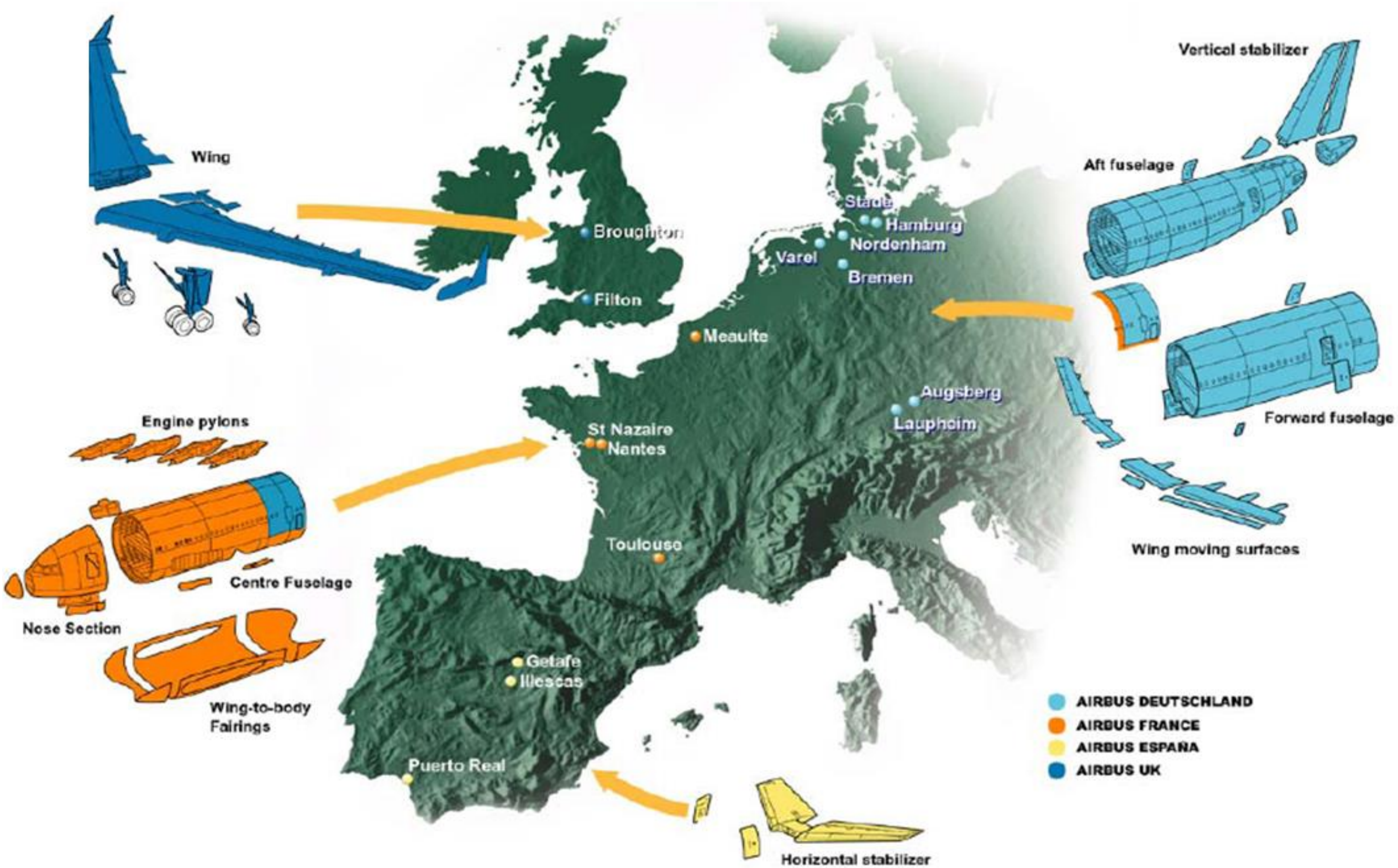


*Fig. 5.1 – Scheme of Airbus industrial cooperation* [23]

---

[23] Source: www.airbus.com.

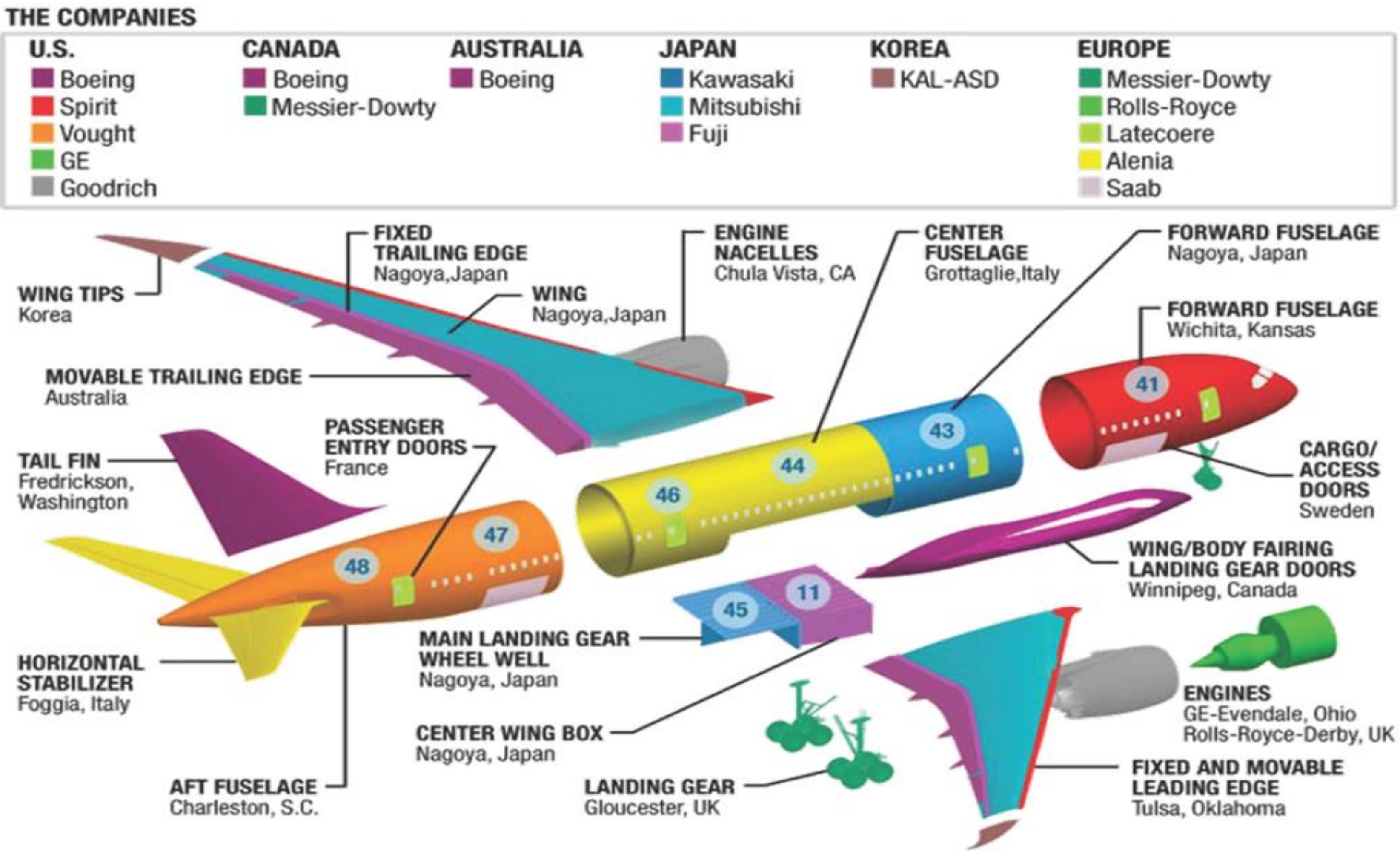


*Fig. 5.2 – Scheme of Boeing industrial cooperation* [24]

[24] Source: www.boeing.com.

2. Internationalization of scientific research is cooperation of companies from different countries to conduct scientific and design work based on the specialization of individual countries in certain types of scientific research. *International trade in patents and licenses* is a form of exchange of scientific and technical information and research results in various countries.

3. Cooperation on the basis of agreements on the specialization and creation of international research and production and other specialized associations includes: agreement on the division of production programs on the basis of contractual specialization; creation of international scientific, technical and production complexes; creation of international management associations (usually in high-tech industries).

It is a monopolistic treaty, often practiced between competing firms, on delimiting the range of products, reducing and eliminating duplication of production and related markets.

4. Cooperating on the basis of organizing joint production is a form of the closest production cooperation of research and technological, scientific and technical, material and financial resources of partners for the realization of certain agreed goals, including the creation of a new product. At the same time, the production of the component parts of the new product of the company is distributed among themselves, based on their specialization. Joint productions are created for the release of new types of products, where risks and capital investments are high in connection with the development of high-tech products and new technologies, taking into account the production, research, production and financial capabilities. This method is used in the implementation of programs for the creation of new generations of weapons and military equipment, space industry, etc. An example is organized joint production of armored vehicles and anti-aircraft systems by defense enterprises of the Russian Federation and the Republic of Kazakhstan, as well as numerous programs of

joint production by *Lockheed Martin*, *Boeing* and *BAE Systems* and other major world manufacturers of weapons and military equipment.

5. A JV is a form of organization of a company uniting the capital of partners (legal entities and individuals) from two or more countries. JV main goal is to increase the volume of exports of goods (services) and increase the efficiency of export-import operations. It may take the form of a full partnership, a limited liability company, a joint stock company.

*Case 21. American pharmaceutical company Pfizer and Chinese company Zhejiang Hisun Pharmaceuticals created a JV Hisun-Pfizer Pharmaceuticals Co., Ltd. for the development, production and marketing of generic drugs (generics) in the PRC and on the world market. The motivation for creating a JV for the American side is a significant amount of the Chinese market, an established sales structure, research and development, cost reduction, benefits and benefits provided by the Chinese side, primarily tax, customs and legal. The Chinese partner motivation was mainly experience in the production and promotion of generics in the domestic and global markets.*

*Profitability created by the JV is determined by the optimal use of all factors of production.*

*German pharmaceutical company Merck and two Brazilian companies Cristalia Labs and Burofarma Laboratorios set up a JV in Brazil for the production and marketing of generics. The motivation for creating a JV for a German company was to reduce costs and share risks between participants, access to new markets and cheap resources, for Brazilian companies - experience in generic production and research cooperation, minimizing negative factors and eliminating the shortcomings of its own production. The optimal interaction of production factors and their rational use contributed to an increase in the profitability of the JV.*

*The French company Alstom is one of the world leaders in the production of high-speed railway rolling stock, including TGV and AGV trains, as well as Pendolino (in Russia, the St. Petersburg-Helsinki line runs under the name "Allegro").*

*The company's products are used mainly by railway operators of EU countries (France, Spain, Great Britain, the Netherlands, Belgium, Italy, Finland).*

*At the same time, Alstom, together with "Transmashholding", has far-reaching plans to strengthen its presence in the Russian market, including in the production of locomotives at the Novocherkassk Electric Locomotive Building Plant, passenger cars at the Tver Railway Construction Plant, and metro trains together with "Metrovagonmash". In its activities, Alstom uses a transnational strategy, adapting its products to the specific needs of national markets. For example, high-speed electric trains "Allegro" were specially adapted for movement both in a contact network of alternating and constant current (the railways of Russia and Finland use a different contact network).*

6. Transnational cooperation of corporate structures, depending on its form, combines almost all forms of international cooperation. Strengthening the inter-firm and intergovernmental competition for sources of raw materials and sales

markets determines the direction of FDI of TNCs in the creation of production capacities abroad using various types of specialization, suggesting the placement of various parts of the production process in different countries of the world. Such conduct of international business is in the first place determined by the affinity of the industrial activity of enterprises and technological processes, by the presence or absence of the mechanism of incorporation.

The presence of the mechanism of incorporation leads to the emergence of a corporate structure of a financial and industrial nature – a transnational financial and industrial corporation. So, for example, the confectionery enterprises *Rossiya, Nestlé Russia* and 10 other companies in the territory of the Russian Federation are wholly owned subsidiaries of the Swiss company *Nestlé*.

7. The international strategic alliance (ISA) is a functional structure based on a formal and informal agreement between TNCs on combining scientific potential, production and financial resources, sharing risks in order to achieve super-profits, implement projects, redistribute markets and consolidate the sphere of influence. It can also be agreements on participation in assets both without the formation of a new organization (mutual exchange of shares, the acquisition of a small stake), and with the creation of a new organization (for example, a JV). The American economist M. Porter defines the ISA as "*long-term agreements between firms from different nations that go beyond normal market transactions but top short of merger"*[25]. None of the alliance partners can control the process of making strategic decisions on a wide range of business issues with another partner. Otherwise, the alliance may develop into a more integrated form of cooperation, the financial and industrial group (FIG) with the dominant role of the parent company. The relatively high concentration of ISAs in the production of computers and software products, the pharmaceutical industry, the automotive industry, the aerospace industry and the entertainment

[25] Porter, M.E. The Competitive Advantage of Nations // Harvard Business Review, 68, 1990.

industry is primarily explained by the fact that companies are looking for ways to collaborate in order to reduce high costs, high tariff and non-tariff barriers, and significant technological and operational risks that are there for these industries to enter the given branch. So, for example, the M&As of the pharmaceutical companies *Human Genome Sciences* and *GlaxoSmithKline* is formed with the goal of developing an original cure for lupus, and the *MCA Bayer* and *Oncomed* aim at creating an original anti-cancer drug.

Enterprises from different countries create international value chains for the production of competitive products (Fig. 6)

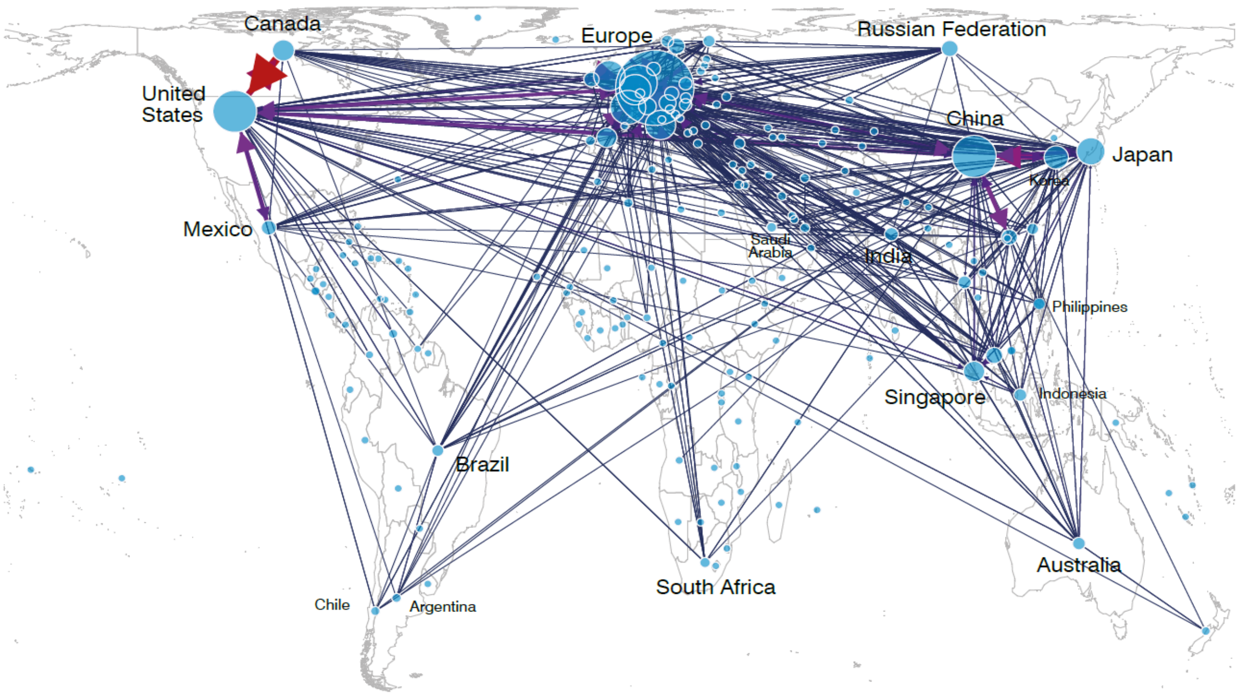


*Fig. 6 – International value chain trade flows*

The most competitive countries have a high degree of adaptation of their economies to the conjuncture of world demand and an optimal national specialization, concentrating material and financial resources in the directions that ensure the highest productivity of industry. The cooperation benefits of participants in international cooperation in this case are determined by the profitability of the industry created.

It should be noted that in Russia industrial cooperation has not been so widespread as in countries with developed market economies. The main obstacle to the participation of Russia in the IPC is commodity-dependent character of its economy.

Due to the fact that the most part of products exported by modern Russia are raw materials and semi-finished products, there is a significant loss of value added potential. Even with export of non-ferrous metals, higher processing products make up only 10%, while 80% are the main primary metals; in this regard, domestic exporters in world markets face opposition from high-tech metal products.

In modern world economic practice, the concept of *a JV* is interpreted quite broadly, including the concepts: *joint-stock JV* and *contractual* (conventional*) JV*. At the same time, a JV is created by two or more participants in the form of a joint-stock company, in which each partner owns a certain share of the share capital. In turn, the contractual JV does not imply the creation of a new company for the implementation of joint activities. Within its framework, all relations between the parties are regulated by contracts. In a narrower sense, a JV is an economic unit that is planned, created, controlled and managed by two or more partners in accordance with their contributions to capital and internal agreement.

Motivation and market research allow us to formulate goals and define one of four possible strategies for creating a JV:

1. production efficiency increase;
2. expansion of operations;
3. reducing the risk in the production of new types of products;
4. production development by attracting investment, technology and skilled labor.

A high level of organization of the JV allows each of the parties to get the maximum profit, subsequently reinvested in production. In general, the motives for creating a JV are as follows:

– strengthening positions in the market by combining the resources of companies (economies of scale);

– gaining access to investments and new technologies;

– overcoming the deficit, expanding exports and replacing imports;

– expansion and diversification of existing production through the release of new products, access to other sectors of the economy;

– simplifying access to new markets and cheap resources;

– adaptation of national production to the conditions and requirements of the world market;

– cost reduction and risk sharing;

– production profitability growth;

– creation of favorable conditions for the development of leasing, engineering, consulting;

– benefits and allowances provided by the organizing country (tax, customs, registration, legal, investment, etc.);

– optimization of the structure of assets;

– optimization of the interaction of production factors and their rational use.

In the Russian Federation, enterprises with foreign investments are established under Russian law whose capital is fully or partially owned by foreign investors. In turn, the JV as a type of enterprises with foreign investments in accordance with the current Russian legislation is defined as *an enterprise with shared participation of Russian and foreign investors*. According to the Federal law “On Foreign Investments in the Russian Federation”, an enterprise (commercial organization) with foreign investments is recognized as an economic entity, at least 10% of the authorized capital of which belongs to a foreign investor. The legal regime for the activities of foreign investors cannot be less favorable than that of Russian ones, with the exceptions specified by Federal laws.

Joint activities of economic entities reflect their economic interests, sharing financial and political risks and strengthening their positions by combining financial and technological resources. The activity of the JV confirms the effectiveness of this form of cooperation in the existing economic conditions.

## Topic 3 Review Questions

1. What are the advantages and disadvantages of various models of entering the external market?
2. Describe the export-import model of international business.
3. Describe the licensed model of international business.
4. Give the main features of the investment model of international business.
5. Give examples of international industrial cooperation.
6. What is a JV and in which industries is it used most often?
7. Define ISA and describe its main features.

# TOPIC 4. COMPETITIVENESS IN INTERNATIONAL BUSINESS

## Competition: its Concept and Types

Competition can be considered in different aspects depending on the subject and purpose of the analysis. On the one hand, it is an economic category that characterizes industrial relations, processes affecting the activities of various entities in various spheres of society. On the other hand, competition is the most important condition for the functioning of the market economy and socio-economic development.

*Competition* is the struggle of economic entities for limited effective demand in the face of uncertainty of the market situation. But at the same time it is an incentive for development, which contributes to the efficiency of economic activity, rational distribution and use of factors of production.

The company entering into a competitive environment analyzes its capabilities and prospects, taking into account the situation in the market. There are three commonly distinguished types of competition:

1. attractive competition (weak);
2. moderate competition (average);
3. cutthroat competition (strong).

Under attractive competitive conditions, the company expects to receive a significant profit. Moderate competition means the preservation and maintenance of the existing conditions of competition. The third level involves a tough fight for the consumer, staying long in the market, increasing profits.

The most intense competition usually takes place between producers of the same type of goods and services. The intensity of competitive relations depends on a number of reasons: the type of market structure (perfect competition, monopolistic competition, oligopoly, pure monopoly), the number of competing companies, the slowdown or decline in demand for products, etc.

Since 1998, the WEF has published ratings of most of the world's countries according to the level of competitiveness. This raises several questions.

First of all, what is *"competitiveness of the national economy"*, i.e. not the competitiveness of the product, firm, industry, but the competitiveness of the country's economic system as a whole?

Secondly, what determines the competitiveness of the country, what factors underlie it? Why do some countries make significant progress in their development and others do not?

Thirdly, if the competitiveness of an individual company is fairly easy to determine (for example, by the profit value and rate of return, the level of technology, the size of market share, etc.), what about the assessment of the country's competitiveness? What macroeconomic indicators should be considered: GNP, gross domestic product (GDP), GDP per capita, availability of natural resources, the country's share of GDP in the world?

Modern economic development of a number of leading countries in the world poses many riddles. Japan and the EU countries gain an advantage from the depreciation of national currencies against the USD. Economy of the USA is unrivaled in the world, despite the "fiscal cliff" and the BQP deficit. The history of the post-war development of such countries as Germany, Italy, Japan and the Republic of Korea is a success story of the states, most of which were defeated in the Second World War and initially had limited natural resources. So what is competitive advantage and where does it come from?

## Porter's Theory of Competitive Advantage of Nations

The theory of *Michael Porter*, a famous American economist from Harvard University, provides answers to many questions. In the 1980s, while working in the Commission on the competitiveness of American industry created by Ronald Reagan, M. Porter tried to define the term "competitiveness" in relation to the state. Proceeding from studies of the practices of companies of the leading industrial countries of the world which account for almost half of the world's exports, M. Porter proposed the concept of *international competitiveness of the nation*. In the 1990s, Porter's theory served as the basis for the development of recommendations in the field of public policy for improving the competitiveness of national goods in Australia, New Zealand and the USA.

There are different methods of determining the level of competition in the domestic and foreign markets. M. Porter identified five main forces that determine the level of competition in both domestic and foreign markets. These are:

1. threat of new entrants;
2. threat of substitutes;
3. bargaining power of suppliers;
4. bargaining power of buyers;
5. competitive rivalry.

The level of competition is established on the basis of expert assessments, which are formed on the basis of the results of data obtained during the survey of entrepreneurs. One of the indicators of intensity of competitive relations is the company's market share and the dynamics of its changes over the years.

Porter's approach is to view a country's competitiveness *from the perspective of the competitiveness of companies representing the country in the global market,* because ultimately a country's national income is created by its manufacturing companies, and international trade essentially redistributes the product created by competitive firms in the competitive industries of different countries. Therefore, the degree of competitiveness of the country should be considered from the micro level. i.e. the level of a single company. Thus, according to Porter, it is not the country itself that is initially competitive, but its companies.

The success of the national economy development depends on the activities of a certain *core of companies* that are internationally active. To be successful in competition, firms must have one of two advantages: either they must have low production costs, and therefore low prices, or they must differentiate the quality of the product based on a high level of prices. Porter notes that no country in the world can be competitive in all positions, and even in the most prosperous countries not all industries and not all companies can simultaneously prosper. Consequently, the country must specialize in the most competitive segments of the economy, and less efficient industries can either be moved abroad, or they should be abandoned altogether.

The competitiveness of national industry, agriculture and services also means that they are developing according to the laws of the free market. Protectionism, state subsidies to local companies, restriction of access to the domestic market of foreign competitors damage the competitiveness of domestic producers.

There is internal and external competitiveness. *Internal competitiveness* means the sale of goods and services in the domestic market in competition with domestic and foreign producers.

Competition in the domestic market is weaker than in the external environment. Within national economies, unlike at the international level, states have the ability to establish and regulate the rules of the competitive environment, balancing the interests of economic entities.

*External competitiveness* is the sale of goods and services on world markets; it is carried out in more complex conditions. The composition of the subjects of market competition is diverse in economic and political influence. Not only large but also small efficient companies from developed and developing economies are emerging. The latter actively use the advantages of globalization, which can be seen in the example of Chinese, Indian, Brazilian enterprises. It should also be borne in mind that at the supranational level, institutions that can limit and adjust the actions of business entities and ensure fair competition are not sufficiently developed.

Companies that operate successfully within a country are not always internationally competitive. The strong position of the company in the domestic market is considered as a necessary, but not sufficient condition for achieving high performance in the world market. Nevertheless, the intensity of internal competition plays an important role in the firm's success in the global market. If the market environment is poorly developed in the country and the company's behavior is not focused on competition, a positive result in the external economic space is improbable.

There are price- and non-price-related methods of competition. The price method of competition is associated with the reduction of production costs and the price of goods in order to attract buyers, ousting rivals from the occupied market positions. This method is also used in competition with the products of large companies or, if necessary, the sale of goods.

Non-price method of competition involves the use of a variety of techniques covering a wide range of activities of manufacturers. We highlight the main, but not exhaustive, opportunities to improve the position of companies in the global commodity market:

- improving the quality of goods or services;
- offering new products or services;
- ensuring high product reliability;
- providing customers with quality assurance of the product;
- providing fast and high-quality service;
- improving after-sales service;
- providing the buyer with timely and useful information, etc.

According to Porter, to retain industry leadership and the overall profitability of the company or individual entrepreneurs may use either a strategy of reducing costs below the level of the competitors, or a strategy of differentiation of its products and focusing activities on specific segments of consumers, generating a steady profit (in this case, it is possible to set prices that exceed the costs of differentiation). In addition, in order to gain a competitive advantage, an economic entity must have a clear idea of profit centers within its often widely diversified structure, having analyzed in detail the entire value chain, noting the key business processes of its greatest competence, generating income, as well as the areas of losses, representing internal secondary processes, from which it is appropriate to abandon. Accordingly, having taken a strong position in the industry in the domestic market, the company or individual entrepreneur will be ready for internationalization.

In most cases, the success of a company or individual entrepreneur will be determined by the degree of attractiveness of the competitive industry and the relative position of the business entity in the industry, now at the global level. Thus the corresponding indicators of activity of physical or legal entity will depend on the presence of its competitive advantage in comparison with competitors representing different states: ability to minimize costs or ability to differentiate their products. It should be noted that global competition equally provides new opportunities (if the national market is small and the company's products are competitive), and creates new threats (increased competition in industries with low entry barriers to competitors).

Thus, relatively small capacity of the Swiss domestic market allows high-quality and innovative products of Swiss pharmacists, machine builders, chocolate manufacturers and watchmakers to easily find markets abroad (in most cases, the differentiation strategy is used, i.e. emphasis on the focus group of demanding foreign consumers with a high level of income), which allows to increase profits and occupy a leading position in the global market within the relevant segment of the industry (the undisputed leader in the global watch industry is the *Swatch* group, among the most competitive pharmaceutical companies in the world – *Roche* and *Novartis*, among the world's best producers of elite chocolate is *Lindt*, and *Sulzer* produces competitive high-quality equipment for the oil and gas industry, which is in demand around the world). Among the companies that took advantage of the economies of scale from global operations, which allows minimizing costs and strengthening their positions in the world, are *Boeing* and *Airbus* aircraft construction companies. Nevertheless, along with the success of global market development, there are examples of failures that are typical even for leading companies.

*Case 22. The American aerospace company Boeing is a recognized world leader in the number of aircraft sold (in 2012, 601 aircraft were delivered to customers against 588 from the nearest competitor-Airbus) – in its strategy of maintaining a global competitive position in the market of passenger aircraft focused on the latest Boeing 787 Dreamliner, characterized by innovative design and high fuel efficiency. With the new airliner, the company was going to strengthen its position in the segment of transportation on the ultra-long lines (more than 10 thousand km), the only competitor on which is Airbus A380. It should be noted that it was globalization, expressed in the increase of tourist and business trips over long distances that contributed to the fact that Boeing engaged in the development of the 787 model (Fig. 7).*


*Fig. 7 – Boeing 787 Dreamliner*

*The first customers of the new aircraft were the world's leading airlines – United, All Nippon Airways (ANA), Japan Airlines (JAL), Qatar Airways, which had already started to* *operate it. Dreamliner was going to be purchased by Qantas, Air New Zealand and Aeroflot in order to put it on the long-distance line (Fig. 8).*


*Fig. 8 – Airlines-buyers of the new Boeing 787 Dreamliner*

*Nothing seemed to portend failure, and Boeing's competitive position in the world market was constantly increasing (this was facilitated not only by innovative aircraft, but also by the general state of the global market of civil aircraft, significantly influenced by the strengthening of the euro, favoring the orders of Boeing, and consistently high prices for jet fuel, stimulating the purchase of aircraft with low fuel consumption). However, in early 2013, Boeing hit a major failure, fraught with weakening of global competitive positions.*

*As a result of the operation of the Dreamliners, numerous design flaws of the new aircraft were revealed, and not all of them were easily removable "childhood diseases" of the innovative liner. The main failure of the aircraft was in its innovative power equipment – lightweight lithium-ion batteries, which became the basis of the design architecture. It is the problem with the batteries (sudden in-flight and in airport fires) that caused serious incidents with Boeing 787, due to which, at the insistence of American and Japanese aviation regulators in January 2013, the flights of these aircraft were discontinued. It is expected that Boeing's losses from the failure of its main project of the decade will range from $ 125 million to $ 5 billion. Although the lower limit of financial losses is even lower than the price of one Dreamliner (its catalog value is about $ 200 million), but the biggest threat is that the Boeing 787 may be permanently banned from moving any farther away from the nearest airport than 180 flight minutes for a possible emergency landing, which automatically closes all long hauls for Dreamliner (for example, Melbourne – Houston).*

*At the same time Airbus, the closest competitor, strengthened its positions as a result of Boeing 787 Dreamliner failure. Airbus A380 at the end of January 2013 immediately rose by 3.5% to almost $ 280 million catalog value, and its more reliable design allows the aircraft to be in the air with no time limits to the nearest airport (Fig. 9).*


*Fig. 9 – Airbus A380*

Porter proposed a "diamond" model that reflects the scheme of factors (determinants) of national competitive advantage (Fig. 10). They are presented in the form of facets of the "diamond" rhombus. "Diamond" is used to indicate its ability to spread and enhance the influence of one facet (characteristic) of the rhombus on the others. The answer to the question why a country is making progress in a particular area is four components (properties) that form the environment in which companies operate (compete). This environment can both facilitate and hinder the creation of competitive advantage. These four determinants are:

1. factor conditions;
2. demand conditions;
3. related and supporting industries;
4. firm strategy, structure and rivalry.

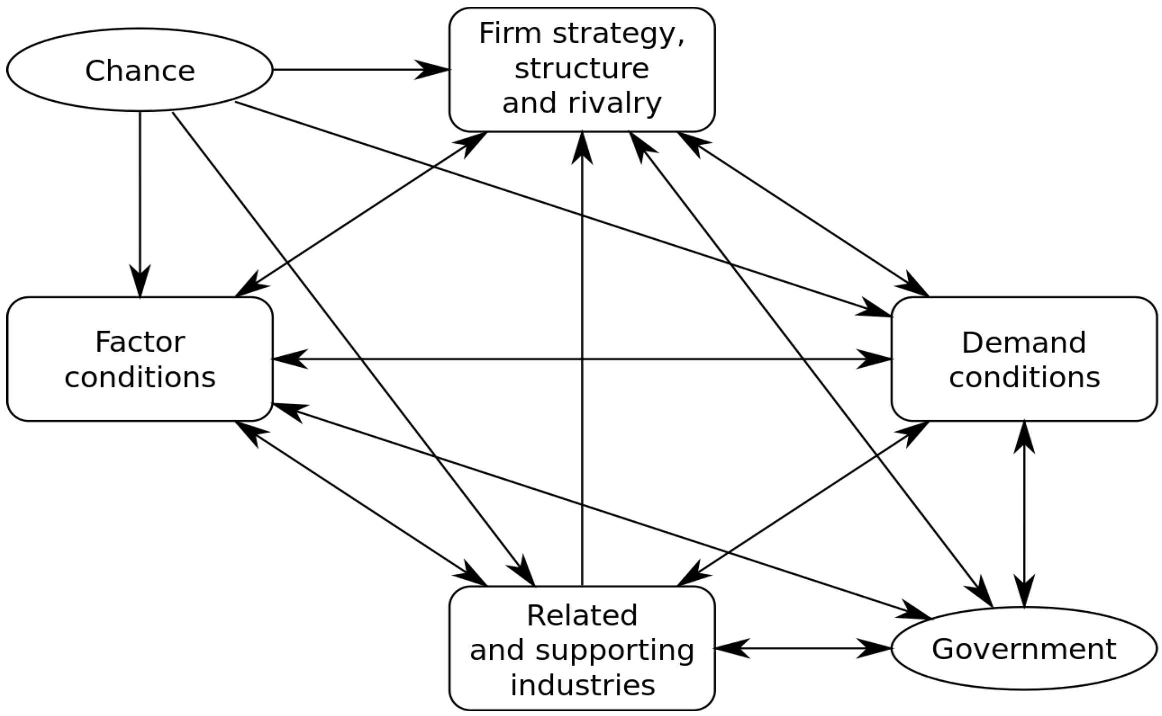


*Fig. 10 – Porter's "diamond" model*

Let's consider these determinants in more detail. Concerning ***factor conditions***, the factors are divided into the main (primary), which the country gets from nature (climatic and natural resources, geographical location, unskilled labor, etc.) and developed (secondary), which appear as a result of the development of production (infrastructure, technology, knowledge, highly qualified personnel). Only developed factors provide a country with competitive advantage that is difficult to copy to competing countries.

Factor conditions are also divided into *general* (universal) and *specialized* (specific). *Specialized* factors require significant investment and are difficult to duplicate in competing countries (insurance companies, medical libraries, mortgage banks, highly skilled labour). The presence of a large number of common and core resources makes the competitiveness of such a country imaginary, illusory.

It should be noted that in science-intensive sectors of the national economy the main factors do not give any advantages. These factors can be easily obtained in any other country of the world. Specialized factors are the most difficult to duplicate; they are difficult for foreign competitors, and require significant investment. It is interesting that the lack of certain main factors stimulates the technological development of the country, generates thrift and rationality of management.

Thus, the initial weakness of the state deprived of natural resources and population may well turn into its strength in competition, as it encourages companies to innovate and improve. Lack of natural resources initiates the inventiveness of scientists, the optimal use of a limited set of available natural wealth. Conversely, if the country has an excess of the main factors, if they are inherited from previous generations as a natural gift, without additional efforts to increase them, it often leads to the waste of resources and their depletion.

The main conclusion that can be drawn with regard to factor conditions is that sustainable competitive advantage gives a country the presence of both developed and specialized factors. Other factors can create the illusion of a country's phantom competitiveness, which can be quickly intercepted by competing countries with a similar set of main and common factors. Thus, it is necessary to be very careful about the factors bestowed by nature, and to work on the artificial creation of factors that give sustainable competitive advantage.

Speaking about the second determinant – ***demand conditions*** – it should be noted that the value is not the volume of domestic demand, but its quality. The national market can be relatively small, and the demand can be huge, thanks to the high level of income of the population, and advertising policy. The quality of the consumers themselves is important. Demanding and informed consumers force manufacturers to constantly improve, introduce new technologies, and improve the quality of the product.

Examples are countries like Burma or Pakistan; their domestic market is quite significant, but the demand existing in this market is mostly insolvent. On the contrary, the narrowness of the domestic market with high solvent demand in Switzerland makes *Nestlé* and *ABB* companies operate mainly in foreign markets.

*Case 23. In the 1970s, Western companies entered the market of passenger air transport in the Persian Gulf countries, using non-price competition. Regardless of local culture, they offered additional services: foreign films, Western food, alcohol etc., and kept prices high. All this caused nothing but irritation among local customers. Soon a local company from the UAE (currently Emirates) entered the market with very low prices and no annoying "Western-style" services, thus conquering the market. Having shown customers what a flight by plane actually is, they later raised prices without losing their market share.*

The character and sophistication of the consumers themselves are also important. The fact is that well-informed consumers force domestic producers to introduce and constantly improve new technologies, and invent qualitatively new products. At the same time, it is important that domestic demand corresponds to trends in the world market. In this case, if the product is sold well inside the country, it can be offered everywhere, and vice versa: the product that no one needs inside the country, is impossible to be sold in the world market. Demanding consumers in this case contribute to the emergence of high-quality national companies, which are driven thanks to "efforts" of their demanding consumers. Superiority of Japanese manufacturers of audio and video equipment in the world market is precisely due to the fastidiousness of Japanese buyers to the quality and appearance of products.

Thus, among the conditions of domestic demand, the most important are:

– demand structure (market segmentation and nature of consumer needs, market size, availability of effective demand, information on needs, level of consumer education, population concentration, public procurement, national quality standards);

– volume and growth pattern of domestic demand;

– mechanisms by which preferences in the domestic market are transferred to the markets of foreign countries.

With regard to the third determinant - ***related and supporting industries*** -

Porter draws attention to the fact that the development of individual industries contributes to the prosperity of related industries. For example, *IBM* has caused the emergence of such giants of the global computer industry as *Microsoft, Intel, Netscape*. Mutual cooperation of related companies allows to implement joint projects, contributes to the emergence of alliances, and, consequently, transaction costs are reduced, exchange of information between specialists of different industries is enhanced. According to Porter, not only individual industries become competitive, but "bunches" of industries, clusters in which companies are integrated vertically or horizontally. For example, in Sweden, all areas of activity related to metalworking are developed: the production of steel, various tools, industrial and electrical equipment, cars (*SKF, Scania, Volvo, Elektrolux*, *ABB*).

The fourth determinant - ***firm strategy, structure and rivalry*** - covers the goals, strategies, and ways of organizing companies that are very different from each other in different countries. The way the firm is managed and the style of management depends on the national characteristics of a particular country. No system is universal, but it must match the sources of competitive advantage. For example, in Germany large companies in industries with a high level of technology are the most competitive, and in Italy small and medium-sized firms, family ownerships are leaders. It is also important which spheres of activity are prestigious in the country, which branches are branches of national pride. The most prestigious professions in the USA are medicine, law, financial services, microbiology, and computer industry. It is not surprising that the USA can be proud of success in these industries.

The main catalyst of the economic system is sufficient intraindustry competition. It is strong domestic competition that facilitates the search for foreign markets and encourages firms to go abroad. In Japan, there are about a dozen car manufacturers; more than 20 companies produce audio and video equipment. The close environment of competitors stimulates the search for new and better solutions in business. The principle of Hollywood: in an environment of prosperous, but at the same time mutually competing stars there is a special atmosphere that promotes the rise of the whole environment. Silicon Valley in California is developing in a similar way.

*Case 24. In the 1970s, the American company Gillette dominated the market of razors and produced traditional razors with one blade. There was a competitor (Wilkinson Swords), who came up with a razor with two blades and decided to take a part of the market away from Gillette, using the policy of the original low price. Due to lower prices and higher quality Wilkinson Swords won part of the market, but not getting normal profit, after three months of the first stage decided to raise prices, but the consumer did not accept them. Wilkinson Swords eventually left the market, and Gillette then brought the same razor to the market – with a higher price, and won again.*

All four determinants interact, forming a "*national diamond"*, which is *a complex system*. In order to gain and maintain competitive advantages in certain sectors of the economy, it is necessary to have advantages in all components of the diamond (in this case, it is impossible to duplicate it to other countries). Advantages based on one or two determinants cannot be held for long, they are "elusive". For example, Russian stocks of raw materials no longer make it competitive even in the raw materials segment of the world market, because, firstly, new deposits have been discovered in Africa, Latin America, Australia, and secondly, modern technologies make it possible to use synthetic substitutes for many natural materials and minerals. Only a range of properties determines the global leadership of the country as a competitive world-class power. National competitive advantage arises only when the whole "diamond" is unique.

In addition to the four determinants, there are two variables in the "diamond" that can either enhance or weaken these four determinants – chance events and government policy.

***Chance events*** include events that are not directly related to the conditions of the country's development. Neither companies nor the national government can influence such events, but these events change the balance of power in the national economy. Chance events include political decisions by foreign governments; wars, epidemics, natural disasters; inventions and major technological changes; abrupt changes in resource prices; global financial markets turmoil, etc.

Chance events include:

– acts of pure invention (absolutely unpredictable);
– major technological discontinuities (e.g. the emergence of the Internet);
– discontinuities in input costs;
– significant shifts in world financial markets or exchange rates;
– surges of world or regional demand;
– political decisions by foreign governments;
– wars[26].

It is obvious that the crisis of 2008-2009, which became global, was largely unpredictable. Since this crisis started in the US mortgage market, first of all, it had a negative impact on the US construction sector, after which the crisis was transferred to the construction sector of most of the leading countries of the world. Consequently, companies whose international business was focused on the construction industry were among the losers. In particular, such elevator and escalator manufacturers as *OTIS, Schindler, Thyssen* suffered due to a significant reduction in housing and commercial construction in the market of Western Europe during the crisis period. On the contrary, due to the fact that the governments of many leading countries of the world allocated huge financial resources to fight the crisis, including large-scale infrastructure projects, among the companies that benefited from the effects of the crisis were the companies that carried out relevant contracts for state orders. For example, the German concern *Siemens* expanded the production of high-speed trains and commuter trains (known in Russia as *Sapsan* and *Lastochka*), the demand for which has

[26] Ibid.

increased due to the fact that the state-associated Railways of China and Russia began to buy in large quantities from Siemens railway rolling stock. Large discounter airlines, such as *Ryanair* or *Easyjet,* which increased the volume of passenger traffic during the crisis and post-crisis periods, also benefited.

Another variable – ***government policy*** in various sectors of the economy and spheres of society (tax, foreign trade, monetary, exchange rate, structural, etc.) can also affect the balance of power and priorities of the national economy. Porter draws attention to a serious problem in the relationship between private business and the state: the temporary discrepancy between the public policy objectives and business tasks. Public policy is more focused on the interests of voters (who do not like to wait long) and on the interests of politicians (elected for a relatively short term). Consequently, the government's decisions are more of a short-term nature, and it is difficult to talk about the long-term strategy of the state. Short-term decisions of the government, as well as short-term wishes of shareholders only "irritate" business. Thus, according to Porter, the basis of competitiveness of the national economy is product and industry competitiveness, which is measured by labor productivity in the industry, i.e. competitiveness at the micro level determines competitiveness at the macro level.

## Assessment of International Competitiveness of Countries and Companies: Comparative Characteristics

The company's competitiveness is best indicated not by the company's total earnings (revenue), but by the actual profit and profitability of its operations. As of 2018, the situation in the world was as follows: the top position in terms of revenue belonged to the American company *Walmart,* the second, third and fourth places were taken by energy companies from China *State Grid, Sinopec Group* and *China National Petroleum* (see Table 4 before). However, in terms of profit, *Apple* was the leader, followed by *British American Tobacco*, and then by *Berkshire Hathaway* (see Table 8).

**Table 8**

**The Largest Companies in the World in Terms of Revenue, 2018** [27]

| **Rank by profit** | **Company name** | **Profit, $ mln** | **Rank by revenue** | **Total revenue, $ mln** | **Profitability of sales, %** |
|---|---|---|---|---|---|
| 1 | Apple | 48 351,0 | 11 | 229 234 | 21,09% |
| 2 | British American Tobacco | 48 327,8 | 453 | 26 128 | **184,97%** |
| 3 | Berkshire Hathaway | 44 940,0 | 10 | 242 137 | 18,56% |
| 4 | Industrial & Commercial Bank of China | 42 323,7 | 26 | 153 021 | 27,66% |
| 5 | Samsung Electronics | 36 375,4 | 12 | 211 940 | 17,16% |
| 6 | China Construction Bank | 35 845,2 | 31 | 138 594 | 25,86% |
| 7 | Verizon | 30 101,0 | 37 | 126 034 | 23,88% |
| 8 | AT&T | 29 450,0 | 20 | 160 546 | 18,34% |
| 9 | Agricultural Bank of China | 28 550,4 | 40 | 122 366 | 23,33% |
| 10 | Bank of China | 25 509,2 | 46 | 115 423 | 22,10% |
| 11 | J.P. Morgan Chase | 24 441,0 | 47 | 113 899 | 21,46% |
| 12 | Comcast | 22 714,0 | 80 | 84 526 | 26,87% |
| 13 | Toyota Motor | 22 510,1 | 6 | 265 172 | 8,49% |
| 14 | Wells Fargo | 22 183,0 | 62 | 97 741 | 22,70% |
| 15 | Pfizer | 21 308,0 | 187 | 52 546 | **40,55%** |
| 16 | Microsoft | 21 204,0 | 71 | 89 950 | 23,57% |
| 17 | Exxon Mobile | 19 710,0 | 9 | 244 363 | 8,07% |
| 18 | Bank of America Corp. | 18 232,0 | 60 | 100 264 | 18,18% |
| 19 | Facebook | 15 934,0 | 274 | 40 653 | **39,20%** |
| 20 | Procter & Gamble | 15 326,0 | 135 | 66 217 | 23,15% |

[27] Source: Fortune Global 500 - http://fortune.com/global500/list/

The international firm *PriceWaterhouseCoopers* conducts research on the volume of market capitalization of companies. In 2018, the main trends in the TOP 100 ranking were as follows:

1. The growth of the total market capitalization of the TOP 100 companies continued and amounted to 15% compared to 2018/2017 (Fig. 11) The largest growth was shown by *Amazon* and *Apple*.

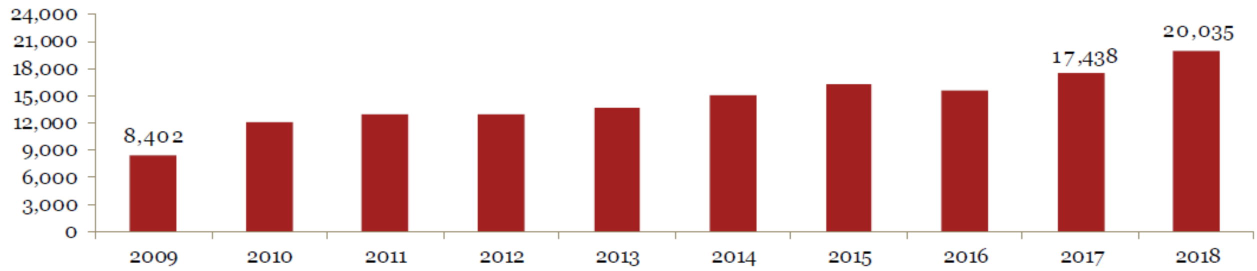


*Fig. 11 – Total capitalization of the TOP 100 companies, $ trillion (as of 31.03.2018)* [28]

2. The quantitative composition of companies from different countries changed (see Table 9). The largest representation of companies from the USA (total capitalization - $ 12.187 trillion).

**Table 9**

**TOP 100 Company Representation from Individual Countries** [29]

| **Countries** | **2009** | **2017** | **2018** |
|---|---|---|---|
| USA | 42 | 55 | 54 |
| China | 9 | 10 | 12 |
| Great Britain | 9 | 5 | 5 |
| France | 7 | 4 | 4 |
| Germany | 5 | 4 | 4 |
| Switzerland | 3 | 3 | 3 |
| Japan | 6 | 4 | 1 |

3. 85 companies from the 2017 list remained in the 2018 list (in 2017 there were 91 such companies – the best indicator of stability for all years of research). The list was left by such giants as *Starbucks, Daimler, Vodafone Group,*

[28] Source: PriceWaterhouseCoopers - https://www.pwc.com.
[29] Source: PriceWaterhouseCoopers - https://www.pwc.com/gx/en/services/audit-assurance/publications/global-top-100-companies-2018.html.

*Deutsche Telekom*, *BASF*, *Bayer*, etc. At the same time, 61 companies from the 2009 list remained in the 2018 list.

4. *Apple* is the leader of the list (see Table 10). It became the first company in the world to reach capitalization of $ 1 trillion in August 2018. In 2009, it was only on the 32nd place in the list with a capitalization of $ 94 billion.

**Table 10**

**The World's Largest Companies by Capitalization (as of March 31, 2018)**[30]

| Rank | Company name | Country | Sector/Industry | Capitalization, $ billion |
|---|---|---|---|---|
| 1 | Apple | USA | Technologies | 757 |
| 2 | Amazon.Com | USA | Consumer services | 670 |
| 3 | Alphabet | USA | Technologies | 609 |
| 4 | Microsoft Corp | USA | Technologies | 540 |
| 5 | Tencent Holdings | China | Technologies | 483 |
| 6 | Facebook | USA | Technologies | 383 |
| 7 | Berkshire Hathaway | USA | Finance | 358 |
| 8 | Alibaba | China | Consumer services | 302 |
| 9 | JPMorgan Chase | USA | Finance | 275 |
| 10 | Bank of America | USA | Finance | 263 |
| 11 | Samsung Electronics | S.Korea | Consumer goods | 237 |
| 12 | Visa | USA | Finance | 204 |
| 13 | Johnson & Johnson | USA | Health care | 199 |
| 14 | Wells Fargo | USA | Finance | 196 |
| 15 | UnitedHealth Group | USA | Health care | 182 |
| 16 | Taiwan Semiconductor | Taiwan | Technologies | 181 |
| 17 | Anheuser-Busch Inbev | Belgium | Consumer goods | 178 |
| 18 | Boeing | USA | Industry | 167 |
| 19 | Home Depot | USA | Consumer services | 167 |
| 20 | Mastercard | USA | Finance | 162 |

[30] Source: PriceWaterhouseCoopers - https://www.pwc.com/gx/en/services/audit-assurance/publications/global-top-100-companies-2018.html.

5. The maximum number of positions (77) was increased by the financial company *Bank of America* (10th in the list of 2018), reaching a market capitalization of $ 307 billion.

6. It is clear that there has been a drastic reduction in the time required for new entrants to take a dominant position in the market and achieve significant revenues, which is a historical turning point. It took *Facebook* six years and *Google* only five years to reach annual revenue of $ 1 billion.[31]

7. There has been no company from Russia for all years of research (since 2009) in the list of TOP 100.

It is interesting to note positions of a number of domestic companies in the leading industry ratings. Thus, in 2018, *Gazprom PJSC* sharply worsened its position in the ranking of the world's largest energy companies according to S&P Global Platts[32], dropping from the first line down to the 17th. At the same time, *LUKOIL PJSC* reached the top of the rating, rising from the sixth place to the second. In the list, it is second only to the American *ExxonMobil*, which regained its leading position lost in 2017 after 12 years of leadership. The re-entering of *ExxonMobil* into the first place occurred "on the backdrop of the recovery of oil prices and hopes for an export boom in the USA. Russian *Transneft PJSC* also got in the top 50 list – falling from the 14th line last year to the 30th. *Surgutneftegas PJSC*, on the contrary, improved its position, jumping from 165th to 35th place. In the top 100 of the list were also Russian *Tatneft PJSC* (54th place) and *NOVATEK PJSC* (60th place).

*Case 25. Switzerland and its two flagship pharmaceutical companies, Roche and Novartis, are a good example of a country with a strong international competitive advantage in pharmaceuticals.*

*What can be noted is as follows: excellent educational training of personnel of these companies due to the high quality of teaching in Swiss universities and polytechnics, the accumulated volume of their own knowledge in medicine, biology, chemistry — the priority Sciences for Switzerland; easy access to a high-quality national banking system that guarantees the financing of research and production.*

[31] Schwab, K. The Fourth Industrial Revolution / Crown Business, 2017.
[32] Source: S&P Global Platts. https://top250.platts.com/Top250Rankings.

*The parameters of domestic demand also contribute to the development of the Swiss chemical-pharmaceutical industry: Switzerland is famous for its rather expensive international private clinics, specializing in cardiology, oncology, bronchopulmonary medicine, sports medicine, whose wealthy patients create a steady demand for innovative medicines.*

*Related and servicing industries are: highly developed chemical production, from which the Swiss pharmaceutical industry has historically emerged (the initial basis for it was the production of dyes for the textile industry in Basel, headquarters for Roche and Novartis, a real cluster of the Swiss pharmaceutical industry; production of medical equipment, for which Roche and Novartis supply consumables; developed national health sector, components of which are one of the main consumers of Roche and Novartis – University and cantonal hospitals, as well as numerous private clinics. It is worth noting that Switzerland hosts WHO and the International Red Cross, which are also focused on the products of Swiss pharmacists.*

*Of course, Roche and Novartis have a long-term strategy, and a structure of regional offices adapted to specific markets, and they compete not only with each other, but also with smaller Swiss companies – manufacturers of drugs.*

*Among the random events that have had a positive impact on the business of Swiss pharmacists, there is a surge in demand for antiviral drugs (in particular, Tamiflu) during the global spread of atypical pneumonia, swine and avian influenza. At the same time, part of the drugs was purchased massively under the auspices of WHO and the national health services of foreign countries.*

*The policy of the state is also favorable to pharmaceutical companies – residents of the Swiss Confederation: the total income tax for them does not exceed 20%, and the royalties received (this is important in the pharmaceutical business associated with intellectual property in medicines production) are exempt from taxation. As a result, we can conclude that both the determinants and variables in the Porter's model contribute to the successful business of Swiss pharmaceutical companies, and their competitive advantage is stable. In fact, up to 40% of Switzerland's merchandise exports are pharmaceutical products, and the share of Swiss companies in the global pharmaceutical market is about 10%.*

Analysis of the attractiveness of the country's economy for business is conducted by the World Bank, and this rating is called DoingBusiness. Although quite a variety of economies in the top list in 2018, there are some common features in the top 20 countries: 14 of the top 20 countries are high–income OECD countries, three are from Europe and Central Asia and three are from East Asia and the Pacific. Eighteen of the top 20 are classified as high-income countries. The Republic of Macedonia and Georgia are two of the top 20 middle – and low-income countries, respectively. Russia is ranked 31st[33] in 2019 and this is its best indicator for all years of observation (Fig. 12).

[33] Source: Doing Business database. http://www.doingbusiness.org/en/reports/global-reports/doing-business-2019.

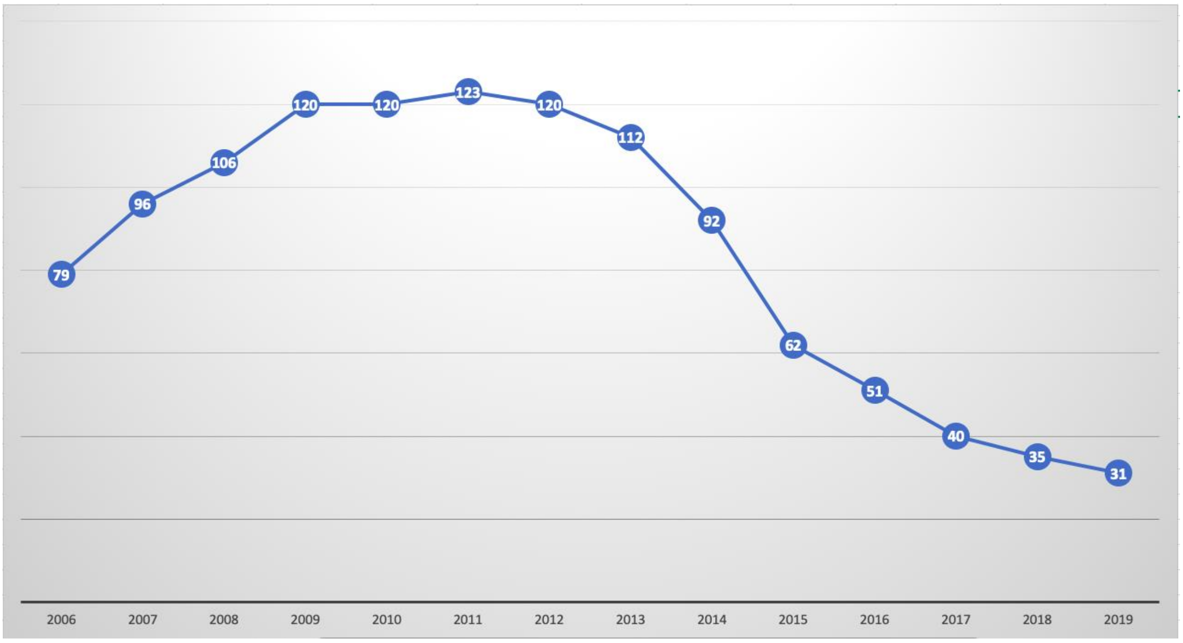


*Fig. 12 – Russia in Doing Business rating*

The GDP of a country can be indicative of the size of the world's economies. The share of countries in GDP in 2018 is shown in Fig. 13.

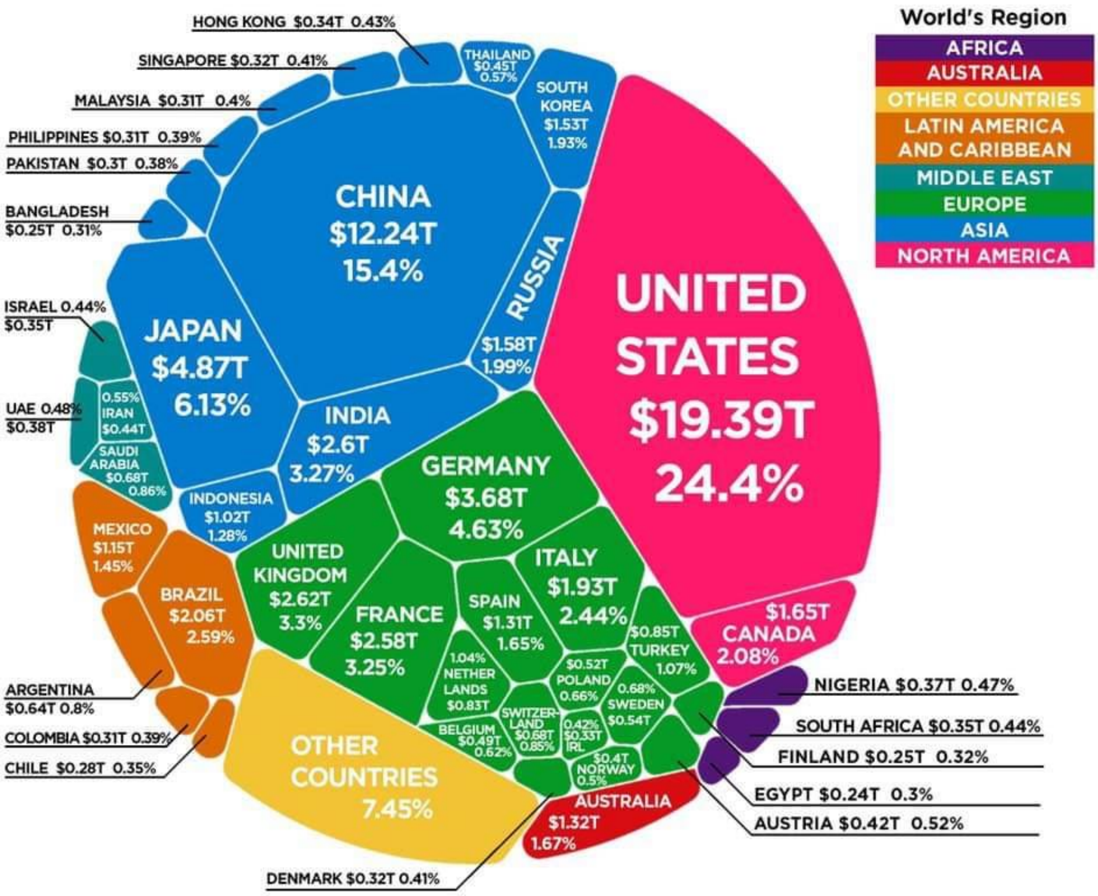


*Fig. 13 – GDP share of countries in the world (total world GDP is 100%)*

Another rating is the Global Competitiveness Index, conducted by The WEF since 1979. Russia in the 2017/2018 ranking, which includes 137 countries, ranks 38th, and it is also its best indicator for all years of observation (Fig. 14). The leaders are Switzerland, the USA, Singapore, the Netherlands, and Germany.

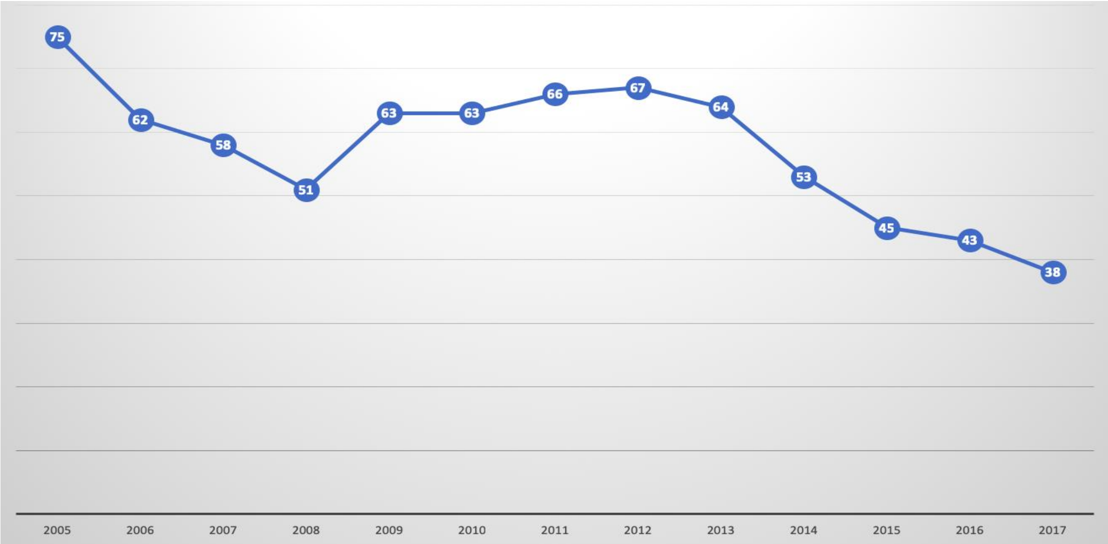


*Fig. 14 – Russia in the Global Competitiveness Index*[34]

Despite the obvious progress of Russia in the ranking, according to experts, its economy is still heavily dependent on exports and prospects in this matter remain uncertain. Weak positions remain in the quality of roads (114th place), inflation (112th place), financial market (107th place), as well as the quality of some institutions, such as property rights (116th), judicial independence (90th) and corruption, which remains one of the most problematic factors for doing business (Fig. 15).

In the period from 2009 to 2016, Russia rose by 19 positions in the Global Innovation Index ranking, to 43rd place, where, however, it failed to gain a foothold (in 2018, the country fell by three rating lines and took 46th place). Russia's strong position is still due to the improvement of indicators in the innovation Input sub-index, which characterizes the disposable resources and conditions for innovation (43rd place).

[34] Source: World Economic Forum - www.weforum.org.

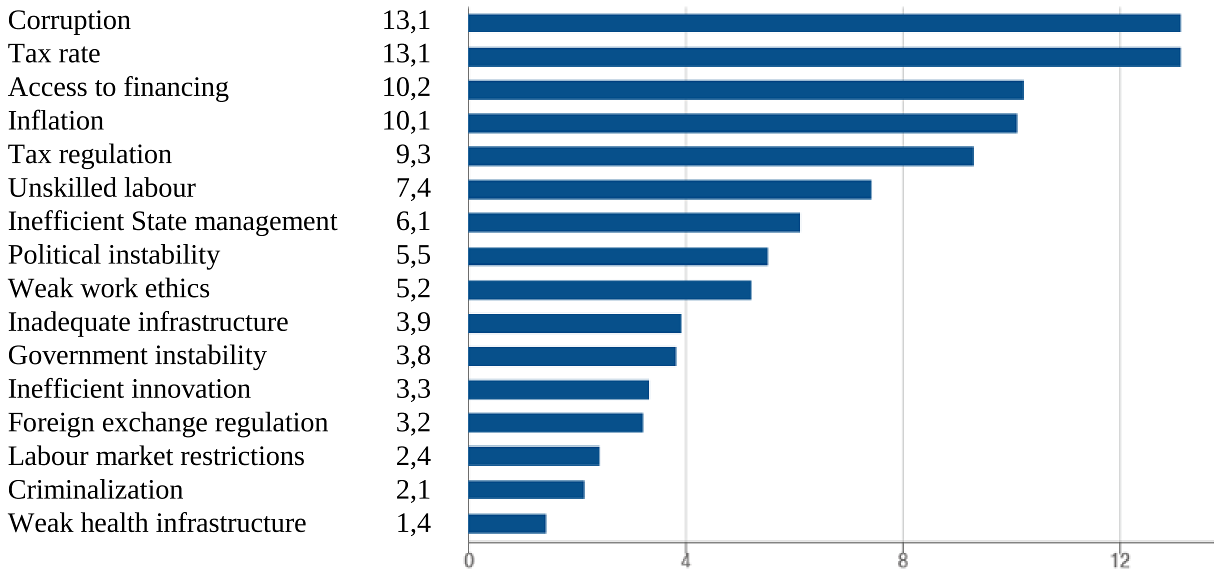


*Fig. 15 – Factors negatively affecting Russia's position in the Global Competitiveness Index*[35]

Since 2014, Russia has seen an alarming trend of falling labour productivity (with moderate growth in other countries and an increase in the stratification of countries in this indicator), where this country occupies a relatively modest place in absolute estimates. The problem here is not the weak orientation of domestic industry to high-tech production and exports, but the insufficiently large scale of exports of manufacturing industries as a whole, as well as the structure of its high-tech part, targeting relatively narrow and unstable markets.

### National Competitive Development Stages

Porter's *four stages of national competitive development are:*

1. factor-driven;
2. investment-driven;
3. innovation-driven;
4. wealth-driven.

*At the first stage*, the country can develop only due to the factor conditions of its "diamond". This is the starting point of development, when there are only

[35] Source: World Economic Forum, Executive Opinion Survey 2017.

the main factors, and therefore a narrow range of industries in which national companies (and with them the entire national economy) can compete in the world market: agriculture, extractive industries. Competition in the world market is conducted exclusively at the price of simple products of mass production. The necessary technologies and equipment are purchased abroad. The income received from the export of raw materials, labor-intensive, material-intensive goods should be directed to investment in its own industrial and technological base. It was the factor-driven stage that started the rise of the economy of Japan and South Korea back in the 1950s.

Investments contribute to the emergence of other determinants of the national “diamond” and the country’s entry into *the second stage*. Japan and the Asian “dragons” passed this stage in the period of 1960-1980, China, Brazil are passing it now. Other countries are prevented from going beyond the first stage (factor-driven economy) by government incapacity, lack of domestic competition, lack of control over foreign sales channels (capital outflow), etc.

*At the third stage*, the country has a full “diamond” in a number of industries. Currently, almost all OECD countries are at the innovation-driven stage, but the UK entered the third stage at the beginning of the XX century, and Italy, Japan did this in the 1970s, quite recently followed by Israel, Singapore, and Taiwan. At this stage, national companies not only develop well-known foreign technologies (as in the second stage), but also create them themselves. Competition is not so much about price; it is more about product differentiation. The importance of companies’ strategy increases. The country’s position in the production of services is strengthening (factor-driven economies and investment-driven economies rarely enjoy success in international services trade).

Innovative-driven economy has the highest resistance to adverse external factors, to macroeconomic fluctuations. At the innovation-driven stage, agriculture, industry and the sphere of intangible production compete on the basis of advanced technologies and are not vulnerable to fluctuations in prices and exchange rates.

*At the fourth stage,* the driving force of the country's economic development is the wealth that has already been achieved. The socially oriented economies of Western Europe have already reached this stage. At this stage social goals of society prevail over economic goals. The prestige of working in the real economic sector declines, production of public goods and the intangible sphere are in high demand. Taxation level increases, to ensure the financial stability of the socially oriented state. But high taxes reduce incentives for work and entrepreneurship, and social guarantees promote dependency. Technocrats-financiers, not pioneering entrepreneurs become managers. Huge capital is invested into financial assets, information technology. At the same time, there is a threat of loss of advantage in basic industries. Foreign investors are increasingly acquiring national companies and integrating them into their intercompany structure.

However, in recent years, global competition has forced these countries to cancel a certain part of social expenditures, to reduce taxes, since sticking to the principles of socially oriented market economy may result in economic stagnation. Deregulation and privatization launched in these countries prevented them from stepping over the line which would mean pullback in development.

Thus, in the field of international business, it is necessary to know by name not only the leading companies in the relevant branches of specialization, but also to take a balanced approach to the competitive opportunities of certain national economies. Of course, businesses are more likely to act only as users of the relevant set of determinants and variables possessed by a particular state, but in some cases companies can also form a competitive environment that enhances the competitive position of the national economy. And the task of national governments is to create and maintain a highly competitive institutional environment in which companies will operate, which guarantees better positioning of the national economy in the rankings of global competitiveness of countries.

At the same time, the development of global competitive strategies should be guided by the general strategic logic of the business, not forgetting about its profitability, protection from competitors and the emergence of substitute products, and taking into account the market power of consumers and suppliers, focusing on the centers of profit of the economic entity. In addition, it is useful to bring reasonable demands for improving business environment to the attention of the state in order to create a common competitive environment both within a single national economy and throughout the global space of international business operations.

**Topic 4 Review Questions**

1. Describe the concept and the types of competition in international business.
2. What is the concept of *competitive advantage of nations*, who is its author and what does it involve?
3. Describe the main components of Porter's "diamond" model.
4. What methods and indicators are used to assess the international competitiveness of countries and companies?
5. List the world's largest companies by capitalization in 2018.
6. What is the "Global Competitiveness Index" and what place does Russia take in it?
7. What are the factors that negatively affect Russia's position in the Global Competitiveness Index?
8. Name four stages of competitive growth of the country and describe their main characteristics.

# TOPIC 5. ROLE OF FOREIGN INVESTMENT IN INTERNATIONAL BUSINESS DEVELOPMENT

## Idea and Forms of Foreign Investment

Investors' willingness to invest in the economy of a country depends on the investment climate in it. The investment climate is a combination of political, economic, legal, social, domestic and other factors that ultimately determine the degree of investment risk.

The concept of *foreign investment* involves the removal of part of the existing capital from the economic system of one country and its inclusion in the economy of another country. Regardless of the form of capital cross-border movement, the most important feature of this process is relocation of future profits creating process or income of an economic entity out of the country.

*Foreign investments* are understood as property and (or) intellectual values invested by investors from other countries in an object of entrepreneurial activity in order to gain profit.

Both financial and industrial investments can be *objects of investment.* The first include securities – stocks and bonds, the second include real estate, production facilities, ready-made enterprises, property rights. In addition, this list will also include the rights to the results of intellectual activity, which can be defined as the rights to intellectual property, as well as the right to economic activity, which is provided in accordance with the law or by contract.

The main objects of investment are:

- property, i.e. buildings, equipment, any facilities, etc.;
- securities (stocks, bonds, shares, etc.);
- property and non-property rights, in particular the rights to intellectual property, patents, licenses, the right to economic activity.

The main competing form of international economic relations for foreign investment has traditionally been international trade. The latter implies the movement across the national borders of the act of selling an already created product (service), accumulating in itself the future profit of the economic entity.

*The main criteria for the classification of forms of international capital flow* in the modern world economy are:

- the origin of capital;
- the peculiarities of the use of capital;
- investment terms;
- investment goals.

From the point of view of the *kind of the origin*, the capital invested outside the national economy can be official (state-owned) and privately-owned.

*Official (state-owned) capital* consists of funds that are moved across national borders by the decision of authorized bodies of state power of the country. This category includes funds that are managed by various intergovernmental organizations, such as: *the IMF, the International Bank for Reconstruction and Development, the International Finance Corporation, the European Bank for Reconstruction and Development*, etc. The main forms of transfer of official capital in the global economy are loans and borrowings. With all this, in the early XXI century the growing trend to place state capital outside the national economy has become a characteristic feature of the development of international investment relations.

The main guides of state capital in the sphere of direct and portfolio investments are the *National Welfare Funds* (Sovereign Wealth Funds (SWF)). They are specially created, state-owned investment units. The main objective of such funds is to invest domestic state capital outside the national economy in order to create sources of future income to cover the needs of national budget and pension systems. The main source of funds of the National Wealth Fund is the current state revenues from privatization campaigns and export operations.

The first sovereign NWF, The Kuwait Investment Authority was created in

1953 by the authorities of Kuwait. NWFs have become the most widespread in countries with a distinct prevalence of raw materials in domestic exports, i.e. Saudi Arabia, the United Arab Emirates, Qatar, Russia, Norway, and Canada. An important role in the field of foreign investment is played by the NWF of Asian countries, first of all by the People's Republic of China and Singapore.

Most of the capital investments of national wealth funds are in the form of portfolio investments in liquid instruments traded in developed markets.

Apart from NWFs, the active involvement of official state capital in the sphere of direct and portfolio investments at the turn of the XX-XXI centuries was facilitated by state TNCs, most of the capital of their subdivisions owned by the government of a particular country.

Regardless of the forms of implementation, the main source of public investment funds is domestic taxpayers' money, which, of course, leaves an imprint on the nature of capital operations.

*Private (non-state) capital* is funds owned by private non-state companies, banks and other financial institutions that are moved across national borders by the decision of their authorized governing bodies.

Unlike official capital, cross-border private flow is less regulated. Geography, industry focus, timing and degree of perceived risk associated with the investment process, in the case of private investment, are usually much broader. Nevertheless, even in the modern conditions of liberalization of international economic and investment relations, public authorities and intergovernmental organizations closely monitor and control private investment activities.

By the *type of its use* the capital that is moved across national borders is divided into loan capital and entrepreneurial capital.

*Loan capital* is funds of a private or official nature that are lent to a foreign counterparty in order to earn interest in the future. The main characteristics of this form of capital flow are traditionally return, urgency and payment.

The concept of *entrepreneurial capital* combines the entire totality of investments made in the organization of the production, technological process abroad for the purpose of obtaining future profits. In practice, the investment of entrepreneurial capital is associated with the creation of new companies or the acquisition of shares in already functioning enterprises outside the national economy.

According to *time of capital allocation* abroad, investments are divided into short-term, medium-term and long-term. If funds are invested in a foreign economy for a period of more than one year, then it is a question of medium or long-term investment. There is no clear boundary between medium and long-term investments in world practice. Traditionally, it is believed that if the investment horizon is more than three to five years, then the investments are of long-term type.

All types of investments made for a period of less than one year are classified as short-term investments. Liberalization of the global financial system and the development of information and telecommunication technologies in the 1980-1990s contributed to the formation of a special category in the world economy - *super-short-term* investments, or *hot money*. There is no formal clear definition of the concept of *hot money* in modern economic literature. Usually, this term implies a variety of forms of speculative capital moved from one country to another in order to extract profits from the differential of short-term interest rates in the domestic and foreign economies and (or) the expected changes in the exchange rates of the respective national currencies. The word *hot* in this case underlines the high mobility of the aforementioned funds, which can not only cause significant fluctuations in the financial markets of the respective countries, but also destabilize their economic systems.

*According to the objectives pursued by the subjects of international* *economic relations*, foreign investments are divided into direct investments and portfolio investments.

The criterion for classifying foreign investments as direct or portfolio is the share of non-residents in the assets of national companies and, therefore, the ability to exercise control over the enterprise. It is believed that the right of such control is acquired by foreign owners when they own no less than 50% of the shares, but when dissipating shares among multiple owners, the right of control can be provided with much smaller amount of them, for example 10%. Holders of shares and bonds which provide less than 10% of property are subjects of portfolio investments. Such boundaries are set individually in each country.

*Case 26. In the European-continental system for recording the capital flows (Germany, France, Italy, Switzerland, Sweden, Norway, Spain, countries of Eastern Europe) direct foreign investments are part of net domestic investments with a stock value belonging to legal entities used in other countries to maintain and increase the production of firms whose assets are owned by non-residents of the country where the capital located exceeds 20-25%, entailing the right to participate in the management of foreign companies' property. Portfolio investments account for less than 20–25% and entail the right to pay dividends. This model is used in Japan. However, due to the fact that more than 40% of Japanese overseas investment falls on NAFTA countries, it takes into account the requirements of American statistics on the 10% criterion of participation in management. In the Anglo-Dutch-American BQP system, FDI is all sorts of property, own capital in the form of foreign currency and securities, material, technological and patent factors of production belonging to legal entities and physical bodies moved between countries and used to maintain and increase production and demand for the products of firms in whose assets the property of non-residents of the home country of the capital exceeds 10%, entailing the right to participate in control and property management of foreign companies.*

Portfolio investments mean owning less than 10% of the capital of an enterprise and entail the right to pay dividends. In countries with emerging markets, direct investments include only those that are directed to the statutory funds of JVs or foreign enterprises. At the same time, quantitative restrictions are imposed, which in some countries set minimal, and in others set maximal limits on the foreign ownership; thus, in China and in Latin American countries the minimum border is at least 25%, in Korea it is no higher than 50%, in Taiwan, Thailand, Indochina it is no higher than 49% (maximum limit). In Russia, direct investments include investments in enterprises exceeding 10% of the company’s own capital.

Direct investors are, as a rule, large companies seeking to expand the markets for goods and services and increase their incomes. Usually such an investment is made through banks and investment companies. The reason for direct investment is the desire to maximize profits by combining the application of financial capital with favorable conditions for using other factors of production (resources, labor, sales markets), other forms of intangible or fixed accumulated capital (technology, managerial experience, experience of the marketing expansion strategy), created competitive advantage (corporation size, economies of scale, popular brands) and other factors (differences in tax levels, in transport costs, the possibility to diversify risks, etc.), as discussed above.

An important feature of direct investment, as opposed to portfolio investment, is the ability of a direct investor to receive not only the main returns on invested capital, but also additional economic benefits arising from the fact of owning a decisive vote in the management of an enterprise. For example, a direct investor may, as a result of such capital investment, gain access to resources or markets that would otherwise be unavailable to him. In this case, foreign investment becomes an important tool of competition, when TNCs strive to strengthen their monopoly position by capturing new markets and acquiring control over enterprises in foreign countries. In addition, by investing in an underperforming enterprise, a direct investor can increase its profitability and value due to its administrative skills, management experience, or expertise in other areas. Finally, to minimize the risk, market instability prompts TNCs to diversify their assets geographically as well as in other ways. Therefore, direct investment, in contrast to portfolio investment, is characterized by long-term relations between the investor and the enterprise that is the object of direct investment, as well as the fairly significant role of the investor in managing this enterprise.

The initial acquisition by a direct investor of assets abroad is possible either through the creation of a new foreign enterprise (greenfield investments), or through the purchase of a share in the authorized capital of an existing company (brownfield investments). The latter form of investment strategy is implemented through the conclusion of cross-border M&As of foreign companies that are the object of investment.

In general, the main forms of FDI are:

- Contributions to the authorized capital, which include tangible assets (contributions made in the form of real estate, equipment, goods, etc.) and cash (monetary contributions). As a rule, this either creates subsidiaries of the company, opens branches, new enterprises, or stimulates purchases of a controlling packet of shares in an already existing enterprise;
- Loans provided by the investor. In this case, investors allocate direct loans to counterparties if they consider that such cooperation is substantial, i.e. the partners have experience, guarantees from the investing side, the idea is not too risky, the project's profitability is high, there is the possibility of increasing the funds invested in the investee;
- Other forms, which include, for example, additional shares acquired by the investor, reinvested earnings, equipment transferred by the investor in addition to contributions to the share capital, etc.

The main *reasons and prerequisites* for the development of foreign investment are, above all, an excess of money capital in the country of investment, as well as high competition in the country where the international company is situated. The desire to increase profits leads to the fact that capital is constantly in search of more profitable premises. As a rule, capital finds new opportunities in other countries. As a result, there is an outflow of capital on a global scale. Among the factors contributing to this overflow are the factors that contribute, on the one hand, to the export of capital, and on the other, to the import of capital.

The abundance of capital, the expansion of the company's activities, the concentration and centralization of capital lead to the need for profitable capital allocation; however, certain legislative measures (for example, antitrust legislation), reduced demand for products in their own country, increased competition and increased barriers to entering the market within countries are forcing property owners to export capital. In the context of globalization, the entire global economic space is becoming the field of activity of a large company. On the other hand, there are positive factors for the development of business abroad, such as the possibility of reducing the cost of working capital, labor and raw materials, lower barriers to entry into the market, high demand for products, and sometimes tax privileges of the host country; all this also contributes to foreign investment (see Table 11).

**Table 11**

**Reasons for Foreign Investment**

| **Internal** | **External** |
|---|---|
| – Lower profit margins<br>– High competition<br>– High entry barriers to the industry<br>– Antitrust law<br>– High costs of advertising, labor, raw materials<br>– Excess capital | – Availability of cheaper labor, raw materials<br>– Low competition<br>– Low entry barriers to the industry<br>– Tax breaks<br>– High demand for products, proximity to a large sales market<br>– Investment loan<br>– Proximity of raw materials and materials, too bulky and expensive to transport |

Factors stimulating modern foreign investment include the increasing interdependence of national economics which is the result of the deepening of the international division of labor and the internationalization of production, international cooperation, the policy of openness of the economy in developed countries and the creation of a favorable environment for the import of capital into developing countries, exacerbation of global problems, activities of international economic organizations.

The main *motives* that can make companies in one country make decisions about investing funds in other economies can be divided into four large groups:

1. obtaining and expanding access to production factors located abroad;
2. the expansion of markets for their own products;
3. improving the efficiency of the company;
4. access to strategic assets.

1. The first motive for implementing a foreign investment strategy is related to the company's desire to obtain guaranteed access to foreign factors of production of higher quality and (or) lower cost than at home. The implementation of this motive allows companies not only to provide themselves with the necessary resources, but also to reduce the cost of production of their own products, and thus increase their competitiveness in world markets.

2. The desire to expand foreign markets for their own products is the second most important motive stimulating the investment activity of economic entities. In modern economic literature there are several factors influencing this motive of foreign investment. Firstly, it is the desire of the manufacturing company to follow the main consumers of their products in their international expansion. So, in the 1980s more than 500 Japanese companies producing auto components opened subsidiaries and JVs with American partners in order to provide their products to the factories built in the USA by Japanese automobile concerns.

The second reason for the desire of global companies to be closer to the end user through the creation of branches and subsidiaries is related to the need to adapt the products to the tastes and preferences of local customers, as well as the formal requirements of domestic authorities. Without such an adaptation, standardized and unified products of global companies may not be competitive in relation to goods fitted for the preference of local consumers and manufactured locally.

An important reason for locating production directly near the main centers of consumption of products can be significant transport costs associated with the delivery of finished goods from the point of production located in one country or region to the final consumer located in another country. If, at the same time, the nature and specificity of the product allows the company to organize the production of goods in close proximity to the main consumers without significant additional costs, then the development model of the company through foreign investment will be economically more reasonable than the export model.

In the struggle for foreign investment resources, governments of developing countries and countries with emerging economies are often ready to provide foreign investors with additional government guarantees, which are issued by bilateral or multilateral intergovernmental agreements. These agreements can be aimed both at insuring risks associated with the economic activities of a foreign company in a host economy, and at eliminating double taxation of economic activities results of a foreign investor.

3. Improving the efficiency of operation, due to the geographic redistribution of capital of companies (the third motive) in many ways echoes the reasons for foreign investment that we have already considered. In addition, expanding the geography of their presence, companies have the opportunity to fully realize the economies of scale associated with saving production costs, which is extremely important for industries that require substantial initial investment in the organization of the production process, such as engineering, metallurgy, chemical industry, etc.

4. The fourth motive for foreign investment can be the company’s desire to gain control over strategically important foreign assets that are necessary to maintain and increase the competitiveness of companies in the global market. In

such situations, as a rule, we are talking about buying a certain foreign enterprise that either possesses unique technology and rights to use it or has some kind of portfolio of knowledge and experience necessary for further promotion of products manufactured by the investor in local and world markets. Most often this motive is manifested in industries related to the production of technological equipment, as well as in the pharmaceutical and biomedical industries. Examples of the implementation of this motive are: 1) 2004 transaction for the purchase of *IBM*'s computer unit by the Chinese company *Lenovo* for $ 1.25 billion to increase production and expand its own sales geography, 2) acquisition in 2011 of the French pharmaceutical company *Sanofi-Aventis SA* for $ 13.7 billion US biotechnology company *Genzyme Corp.*

### Dynamics and Structure of Foreign Investment in Global Economy

Initially, the main areas of foreign investment were countries that could provide cheaper raw materials and working power, as well as ensure the demand for finished products. In addition, foreign companies did not need to spend money on the design and discovery of new technologies, since companies already existing and sometimes even obsolete in the home country were still new for the recipient country. The main objects of export of investments were mainly raw materials and agricultural goods, and only later TNCs began to develop individual industries to export not only raw materials, but rather the results of the manufacturing industry. They dominate in the development of minerals and trade in agricultural products. The share of developing countries in total global investment has steadily decreased since the mid-1970s, dropping to 17% in the 1980s compared to 25% drop in the 1970s. In the 1980s and 1990s, due to the rapid development of low-cost production in Southeast Asia, significant investment flows were channeled into this region.

By the beginning of the XXI century international capital migration took on a significant scale. However, if the volumes and dynamics of FDI can be assessed quite accurately, with portfolio investments it is more difficult to assess the situation: equity stocks are often resold; capital can quickly flow into the country, but just as quickly leave it.

In general, throughout the XX century the world economy was characterized by a tendency of growth of dynamic movement of capital. At the same time, there was a difficult period from 1914 to 1945 (until the end of the Second World War), accompanied by the world economic crisis of 1929–1933, when foreign investment as a whole increased only by 1/3.

After the Second World War, the dynamic growth of foreign investment began. Over the 10-year period (from 1946 to 1955), it doubled, afterwards this doubling occurred approximately every 6–7 years. From 1981 to 1990, foreign investment increased by about 4 times. As a result, by 1990 direct accumulated foreign investments amounted to $ 1.76 trillion, and in 1999 they already reached the level of $ 4.77 trillion – about 1/7 of global GDP.

In the XX century there were dramatic shifts in the geographical distribution of the export of capital. In the colonial era, the main targets for the export of capital were predominantly colonies and dependent countries. After the collapse of the colonial system, the direction of capital flows changed: an intensive capital exchange between industrialized countries began. In the 1980s there were even fears that developing countries would be on the sidelines of international capital movements.

In 2017, the ratings of the largest capital exporting and importing countries (according to accumulated FDI) were as follows. [36]

– capital exporting countries (the USA, the Netherlands, Japan, Great Britain, Germany, China, Hong Kong, Canada, British Virgin Islands, France);

[36] Source: World Bank World Development Indicators database of 2017 - https://data.worldbank.org/indicator/BM.KLT.DINV.CD.WD?year_high_desc=true.

– capital importing countries (the USA, the Netherlands, China, Hong Kong, Germany, Brazil, Great Britain, Singapore, France, Australia).

Analysis of data on the export and import of FDI indicates the following characteristic trends in international capital migration.

1. In addition to the leading industrialized countries of the world (the USA, the UK, Japan, Germany, France, Canada), China, Hong Kong, the Netherlands and the British Virgin Islands are in the top ten of the leading countries that export capital.

2. The United States is the leader in both direct export and import investments (with excess of exports - $ 379.221 million over imports – $ 354.828 million).

3. Japan takes 3rd place in the list of leading capital exporting countries, and is missing on the "top ten" of leading capital importing countries (this is due to the fact that during the 1990s, Japan restricted inflows of foreign investment, and only in 1999 did it somewhat relax the restrictions).

4. The top ten leading capital exporting countries include 4 European states (the Netherlands, Great Britain, Germany, and France). All of them are members of the EU (with the UK currently implementing the Brexit procedure). In general, in Western Europe there is a concentrated export potential of FDI and characteristic feature is that most of them move within Western Europe itself (primarily within the EU).

5. Outside Europe, the main target for exporting capital from Western European countries is the United States and Canada. By the beginning of the XXI century there formed the "investment axis" of the USA, that is, the EU. At the same time, almost half of the investment goes into merger operations with foreign firms and their absorption.

6. The world economy is expanding the range of countries participating in the global investment process. In fact, all countries of the world are involved in

this process, acting as exporters, importers of capital, or both simultaneously and in both capacities.

7. Developing states as a whole retain their position as capital importing countries.

8. The role of emerging countries (including Russia) in the global investment process remains modest. However, in the 1990s the attraction of foreign capital to the countries of Central and Eastern Europe (primarily to Hungary, Poland and the Czech Republic) became much more active.

On the whole, the following conclusion can be made: in spite of the uneven distribution of capital export among different regions of the world and individual countries, a more integrated world capital market is emerging; it becomes the global system for accumulating free money resources and making them available for business structures and government bodies of various countries on the principles of competition.

## Topic 5 Review Questions

1. What is the investment climate and what does it depend on?
2. Define foreign investment; what can the objects of investment be?
3. What are the main reasons and prerequisites for the development of foreign investment?
4. What is the difference between direct and portfolio investments?
5. What are the functions of the *National Welfare Funds?*
6. What are greenfield investments and brownfield investments?
7. What are the main directions of foreign investment depending on industry and country?
8. What are the main motives that can force companies in one country to make decisions about investing funds in the economies of other countries?
9. What is the dynamics and structure of foreign investment in the global economy today?

# TOPIC 6. MARKETING AND ELECTRONIC COMMERCE IN INTERNATIONAL BUSINESS

## International Marketing

As there are often large differences between the national market of the company's home country and foreign markets, it is impossible to use national marketing to successfully enter them. In foreign jurisdictions, a company typically faces business conditions completely different from the domestic market, which requires a more complex arsenal of marketing tools than international marketing has.

*International marketing* is a set of tools and actions related to the company's expansion of foreign markets. International marketing includes planning and implementation of transactions involving crossing of national borders in order to meet the needs of individuals and legal entities. International marketing uses the methods and tools of traditional national marketing, but at the same time has a number of features related to the company's activities in two or more markets, including foreign jurisdictions. International marketing includes analysis, planning, implementation, coordination and control of all market-oriented processes in relation to consumers of goods (services) of a company in two or more countries.

Principles of international marketing are the same as for domestic marketing. This means that methodology is the same. However, because of the progress of internationalization and globalization, there appear additional factors that affect international marketing activities of the company. For example, it is necessary to understand the issues of international financial and risk-management, international law; one needs to take into account the problems of cross-cultural communication. Decisions in international marketing are characterized by high level of complexity; they are made under conditions of increased uncertainty and, at the same time, are subject to additional risks. In view of this, the need for information and coordination is noticeably higher here than at the national level.

The following three features characterize international marketing:

1. marketing activities of an economic entity are spread over several countries at the same time, while such marketing business activity is regular;
2. marketing decisions for each country are made with due regard to the international marketing strategy of the company as a whole;
3. international marketing activities are systematically planned, resulting in purposeful development of the external market.

The toolkit of the marketing complex (the so-called marketing mix) for the foreign market is developed on the basis of the concept of *international marketing*, and the company makes decisions about the appropriate choice of foreign markets and the combination of marketing tools.

The *international marketing mix* is a set of operational and tactical marketing tools selected in accordance with the objectives and strategy of international marketing. The international marketing complex consists of specific instruments of influence that can be operated on in a specific foreign market and react on its changes in order to achieve the goals set. The international marketing mix includes four components: product and pricing policies, distribution and promotion. Before a company can handle a foreign market, it must successfully come to this market. At the same time, it needs to determine not only the optimal time, but also the market entry form.

As mentioned earlier, we can distinguish *three main groups of forms for entering the external market* by a company: market development through market coordination; market development through the formation of cooperative forms, and market development through hierarchical coordination.

Consider the *criteria for selecting a distribution channel* in the foreign market. The distribution channel in international marketing is a collection of companies or individuals who undertake the subject matter to take over or help to transfer ownership of a product to someone else in the course of its movement from producer to consumer in a foreign market. Thus, the distribution channel may include several intermediate stages (intermediaries).

In international marketing, decision-making about distribution channels is determined by the country in which the goods are produced, by the form of entry into the foreign market, the specific features of the goods, the company and the foreign market. A company in the target country can apply a distribution system which it also uses in the domestic market, or modify it so as to take into account characteristics of the external market, such as consumer characteristics and demand, competitive structure, intermediaries, legal regulation of the distribution and distribution itself.

Product policy in international marketing involves determination of product lines (product range) and the parameters of goods that best meet the needs of buyers in markets in various countries around the world. Product policy in international marketing is related to the objectives of the company and the concept of *international marketing* in general; with the resources that the company possesses or it has to access and with the needs of the markets of the target countries.

The *expanded national market concept* assumes that product decisions developed for the domestic market also extend to foreign markets. This approach may reflect two views:

1. consumers in other (often neighboring) countries have common features with consumers of the manufacturing country;

2. product program developed for domestic consumers is the best practice and can also be addressed to foreign consumers.

Standardization of the goods within the framework of the concept of an *expanded national market* has the advantage that this is a simple, fast and economical approach to be applied.

The concept of *global marketing* suggests that international product policies are developed within the global context. Ideally, a global company identifies international segments with similar needs that a standard product can target. Another option is possible using of an international communication policy, through which a company attempts to create an international group of consumers of a standardized product. The attractiveness of this product policy is based on saving on the scale of production and on a number of components of the company's marketing activities.

Adaptation of a product or even the development of new products for individual markets is peculiar to companies that follow the *concept* of *multi-national marketing*. Adaptation entails the development of a product's program for each target foreign market in accordance with the needs of its customers and environmental factors. Adaptation may be required when the needs of customers, the conditions of use of the product and other important factors vary significantly between external markets.

The value of *sales promotion activities* is much higher in those countries where the company encounters restrictions on the use of advertising and other components of the promotion complex.

Such restrictions may include, for example, the specifics of legislation on advertising (regulation of the time of television and radio broadcasting, restrictions on advertising specific products (services); a low level of infrastructure development for the implementation of direct marketing activities, Public Relations (PR) or advertising (television, telecommunications, Internet, etc.); low level of literacy of the population. When developing a sales promotion program, a company must be sure that its tools fully take into account national peculiarities of consumers of different countries and do not contradict the legislation of the target country (conditions and types of discounts, lottery conducting, etc.).

PR activities are an important method of advancement in all major economic regions of the world. When entering external market, it is advisable for the company to determine the characteristics of the target audience, which will be the object of the impact of these actions. In different countries, depending on a wide range of factors, the target audience for PR may have its own structure and peculiarities. Useful information for the PR campaign will be identifying which media is better to use to reach the contact target audience. Assessment of public awareness of the company and its products (services), and in some cases clarifying attitudes towards products and the company as a whole should be included into the directions of research in the field of PR for planning and carrying out relevant activities.

At the international level, direct marketing is an activity aimed to obtain a direct response from consumers in the market of the target country. A company can use direct mail, telemarketing, teletext, print direct marketing and widely use direct marketing via the Internet. It can also combine these types of direct marketing depending on the specifics of the target country. Factors affecting the expansion of international direct marketing include increase in the number and quality of mailing lists, development of print technologies, spread of interactive television, the increasing role of the Internet, and the rising costs of other promotion methods in many countries. Thanks to the development of information technology, today it is easier to carry out direct contact with the consumer. At the same time, when making decisions about direct marketing they take into account, as we have already noted above, the state of the infrastructure of direct marketing, as well as the quality of address lists and the regulation of their protection.

*Personal salesmanship* is a widespread method of communication in international marketing. The extent to which a company is involved in personal (personalized) sales in foreign markets is a function of its presence in the market, marketing objectives and characteristics of the distribution system. Personal sales are used in business-to-business (B2B) markets, where they often occupy the first place among the company's promotion tools. Personal salesmanship is widely used by a number of companies in some consumer markets. *Mary Kay Cosmetics, Oriflamme, Avon* sell perfumes and cosmetics using personal sales tools. The use of personal salesmanship is especially relevant for countries with low labor costs. When interacting with intermediaries, in the negotiation process with the end customer, the role of the culture knowledge of the target country and especially the specifics of the national style of negotiation, business culture in general, increases.

The American Marketing Association (AMA) is one of the most authoritative organizations in the field of information technology; it indicates that Internet marketing is a marketing activity based on the principles of the Internet and e-mail and includes advertising using banners, e-mail, search engine optimization, e-commerce (EC) and other tools.

The following differences of Internet marketing are worth highlighting:

1. The relationship between producer and consumer shifts towards the consumer and their needs; long-term relationships with them become the focus of the organization's strategy.

2. Globalization of activities and reduction of transaction costs.

3. The transition to a one-to-one marketing model led to the personification of marketing. Companies acquire the ability to obtain detailed information about the preferences of each individual customer and provide products that meet individual requirements.

It is important to understand that in today's conditions an enterprise participating in international business needs to use Internet marketing (or online marketing) in order to expand existing marketing methods. For enterprises conducting their activities exclusively in the Internet environment, this type of marketing may be the only one, therefore, for successful operation, the enterprise will carry out marketing activities in the Internet.

The main instruments of traditional marketing, the so-called 4P (price, product, place, promotion) has always been considered the cornerstone of the company's marketing strategy. The use of the Internet includes in the concept of *4P* what is presented as the fifth element of marketing: people.

Internet marketing tools allow one to solve problems that are difficult to implement in traditional marketing, namely, to personalize each individual customer. Personalization gives you the opportunity to work with each specific client individually, to provide new services and thereby increase brand loyalty.

## E-commerce

EC is implementation of common business processes based on computer networks so that a potential client of a company or a user of its products can remotely use the Internet to perform the necessary operations (choice of goods (services), purchase, payment, documentary registration of the transaction, etc.).

Currently, there is still a big gap between EC and traditional business practices. This is particularly characteristic of retail trade, which is considered to be one of the drivers of EC development. EC is developing at a fast pace in relation to traditional business practices (12–20% growth per year compared to 2–11% in traditional trade). Volumes of EC markets are shown in Fig. 16.

1. Global access. Wired and wireless Internet embraces, in fact, the bigger part of our planet and penetration of the "global web" into the lives of individuals and legal entities in any country of the world is only increasing. Therefore, from almost anywhere in the world, any of the current 4.02 billion Internet users can be a client of any company that uses EC methods.

2. Wider company profiling, including opportunities for conducting international trade operations. The assortment of products or services of companies operating using traditional methods is limited to the set that is in the stock or listed in the price list. Line of goods of companies working with the use of EC methods can theoretically be represented by the entire set of goods (services) offered within the global economic space.

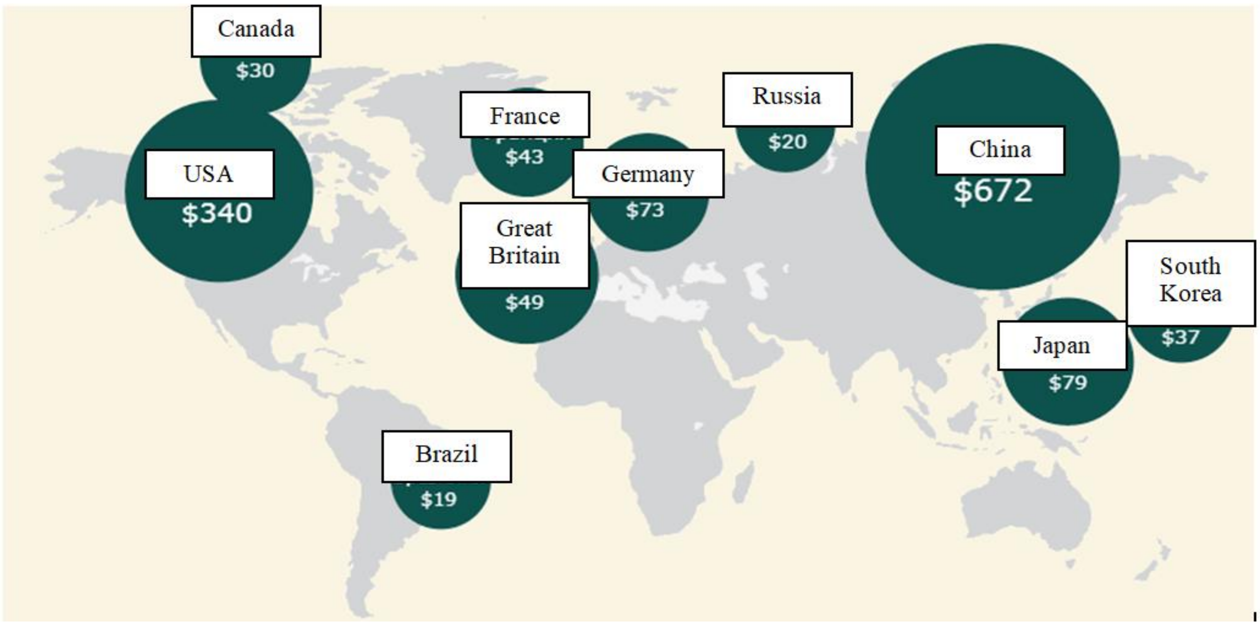


*Fig. 16 – The largest EC markets ($ billion)*

*Factors contributing to the growing popularity of EC operations:*

3. Operating 24/7, 365 days a year guarantees the purchase and delivery of the necessary products at any time, regardless of weekends and holidays. This becomes especially convenient for consumers from countries around the world with strict labor laws (limiting the opening hours of traditional stores and service companies).

4. Transactions personalization to a high degree: the ability to offer each client exactly what they need. Based on the study of customer behavior, statistics of previous purchases, collection of other information from the Internet, a conclusion is made about the preferences of each particular customer and

automatically they are offered the set of goods (services) that match their interests. It is clear that with traditional business methods it is impossible.

5. Cost savings occur due to the minimization of space for warehouses (the allowable amount of storage space, as a rule, corresponds to the volume of goods required by 1-2 shipments), staff cuts (first of all, there is no need for procurement and sales managers, and also in back-office specialists who are not directly in contact with the buyer), a significant decrease in office space (for the normal functioning of EC schemes, only the company's management, employees involved in shipping / receiving goods and operators entering the necessary information). The rest of the business processes of the enterprise are either implemented by the system itself, or can be outsourced, which significantly reduces the rent, utility bills, personnel salary costs and other expense items of traditional business structures.

However, EC, like any other business, has certain *disadvantages*:

1. At the time of the transaction the buyer cannot assess the real properties of the products purchased by him (feel, touch, smell, and try on the product or get an objective idea of the nature of the service provided). This is the main disadvantage of EC, which is a consequence of distance sales, the impersonal nature of the buyer's contacts with the seller and imposes restrictions on the range of products offered by online stores and services sold on Internet portals.

2. EC operations are associated with greater risks of non-delivery of goods (services) and refusals to return funds paid than traditional business transactions. With traditional trade, the buyer always sees the goods or agrees upon the services which they buy, transferring cash to the seller or using other payment means, instead immediately receiving the goods or consuming the corresponding service. During the implementation of the EC transaction, the buyer acts primarily in the prepaid mode for the goods not yet delivered or the service not rendered.

3. EC safety also causes numerous questions. This concerns computer systems security problems as a whole, as well as ensuring security of transmitted personal consumer information in EC systems.

### Basic E-commerce Models and their Implementation Features

Traditionally, the implementation of business methods of EC is based on one of the following two models.

1. **B2B** *(business-to-business),* in which a company (a legal entity) offers (sells) its goods (services) to another company (legal entity). At the same time, business processes that are characteristic of a production or wholesale link in the chain of movement of goods are automated: the purchase of raw materials and components; wholesale of finished goods and their delivery; non-cash payments, including the payment of taxes and customs duties; concluding contracts; document exchange, etc.

2. **B2C** *(business-to-customer),* in which the company offers (sells) its goods (services) to individuals. The B2C model is used when selling goods at retail and, accordingly, the emphasis is on various types of cash payments, retail sales, support service, support documents, etc.

In a number of sources we can find other varieties of EC models, including b*usiness-to-government* (B2G), *government-to-business* (G2B), *consumer-to-consumer* (C2C), etc. In addition, there are separate areas in virtual business: intertrading (trading on raw materials and capital markets), *marketing-to-business* (M2B) (marketing activities of the company by means of EC), etc. But such a classification is not entirely legitimate, for it is based on either a B2B or B2C model.

The B2B model is currently most often implemented in the form of trading platforms or full-featured B2B systems.

*Trading platforms* are specialized websites on the Internet where any company can post their commercial offers or requests. Such platforms can be either industry-specific, on which requests and proposals of companies operating in certain industries are placed, or diversified (*http://www.alibaba.com/* is a platform where companies from various industries from all over the world place their offers). At the same time, inquiries and proposals of companies are formed as information in the general site directory of the site, which simplifies their search both in the context of goods (services) and companies / industries.

The *B2C model* is currently most often implemented in the form of electronic shopping malls (sometimes they are also called online supermarkets, shopping centers, online storefronts), electronic auctions or online stores.

*Electronic trading malls* in their tasks and capabilities are very similar to the trading platforms of B2B systems. On them, as well as on B2B marketplaces, companies place their price lists in the catalog of price lists of the trading mall. The buyer can view this all price lists one by one, or in the price list of the offers of other participants in the marketplace, sorted by category, characteristics or models of the goods offered. After selecting a product, the buyer is redirected to the company's website, the seller, where the transaction is carried out.

The advantages and disadvantages of electronic shopping malls are similar to those at B2B marketplaces. Just like with trading platforms, companies pay little money for placing their commercial offers in the mall, with an increased number of potential buyers in return. As well as with trading platforms, the malls do not provide opportunities for integration with the company's website or at least back office.

*Online auction* is a type of EC, which is most often implemented on the basis of the B2C model. In this model, the principle of the auction is implemented, when the sale of goods (services) is based on public competitive bidding, during which the final price is set for them.

In spite of the fact that traditional auctions apply both the standard (English) scheme for price increase, and the so-called reverse scheme (Dutch auction) for price reduction, the direct scheme has taken root in online auctions. It is characterized by the fact that the seller sets the initial price and, in some cases, sets a certain minimum price (*reserve price*), which is unknown to buyers. Bidding for price increases is scheduled. The winner is the one who sets the highest price at the end of the auction. When the reserve price is established, the winner will receive the goods in case if the last bid price offered by the bidders is higher than this value; otherwise, the bidding is considered as non-standing, and the lot remains with the seller.

*Online store* (*online shopping, online retailing)* is the most functionally complete implementation of the EC method in the retail business. Usually, an online store is a website selling goods (services) on the Internet. Historically, the first Internet shops appeared in 1982-1984 from companies doing business in the traditional way. At the same time, stores on the Internet traded the same goods as offline. In this case Internet shops were considered as a new sales channel, and during their development they showed good results.

In fact, electronic stores enjoy synergy effect by combining the advantages of online stores and malls. At the same time, the store does not have the goods on offer in stock, however, the buyer has access to a huge assortment of many companies with which the store has an agreement. Good examples of such implementations are companies that are conquering the market at a fast pace due to the combination of the advantages of the trading range (a huge range of goods offered) and the online store (the possibility and safety of making a purchase).

Currently, business is aimed at attracting and, most importantly, retaining the consumer. In 1983, L. Berry coined the term “relationship marketing” to describe a new approach to marketing that focuses on longer-term relationships with consumers. Consumer retention marketing (loyalty marketing or relationship marketing) has never been as popular as it is today, due to the fact that competition between producers is growing and the consumer, in turn, is gaining more and more influence on manufacturers. It is consumer behavior that determines the volume of the market for goods and services, supply and demand in the market. Consideration of the interests of the consumer as a fundamental principle leads to the fact that companies realize their goals, inasmuch as satisfying the needs of society to the maximum extent, profits and loyalty to the company increase. A proprietary digital platform is needed.

*A digital platform* is a collection of digital assets (and their respective content) through which the company and users will constantly communicate. For some marketers, this may simply mean a website or a mobile site (Fig. 17).


*Fig. 17 - Digital platforms in the world and Russia*[37]

A digital platform offering is a route that a company must take to determine its approach to creating content. In some cases, it can be concluded that the implementation of the proposal is simply unrealistic, as it will require a huge amount of content. In this case, it is necessary to return to the proposal itself and concretize it further.

[37] Source: Digital Russia – New Reality. [Electronic Resource]. www.mckinsey.com/~/media/McKinsey/Locations/Europe%20and%20Middle%20East/Russia/Our%20Insights/Digital%20Russia/Digital-Russia-report.ashx.

One of the key advantages of online stores in relation to the traditional way of doing business is the possibility of creating a personalized supply of goods to the buyer. This has become possible due to the *profiling* procedure, which involves an online store gathering information about the visitor's behavior in the shop (what products a particular buyer prefers, what products they look at, how much they study the characteristics of the goods, etc.). In addition, information can be used from other sources on the Internet (social networks, questionnaires from different sites, other sites that accumulate information about a particular individual). On the basis of the systematization of the information received, a conclusion is drawn about consumer preferences, and when the buyer enters the store once again, he is first offered those goods (services) that fall within his area of interest.

Describing the prospects for the development of EC, we note that at the current stage the most important areas for improving the operations of EC are the following:

1. *Increased security*. This process develops in two directions.

– For added security of the functioning of the EC systems themselves. This development path is undoubtedly connected with the constantly increasing volume of attempts to hack computer systems. The goal is to protect users from Internet fraudsters and strengthen the capabilities of EC systems to counteract hacker attacks;

– The problem of using customer data. Profiling, i.e. the collection of information about consumer preferences in order to offer him those goods (services) in which they are primarily interested in determines the obvious competitive advantage of EC for the seller. On the other hand, if such data becomes known to an outsider, it may be detrimental to consumers.

2. *The reliability of the systems.* Modern EC systems are built on the basis of explicit client-server applications, where the main part of the programs

responsible for the functioning of the entire system (catalog of goods (services), customer identification, automation of product selection, payment, accounting, etc.), are located on one computer, i.e. server. In case of cyber-attacks on this server, the whole system becomes inoperable, which entails direct loss for companies that implement their business using EC.

On the other hand, on the Internet there are so-called P2P (Peer-To-Peer) networks, one of the pleasant properties of which is that any computer in these networks is both a source and a receiver of information (in terms of EC, the seller and the buyer). At the same time, if any number of computers of such a distributed peering network fails, the network still remains fully operational.

3. *Prospects for the development of EC in the B2C segment.* According to estimates by “The I Factor”, mobile devices (tablet PCs, smart phones, etc.) will, by 2020, become the main channel for retail communication with customers, ahead of traditional stores, websites and call centers. The trade itself will become even more personalized, as the stores will offer the goods needed by the consumer, based on the profiling technology. According to the results of many studies, a general consensus has also emerged that the future of retail is in mobile commerce, with its contactless payment technologies and customer positioning services on the ground to offer targeted discounts.

## Topic 6 Review Questions

1. What is international marketing and how is it different from national marketing?
2. What is a digital platform and how does it function?
3. What is e-commerce and what are its distinctive features?
4. List the main types of EC.
5. Name the functions of profiling.
6. What are the main improvement directions of EC operations?

# TOPIC 7. LOGISTICS IN INTERNATIONAL BUSINESS

## Logistics, its Definition and Participants

Logistics is important in international business as well as in business in general. There are several definitions of this term. According to a widely known definition given by the US Board of logistics management, *logistics* is a process of planning, providing and control of effective receipt and safekeeping of goods, services, relevant information from source to the point of consumption with the purpose of satisfaction of consumer needs. According to a simpler, common definition of logistics, it is delivery of the necessary product or service to the right place and at the right time. There are the following types of logistics: procurement, production, distributive, after-sale, reverse (for the return of previously sold goods), and waste disposal logistics.

Logistics is closely related to *supply chain (logistics chain)* which refers not only to the organization of logistics within a single enterprise or organization, but also to suppliers, manufacturing firms, wholesale and retail infrastructure.

Supply chain planning (SCP) begins with selection of partners, place, determination of storage capacity and production capacities intended for production, ways of transportation of production and creation of relevant information systems.

The supply chain ends with either the procedure of warehousing (safekeeping) or product ownership transfer. Thus, the supply chain includes control of the goods in terms of accounting and management from suppliers of components and materials on the one hand and retail point of sale on the other hand.

The idea of supply chains effective management appeared on the basis of manufacturing control concept known as *Just in Time* (JIT). At present all the large organizations and firms use the elements of this concept to some extent. Traditional approach to organization of work presupposes that stocks are an important element of the entire production system, ensuring faultless running of all operations. On the contrary, the JIT concept is based on the provision that long warehousing results from poor management and coordination of work. In a broader sense, the JIT method analyzes the problems that prevent the effective performance of foreign trade operations, for example, long lead times, unstable delivery, imbalance of operations with each other, limited capacity, equipment failure, supply of defective materials, interruptions, unreliable suppliers, too much paperwork, etc.

JIT methods reduce volume of stocks using the main schedule so as to ensure closer match between the supply of materials and the demand for them, while some reserve stock still exists in case of unforeseen problems. It's clear that the higher the degree of correspondence between supply and demand, the smaller the reserve stock required. The use of JIT concentration forces suppliers to change working methods to ensure faster deliveries, higher quality, smaller batches and absolute reliability. This ensures that the entire supply chain will operate in accordance with the same aims and principles.

*Case 27. In 1970s Harley-Davidson, the famous American motorcycle company, faced increased competition with Japanese companies: Honda, Yamaha, Suzuki and Kawasaki. Most of the previously stable companies in the industry went bankrupt. Four Japanese companies could supply their motorcycles almost anywhere in the world, with higher quality and at a lower price than their competitors. In 1978, Harley-Davidson tried to prove in court that Japanese companies sell motorcycles at dumping prices, i.e. below their cost. But during the trial it turned out that the operating costs of Japanese companies are 30% lower than those of Harley-Davidson. One of the main reasons for this was the use of the JIT concept.*

Supply chain management is the result of evolution of logistics systems and is directed at improving management of material and related information, financial flows in foreign trade from primary suppliers to the manufacturer of goods and buyers of the final product.

Modern approaches show that supply chain management is a part of the concept of *the corporate and strategic management manufacturing organizations* and the most popular definitions of supply chain management now are as follows:

– planning, execution and control of materials flows, of work in progress, of finished products, and also providing effective and fast service by obtaining operational information about goods movement;

– a complex of approaches for effective integration of suppliers, manufacturers, distributors and sellers;

– a multitude of links related to information, money and commodity flows. It begins with the purchase of raw materials from suppliers and ends with the sale of finished goods and services to the customer;

– a systemic approach to manage the entire flow of information, materials and services from raw material suppliers to plants and warehouses to the end user.

Also, researchers identify two processes that can be divided into the following groups:

– supply chain planning (SCP) that includes planning for supply chain and business processes in the individual units;

– supply chain execution (SCE) that includes realization of plans and operational management of the supply chain (for example, transport, warehousing).

In the modern world the management of the supply chain can maintain the competitiveness of the organization and increase its advantages because of the rapid development of the market, stiffening of competitiveness, the requirement to improve the quality of customer service, pose new challenges to companies. Supply chain management can optimize all the processes of value creation (from raw materials supply to servicing the end user)[38].

Supply chain management stages are shown in Table 12.

[38] Pavlov, P.V., Makarova, E.L. Supply Chain Management of the Aviation Industry Enterprise // Vestnik VSU. Series: economics and management, 2, 2017.

**Table 12**

**Supply Chain Management Stages**

| Stage | Description |
|---|---|
| **Stage 1. Traditional logistics** | Impulsive activity<br>No team work<br>No information exchange |
| **Stage 2. Multifunctional production** | Reduction of stocks in companies that belong to the production chain<br>Procurement strategies<br>Strengthening of training skills, improving the quality of work<br>Strengthening of marketing and forecasting<br>Lack of proactive coordination |
| **Stage 3. Integrated enterprise** | Focus on internal integration processes<br>Development of domestic distribution networks<br>Design team |
| **Stage 4. Joint supply chain** | Cross-boundary integration processes<br>Possible electronic information connections between several partners<br>Importance of the supply chain |

## Logistics Transport Infrastructure

Foreign trade transportation management is a necessary element of supply chain management. Cargo transportation services costs depend on many factors, primarily on the volume and characteristics of goods, on the interval, on the type of transport. Improving the efficiency of transportation of foreign trade goods can be achieved by reducing the time of passage of goods through the logistics chain. In the developed countries the total time spent on the goods movement from the primary source of raw materials to the final consumer consists of only 2-5% of the actual production time, and 95% of storage, loading/unloading and other logistics operations time. The reduction of this component provides for acceleration of the capital turnover, respectively, to increase profits per unit time, to reduce the cost of production. The second way to improve efficiency is to reduce transportation costs.

In foreign trade transportation it is necessary to resort to the services of freight forwarders. *A freight forwarder* is a person who performs or organizes the performance of freight forwarding services specified in the contract. The freight forwarder also carries out packing, marking, storage of goods, customs operations, etc. Freight forwarder services payment is usually from 1 to 5-7% of the total cost of transport services. As per the contract, the freight forwarder's duties may be performed by the carrier.

Comprehensive development of transport infrastructure is based on the standardization of sets of goods (tare), vehicles, loading and unloading machines and mechanisms. The most important problem in foreign trade is the choice of mode of transport depending on the route of delivery. This choice is determined by the capabilities of the global transport system, which is a set of all routes, transport companies and vehicles around the world. It is customary to distinguish the following main modes of transport: all-rail, road, all-water (inland water and sea), air, pipeline. Currently, the main type of transport in the world economy is maritime transport, which is characterized by high capacity of vehicles, unlimited carrying capacity, relatively low transportation costs. A comparative assessment of all modes of transport in determining the route of goods delivery in foreign trade will be shown in Table 13.

**Table 13**

**Transport Type Choice (W. Stanton)**

| Type of transport | Choice criteria | | | | | |
|---|---|---|---|---|---|---|
| | Speed | Level of costs | Range of goods | Considerations for goods | Number of markets served | Reliability of delivery |
| All-rail | middle | middle | widest | most convenient for many products | large | middle |
| All-water | lowest | lowest | wide enough | most convenient for a large number of products | limited | low |
| Road | high | high | middle | goods with high price in a short time | unlimited | good |
| Pipeline | low | low | very limited | liquid and gaseous | very limited | high |
| Air | highest | highest | partially limited | expensive and perishable products | above the average | middle |

Traditionally, *maritime transport* plays a strategically important role in the economic development of countries, maintaining their military and political role. More than 60% of the cargo in international turnover is transported by sea.

For many countries sea transportation is the main branch of economy, connecting them with the whole world (Japan, New Zealand, Australia, Indonesia, etc.). Transportation of goods by sea is the only option for the delivery of goods to some territories. More than half of the world's states (120 countries) have access to the sea with equipped ports.

Sea transportation can be used for all categories of cargo – liquid, granular, fragile, solid, and goods that require special treatment when moving. For these purposes, shipbuilders have developed specialized sea transport – lighters, tankers, barges, refrigerated vessels LO-RO, RO-RO, etc.

The average range of maritime transport is much higher than that of other modes of transport. Today it is about 3.5 thousand km.

Thanks to Suez and Panama canals long-distance sea transportation of goods is now several times reduced by the length of sea routes.

The main points on the map of international maritime transport are Southeast Asia and its adjacent states: China, India, Japan, which are among the most densely populated regions with intensive economy. For the states of this region, sea transportation is the most affordable and profitable.

*The main types of ships:*

– Cargo container ships, designed for transportation of products in containers of standard sizes;

– RO-RO (Roll-On/Roll-Off ferries) is a category of vessels for the transportation of cargo that can be unloaded horizontally. Such vessels are used mainly for sea transportation of cars, trailers, container ships with semi-trailers and goods equipped with euro-pallets, with roller forklifts required when loading and unloading. The RO-RO design and appearance makes them very similar to ferries, but without the living space;

– A lighter is a category of vessel specially designed for transportation in lighters (one of the varieties of non-self-propelled sea barge used for transportation by means of a towing vessel). Lighter vessels are very efficient in the mixed, sea-river cargo movement. Heavy load lighters with shallow draft can be towed on shallow rivers and canals over long distances inland;

– A bulker is a vessel intended for transportation of bulk cargoes (cement, coal, ore, grain and other dry bulk cargoes that can be transported without packaging). The construction of the bulk carriers consists of several high capacity holds with special covers;

– Dry cargo ship is a category of ships used for the transportation of piece products in packages without special conditions, and therefore considered as general cargo. In practice, dry cargo is used for transportation of heavy and small cargoes. The design of bulk carriers is similar to bulk carriers, as there are also holds with special hatches. The difference between dry cargo from bulk carriers is the presence on the deck of its own loading and unloading crane manipulator installed directly on the deck;

– A tanker is a large ship used for transporting liquid cargo (chemicals, petroleum products, liquefied gas, wine and even grout). For loading and unloading of goods on tankers, a special pumping system is used, and there are tanks for the transported cargo. The main part of tankers for transportation of liquid cargoes is universal, which makes it possible to transport various liquid cargoes at the same time;

– Highly specialized vessels include gas carriers with spherical cargo spaces that rise above the deck of the vessel. They are endowed with the necessary technical characteristics and are able to maintain a high level of pressure.

*According to their size, vessels are divided into:*

– Handysize: bulk carriers with deadweight ranging from 10,000 to 50,000 tons;

– Aframax: tankers for oil products with capacity from 80,000 to 120,000 tons. Aframax class tankers are commonly used in the Black, North, Caribbean, Chinese and Mediterranean seas;

– Suez-max vessels, which can pass the Suez canal fully loaded. The deadweight of such a vessel is approximately 150,000 tons with a length of 285 meters and a width of 35 meters. The maximum draft of such a vessel is 23 meters;

– Panamax: a vessel with a deadweight of up to 75,000 tons, which, when fully loaded, can pass the Panama canal;

– Capesize: the ship (usually the bulk carrier), the dimensions of which exceed dimensions necessary to pass the Panama canal;

– VLCC (Very Large Crude Carrier): a tanker with a capacity of up to 300,000 tons.

– ULCC (Ultra Large Crude Carrier): a tanker with a capacity of more than 300,000 tons.

The total length of *the railway tracks* of 42 main countries of the world exceeds 915 thousand km, about 5 billion tons of cargo are transported annually, 1/3 of them in international traffic. The United States ranks first in the length of the railway (176 thousand km), followed by Russia (85.2 thousand km total length, 43.3 thousand km electrified lines length. With high-speed railways the situation is different. China is the undisputed leader here, with a long-term program for the development of the railway network since 2008 until 2020. By 2014, 13,750 km of the planned 16,000 km of expressways had been put into operation, i.e. the decision to accelerate the implementation of the planned indicators had been in effect implemented 5 years earlier. High-speed trains travel fees in China are lower than in similar trains in other countries. This is due to the high intensity of high-speed communications, the large population of high-speed trains, and relatively low base cost of construction and operation of high-speed railways. As far back as 2008, high-speed lines accounted for only 6% of trips in China, in 2013 the share of these trips soared to 79% (Fig. 18).


*Fig. 18 – A high-speed train in China*

In recent years, international road transport has been characterized by an increase in traffic and fleet. Road transport is inferior to sea and railway transport in terms of cargo turnover, due to the small distances of transportation.

The total length of the road network in the world exceeds 23 million km. One third of the roads is in North America, one quarter – in Western Europe. Transcontinental roadways play the key role. For example, these are the highway through the Sahara Desert in Africa, the road from the Atlantic to the Pacific across the United States, the Pan-American Highway connecting North and South America, and a number of others.

International road transport is highly mobile. They make it possible to deliver goods to any point where there is a road. Automobile transport combines well with other types of transport. Meanwhile, inside Russia, the car remains a short-range transport. According to statistics, the average range of transportation of 1 ton is less than 50 km. Basically, it is delivery from sea ports or railway stations. Transportation over long distances is unprofitable due to high costs and limited cargo space.

*Air transport* plays an extremely important role in the global economy as one of the most profitable industries. Civil aviation creates a “snowball” effect, which is that every $ 10 billion consumed by airlines, accounts for $ 15 billion spent by supplier industries. It provides not only the development of a complex of industries, but also stable employment for a large number of employees. Air transport is used mainly for transportation of perishable and unique goods. Its undeniable advantage is speed. This is the only way to quickly transport the goods over a long distance.

The aircraft fleet is most significant in the USA, Canada, France, Germany, and Australia. The scheme of the turnover has more than 1 thousand airports around the world.

Three regions are distinguished by the size of demand for air transportation and traffic intensity: the USA, Western Europe and East Asia, which together account for 2/3 of the world’s cargo and passenger turnover. The USA is the leader in air transportation. The number of cargo annually transported by air ways is in the range of 3-4.5 million tons. In contrast to other Western countries, the bulk of air traffic is on domestic routes. The greatest concentration of airlines falls on the North-East and the Midwest – the Pacific coast of the United States.

The airspace of Europe is extremely saturated with air routes. This region accounts for more than 1/4 of the world cargo turnover and 1/5 of passenger turnover. The region of East Asia, including Japan, China, Singapore, Thailand, Indonesia, provides up to 1/5 of cargo and passenger turnover in this industry.

In recent years, the role of *pipeline transportation* of gas, oil and oil products in the national economy and the world economy has increased dramatically due to the remoteness of production sites from consumption areas, the complexity of the structure of oil and gas transportation systems.

It is also important to rank the factors during transportation in different range zones. In general, for consumers of transport services, the factor of timely delivery is in the first place. However, when the delivery distance is less than 100 km, it is followed by the factor of compliance with the schedule; with the range from 100 to 500 km the factor of low transport costs is in the second place; at a distance of more than 500 km – the factor of delivery speed is crucial.

Depending on the quality difference of transport products (transportation of goods and passengers), two main branches of transport production can be distinguished: *freight and passenger transport.*

Depending on the frequency of delivery of goods or the form of organization of the transport process, there are two main categories of transport – *regular and irregular*. Initially, this division was formed in maritime transport, where regular transportation was called linear, and irregular was called tramp. The liner vessel commutes on the established route according to the schedule. The transportation fee is determined according to the fixed tariff. A tramp vessel is a chartered vessel ready to carry any cargo in any direction. The freight charge for the vessel varies according to the agreement between the ship owner and the charterer.

By the number of types of transport involved in the delivery of goods, transport systems are divided into *single-type (unimodal)* and *multi-type mixed (multimodal or intermodal)*. Single-type system, despite the external simplicity and widespread character, complicated in foreign trade due to the operation of vehicles and road trains of different capacity at the stages of selection of goods, the formation of larger shipments, especially in the terminal system. The intermodal system is a more complex option in foreign trade transport in terms of solving commercial, legal, financial, economic, organizational and technical aspects of delivery and development of transport infrastructure. Intermodal system is a system of goods delivery by several types of transport under a single transportation document with their transshipment at certain points without the participation of the cargo owner.

Intermodal organization of cargo transportation consists in the creation by the operators of container cargo transportation of integrated transport systems, through which goods are transported in integrated standard cargo areas in mixed traffic with the participation of different modes of transport, the work of which is strictly coordinated and interrelated. The main objective of integrated transport systems is to speed up, reduce the cost and simplify the process of movement of goods in large cargo spaces (in containers and trailers) from the manufacturer to the consumer on the "door-to-door" option.

Thus, international intermodal transport, in contrast to the traditional transport system (unimodal transport), has the following characteristics:

– participation of at least two modes of transport;
– point of departure and destination of goods are in different countries;
– one of the participants of transportation (operator) organizes the whole process of transport on a single document and is responsible for the safety of goods from the place of dispatch to the destination;
– goods are transported mainly in containers, trailers and pallets.

Due to the complexity of foreign trade operations in foreign trade, outsourcing has become widespread. *Outsourcing in logistics* is the transfer of control over the distribution of cargo flows from manufacturers to specialized firms. This trend first manifested itself in the 1980s, initially in Western Europe, Japan, and later in the USA, and is still present. Large and medium-size enterprises are increasingly inclined to purchase holistic logistics solutions. This allows them, firstly, to use the extensive experience of specialized logistics firms in the distribution of products, and secondly, to focus more on their core business – production, development and promotion of their products, and, thirdly, to reduce their overhead costs. Thus, they manage to use the skills and experience of the logistics company to improve their own efficiency.

## Basic Delivery Terms: INCOTERMS 2010

In any trade transaction, the movement of goods from the seller to the buyer, from the moment the goods leave the factory or workshop to the moment of transfer into the hands of the seller, i.e. before the buyer takes possession of the goods, involves a number of responsibilities of both parties and involves risks that must be properly reflected in the text of the contract.

There may be certain difficulties affecting the results of the contract. According to the accepted terminology, the conditions on the basis of which the price of the goods under the contract is established are called *basic conditions*. On their basis the obligations of the parties to the transaction (the seller and the buyer) are determined.

It is clear that the price of the goods will be lower if the buyer exports the goods from the factory warehouse, and, accordingly, higher if the seller undertakes to deliver the goods to a certain place specified by the buyer.

In any case, the price of the goods is paid by the buyer, but depending on where the goods are delivered, the risk of damage or loss, as well as cargo insurance will be charged to either the seller or the buyer.

Since there may be differences between the seller and the buyer in the understanding of the obligations of each party in the performance of the contract, the same, universally accepted interpretation of the contract's provisions with respect to obligations and risks is essential. An application of

International Commercial Terms (INCOTERMS) or Rules of international trade terms interpretation is often there in contracts for the international sale of goods.

These rules were first prepared and published by the International Chamber of Commerce (ICC) in 1936. Later, they were refined and amended in 1953, 1967, 1976, 1980, 1990 and 2000. Currently, the version of the Regulations 2010 “INCOTERMS 2010” is valid. These Rules establish a common interpretation of the basic rights and duties of the parties under different basic conditions, as a result of which the terms included in the INCOTERMS, are often understood as the basic terms of delivery of goods. However, strictly speaking, this is not entirely accurate. The interpretation of the basic conditions given in INCOTERMS is not obligatory, but recommendatory. And if the seller and the buyer agree to follow the INCOTERMS, they must make an appropriate entry in the contract, i.e. to fix a clear intention. The absence of such a record does not mean the absence of basic terms of the contract, since the problem of establishing a basis of price, distribution of responsibilities and risks is one of the most important in the conclusion of the contract. Moreover, if the contract provides a different understanding than INCOTERMS of the specific underlying conditions, the provisions of the contract shall prevail.

Thus, the basic terms of the contract are essential, while INCOTERMS (or other interpretations) are the form in which this essence is implemented in practice.

The rules of interpretation of international trade terms INCOTERMS consist of groups E, F, C and D, which are used to summarize 11 terms. To understand the logic of INCOTERMS construction it is necessary to keep in mind that the seller and the buyer are located in different countries, therefore, as a rule, in different customs spaces.

The details of INCOTERMS are given in Table 14.

**Table 14**

## The Rules of Interpretation of International Trade Terms INCOTERMS

| Designation | Interpretation | Brief description of the terms of the group | Packing | Loading on the vehicle | Delivery to the main carrier | Export formalities | Basic transporta-tion insurance | Loading on the main transport | Payment for the main transport | Discharge | Import formali ties | Delivery from the main transport | Unloading at the buyer's warehouse |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | 2 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 |
| EXW | Ex Works | The seller transfers the goods to the buyer directly at the enterprise | SO* | BO** | BO | BO | BO | BO | BO | BO | BO | BO | BO |
| FAS | Free Alongside Ship | The seller must deliver cargo carrier selected by the buyer | SO | SO | SO | SO | BO | BO | BO | BO | BO | BO | BO |
| FOB | Free on Board | | SO | SO | SO | SO | BO | SO | BO | BO | BO | BO | BO |
| FCA | Free Carrier | | SO | SO | SO | SO | BO | BO | BO | BO | BO | BO | BO |
| CFR | Cost and Freight | The seller is responsible for shipping, but not for its loss, damage, or additional costs incurred after sending | SO | SO | SO | SO | BO | SO | SO | BO | BO | BO | BO |
| CPT | Carriage Paid to ... | | SO | SO | SO | SO | BO | SO | SO | BO | BO | BO | BO |
| CIF | Cost, Insurance & Freight | | SO | SO | SO | SO | SO | SO | SO | BO | BO | BO | BO |
| CIP | Carriage & Insurance Paid to ... | | SO | SO | SO | SO | SO | SO | SO | BO | BO | BO | BO |
| DAT | Delivered at Terminal | The seller must bear all costs and all kinds of risk, arising along the route of the cargo, up to its delivery to the country of destination | SO | SO | SO | SO | SO | SO | SO | BO | BO | BO | BO |
| DAP | Delivered at Place | | SO | SO | SO | SO | SO | SO | SO | SO | BO | SO | SO |
| DDP | Delivered Duty Paid | | SO | SO | SO | SO | SO | SO | SO | SO | SO | SO | SO |

** SO – Seller's obligations; ** BO – Buyer's obligations*

An exception applies to the cases when two or more countries belong to the same integration grouping, for example, a free trade zone or a customs union, in which duties and other customs fees are abolished when goods are moved from one country-member of the integration grouping, to another country-member of the same integration grouping.

The presence of two customs borders should be taken into account in the distribution of responsibilities and risks of damage or loss of goods during their movement from the seller to the buyer. Therefore, the transportation to the customs border of the seller, the main transportation, and transportation after the customs border of the buyer are different.

Principally, there are two opposite ways of delivering goods to the buyer: a) with minimal cost for the seller (and, consequently, the maximum cost for the buyer) and b) with the maximum cost for the seller (and, accordingly, the minimum cost for the buyer), which, of course, will be reflected in the base price that the buyer will have to pay for the goods.

Between these two extremes there is a variety of combinations, depending on where the duties of the seller end and the duties of the buyer begin, whose duty will be to clear the goods at the customs border of the seller and the buyer, which party will insure the goods, what type of transport will be delivered to the buyer, etc.

INCOTERMS is not an international treaty. But in case of reference to the basis of delivery of INCOTERMS in the contract, various state bodies, primarily customs, as well as state courts, considering foreign economic disputes, are obliged to take into account the provisions of INCOTERMS. In some countries, INCOTERMS have the force of law and this is especially important when concluding supply contracts with residents of these countries, in terms of determining the applicable law to the transaction. For example, when signing a contract for the supply of goods between a Russian company and a Ukrainian company in determining the applicable law – the law of Ukraine, the INCOTERMS is subject to mandatory application even if it is not specifically stipulated in the contract. Therefore, having made a deal with partners from these countries and not wishing to be guided by INCOTERMS, this circumstance should be specifically stipulated. In Russia the INCOTERMS is advisory and only provisions of the contract with reference to INCOTERMS have legal effect. But, if the contract refers to the basis of delivery under INCOTERMS, but other points of the contract are contrary to the terms of delivery under INCOTERMS used, the relevant paragraphs of the contract and not INCOTERMS shall apply: it is considered that the parties have established certain exceptions to INCOTERMS in the interpretation of individual bases of supply.

When choosing a basis of supply the INCOTERMS terminology must be strictly adhered to. In applying a term, it is necessary to specify a geographical location (and sometimes the exact location, as in the case of *Ex Works* delivery) where the seller is deemed to have fulfilled its obligations to transport the goods, to bear the risk of accidental loss of or damage to the goods, etc.

It's obligatory to refer to the version of INCOTERMS.

When entering into a foreign economic contract, it is necessary to clearly define the details of the basic terms of delivery, i.e. before you can specify in the contract the basis of delivery you must carefully examine the customs of the port specified in the basis, charter contract, to ensure accurate allocation of costs between buyer and seller. All delivery bases that require the seller to provide insurance in the event of insured events are covered by insurers on minimum conditions (cost of goods + 10%).

INCOTERMS rules only indicate which party to the contract of sale must perform the necessary actions for transportation and insurance, when the seller transfers the goods to the buyer, and what costs are borne by each party.

INCOTERMS rules do not indicate the price or method of payment to be paid. They also do not regulate the transfer of ownership of the goods or the consequences of a breach of contract. These issues are usually defined in explicit terms in the sales contract or in the law applicable to such contract. The parties should, however, bear in mind that strictly binding national law (*mandatory local law*) may have an advantage with respect to any aspect of the contract of sale, including the chosen term INCOTERMS.

Eleven rules INCOTERMS 2010 can be divided into two separate groups (see Table 15).

**Table 15**

**Application of Delivery Conditions Depending on the Type of Transport**

| **Rules for any mode of transport** | |
|---|---|
| EXW | Ex Works |
| FCA | Free Carrier |
| CPT | Carriage Paid to |
| CIP | Carriage and Insurance Paid to |
| DAT | Delivered at Terminal |
| DAP | Delivered at Place |
| DDP | Delivered Duty Paid |
| **The rules for sea and inland waterway transport** | |
| FAS | Free Alongside Ship |
| FOB | Free on Board |
| CFR | Cost and Freight |
| CIF | Cost, Insurance and Freight |

The first group includes seven terms that can be used regardless of the mode of transport chosen and whether one or more modes of transport are used. They can be used even if there is no maritime transport at all. However, it is important to remember that these terms can be used when a vessel is used for carriage in part.

In the second group of INCOTERMS 2010, both the point of delivery and the place to which the goods are transported by the buyer are ports. The last three terms omit any reference to the ship’s rail as the point of delivery, because the goods are deemed to be delivered when they are “on board” the ship. This more closely reflects modern commercial reality and excludes any idea about the risk transferring to and fro relatively to imagined perpendicular line.

**Topic 7 Review Questions**

1. Define the concept of *logistics*, specify its components.
2. What is the JIT system and what are its principles?
3. What are the main requirements for the supply chain management process?
4. Describe the stages of supply chain management.
5. What are the main criteria for choosing a type of transport according to W. Stanton?
6. List the main characteristics of sea, rail, air, and road international transport.
7. What is INCOTERMS and why are they used?
8. List the basic terms of supply INCOTERMS 2010.
9. What are the obligations imposed on the seller and the buyer by basic supply conditions?

# TOPIC 8. PRICING IN INTERNATIONAL BUSINESS

## Fundamentals and Features of Pricing in Global Market

In today's global business environment, competition between companies in both domestic and foreign markets is increasing. In these conditions, determining the price of products plays a very important role for survival in the competitive struggle. Improper pricing can lead to very dramatic consequences, including the company's withdrawal from the market. It should be borne in mind that there are many different factors that influence the pricing in international business. This leads to price differences in countries around the world, as well as the need to develop a specific pricing policy when the company enters foreign markets.

In analyzing the processes associated with pricing in world commodity markets, it is necessary to carefully study all the factors that influence pricing, both of a general nature and purely applied ones. Prices determine which costs of manufacturers will be reimbursed after the sale of goods, and which will not; they determine the level of income, profits, and where (and whether) resources will be allocated later, whether incentives will arise for further expansion of FEA.

For a number of reasons pricing in foreign markets differs from pricing at the national level. First, it is necessary to take into account the wide variety of markets, in which demand and supply have different characteristics. Secondly, it is impossible to avoid price escalation when exporting due to possible additional costs in its implementation, although with a certain strategy of the company the price may decrease. Finally, the main difference between prices set at the international level and national ones is the influence of external factors in relation to the interaction of sellers and buyers of goods (services).

First of all, we are talking about differences in the state regulation of prices in the domestic market. In a number of countries, retail prices are subject to control; in particular, price limits are set for the sale of strategic goods, such as food or fuel. In addition, domestic prices can be regulated through single purchase prices or, in general, purchases of surplus goods in order to maintain a stable market situation (often used in agriculture), or to provide subsidies to national producers to increase their competitiveness compared to importers.

Country customs policies also lead to price differences. The customs policy includes both tariff (customs duties) and non-tariff methods of trade regulation. The level of customs protection in many types of products in developed countries is significantly lower than in developing countries.

The currency factor is also essential for pricing. In particular, prices for hamburgers in *McDonald's* are different in the USA, China and Russia. However, this may be associated not so much with demand, with different productivity and cost of ingredients, but with the monetary policy of countries. By lowering the exchange rate of the national currency, states can promote the development of exports, on the one hand, and worsen the position of importers on the national market, on the other. High exchange rate of the national currency, on the contrary, can become an obstacle to the development of export supplies, as well as reduce the demand for domestically produced goods.

Another important factor affecting prices is inflation. Thus, inflationary processes in countries around the world lead to higher prices. However, we must not forget about the cyclical nature of price fluctuations. Another significant characteristic of FEA is the participation of intermediaries, as well as country differences in the behavior of distributors, which affects pricing, etc.

In a market economy, pricing in foreign trade, as well as in the domestic market, is influenced by a specific market situation. Principally, the very concept of *price* is similar to the characteristics of both the domestic market and the external one. The price, including international trade, is the amount of money that the seller intends to receive by offering a product or service, and which the buyer is willing to pay for this product or service. The coincidence of these two requirements depends on many conditions, called pricing factors. By character, level and scope, they can be divided into five groups listed below.

*Economy-wide pricing factors* – operating regardless of the type of product and the specific conditions of its production and sale:

- economic cycle;
- state of aggregate demand and supply;
- inflation.

*Economic pricing factors* – determined by the characteristics of this product, the conditions of its production and sale:

- costs;
- profit;
- taxes and fees;
- supply and demand for a specific product or service, taking into account interchangeability;
- Consumer properties: quality, reliability, appearance, prestige.

*Specific* – valid only for certain types of goods and services:

- seasonality;
- operating costs;
- completeness;
- warranty and service conditions.

*Special* – associated with the action of special mechanisms and economic instruments:

- government regulation;
- exchange rate.

*Noneconomic*:

- political;
- military;

– religious;
– ethnic, etc.

Prices are determined by the conditions of competition, the state and the ratio of supply and demand. However, the pricing process has special features in the international market.

For example, it is known that the relationship between supply and demand in the world market is felt by foreign trade subjects much more acutely than by the suppliers of products in the domestic market. A participant in international trade faces a larger number of competitors in the market than in the domestic market. Ongoing monitoring of the world market is necessary to constantly compare production costs not only with domestic but also with world market prices. Manufacturer, who is at the same time the seller of goods in the foreign market, is in constant "price stress". Firstly, this is because the international market has significantly greater number of buyers. Secondly, within the world market, production factors are less mobile. No one will dispute the fact that the freedom of movement of goods, capital, services and labor is much lower than in the framework of one particular state. Their movement is constrained by national borders, relations in the monetary sphere, which counteracts the alignment of costs and profits. Naturally, all this cannot but affect the formation of world prices.

*World prices* are the prices of large export-import transactions made on world commodity markets, in the main centers of world trade. The concept of a *global commodity market* means a set of stable, recurring transactions for the purchase and sale of these goods and services that have organizational international forms (exchanges, auctions, etc.) or expressed in systematic export-import transactions of large firms – suppliers and buyers.

In world trade, factors affecting market prices primarily include the state of supply and demand. In practice, the price of the proposed product is affected by:

– the effective demand of the buyer of this product, i.e. the availability of money;

– demand volume, i.e. the amount of goods that the buyer is able to purchase;

– usefulness of the product and its consumer properties.

On the supply side, constituent pricing factors are:

– the quantity of goods offered by the seller on the market;

– costs of production and circulation in the sale of goods on the market;

– prices for resources or means of production used in the production of the relevant product.

A common factor is the substitutability of the goods offered for sale with another product that satisfies the buyer (substitute product). The level of world prices is influenced by the currency of payment, the terms of settlement and some other, economic as well as non-economic factors.

In the world market, there are cases of "distortion of supply and demand ratio". In the case of a huge demand for certain goods, there is a possible situation when goods produced in the worst conditions will be thrown onto the market at the national price, which in essence will for some time determine the world price, and will certainly be very high. And vice versa, often supply significantly exceeds demand. Then goods produced in the best conditions sell best, and at lower prices.

When working with market prices, including foreign trade, one should take into account the differences in them, taking into account the positions of individual parties and the market situation. First, there are notions of the seller's price, i.e. the price offered by the seller, and therefore relatively higher, and the buyer's prices, i.e. price from the viewpoint of the buyer, and therefore relatively lower. Secondly, depending on market conditions, there is a seller's market, where the seller dictates the commercial indicators and prices due to the prevalence of demand, and the buyer's market, where the buyer prevails and the price situation is opposite. But this market situation is changing all the time, which is reflected in prices. This means that it must be subject to constant observation and study. Otherwise, very serious pricing mistakes may occur.

In the past two or three decades, an important role in the pricing of goods, especially in world trade, has been played by the related services provided by the manufacturer and supplier of a product to the importer or end user. We are talking about the generally accepted terms of delivery: maintenance, installation supervision, warranty repairs, other specific types of services related to the promotion, sale and use of goods. This aspect is especially important in modern conditions, in the period of development of high technologies, and the complexity of machinery and equipment. There are examples when the cost of services for the export of equipment and machinery was 60% of the price of delivery.

The advance of science and technology, influencing the improvement of the quality characteristics of a product, on the other hand, affects world prices. The introduction of new technologies improves productivity, production efficiency, reduces labor costs. In terms of scientific and technological revolution in absolute terms, the price rises for almost all groups of goods. However, taking into account the beneficial effect (for example, speed increase, reliability, etc.), the relative cost of the product, and hence its price to the consumer, decreases.

When analyzing prices, one should also take into account the movement of the economic cycle, which has certain specific features in the sphere of international economic relations. So, in a recession prices do not rise, as a rule. And, on the contrary, in the stage of recovery in connection with the excess of demand over supply prices increase. However, both trends spread to international trade slowly, depending on the scope and depth of these phenomena, especially in the phases of crisis and recovery. It should be noted that the dynamics of price changes depends on the type of goods and product groups. So, when the conjuncture changes, there happens the most dramatic and quick rise of prices of almost all types of raw materials; the response of manufacturers and suppliers of semi-finished products is slower, and the machine-building complex reacts even weaker.

### Pricing in Global Commodity Markets of Various Types

In a market economy, the pricing process in trade between foreign economic entities of different countries is carried out in a competitive environment, in conditions of dynamic balance between supply and demand, and comparative freedom of behavior in the market of the exporter and importer. However, these postulates require certain reservations depending on the type of market. The main criterion for the classification of markets, including world markets, is the nature and degree of freedom of competition of sellers. By this criterion economists distinguish four types of ***seller's markets***:

- perfect (pure) competition;
- pure monopoly;
- monopolistic competition;
- oligopolies, i.e. competition of a few suppliers.

First of all, these markets differ in the number of traders, which greatly affects the pricing mechanism.

*The market of perfect (pure) competition* is characterized by a very large number of subjects of foreign trade (buyers and sellers) and the relatively homogeneous nature of the products supplied. Under the influence of supply and demand, prices tend to converge, i.e. in this region in this time period, prices are almost the same. According to practical observations, in the conditions of this market model, the desire of each exporter to obtain maximum profit leads to a decrease in the price of goods. To maintain its position in the market, the exporter resorts to not too significant 3-5% discounts. The exporter's gain is due to increasing volumes of supplies.

It has been observed that in the market of perfect competition, product suppliers (they can be both the manufacturers-exporters and their sales agents) strive to maximize the satisfaction of consumer demand. Competing supplier firms are oriented towards products produced using more efficient technologies and manufacturers are oriented towards the sale of goods at a fairly low price, taking into account their production costs.

In practice, this type of market (with a certain reserve) includes, for example, international trade in various consumer goods – clothing, footwear, tobacco, agricultural products, including food, etc.

*The market of pure monopoly* is characterized by the presence of a single supplier of goods. Pricing in this case is dictated by the monopolist, who controls all the offers, varies prices depending on demand and can cause price changes, manipulating the volumes of products produced, obtains the exclusive right to supply its products in foreign markets in advance, and this makes it harder for the competitor to enter the market.

The monopolist, by virtue of the very nature of this market, seeks to set prices for the goods at the highest level according to the method of full costs, including production costs and desired (for the manufacturer) profits. There are, however, certain attitudes which the monopolist has to adhere to. So, despite the sole presence in the market, the monopolist, as a rule, does not assign the highest price to the product, because then the total profit may ultimately be less. There happens, however, such an optimal selection of production volumes and prices dictated by a monopolist, that total income is as high as possible, but still it will be lower than the maximum profit per unit of output. There is a concept of *price discrimination*, which means that the monopoly supplier of goods to the international market varies the price of the goods supplied depending on the importing country, more precisely on the financial possibilities of the importer. However, it is always taken into account whether further re-export of this product is possible. Discriminatory prices are usually set in isolated markets that exclude re-export.

Currently there are relatively few pure monopolists in the world. Between the 1970s and 1980s, the USA acted as a pure monopolist on the global space market through National Aeronautics and Space Administration (NASA), which completely controlled commercial launches (The USSR, for reasons not completely understood, was missing from this market). *De Beers* is almost a pure monopolist in the diamond market.

*The market of monopolistic competition* is a mixed type of market. It sees, as a rule, a number of large monopolists and a significant number of less strong firms, but they occupy a prominent place. The nature of pricing is competitive, with the priority of monopolism within the differentiated brand product market.

The dominance of one country’s large firms in the individual goods market is weakened by the pressure of large monopolistic firms of another country, as well as more “lightweight” competitors seeking their share of high profits. In the case of price inflation by monopolies, there are always competitors who can offer better deals, i.e. the best prices.

Competition of monopolies representing different industries, offering goods with different merchandising characteristics and different physical properties, but used for the same purpose, has a significant impact on prices. As an example, there can be a competition between manufacturers – suppliers of metal and plastics to automobile manufacturing concerns. When pricing, the competition of goods replacing traditional ones in their qualities is also taken into account. For example, companies in Australia and England, traditionally supplying wool to the world market, are faced with serious competition from manufacturers – suppliers of chemical fibers.

*The market for the competition of a few suppliers (oligopolistic)* is characterized by the presence of several large manufacturing companies-suppliers with significant market segments that fully or almost completely ensure the supply of goods to the world market. Between firms and importing countries, as a rule, there are agreements on cooperation (spheres of influence are separated), often firms have exclusive rights to purchase strategically necessary raw materials, invest huge sums in promotional activities.

The practice of pricing for the supplied products shows that any major decision made by the exporter: setting prices, determining the volume of production, purchases, investments, etc., requires weighing the likely reaction of competitors. An important role in terms of preserving the status-quo by companies is played by informal agreements of major competitors that are not advertised to the general public. In the course of special negotiations, agreements are reached on price fixing, on the division of sales markets, and on production volumes.

The need for relative coordination of activities in the global market has led companies to create special mechanisms by which they could operate with a greater degree of predictability. The simplest form of such a mechanism is a cartel, under which a formal written agreement on production and pricing is prescribed. Companies agree on the distribution of markets in order to maintain agreed price levels. The most famous cartel, which until recently regulated the world oil market, was the Organization of the Petroleum Exporting Countries (OPEC). For a long time, this cartel managed to quite successfully coordinate oil markets.

For companies involved in such mechanisms, there is a tendency to maximize profits, i.e. their behavior to some extent resembles the action of pure monopolies. The magnitude of the impact of the subjects of the oligopolistic market on the price level depends mainly on the degree of monopolization of the market, on the intensity of control over the production and sale of goods, on sources of raw materials and other equally important factors. It is noted that the higher the degree of monopolization, the higher the level of monopoly prices and the more moderate their fluctuations are.

***Buyer's market.*** As in the case of a similar factor for the seller, four variants of the balance of forces are theoretically possible in the buyer's market. They are usually defined as monopsony, oligopsony, monopsony competition and perfect competition of buyers.

*Monopsony,* or monopoly position in the market of one buyer, all other things being equal, implies a restriction of demand and lower prices. As in the case of a monopoly, a monopsony is rare in the world market.

*Oligopsony* or the presence on the world market of several (from 2 to 10) very large buyers; this suggests two possible scenarios: collusion and, therefore, a likely decrease in demand and prices or increased competition in the absence of collusion and, therefore, a possible increase in prices. The probability of collusion in a monopsony is large enough, but the collusion will be, in any case, temporary.

*Monopsony competition* (tens or even millions of buyers of different strengths) assumes as the most likely scenario (other things being equal) the growth of demand and prices, since it is difficult to reach an agreement, but in the case of a temporary agreement, which is much less likely, there may be a decrease. In addition, here you should not forget about antitrust policy.

And, finally, the *perfect competition of buyers,* as well as a similar option for the seller's market, is a phenomenon more from the realm of theory rather than practice. However, if such a market existed, then, other things being equal, it would rather correspond to the stabilization of prices.

At the same time, pricing in the markets for machinery and equipment is a process that significantly differs, for example, from pricing in the markets for raw materials and semi-finished products, and the analysis of pricing for specific products supplied to the international market is difficult due to differences in design, diversity of equipment, etc. Nevertheless, suppliers of similar products to the world market have a certain idea of competitor prices. As a rule, the price level reflects the specific production costs with the addition of a certain percentage, taking into account the specific sales market, partner, region, etc.

## Foreign Trade Pricing: Practice and Methods

Any company or organization that determines the prices of its products takes as a starting point certain economic indicators: internal (own costs or profits) or external (level of demand or prices of competitors). Accordingly, pricing occurs in different ways, which in turn suggests that there are different basic pricing methods.

*A. Cost-based pricing (cost plus method)* is the most important basic method today, the most popular in the world. The starting point for the formation of prices here are the costs per unit of products produced by the company. In a market economy, it is assumed that the company builds pricing in the following way: its own costs per unit of output are considered and the desired profit is also added per unit of output. With this general approach, pricing is subject to the maximum influence of internal factors for the company.

The advantages of this method are: simplicity, break-even character, the ability to plan the profit, price transparency (that is, the ability to clearly see all the components of the price). However, this method is not focused on demand. In addition, this is an inflexible method, it does not allow to compete, since we do not pay attention to the prices of competitors. It does not stimulate cost reduction, is not aimed at updating and expanding the range (new products are introduced cautiously, because the price for them, formed with the help of this method, turns out, as a rule, very high in comparison with the company’s traditional goods).

This method can be used in the secondary (manufacturing industry) and tertiary sectors (services sector, including engineering services, trade and other services) and, to a somewhat lesser extent, in the primary sector (extractive industries and agriculture); it is also actively used on monopolistic market, with oligopoly (with collusion), with the state order, i.e. with a guaranteed solution to the problem of demand.

*B. With the target profit method (break-even)* the price is formed from the total target profit that the company wants to receive. Thus, the main generating element of the price is profit. A feature of the method is a multi-stage pricing. First the rate and amount of profit are determined. Then they consider several options for possible sale prices: usually three to five price options. Competitors' prices are analyzed; if there is no such product in this market, the price is determined on the basis of experience in past markets; if there is no such experience, then we determine the price based on the prices of similar products (for example, other sweets in this market).

Next comes the calculation of break-even shipments of goods at given prices, i.e. the value of the consignment of goods that provides the planned profit. The next stage is the most difficult and expensive; it requires maximum attention and taking into account various factors: determining the probability of selling each of the break-even parties. To do this, we determine the total market capacity; we find out effective demand; we look at the age and sex market structure; we determine the economic development of the region, the state of its economy; consider seasonality; we estimate competitors; we determine the specifics of state regulation (certificates, licenses, etc.), etc. Based on this analysis, we choose the price at the highest probability. Finally, knowing the price and volume of the break-even batch, we determine the costs.

Thus, the price covers the costs (break-even point), and we can also plan the amount of profit and ways of its distribution. In addition, this method is more focused on demand and competitors; it is more flexible (due to several price options) and more effective in competition. It creates incentives to reduce costs, it is transparent, although less than the cost method. The disadvantage of the break-even method is that it requires a significant investment of time and money. The method is complicated, and because of its complexity it is difficult to update the range. It is most often used in the secondary and tertiary sectors, but it is not very popular.

*C. Pricing based on demand*. According to a number of experts in the West, this method is considered the most suitable for use in a market economy. But in practice this is not always so. Here, the price is tied to the demand and its dynamics (we proceed only from changes in the demand for our own products). If the demand for products increases, then the price should rise, and, on the contrary, if demand decreases, the price should also decrease. This method in practice is one of the least popular, although it is used more often than the target profit method.

The practical difficulties of applying the method are as follows. Firstly, it is the absence of the start price. Solution: in case of a mistake, you can correct it the following day by changing the price. Secondly, there are no standards for price increase (it is impossible to constantly increase the price based on the volume) and recommendations for the degree of price change depending on the degree of change in demand. Solution: if we constantly adjust the price, then we empirically determine the elasticity index of demand, if we increase the price, the demand drops, and vice versa, then over time we will have experience, our own algorithm, we feel how much we need to raise the price so that it does not cause demand fall. But in practice, the accumulation of experience with frequent mistakes can lead to adverse consequences. Finally, it is difficult to get the buyer accustomed to frequent price adjustments.

Thus, the advantages of the method include: compliance with demand, full flexibility, impact on competition (but not very strong), incentives to reduce costs. However, the method is relatively complex; it does not provide break-even, there is no opportunity to plan profit, it is opaque, there is no incentive to expand the assortment. It is used for durable goods: household chemicals, personal care products; hairdressing, laundry and other services that are constantly used by consumers.

*D. Pricing based on competitor prices.* This method has a differentiated scope, which accounts for its several types. For example, a change in prices may go in the same direction in which they were changed by a competitor, or in the opposite direction.

The advantages and disadvantages of the pricing method based on competitor prices are as follows. Firstly, it is simplicity. Secondly, the method does not provide break-even, does not provide for profit planning and ways of its distribution; transparency is also not provided. The method can be used as an instrument of competition. In addition, it is worth noting the relative flexibility, put restrictions on the introduction of new positions in the range (dependence on the leader).

The presence of a large number of various industrial markets for goods and services, a multiplicity of prices are characteristic of the modern world market. In practice, the price of a specific product of the same market may vary significantly. Therefore, when justifying, determining and agreeing on the foreign trade price, it is necessary to have a clear idea of the nature of the transaction, which dictates the price selection feature:

- use of prices for separate export and import operations;
- prices in terms of cash payment;
- prices formed in the framework of ordinary commercial transactions.

Suppliers of goods to the external market face significant price fluctuations, provision of various discounts, application of allowances. In addition, the prices for similar products are almost always different, since different suppliers deliver goods of various qualities, sets, etc. A significant share of the final price is transportation cost. In modern international trade, especially in trade in commodities and semi-finished products, intermediary firms occupy a prominent place, also having their margin as a result of sales. Prices for machine-technical products, technically complex products, as a rule, are formed only through direct contact between the seller-manufacturer and the buyer-consumer. In this case, the price includes a variety of components, i.e. bonuses for warranty, pre-sales and after-sales service, packaging, etc.

To study and use in practice the price indicators of the world market it is necessary to know the main sources of information about prices. Currently, special data banks have been created for almost all products and product groups by region and time periods (for seasonal goods).

By sources of information, scope and method of use *prices of global commodity markets* can be divided into several groups.

*Contract prices* are specific prices for products agreed upon by the seller and the buyer during the negotiations. They are usually lower than the offer price of the supplier. The contract price is valid for the entire duration of the contract, if it has not been revised in the course of delivery. Contract prices are not published anywhere, because they represent a commercial secret. Principally, contract prices for a certain product in a certain region and in the presence of a small circle of sellers and buyers are known. The practical task is to collect information and create a data bank.

*Advertised (reference) prices* are seller's prices, published in newsletters, as well as in periodicals, in newspapers, magazines, in channels of computer information.

The range of products included in price guides mainly covers over-the-counter commodities and semi-finished products (oil and oil products, ferrous metals, fertilizers, etc.). Currently, reference books on prices of over-the-counter goods have become very widespread. Thus, an exporter of petroleum products focuses on daily commodity and regional price quotes, published in reference books that can be obtained daily through a computer communication system.

However, it should be borne in mind that there is a gap between the prices published in reference books and actual transaction prices. As a rule, reference prices are somewhat overestimated. Reference prices do not react quickly to changes in the situation or to any political events, with the possible exception of oil prices, which is a very specific product. At the same time, they reflect the dynamics of prices in this market and trends.

*Exchange prices* are the prices of goods that are traded on commodity exchanges. For commodities include mainly raw materials and semi-finished products. Commodity prices promptly reflect all changes in the market for this given product. The slightest changes to one or another side of the market situation instantly affect stock quotes. This is explained by the fact that the stock quotes themselves are actual transaction prices at the moment. Stock quotes do not reflect other instruments of international trade, such as: terms of delivery, payment, etc. There is a specific regulation of the stock exchange and participation in its work. The exchanges are functioning daily, and the quotation commission registers and publishes quotation prices in special bulletins. There are two types of quotes: urgent quotations (futures) for goods that are not currently available, with terms of delivery after a certain time, and quotations for goods sold. As practice shows, stock quotes, rather sharply reacting to various external stimuli, still cannot reflect real trends in price movements. Often operations are carried out on stock exchanges that are frankly speculative in nature. In international trade practice, experts are guided by the quotes of the most well-known, well-established exchanges with highly qualified personnel, such as the *London Metal Exchange*, the *Chicago Stock Exchange*, which deals with grain quotations and sales, and the *New York Cotton Exchange*.

*Auction prices* are received as a result of bidding. These are real prices, reflecting supply and demand in a given time period. Auction type of trade is quite specific. At auction sales, for example, furs, animals, and objects of art are bought and sold.

*Statistical foreign trade prices* are published in various national and international statistical reference books. These prices are determined by dividing the value of exports or imports by the volume of purchased or supplied products. They do not show the specific price of a particular product. From the point of view of their practical application, they are interesting for understanding the general dynamics of the foreign trade of a particular country, for statistical calculations, and are used as an approximate guideline.

In the process of negotiating prices, the exporter and importer, proceeding from their own analysis of data on the situation on the commodity market, start negotiations, knowing in advance what concessions they can make. In the world practice of foreign trade a large number of various discounts are known. Price discounting is a method of price trading taking into account the state of the market and the terms of the contract.

According to experts, there are about 40 different types of price discounts and allowances. The most common include the following ***discounts:***

– *Seller's discount*, when in the course of bargaining the exporter offers a discount for the volume of a one-time purchase (batch) or for the stability of purchases, depending on the situation in a particular market. It can reach 20–30% of the original price;

– For *an exclusive importer*, if the importing company is the only supplier of goods to a country or region who achieves the best conditions for the sale of this product, essentially helps the exporter to gain a foothold in the market of this country. This discount reaches 10-15% of the original price. It is practiced in the conditions of the market of monopolistic competition;

– *Cash discount* – in case of prepayment by the importer, in full or in part, for the goods supplied. As a rule, such a discount is also provided for direct bank transfer of money when issuing invoices;

– *Traditional partner (bonus)*, as a rule, is granted to an importer who has been working in the market with the same exporter for a long time. In this case, the exporter is confident in his partner-buyer regarding the correct and timely fulfillment of contractual obligations; the discount is usually granted on the annual sales of goods. It is primarily characteristic for the market of perfect competition;

– Discount for *the purchase of off-season goods*; as a rule, it is provided in the markets of agricultural products, clothing, footwear, etc.

– *Dealer's discount* is available to wholesalers and retailers, agents and intermediaries. This discount should cover the costs of dealers for sale and service and provide them with a certain amount of profit.

The sizes of discounts are determined separately for each specific case. As a rule, the sizes of discounts vary between 2 and 10% of the originally offered price. Of course, more substantial discounts may be achieved.

When entering the market, the following *types of pricing policy* can be used: the policy of initially reduced prices, the policy of "cream skimming", the policy of quick sales revenue and the policy of "arrows throwing". Let us consider each of them in more detail.

*1. The policy of the initially reduced price (penetration price)*. First, the price is artificially low, i.e. the company deliberately does not receive a normal profit or does not receive it at all and, perhaps, even sells its products below cost. The objectives of such a policy are: to quickly gain market share, to press competitors, to draw the attention of the buyer. The company cannot work for a long time because it does not receive a normal profit, and proceeds to the second stage: it raises the price, but if it fails or not fully manages to raise the price, then it is necessary to reduce costs, and this requires reserves.

The advantages of the penetration price are that the company quickly gains market share, pushes competitors and draws the attention of the buyer. Relative cheapness of such a policy in terms of marketing costs and creation of incentives to reduce costs is also worth noting.

The disadvantages of the policy of initially reduced prices include the lack of normal profits or even losses, as well as risk (provoking a price war; the likelihood that the consumer will consider low-quality products; buyers will probably not like the subsequent price increase). A company must be prepared to reduce costs (for economies of scale, reserves of production capacity, personnel reserves, availability of additional raw materials, financial reserves are needed); if it does not work out to reduce costs, it will be necessary to reduce quality.

*Case 28. Easyjet and Ryanair, low-cost air companies from the UK and Ireland, borrowed the following business model from the American Southwest Airlines: one type of aircraft in the fleet (usually no older than three years from the time of production), maximum possible flying time per aircraft, minimum demurrage at airports (Ryanair standards assume no more than half an hour between landing and the subsequent take-off), minimum free service in flight (no in-flight catering, paid-only baggage allowance), high punctuality of flights, direct ticket sales via the Internet or by telephone, using airports with low tariffs for flight service, low starting price tickets, with a gradual increase in tariffs on the approach of flight dates, no fixed seats when boarding the flight. This approach can significantly reduce the operating costs of airlines and expand the number of customers who constantly use their services.*

*2. The "cream skimming" policy* involves, at the initial stage, artificially raising the price for the richest buyers, then moving to the second stage and lowering the price to enter the mass consumer market. Policy aims at excess profits in the first stage, an increase in sales and revenues in the second stage.

The advantages of this approach are: obtaining super profits, increasing sales and revenue. Such a policy is less risky from the point of view of the psychology of the buyer (it is easier for the buyer to perceive the price reduction), and also the positioning of goods as high-quality goods takes place. In addition, there is no danger of charges of dumping and unleashing a price war. Lower prices lead to higher sales, economies of scale and lower costs.

The obvious disadvantage is the need to find a buyer who will pay such an artificially high price; rather, they will purchase a competitor's product. At the first stage, there must be monopolization of something that a competitor currently does not have (building of barriers that competitors cannot bypass). For example, a monopoly on a patent, know-how, etc., on unique natural resources, distribution channels, etc. The main problem is the creation of such a monopoly when a rich buyer has no choice. In addition, the policy is not suitable for countries with too large a difference between incomes of the population, when it is impossible to lower the price so much that the majority of consumers can buy them, and for luxury goods. There is a need to choose the right product that can pass both stages. Too much overpricing at the first stage is fraught with the desire of competitors to develop the same product (to get access to the same resources, etc.).

*Case 29. The Japanese company Sony traditionally used the "cream skimming" policy, using it for all its new products based on progressive technologies; home video recorders brought to the world market in the 1980s were no exception. Their uniqueness, however, consisted in the new "beta" standard. At first it turned out well because the design of video recorders was more attractive, and the product itself was more compact than that of competitors. But the transition to the second stage failed, as even after the price reduction the mass consumer did not accept Sony products that were inferior to the mass models of competitors relying on the popular VHS standard. Sony had to withdraw from the market for home video recorders for several years (Fig. 19).*

*3. The policy of quick sales revenue*. The purpose of this policy is to obtain a large amount of revenue in a short predetermined time, followed by leaving the market. The company uses this pricing policy when it enters the market, but is about to leave it. Reasons for leaving may be different: the company has goods at a late stage of its life cycle; upcoming political changes in the country (shortly before them one can take advantage, for example, of your acquaintances, or low fees, in order to get quick revenues); the company has accumulated illiquid assets (it is necessary to get rid of them at any cost, this is what we enter any market for); acute shortage of working capital, etc.

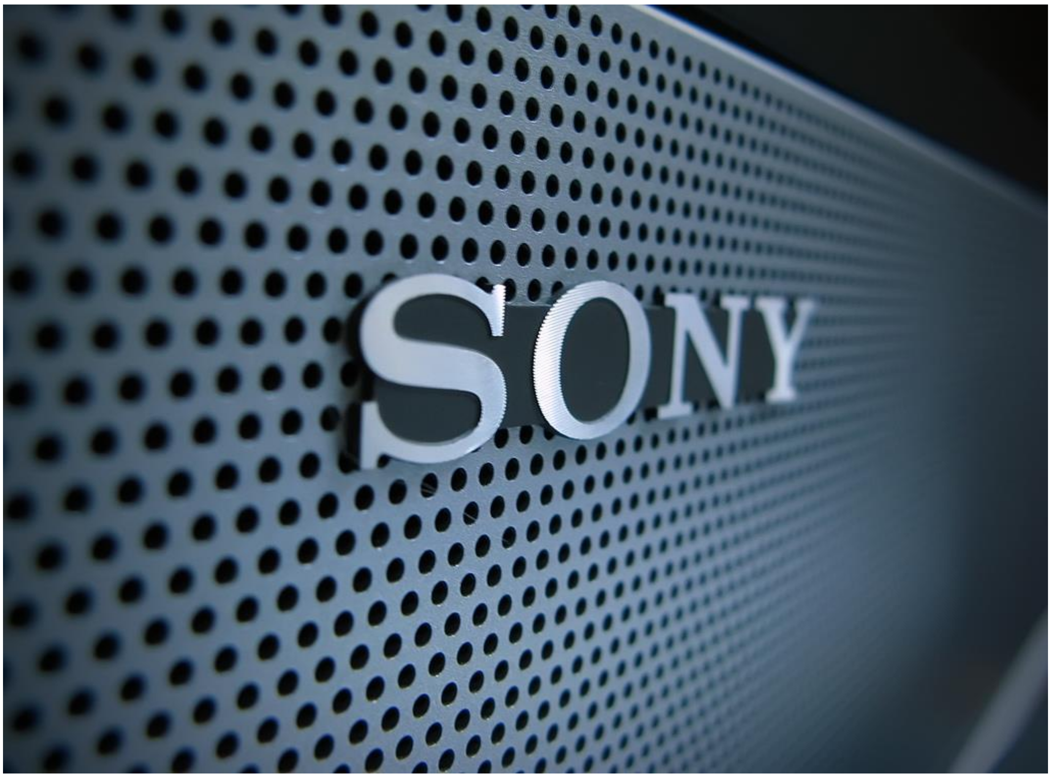


*Fig. 19 – Sony logo*

The advantages of this politics are speed (time saving), intensity, compactness (relative economy, fewer preparation activities, etc.). Also, the task of selling goods, which may not be sold in other markets, is solved. There is an incentive to reduce marketing costs and brand investment. The company receives information and experience in the new market, which can then be sold to other companies that will work in this market in the future.

The disadvantages are the possible damage to the company's image due to the imminent departure from the market. The policy is unprofitable from the point of view of strategic goals, the return to this market will be associated with additional costs (time, money). In addition, the amount of information accumulated, in many cases is impossible to use in other markets, and it is not easy to sell it to other companies. Brevity increases the risk (there is no second stage, which could correct the situation), no time to correct mistakes.

*Case 30. In the mid-1970s DuPont decided to enter the East Asian rayon market with a new type of product. The price was too high, almost like that for the natural silk. To justify the price, the silk was offered to Parisian fashion designers (Christian Dior, Pierre Cardin, Givenchy). Somehow, DuPont representatives managed to convince the Parisian fashion houses to make most of the models from this type of silk. The first stage was a success. The success with the women of fashion in East Asia was assured. When everyone who was ready to pay such a price had already purchased new clothes, they reduced the price. As a result, there was a sharp increase in demand from the mass buyer and the company's revenue grew (Fig. 20).*

*Fig. 20 – DuPont logo*

*Case 31. Iran, late 1978; the end of Shah M. R. Pahlavi rule. The (secular) regime of the Padishah was liberal; the population of the country had practically no restrictions on the manifestation of tastes and preferences, including clothing. Muslim norms were not too strict. In the late 1970s it became obvious that the Muslim revolution and the change of power in the country are inevitable. The growth of student and other social unrest in the country left no doubt that the orthodox Muslim leader Ayatollah Khomeini would come to power. Shortly before the collapse of the Shah's regime, small Italian firms brought large quantities of fashionable Western-style men's shirts that did not comply with strict Muslim canons (in terms of colors, cut, etc.), which meant that they would soon become inaccessible. These companies made quick revenues and left the market after the start of the Islamic revolution.*

4. *The policy of "arrows throwing"* is a kind of experiment. The company carries out trial sales at specific prices and selects the price that will allow it to achieve maximum sales in this market. The policy has two varieties:

– *The main option (provisionally called "geographical").* Before entering the market, the company decides in advance in which localities (three to five) it will conduct an experiment. Localities should be as similar as possible; their local markets should reflect the situation on average of the entire market of a country (region) where goods will be sold later. This experiment is carried out simultaneously in all points: trial sales during the day (several hours), with prices different in all localities. In the end the price at which more goods were sold is chosen. In this case, sales are carried out in areas where there is a high concentration of population;

– *Backup plan (conditionally called "temporal").* Sometimes it is very difficult to find such similar locations. Then such sales are carried out in the same city, but with a time gap (two to three weeks) after each trial sale at a new price. Three trial sales are usually conducted (each time within a few hours).

*Fig. 21 – Maybach logo*

This policy allows one to find a price that meets the market conditions (if the experiment was conducted correctly). Preparatory activities make it possible to explore in advance the region where the experiment will be conducted. It is possible to use this pricing policy to obtain information about the consumer (preferences, etc.).

This experiment is self-sustained (as the products are sold and not distributed free of charge), as well as reducing the risk of subsequent mass market entry. In addition, it is possible to identify errors and correct them; there is an incentive to reduce costs. At the turn of the 1980–1990s *Unilever* and *P&G*, leaders in the global markets for many types of personal care and household chemicals, used the "arrows throwing" policy entering new markets of Poland, Hungary, Czechoslovakia; thus they determined the optimal price for a number of their products, and learned a lot about requests and preferences of buyers.

*Case 32. Today, opportunities are expanding to promote consumer goods in foreign markets through retail chains, a number of which have gone beyond national borders. The American company WalMart, the largest player in international retail trade in terms of sales, owns 10.7 thousand stores in 27 countries. At the end of 2012, the French group Carrefour had almost 10 thousand stores in 32 countries; it was the world leader in terms of the share of revenues received in foreign markets (60%) and the second company in the world in terms of sales. The processes of retail trade internationalization also include Russia. Stockmann, Auchan, Zara, Real, OBI – this is a far-reaching list of retailers that have entered the Russian market and offer both brands of manufacturing companies and products under their own brands.*

*The German chain Aldi opened more than 1,000 of its stores in 34 states of the United States, guided by the slogan: "Always steer near to WalMart: Old WalMart customers are new Aldi customers." Inside the German retailer Aldi, everything is modest, businesslike; everything is the same as in Germany. Products are in boxes, on the same pallets as they were brought, narrow aisles, few cash registers, almost no brand products. When using a trolley, you must have $ 1, which is unusual for American buyers, as well as the fact that you have to pack the purchased products yourself. Aldi is assisted by the current situation in the US economy. Today, Americans are trying to save on food. If earlier they often bought famous brands, now they are switching more and more to the products promoted under their generic name (no-name). Aldi's product range mainly includes its own brand products, thus products are 20% cheaper than WalMart's, and even 30% cheaper than products in traditional supermarkets. Every year Aldi grows in the USA by 10%; more and more Americans shop here. The press has already expressed the opinion that if this trend continues, Aldi will become a serious competitor for WalMart.*

However, the policy requires compliance with a large number of conditions and restrictions; it is difficult to use this method in large markets (like Russia). The policy does not take into account inflation (a temporary option); market homogeneity is an essential requirement. Preliminary research (search for homogeneous settlements) is a rather expensive study (although reference books can be used for obtaining more or less reliable information), therefore such policy is more suitable for large companies. It is not suitable for all products (seasonal, high-priced, products requiring fitting cabins); they should be small inexpensive goods. When choosing the prices mistakes are highly probable, so it is necessary to study the calendar (holidays, days of salaries, etc.). Hence, such a policy is not so commonly applied.

*Case 33. When PepsiCo attempted to enter the Indian market, the Indian Government set a condition for the company to use the part of profit to buy Indian tomatoes. As PepsiCo already owned Pizza Hut at the time, it accepted this condition because it could export tomatoes for consumption in other countries.*

## Topic 8 Review Questions

1. What are the features of pricing in the global commodity market?
2. What are "pricing factors" and how are they manifested?
3. What are the features of pricing in the seller's markets?
4. What are the features of pricing in the buyer's markets?
5. Describe the basic pricing methods in the global markets.
6. What are the main sources of pricing information for the global markets?
7. What types of price discounts and allowances are there in the world practice?
8. What types of pricing policies do companies use when entering the market?

## TOPIC 9. FINANCING AND PAYMENTS CONDITIONS IN INTERNATIONAL BUSINESS

### Forms of Financing International Business Activities

In modern international practice, various forms of financing foreign trade activities of companies are used. The types and forms of financing largely depend on the nature of international transactions.

In general, forms of financing the activities of exporters and importers can be divided into traditional *banking credit, trade finance instruments* (in particular, letters of credit, guarantees), *factoring and forfeiting, financing with the participation of insurance and export guarantee institutions*.

Lending in foreign trade is one of the instruments for stimulating international operations. The loan implies the provision of cash on the terms of payment, urgency and repayment. Financing is provided by commercial banks, loan recipients can be both importers who are given a loan for the purchase of goods and, accordingly, payments to the exporter, and exporters.

It is possible to list several economic reasons to obtain a loan by the exporter: the acceleration of sales, the increase in the supply of goods, the possibility of providing a commodity loan to the counterparty and, accordingly, an increase in competitiveness. The possibility and expediency of obtaining credit funds depends on the ability to return the interest and accrued interest for the period of its use due to the incoming proceeds from the sale of exported goods.

*Case 34. The HSBC group has a long history. The name of the group comes from The Honkong and Shanghai Banking Corporation Limited, a small bank that was established to finance international trade between Asia and the West and began operations in Hong Kong in 1865. Now HSBC is one of the largest banking organizations and financial services in the world. The headquarters of the group is in London. Through an international network of more than 7,200 offices located in more than 85 countries and territories of Europe, the Asia-Pacific region, North and South America, the Middle East and Africa, the HSBC group provides a wide range of financial services to over 85 million private clients and nearly 3.6 million commercial customers. The group HSBC employs about 300 thousand employees, speaking more than 100 languages. As of December 31, 2012, the group's assets amounted to more than $ 2.5 billion. Thanks to the global network of the HSBC group, its divisions can use banking products and services developed in various markets and adapt them to meet the needs* *of local customers, which allow them to meet their diverse financial needs.*

A loan to importers may be required for the purchase of goods from the exporter; respectively, the return of loan funds will be made at the expense of the subsequent sale of goods on the domestic market (for a trading enterprise) or, in the case when production equipment is purchased, at the expense of the sale of products, made using this equipment.

The forms of crediting of foreign trade transactions are quite diverse and are classified according to the signs characterizing credit relations, in particular: the terms of crediting (long-, medium- and short-term crediting), purposeful assignment (to complete the production of export goods, preparation for sending the goods to the importer, purchase of goods by the importer), under the terms of repayment (according to the schedule, monthly in equal shares, at the same time at the end of the term), by security (secured, unsecured), etc.

In addition to bank lending, a commodity credit (or supplier credit) can be used in international transactions as a deferred payment for goods sold.

The provision of a loan on an open account assumes that the exporter, when shipping the goods and sending the documents to the importer, takes into account the value of the goods in the account of the importer, who opens it, the importer repays the debts on the open account according to the deadline set in the contract. A loan on an open account can be provided both for a separate consignment of goods, and for regular deliveries.

A commodity credit, of course, is beneficial for the importer, along with the fact that for the exporter it is fraught with certain risks, in this regard, when concluding a contract involving payment for the actually delivered goods, it is advisable to foresee how the risks of payment non-receipt will be reduced from the counterparty. One of the common forms of risk reduction for foreign trade transactions is the bank guarantee.

On the part of the importer, it is also possible to provide a commercial loan to the exporter in the form of consumer advances (prepayments), for example, in case of ordering expensive equipment that requires a long period of time for its manufacture. In this case, the receipt of an advance can reduce the need for the exporter to obtain a bank loan; respectively, the exporter has the opportunity to reduce the price of the export product.

Importer risks associated with the transfer of advance payments may be covered by bank guarantees for the return of prepayment.

*Factoring* is financing for receivable accounts (assignment of a monetary claim) arising in the course of trade operations between commercial enterprises. The factor usually provides the supplier with up to 80-90% of the amount of receivables immediately after shipment of the goods (before the maturity date) and then reimburses this financing from subsequent receipts of funds from the buyers-counterparties of the supplier. The remaining part of the receivables, i.e. 10–20%, minus factor commissions, paid to the supplier after the buyer has paid.

Currently, there are quite a lot of types of factoring operations depending on the obligations that the factor assumes. At the same time, there are several forms of factoring used in modern international practice.

*1. By the number of participants in the operation and their location.*

Domestic factoring: the buyer and the seller are in the territory of one country, the factor itself is also a resident.

International factoring:

– two-factor factoring: the buyer and seller are in different countries, while the import factor and export factor are involved in the transaction;

– single-factor import factoring: only the import factor in the importing country is involved in the transaction;

– single-factor export factoring – only the export factor located in the country of the exporter participates in the transaction.

*2. According to the buyer’s knowledge of the assignment of debt.*

An open factoring type is an operation in which the supplier's buyer is notified of the factual company's participation in the transaction. Such notification is usually made using a special inscription on the invoice indicating that the receivables for this account were completely assigned to the factor, which is the only legal payee, with the indication of the payment re-visits of the factor.

With a closed (confidential) type of factoring, the contract between the supplier and the factor is not publicized for the buyer until the buyer violates the terms of the contract without making a timely payment. In this case, the supplier authorizes the factor to notify the buyer of the reassignment.

Receivables management in this type of factoring is handled by the seller on behalf of the factor.

*3. If possible, regress to the supplier.*

In case of factoring with recourse, the supplier bears a credit risk in respect of receivables sold to the factor. In case of non-payment by the buyer, which occurred for any reason, including financial insolvency, the factor has the right to demand the appropriate payment from the supplier.

In non-recourse transactions, the factor actually assumes the credit risk in respect of the supplier's customer's debt, assigned to the factor.

The value of factoring commissions depends on the type of agreement, including the availability of administrative management of debtor's debt, recourse rights, etc. The rate of the commission is affected by the state of the financial market as a whole.

The total value of factoring commissions usually consists of two components. The first type of commission (the commission for the proposed financing) in most countries is calculated in percent per annum, and its value is comparable to the amount of interest on a bank loan. The second type of commission is charged with the administration of receivables and insurance of non-payment risk, calculated as a percentage of the trade turnover serviced and depends on sales, the number of invoices served, the creditworthiness of debtors, etc.

*Forfeiting* is a form of financing foreign trade transactions involving the purchase of bills of exchange accepted by the importer from the exporter. When forfeiting, the seller assigns his requirements to the buyer to a specific credit institution. The seller buys immediately the entire amount minus interest. At the same time, the buyer of the goods liquidates his long-term obligations with regular payments. Forfeiting differs from the usual accounting of bills of exchange by banks in that it assumes the transfer of all the risks of a debt obligation to its purchaser, the forfeiter. Forfeiting reduces the seller's receivables, improves the balance structure, accelerates capital turnover.

Forfeiting is mainly interesting for machine-building enterprises that export their products and provide trade loans to buyers (deferred payment). The exporter sells the buyer's promissory notes to forfeiter (to a bank or a forfeiting company) and can use the funds received for business development.

Compared with factoring, forfeiting has certain advantages. The first is usually used for short- and medium-term financing (up to 180 days), while in the case of using factoring, with recourse, the risk of non-payment by the importer remains on the exporter. Forfeiting, in contrast to factoring, does not imply the provision of additional services to the exporter.

Factoring and forfeiting may be of interest to participants in foreign trade transactions, the exporter determines the appropriateness of using one or another form of financing based on its needs and the nature of transactions.

Factoring can be demanded by small and medium-sized businesses that provide commodity credit to counter-agents and lack working capital, and factoring can also include the management of accounts receivable from the exporter, which can also be more expedient than creating an appropriate unit by the exporter. Forfeiting is more effective for large enterprises, which aim to accumulate funds for the implementation of long-term and expensive projects.

**Financing of Company's International Operations with Participation of Insurance and Export Finance Institutions**

In international practice, within the framework of trade financing, banks offer programs for organizing long-term and medium-term financing of projects involving the purchase of expensive imported equipment, the reconstruction, modernization or expansion of existing production based on foreign technologies with the participation of export financing institutions (banks development, export credit agencies). In particular, the following export development institutions function in various countries: HERMES Kreditversicherungs-AG – in Germany; COFACE – in France; ESCESA - in Spain; NCM - in the Netherlands; KUKESA – in Poland; Exim Bank – in the USA; NEXI – in Japan, etc.

The programs of development institutions provide various forms of support to exporters, including the provision of guarantees, insurance of commercial and political risks, and refinancing of commercial banks that provide loans to exporters. At the same time, foreign trade transactions must meet certain requirements (in particular, a product with a high added value, risk coverage or financing is not provided in full volume of the transaction, etc.).

The use of various financing schemes for short-term export-import transactions with the participation of export development institutions allows counterparties to:

– carry out trading operations on the basis of commodity credit (supplier credit);

– increase supply volumes;

– significantly reduce the cost of financing transactions (in comparison with letter of credit and advance payment forms);

– not distract their own working capital;
– reduce risks, both commercial and insurance.

### Forms of Payments in International Business

Under the *form of settlements in foreign trade*, we understand the methods of processing, transferring, and paying for goods and payment documents that have evolved in international commercial and banking practice. Settlements are made by non-cash, if not immediately in cash. The settlement procedure must be clearly defined in terms of the international sale contract.

In the practice of international trade there are five widely used main ***forms of payment for the goods supplied:***

– settlement of payment orders;
– check form of payment;
– bill form of payment;
– settlements using a letter of credit;
– settlements for collection.

*Payment orders*

The simplest form of payment is *payment by bank transfer*. When making a payment order, the bank undertakes, on behalf of the payer (buyer), to transfer a certain amount of money to the account of the payer's person in this or another bank using the funds in his account within the period prescribed by law or established in accordance with it, if a shorter term is not stipulated by the bank account agreement or is not determined by the customs of business turnover used in banking practice[39].

Settlements are made through the bank, in two ways: before the start of the delivery and after the goods arrive. In the first case, this will be a *prepayment*,

[39] Federal Law of 26.01.1996 No. 14-ФЗ. Civil Code of the Russian Federation. Part two. Ch. 46, § 2.

which may cover both the entire amount of the value of the goods supplied, and part of it. In order to provide the buyer with its obligations, the seller is entitled to demand from the buyer to pay a portion of the sum of money intended for payment (usually 25-50% of the value of the goods supplied) in the form of an *advance* immediately after the conclusion of the contract. Advance payments are beneficial to the seller (exporter) and unprofitable to the buyer (importer), since he does not have guarantees of receipt of goods and he slows down the turnover of funds.

*Deposit* should be distinguished from the advance payment; like the advance payment, deposit is a part of the sum of money intended to pay for the goods. But in contrast to the advance, the deposit serves as a means of ensuring the fulfillment of an obligation not only by the giving party, but also by the receiving party.

As well as the advance payment, the deposit is not returned by the seller to the buyer if the latter refuses to accept delivery of goods. However, if the seller does not fulfill their obligation, having received a deposit after concluding the contract, they are obliged to return it to the buyer in double amount, and not in the amount received as advance[40]. In the case of prepayment, the clause on the buyer's responsibility in the event that the seller suffers losses due to such a delay can be included in the contract.

If the goods have already been received by the buyer, and payment for it has not yet been made, then there is a *commercial loan*, i.e. installment payment. Naturally, such terms of payment are most beneficial to the buyer (importer).

If the contract does not indicate the place of payment for the cost of the goods, then the location of the seller's business or the place of transfer of the goods or shipping documents shall be considered as such.

The settlement scheme for payment orders is shown in Fig. 22.

---

[40] Federal Law of 30.11.1994 No. 51-ФЗ. Civil Code of the Russian Federation. Part one. Ch. 23, § 7.

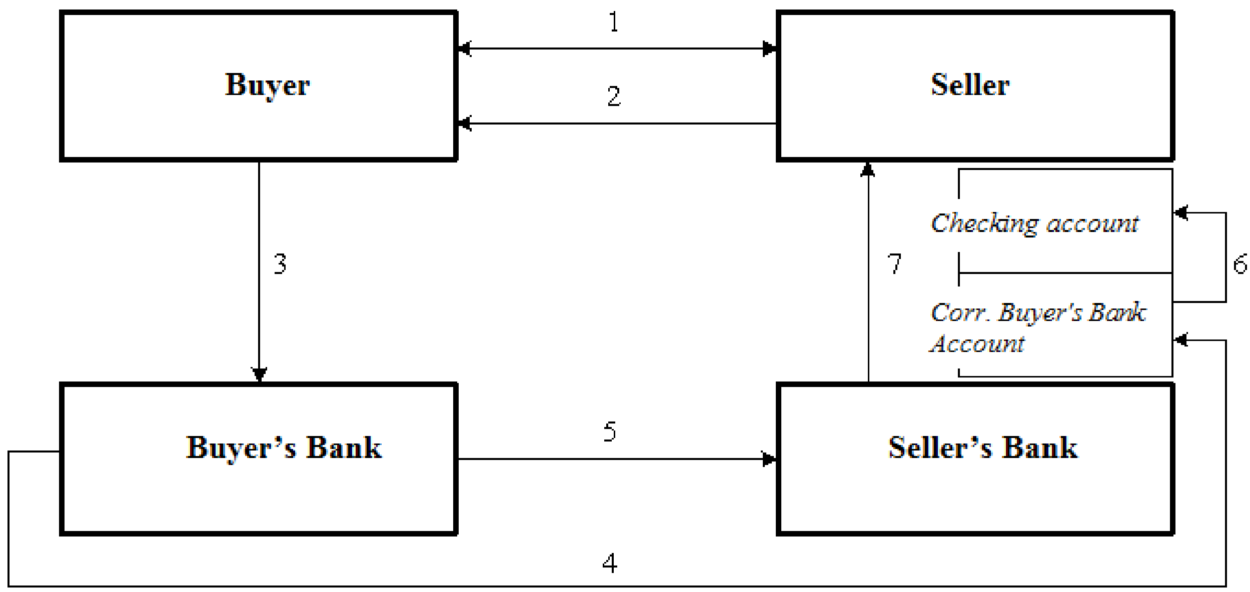


*Fig. 22 – Payment order settlement scheme*

Payment order settlements include the following operations:

1. The seller and the buyer enter into a contract for the supply of goods (execution of works, provision of services).

2. The seller sends the goods and documents for the goods to the buyer in accordance with the concluded contract.

3. The buyer places a payment order (order to pay a certain amount of money) to the bank that serves it.

4. Withdrawing money from the account of the buyer and crediting it to the correspondent account of the buyer's bank at the bank serving the seller.

5. Notification (advising) of the bank servicing the seller of the implementation of this transfer.

6. When a notice is received, the funds are debited from the bank account serving the buyer and credited to the seller's current account.

7. Notification of the seller about the receipt of money in his account.

*Correspondent account* is an interbank account opened by one bank in another. Correspondent accounts through which international payments are made are divided into:

– “nostro” account, which is an account held by a particular domestic bank in a foreign bank in the home currency of the foreign country. “Nostro” account is “our account with you”. For example, Russian PVBANK’s dollar account with American DABANK in the USA;

– “vostro” account, which is a local currency account held by a foreign bank in a domestic bank. “Vostro” account is “your account with us”. For example, the ruble account maintained by DABANK in the USA with PVBANK in Russia:

– “loro” account, which is an account maintained by one domestic bank on behalf of another domestic bank in a foreign bank in foreign currency. “Loro” account is an account held by a second bank on behalf of a third party; i.e. “their account with you”. For example, Russian PVBANK opened an account with American DABANK in the USA. If some Russian YUBANK uses that account of PVBANK for its correspondence, then it is called “loro” account for YUBANK and it is “nostro” account for PVBANK.[41]

### *Check form of payment*

The second is a check form of payment. Checks are used when paying for goods purchased at trade shows, from consignment warehouses, when recalculating for goods delivered and in other cases.

A *check* is an unconditional order of the drawer to the paying bank (or other credit institution) to pay, upon presentation, a certain amount to the check holder or his authorized representative (order) using the funds of the drawer[42]. Usually, a check is related to the availability of funds on the current account, but the bank may have an agreement with its client, providing for putting checks on it in a certain amount that exceeds the credit balance on the current account (*overdraft*).

[41] Provision of the Central Bank of the Russian Federation of 03.10.2002 No. 2-П “On Cashless Payments in the Russian Federation”. Part III. [Electronic Resource]. www.law.ru/npd/doc/docid/901830578/modid/99.

[42] Federal Law of 26.01.1996 No. 14-ФЗ. Civil Code of the Russian Federation. Part two. Ch. 46, § 5.

The scheme of the check form of payments is presented in Fig. 23 and includes the following operations:

1. The buyer applies to the bank for receipt of the checkbook.

2. The buyer draws up a payment order at the bank for the deposit of funds from his current account to the deposit.

3. The bank makes a deposit of funds to cover payments by check.

4. The bank issues a checkbook to the buyer.

5. The seller ships the goods (performs work, provides services).

6a. 6b. 6c. Transfer check to pay.

7. Transfer of funds from the account of the buyer to the account of the seller to pay the check.

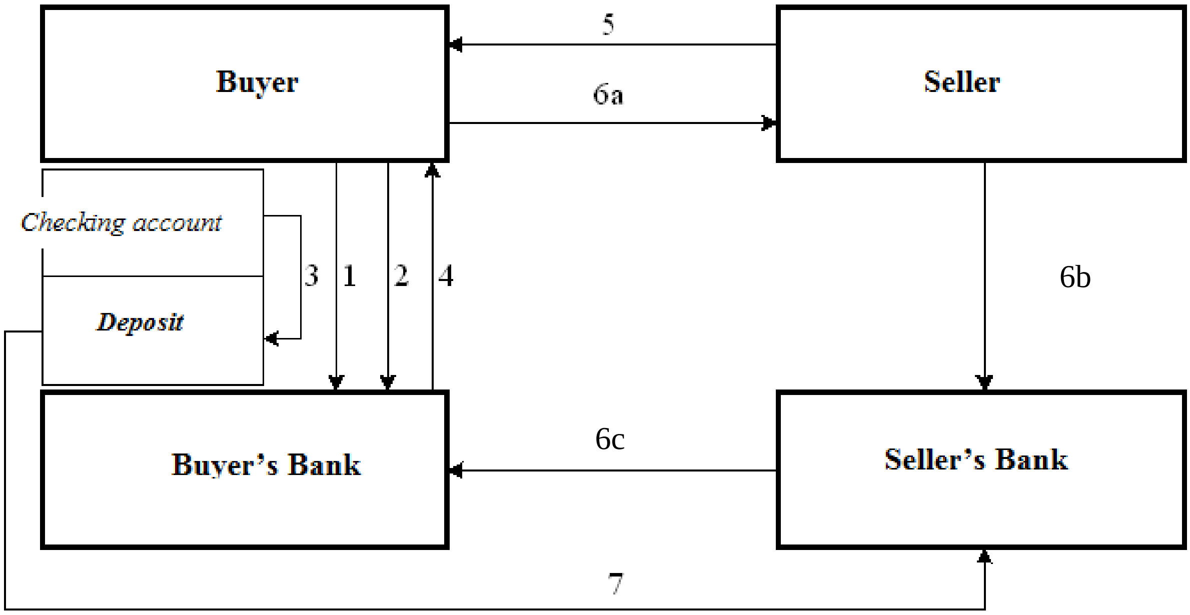


*Fig. 23 – Check form scheme*

A check is a private obligation that is not a valid legal tender. Issuing a check is not yet repaying a debt. To do this, the check must be converted into money or into the obligation of the bank to pay the money. The seller (creditor) receiving a check for the payment of a debt must verify and accept the check only if he is sure that the check can be turned into money. This is important to keep in mind because the bank for which the check is issued is not liable to the check holder for paying the check drawn on it. The bank acts as the agent of the drawer of credit, who has a deposit in the bank, and is only responsible to the drawer of the check for the payment of a correctly executed check within the limits of the availability of funds on his account.

*Bill form of payment*

*The bill form of payment* is carried out by using the bill, which may be *promissory note* or *bill of exchange*[43]. A promissory note is an obligation of one person (the drawer) to pay a certain amount to another person (the bill holder/drawee/payee) at the appointed time and in a certain place.

Mandatory details of a promissory note are:

1. The name “bill of exchange”, which should be included in the text of the document and written in the same language as the document. This is necessary to distinguish the bill from its related documents.

2. Specifying the date and place of drawing up the bill. A certain geographical point must be specified as a place of drawing up the bill. The date of drawing up the bill is of significant importance in bills with payment terms “in so much time from drawn up”, “upon display”, “in so much time from display”. Bills with unrealistic dates are considered invalid.

3. Name of the drawer. The drawer can be both a legal entity and an individual.

4. A simple and unconditional obligation to pay a certain amount. The bill amount cannot be accompanied by any reference to the obligations under the transaction. If they exist, then the document loses the power of the bill. The bill amount must be specified in the text of the bill in words and numbers. If the sums in numbers and in words differ, then the sum in words is considered correct. If there are several sums in the bill, then it is considered to be written out for a smaller one.

[43] Federal Law of 11.04.1997 No. 48-ФЗ On a Simple and Transfer Bill of Exchange.

5. Specify the date of payment. The following terms of payment are distinguished: on a certain date, upon display, at such time from display, at such time from preparation.

6. Indicating the place of payment. The meaning of this property is that it is not the debtor who comes with the payment to the creditor, but the creditor comes to collect the payment to the debtor.

7. The name of the payee to whom or by whose order it must be made. Bearer bills are not allowed.

8. Signature of the drawer. If the bill is issued by a legal entity, it is signed by two persons endorsing the money documents. The lack of signature of the drawer makes the bill void of any meaning. Without a signature there is no written commitment, which means there is no bill of exchange.

The scheme of settlements using a promissory note is presented in Fig. 24.

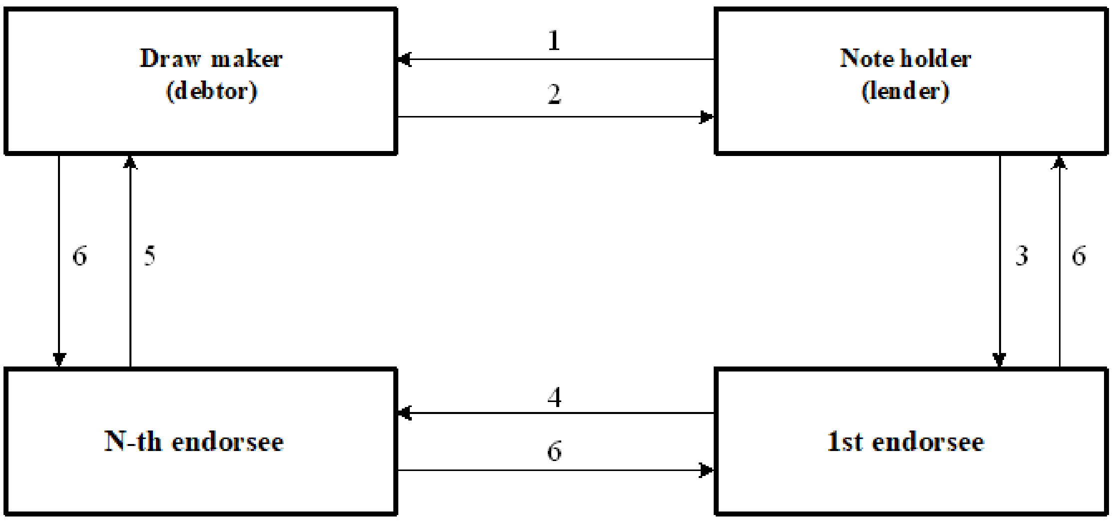


*Fig. 24 – The procedure for making payments using a promissory note*

Settlements using a promissory note are carried out as follows:

1. The seller transfers the goods to the buyer and becomes the creditor in relation to the buyer.

2. The buyer (debtor) in order to comply with their obligations to the seller (creditor) gives him a promissory note and becomes a drawer, and the seller,

respectively, becomes payee.

3. The promissory note holder will transfer the note to a third party (endorsee) by endorsement, i.e. a transfer letter on the back of the promissory note to guarantee the fulfillment of its obligations to a third party.

4. The endorsee, in turn, has the right to transfer the promissory note to the other party to which it is obliged by its transactions.

5. An endorsee who has a promissory note at the time of the expiration of the period for presentation for payment, presents it for payment to the drawer – the buyer.

6. The drawer will pay off the promissory note by paying the amount specified in it to the account of the endorsee who has presented the promissory note to maturity.

In the practice of international trade, a *bill of exchange (draft)* is often used, i.e. a document containing the disposition of one person – drawer, addressed to another person – drawee, to pay a certain amount to a third party – holder (payee) at the appointed time.

The offer of the drawer to the payer to pay the amount of the bill to the draft holder is entered in the text of the bill. The drawer is at the same time a creditor in relation to the drawee and a debtor in relation to the payee. The issuance of a bill of exchange is intended to settle both debt claims.

However, a bill of exchange has a characteristic of *acceptance*, an act of consent to pay the bill. By accepting a bill of exchange for payment, the payer becomes a person unconditionally obligated under this document, i.e. he accepts the bill obligation. Until such time as the person indicated in the bill as the intended payer does not accept it, it has nothing to do with the bill of exchange obligation. Consequently, prior to the acceptance of a bill by the drawee, this document constitutes a unilateral obligation of the drawer.

With the acceptance of the bill for payment, the acceptor becomes an obligated person. The debt of the drawer is conditional (in case of default). Settlements using a bill of exchange are carried out as follows:

1. The seller transfers the goods to the buyer and becomes the creditor in relation to the buyer.

2. The buyer (debtor), in order to comply with his obligations to the creditor, gives him a bill of exchange and becomes the drawer, and the seller, accordingly, the holder of the bill.

3. The drawer will transfer goods to another buyer for any other contracts, thus the other buyer becomes the debtor of the drawer.

4. The drawer will inform the payee that there is a drawee in front of him, and the payee proposes to the drawee to pay the promissory note directly to the payee (obtain consent for acceptance of the bill).

5. In the case of drawee’s consent to pay the debt not directly to the drawer, but the payee, he accepts the bill and returns it to the payee.

6. When the payment deadline for the bill of exchange is reached, the remitter sends the bill to the drawee for payment.

7. Drawee redeems the bill by paying the amount specified in it to the account of the payee who presented the bill to maturity. In this case, the drawee is considered to have fulfilled its obligations in the amount of the bill to the maker, and the bill maker is considered to have fulfilled its obligations to the payee.

The scheme of settlements with the use of a transfer bill is presented in Fig. 25.

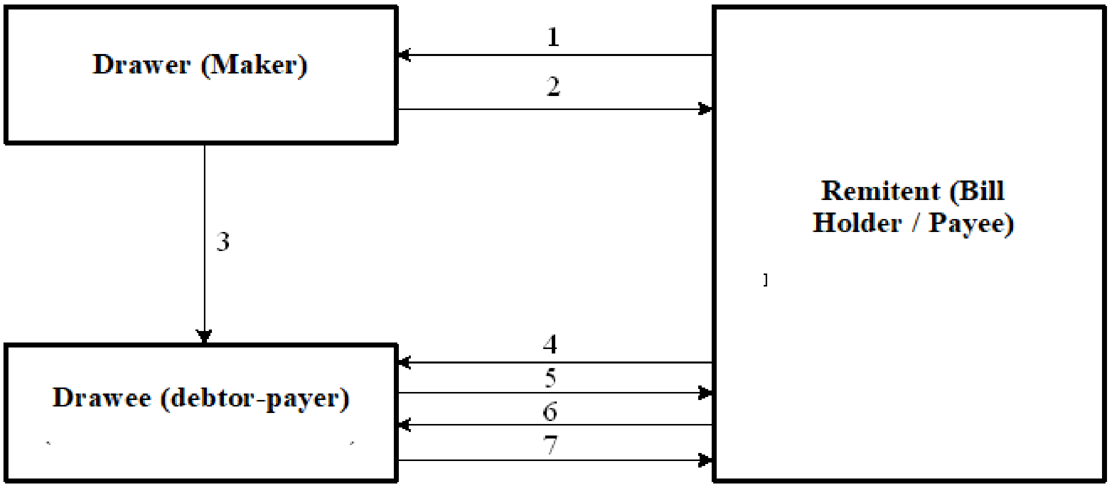

*Fig. 25 – the Order of settlement with the use of a transfer bill*

*Letter of credit*

Another form of payment is ***payments using a letter of credit.*** Export-import transactions may be complicated by a number of circumstances: time and risk of transportation, customs formalities, import-export restrictions, and the fact that the buyer and seller are separated from each other by borders. In addition, it is possible that the parties have never seen each other and know nothing about the business reputation and honesty of the partner. Therefore, for such transactions a procedure is needed that can protect the interests of the parties. The buyer needs to know that he pays for exactly the needed goods. The seller is interested in receiving payment for the goods shipped by him as soon as possible. In order to ensure respect for the interests of both parties, documentary letters of credit are widely used in international banking practice.

A *letter of credit* means an obligation taken by a bank for a certain period of time to pay the entire cost of goods upon presentation of predetermined documents to the bank (for example, documents for the shipment of goods).

A letter of credit gives the seller a guarantee of receiving payment from the buyer. The seller receives the obligation of the bank opening the letter of credit for which he will receive the money if all the documents comply with the terms of the contract.

The letter of credit operation procedure is shown in Fig. 26.

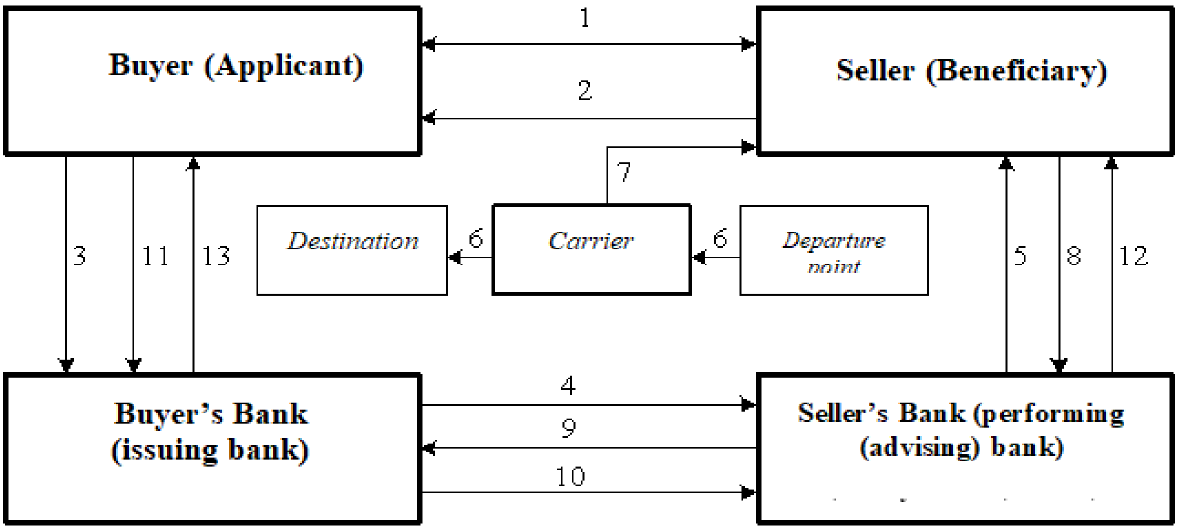


*Fig. 26 – The letter of credit operation procedure*

Settlements in the form of a letter of credit are carried out as follows:

1. The parties (the seller and the buyer) enter into a contract in which it is determined that payments for the goods delivered will be made in the form of a letter of credit. Letters of credit are issued by banks on the basis of an order or a statement from the buyer (applicant for the letter of credit), which in fact repeats all the conditions of the section of the contract regarding the procedure for payments.

2. After the contract is signed, the seller prepares the goods for shipment, and informs the buyer about it.

3. Upon receipt of such notice, the buyer sends to his bank an application for opening a letter of credit, in which he indicates all the necessary conditions. The bank opening the letter of credit (issuing bank) acts on the basis of the instruction of the applicant.

4. After the opening of a letter of credit, in which the issuing bank usually indicates how it will be credited, the letter of credit is sent to the seller, in whose favor it is open (to the beneficiary). At the same time, the issuing bank sends a

letter of credit to the beneficiary, as a rule, through the bank servicing the seller, whose task is to advise the letter of credit to the seller. Such a bank is called the advising (performing) bank.

5. Having received a letter of credit from the issuer, the advising bank checks its authenticity by external signs and transfers it to the beneficiary. The advising bank also receives a copy of a letter of credit or telex, since it is authorized to receive documents on the letter of credit from the beneficiary, checks them and sends them to the issuing bank, and in some cases is designated by the issuer as the bank performing the letter of credit, i.e. authorized to pay the seller for the goods shipped.

6. Having received a letter of credit, the beneficiary checks it for compliance with the terms of the contract. In case of non-compliance, the beneficiary may notify his bank of the conditional acceptance of the letter of credit (or even of its non-acceptance) and request the applicant to make the necessary changes to its conditions. If the beneficiary agrees with the terms of the open letter of credit in his favor, he will make the shipment of goods in a timely manner.

7. The seller receives the shipping documents from the carrier.

8. The seller submits them together with other documents required by the letter of credit to his bank within 21 days.

9. After verification, the seller’s bank sends documents to the issuing bank for payment, indicating in its accompanying letter how the proceeds should be credited.

10. Having received the documents, the issuer checks them and then transfers the amount of the payment to the seller’s bank.

11. At the same time, the issuing bank collects funds from the buyer.

12. The seller’s bank credits the proceeds to the beneficiary.

13. The buyer, having received documents from the issuing bank, takes

possession of the goods.

In accordance with the condition of the letter of credit, the advising bank can also pay the documents to the seller at the time of their submission to the bank, and then demand reimbursement of the payment made from the issuing bank.

A letter of credit most fully ensures the timely receipt of export earnings, i.e. best meets the interests of the exporter. However, the letter of credit is the most complicated and expensive. For performing credit operations, banks charge a higher commission than other forms of payment[44].

### *Collection form of payment*

*Collection form of payments* represents a banking operation whereby a bank, on the instructions and at the expense of the customer, acts on the basis of settlement documents for the purpose of receiving payment from the payer.

*A collection* is an order from the seller (creditor) to his bank to receive a certain amount of money from the buyer (payer, debtor) directly or through another bank or confirmation that the amount will be paid on time. At the same time, the seller must provide the bank with documents for the goods shipped (work performed, services rendered) to the buyer.

The basis of the collection form of payment is the agreement of the seller with his bank, providing for his obligations to transfer the documents of title to the buyer only if the latter pays the value of the goods shipped or to agree on this with the buyer's bank[45].

There are two main types of collection orders: documents are issued to the payer against *payment* or against *acceptance.*

*Acceptance* is the agreement of the payer to pay the commodity documents on time. Using such conditions, the buyer has the opportunity to sell the

[44] Federal Law of 26.01.1996 No. 14-ФЗ. Civil Code of the Russian Federation. Part two. Ch. 46, § 3.
[45] Federal Law of 26.01.1996 No. 14-ФЗ. Civil Code of the Russian Federation. Part two. Ch. 46, §4.

purchased goods, receive the proceeds and then pay the collection to the seller. In this form of settlement, the seller bears a certain risk associated with the possible refusal of the buyer to pay, which may be due to the deterioration of market conditions or the financial position of the payer. Therefore, the condition of the collection form of payment is the seller's confidence in the buyer's solvency and his good faith[46].

The scheme of the collection form of payments is shown in Fig. 27.

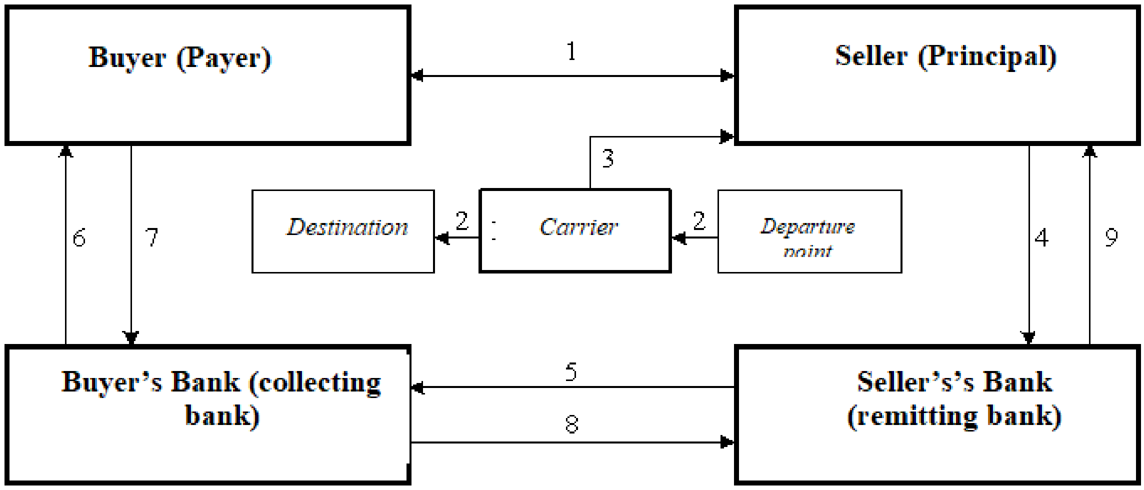


*Fig. 27 – Collection form of payments*

The settlement procedure in the form of a collection *against* the buyer's *payment* is as follows:

1. The parties enter into a contract in which they usually specify through which banks settlements will be carried out.

2. The seller in accordance with its conditions makes the shipment of goods.

3. The seller receives shipping documents from the carrier.

4. The seller prepares a set of documents (bills, other documents, and, if necessary, other financial documents, for example, bills of exchange issued by the seller to the buyer, if a commercial loan is granted to the latter) and presents it to the bank with a collection order.

[46] Civil Law: Textbook / S.P. Grishaeva, ed. / Yurist, 2004.

5. The seller’s bank (remitting bank) acts in accordance with the instructions of the seller (principal) contained in the collection order. Having checked on the external signs the compliance of the submitted documents listed in the collection order, the remitting bank sends them together with the order to the correspondent bank in the buyer's country. In a collection order, the seller’s bank usually provides instructions regarding the transfer of funds received from the buyer.

6. Having received a collection order and documents, the collecting bank presents them to the buyer (payer) for verification in order to receive payment from him. In this case, the collecting bank can make a presentation to the payer directly or through another (representing) bank. The buyer’s bank sends a notice to the payer that a collection order with documents has been received and with a request to pay for the specified documents. Documents are issued to the payer against payment.

7. The buyer’s bank receives payment from the buyer.

8. The collecting bank transfers the proceeds to the remitting bank.

9. Having received the transfer, the remitting bank credits the proceeds to the seller.

***The place of payment of the price*** may be important in terms of the fulfillment by the buyer of their primary responsibility in the conditions of strict measures of state regulation and control in some countries with regard to the transfer of foreign currency abroad. Therefore, counterparties should choose a place of payment that would be minimally affected by this regulation.

If the parties have not agreed on the place of transfer of goods or documents of title in the contract, then according to the Vienna Convention there are the following conditions:

– the buyer is obliged, and the seller has the right to demand payment at the location of the seller’s enterprise, and if payment is to be made against the transfer of goods or documents, at the place of transfer;

– the buyer is not entitled to demand the receipt of goods (documents) before paying the price;

– the seller has the right to ship the goods and hold the documents of title before the price is paid.

The increase in the cost of the payment, caused by the change after the conclusion of the contract for the location of the seller's business enterprise, is attributable to the seller[47].

The buyer is not obliged to pay the price until he has the opportunity to inspect the goods, unless the procedure agreed upon by the parties for the delivery or payment is incompatible with the expectation of such an opportunity[48].

The use of a letter of credit as a means of payment that is very common in international trade makes it possible to logically link the points mentioned above. The seller does not ship the goods until the buyer opens (provides confirmation) a documentary letter of credit at a bank located in the seller's enterprise, which guarantees payment, provided that the seller submits the documents specified in the letter of credit to this bank.

The share of participation of commercial banks when using one or another form of payment is different: when making bank transfer payments, the bank's participation actually consists only in the execution of a client's payment order in accordance with the instructions received; the bank's share in documentary collection payments is more significant (transfer control, shipping documents of title and issuing them to the payer in accordance with the instructions of the principal) and the maximum share of participation of banks in the letter of credit (the provision of beneficiary with the payment obligation realized when the latter

[47] United Nations Convention on Contracts for the International Sale of Goods (Vienna 04/11/1980), Art.57. [Electronic Resource]. www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf.

[48] Ibid. Art. 58.

has complied with the conditions contained in the letter of credit).

Accordingly, the risks for the parties to a foreign trade transaction with different forms of payment differ, in particular, for the exporter: high risks in a bank transfer for the actually delivered goods, low risks with a letter of credit, which is essentially a monetary guarantee for payment of the goods shipped by the bank that opened letter of credit.

## Topic 9 Review Questions

1. List the main forms of financing international business activities.
2. Give a definition and describe the main provisions of factoring.
3. Give a definition and describe the main provisions of forfeiting.
4. Describe the procedure for financing the company's international operations involving insurance institutions and export financing.
5. Describe payment orders as a form of payment in international business.
6. Describe check form of payment as a form of payment in international business.
7. Describe bill form of payment as a form of payment in international business.
8. Describe settlements using a letter of credit as a form of payment in international business.
9. Describe settlements for collection as a form of payment in international business.

# TOPIC 10. INTERNATIONAL TAX PLANNING

## International Tax Planning Main Categories

International business entities need to take into account the tax implications of their international operations. Knowledge of the mechanisms of legal optimization of tax payments in all countries where FEA is carried out is extremely helpful, as well as possibilities of lawfully minimizing the tax burden in the jurisdiction of residence of a natural or legal person. The applied mechanisms and schemes of international tax planning (ITP) contribute to the growth of post-tax revenues of subjects of international business; they also provide for the use of savings saved on tax payments in the investment process.

*Tax planning* is an integral part of the financial and economic activities of individuals and legal entities, the purpose of which is to maximize the income of economic agents through the legal minimization of their tax payments. When planning the tax consequences of economic activity, it is important to know the amount of taxes to be paid, as well as location, time, methods, and ways not to overpay taxes, maximize incomes operating on the basis of legal ways and methods, and staying within business ethics.

ITP is permitted by national legislation as well as international legal acts to reduce the global tax burden of individuals and legal entities in order to maximize their total revenues arising in all jurisdictions for international business operations.

ITP includes three levels of minimization of the total tax burden of the payer:

1. the use of low tax rates and appropriate tax incentives both in the jurisdiction of the residency and in the countries – sources of income of individuals and (or) legal entities;
2. effective use of various methods of eliminating international double taxation (tax exemptions, tax credits and tax deductions, advantages of

international tax agreements);

3. minimization of taxes on the repatriation of income from the countries – sources of their formation in the jurisdiction of residence of the tax payer.

By its form, ITP can be classified into a corporate ITP and an individual ITP.

*The subject of a corporate ITP* is a corporation, a legal entity.

*The goal of a corporate ITP* is to optimize the internal structure of TNCs to maximize the total profit of the company.

The corporate ITP is reduced to finding legal ways to reduce the tax burden of TNCs. It is designed to minimize the total tax payments of TNCs, which are the sum of local taxes in all countries of business (levied in accordance with the principle of taxation at the source of income), as well as taxes imposed on the company in the country of its incorporation and (or) location of the central governing bodies and control (levied on a residency basis).

*The object of a corporate ITP* is the profit of a TNC. To maximize the global profits of the group, it is necessary to minimize the main direct and indirect taxes arising from the activities of TNCs.

*The main mechanism* contributing to the achievement of the goal of a corporate ITP is the creation of a flexible intracompany group structure, within the framework of which the following basic operations are carried out to minimize taxes.

1. Profit diversion is the transfer of global profits of TNCs between countries with its subsequent placement in jurisdictions with mostly low tax levels. Such a transfer can be done, for example, using transfer pricing and intracompany lending mechanisms.

2. Understating profit is a deduction from the tax base of the company of costs associated with the provision of various services to it by associates of a transnational group, as well as payment of interest and repayment of debt

obligations from the gross revenues of an enterprise in favor of related intracompany structures. Understating the profit of a company that is a resident of a country with a high level of taxation essentially means transferring the actual results of the activities of this enterprise in favor of companies that are residents of a jurisdiction with moderate taxation.

3. Profit creation is the actual removal of all operations of a transnational group in a jurisdiction with a preferential tax regime without regard to taxable activity in states with a high level of tax burden.

*The subjects of an individual ITP* are all unincorporated forms of business organization, as well as individuals. The main forms of business organization in the unincorporated sector of the economy are individual private enterprises in the countries of Anglo-Saxon law, entrepreneurs without a legal entity in continental Europe and Russia, as well as partnerships. Individual ITPs can also be used by some hybrid business structures, if TNC units are enterprises registered in the form of partnership, one of which founders is a foreign corporation.

*The goal* of an individual ITP is to maximize the total income of individuals by minimizing their total tax burden. Even if an individual lives in a country where he is a resident and a citizen, and does not conduct any FEA, all the more connected with leaving the country, and in this case, one can still use the mechanisms of an individual ITP. Obviously, if taxes on personal income and personal property of individuals in other jurisdictions are lower than in the country of their permanent residence, then there is always the possibility of transferring personal capital and other assets there to reduce the level of taxation.

For individuals engaged in international business, the ITP is doubly needed: thanks to the mechanisms of international tax optimization, one can also maximize the net income earned in foreign tax jurisdictions, while avoiding the burden of international double taxation.

*The object of an individual ITP* is the total income of an individual received in all jurisdictions of its commercial activity.

*The main areas of individual ITPs are minimization of the following*:

– individual income taxes;

– taxes on movable and immovable property, on income from such property and transfer of rights to own property, to receive income from property by other persons on the fact of inheritance or donation;

– consumption taxes (VAT, excise, luxury taxes);

– taxes on the repatriation of passive income (dividends, interest, royalties) received in foreign jurisdictions.

In world practice, the foundation of an individual ITP is the creation of a trust, under whose management assets of an individual are transferred in order to extract income in favor of the client while avoiding excessive taxation of income received.

Entrepreneurs need not only to have an idea of the tax legislation of all countries on whose territory incomes are generated, as well as assets are placed, but also to take into account the nature of intergovernmental relations in the tax field, including in the area of solving problems of international double taxation and tax discrimination of subjects of FEA, as well as in the prevention of tax offences.

The key problem of legal regulation in the field of taxation of international business transactions is the procedure for determining the taxpayer's belonging to the relevant fiscal jurisdiction, as well as the procedure for the distribution of income of foreign economic entities between the countries applying for them.

In this case we are talking about the definition of the two most important categories of international tax law:

1. residence of individuals and legal entities;
2. taxable situs, associated with the extraction of income by the resident of any country from sources in foreign fiscal territory.

*Case 35. In the early 1990s the US Customs Administration decided to treat universal cars as light trucks, so they should be subject to customs duty of 25% rather than 2.5% like other cars. In order not to keep their costs when exporting down, British manufacturers of Range Rover tried to settle that their luxury car worth $ 56,000 at the time was not a truck, and succeeded.*

*Then a sumptuary tax was introduced in the United States, which amounted 10% for vehicles worth more than $ 33,000. The British company negotiated with the US Internal Revenue Authority that their car was a truck because the trucks were free from this tax. However, the company had to make small changes to the car, as the minimum weight for trucks, according to the Office of Internal Revenue, had to be more than 6,000 pounds, and so Range Rover weight grew to 6,019 pounds.*

## Tax Residency of Individuals

*The residence principle* in international tax law means unlimited fiscal obligations of the tax subject, i.e. payment of taxes on the total income of a natural or legal entity in their country of residence.

*The criteria for tax residency of individuals* provided for by the internal legal norms of the relevant jurisdiction, can be summarized in the following most common groups.

*Permanent residence in a given country*, which means physical presence within the boundaries of a certain fiscal territory corresponding to the minimum period established by national legislation or exceeding this period. To determine the tax residency of individuals in this case, a mechanical test is used for the total number of days in this tax jurisdiction during the reporting tax period (usually a calendar year or, as in Russia, any period consisting of 12 subsequent months). At the same time, an individual is recognized as a tax resident if they have been permanently located in this fiscal territory for at least 183 days (six months) a year.

*Location in the country of permanent residence*. This method of recognizing a taxpayer as a resident assumes that in the territory of the country in question an individual has a permanent residence which is either privately owned or used as a long-term lease. The presence of such housing means the automatic presence of a permanent address at which a given resident tax payer can always be found. Both own and rented house (apartment) can be considered permanent housing, as well as a hotel room rented for a long time.

*The presence of the center of vital interests in the fiscal area*. The criteria for personal interests in a given country usually include family members, relatives, and acquaintances. Economic interests, in turn, imply priority sources of income in the territory of the jurisdiction under consideration, the presence of movable and immovable property, including housing and banking assets.

*Citizenship (nationality).* This criterion of tax residency is based on the once widespread concept of *national attachment* (nationality link). This concept assumes that a citizen of a given country, regardless of the jurisdiction of his actual long-term residence, is obliged to pay taxes on the principle of residency in the country of which he is a citizen.

When a *double (or multiple) tax residency* arises for an individual, international tax agreements can fix exclusive rights to tax income from this individual on a global basis only for one of the contracting countries. Such agreements should be signed between the states applying for the recognition of the rights of the jurisdiction of the residence of the person. In the absence of agreements, the taxpayer may remain a double resident, which inevitably means excessive tax burden.

Tax agreements, as a rule, use the following scheme for delimiting the claims of two jurisdictions to the right of recognition of an individual as their resident, with subsequent taxation according to the global principle: gradually, going top down, based on the following four main criteria, both countries assess the legitimacy of their claims. At the same time, on each stage of the analysis, the country is selected that most closely matches:

– permanent residence location;
– center of priority of personal and economic interests;
– permanent whereabouts;

– national ownership (citizenship).

Absence of tax residency does not relieve the taxpayer from the need to pay individual income taxes. Only in this case there is no tax jurisdiction that would tax global income of an individual, including the income received in other countries. Nevertheless, in all countries that represent sources of formation of income the corresponding taxes from this income are withheld. Such taxation is carried out in accordance with another principle of international taxation, i.e. the principle of taxation at the source of income.

*Case 36. At the beginning of 2013 the world was shocked by the news that the famous French actor J. Depardieu all of a sudden received Russian citizenship and decided to reside permanently in Russia. But there is no riddle: the government of the Russian Federation for a long time has been conducting a balanced tax policy, attractive for both individuals and companies (mainstream personal income tax rate in the Russian Federation is only 13%, while the French government has set a goal to raise the top bar of individual income tax from 41 to 75%; the basic income tax rate for businesses in Russia is also moderate at 20%). In this context, the low level of income taxes is one of Russia's competitive advantages, which can be considered by global economic entities (among which G. Depardieu can certainly be counted) to make appropriate decisions about the choice of basic jurisdiction for permanent residence and running business (Fig. 28).*

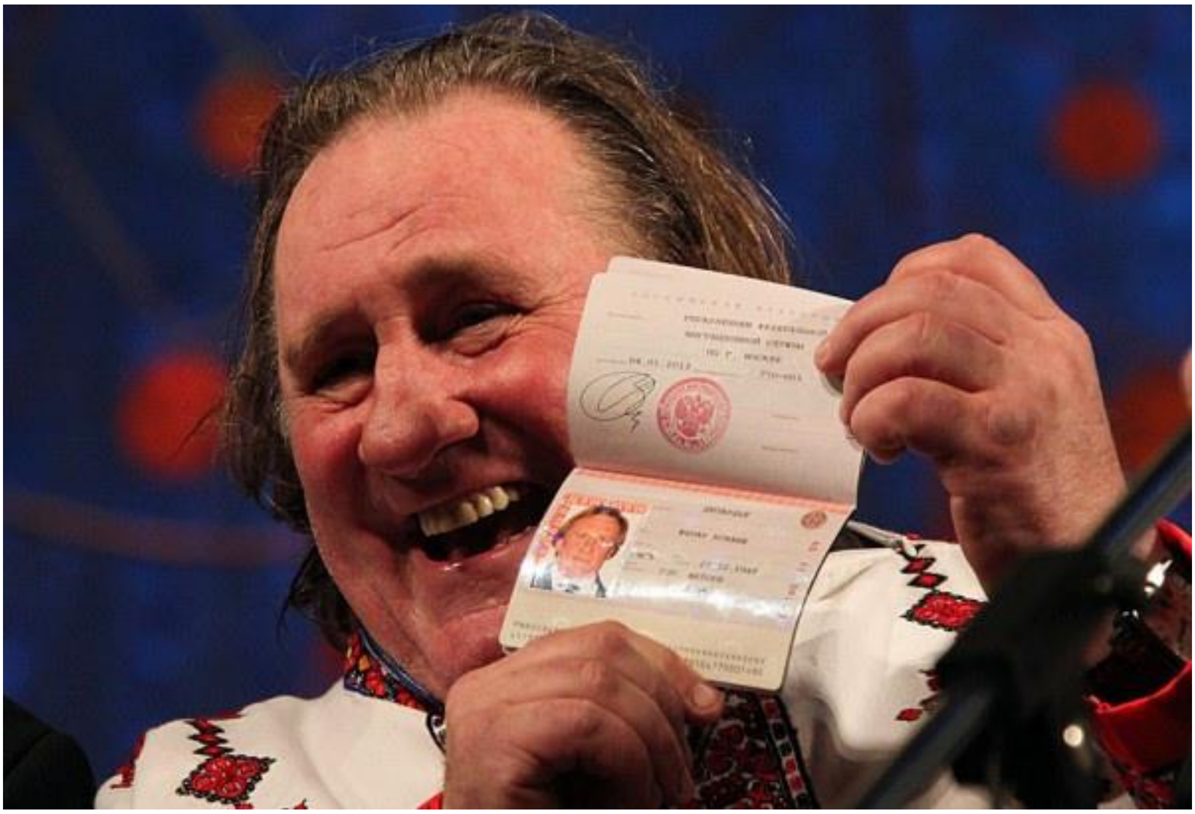

*Fig. 28 - J. Depardieu with a Russian passport*

## Tax Residence of Legal Entities

*The tax residency of legal entities* is also determined solely by the national legal norms of the countries on whose territory economic activity is carried out. For legal entities (corporations, organizations), in the national tax legislation, when determining the country of residence, as a rule, two main criteria are used:

– fact of incorporation (creation in accordance with national legislation and registration in the commercial register) in this jurisdiction;

– location of the company's management and control bodies in this jurisdiction.

Sometimes a company is recognized as resident in accordance with national tax laws, if it simply carries out commercial activities in a given jurisdiction. In Russia, resident legal entities should be understood as "Russian organizations" whose location is the place of their state registration[49].

The *source principle* of taxation involves the taxation of all incomes obtained from sources in this tax jurisdiction. For recognition of this state of the nature of taxation at the source of income generation, the category of *taxable presence (taxable situs)* in this sovereign tax jurisdiction is used. On the basis of such territorial attachment of the subject of FEA, the corresponding tax sovereign state is entitled to tax income derived from sources within the considered fiscal jurisdiction (the right to the so-called limited fiscal obligations of the tax subject).

In this context, when taxing non-residents, the fact of their income source formation in the relevant fiscal territory is sufficient. This implies the presence of a permanent representative office of a foreign legal entity for the purpose of carrying out vigorous commercial activity in a given country (making profit, business income) or obtaining so-called passive income (interest, dividends,

[49] Tax Code of the Russian Federation, Art.11.[Electronic Resource].ivo.garant.ru/#/document/10900200/paragraph/1:0.

royalties). At the same time, the corresponding income of a foreign resident are taxed either as similar income of resident legal entities or in accordance with international tax agreements; in relation to them a different procedure for withholding taxes at the source of passive income is provided.

*Permanent establishment* is a significant category of international tax law. The presence of a permanent establishment in any particular jurisdiction does not allow us to consider the taxpayer a resident, since the permanent establishment is not a legal entity of the country of its location.

Permanent establishment is a place of business located in one state, through which commercial operations (income generation) of a company are carried out, the business being a resident of another state. Signs of the presence of a permanent establishment (taxable presence of a foreign resident in a given jurisdiction) are: movable and immovable property (including buildings, structures, equipment, financial and other assets), personnel, the actual implementation of activities related to profit.

*The principle of territoriality* in international tax law implies the extension to the given fiscal territory of the exclusive rights of the state – tax sovereign. This means not only taxation of all incomes of residents and non-residents formed within the boundaries of a given fiscal territory (in essence, the principle of taxation of income from the source of their education), but also taxation of foreign income of taxpayers connected by economic ties with this fiscal territory (residents – subjects of FEA).

## International Double Taxation

*International double taxation* is the main fiscal problem in internationalization of the activities of both individuals and legal entities. Often it can lead to a complete absence of any incentives for international business operations, and therefore needs to be settled at the level of a single state – the jurisdiction of residence of the FEA entity, and at the intergovernmental level.

International double taxation (or double legal taxation) is a situation when two states which initially possess national tax sovereignty, tax the same income (or property) of the same tax subject with the same or similar tax form. The reasons for double legal taxation can be:

– recognition of the taxpayer as a simultaneous tax resident of two countries, in each of which, in accordance with the principle of residence, the total (global) income of a given natural or legal entity is taxed;

– the collision of two main principles of international taxation, i.e. the principle of residence, and the principle of taxation at the source of income, arising when in a foreign jurisdiction a subject of FEA is taxed according to the principle of withholding tax at the source of income generation, and in the country of residence of the given subject of international business, previously taxed, income is again included in the taxpayer’s total tax base, from which, according to the principle of residence, a similar tax is levied again.

*Alleviation of double taxation in national legislation*. National tax legislation can guarantee alleviation of double legal taxation on residents of a given fiscal territory by providing them with tax exemptions, tax credits (offsets) and tax deductions on taxes already paid in foreign jurisdictions – sources of income. The choice of a specific method of eliminating international double taxation depends on the specifics of the national tax legislation and does not depend on the wishes of the business entity.

*Tax exemptions method* is based on the principle of excluding certain types of foreign income from the tax base in the country of residence, i.e. involves the full transfer of rights to their collection in the country – source of income. If all incomes of a national resident from sources abroad are excluded from the tax base in this jurisdiction, then the end result is the absence of double taxation. This method of eliminating international double taxation guarantees the international competitiveness of domestic residents (legal entities and individuals) conducting commercial operations abroad.

*The method of tax credits (offsets) / imputation method* guarantees offset of tax payments already paid in foreign jurisdictions – sources of income, when calculating the amount of total tax liabilities for global income (payable in the taxpayer's country of residence). The amount of taxes previously paid abroad is deducted from the amount of the calculated global tax liabilities using the tax credit method.

*Tax deductions method*, although designed to facilitate international double taxation, does so less than tax exemptions and tax credits. According to this method, taxes paid in a foreign jurisdiction – the source of income, are deducted from the tax base when calculating the total tax liabilities in the state of residence of the taxpayer. Tax deductions do not contribute to the neutrality of taxes for subjects of foreign economic operations, since they make national residents less competitive in comparison with residents of countries that use tax exemptions and tax credits to eliminate double legal taxation.

*Case 37. The total income of the company is 100 units, 50 of which were formed in a foreign source country (S), and 50 units – in the jurisdiction of residence (R). The tax rates are: 10% in the source country, 30% in the country of residence. If there are no methods for eliminating double legal taxation, then the company pays 5 units tax in the source country (with tax base 50 units, tax rate 10%), and in the country of residence –30 units (with tax base 100 units, tax rate 30%). All taxes paid are thus 35 units, which for a total income of 100 units corresponds to the effective tax rate (the ratio of the total amount of taxes paid to the total amount of income received) of 35%.*

*When the method of tax exemptions is applied, 5 units tax is paid in the source country, and 15 units in the country of residence. (The tax base of the country R in this case is 50 units). The total tax payments are 20 units, which corresponds to an effective tax rate of 20%.*

*When applying the method of tax credits, the results are as follows. In the source country, the tax payment is 5 units. In the country of residence, the calculated amount of tax liabilities corresponds to 30 units. (100 units of the tax base multiplied by the tax rate of 30%). By the method of tax credits, we count the tax paid in the source country, therefore the amount of tax payment in R will be: 30-5 = 25 (units). Thus, all taxes paid by the company are equal to 30 units, which corresponds to an effective tax rate of 30%.*

*And finally, in the case of using the tax deductions method, we have the following: in the source country, 5 units tax is paid. In the country of residence, we deduct this amount of tax from the company's global (aggregate) tax base (100 - 5), and apply the tax rate of the country of residence (30%) to the calculated tax base of 95 units. As a result, the amount of tax paid in the country R will be 28.5 units. The total amount of taxes paid by the company is equal to 33.5 units, which corresponds to the effective tax rate of 33.5%.*

*In this example, the method of tax exemptions is the most advantageous for the company, the least is the method of tax deductions. At the same time, the tax deductions method still brings the company some relief from the international double taxation compared to the situation when there are no ways to eliminate double taxation.*

### Elimination of Double Taxation

*Elimination of double taxation in conventional law:* for the elimination of double legal taxation, agreements governing exclusively tax relations between contracting countries (the Convention for the avoidance of double taxation of income and property) are of fundamental importance.

International Tax Agreements (ITAs) solve the problems of eliminating double legal taxation when a solution cannot be found unilaterally. A classic example here is the case if the tax rate abroad for this type of tax is higher than the similar rate of the country of residence of the taxpayer. This leads to an additional tax burden for the subjects of FEA, which cannot be alleviated by using the methods of tax exemptions or tax credits.

Due to the complexity of the process of harmonizing the legal positions of each of the contracting parties, most of the ITAs are bilateral. Each specific tax agreement is a certain compromise between the national tax laws of the two contracting countries. The adoption of the ITA requires a certain modification of the national tax legislation, since after its signing and ratification procedure in the highest legislative body of the country, the ITA is integrated into the national tax law and becomes its integral part.

The ITA is classified into *general,* regulating all or several types of taxes (the so-called bilateral conventions for the avoidance of double taxation of income and property) and *special,* i.e. agreements on specific issues, regulating specific types of taxes or taxes, taken only from certain incomes.

It should be noted that ITAs, both general and special, regulate only relations between the contracting countries in the sphere of direct taxation (income and property). Thus, their area of competence includes taxes on income (profits) and taxes on property (including inheritance and gift taxes). ITAs do not apply to indirect taxes.

In their activities, economic agents, including subjects of international business, seek to use various ways to *minimize the tax burden.* At the same time, they seek to reduce tax payments both by legal methods and through illegal operations. Both individuals and legal entities use the following basic options for minimizing taxes:

– tax evasion;

– tax avoidance;

– tax planning.

Tax evasion, and in many cases, various ways of avoiding tax payments contradict both the legislation and the principles of tax planning. Persons using them are subject to persecution for abuses by national tax administrations. On the contrary, tax planning is initially legally permissible way to reduce the tax burden of business entities.

*Tax evasion* implies taxpayer's actions that are somehow related to violation of the law, i.e. the consequences of such activities are criminal in nature, implying the corresponding responsibility of tax evaders.

*Case 38. According to an investigation by the US Senate publicized in September 2012, Microsoft in 2009-2011, within the structure of its transnational group consisting of the parent American company and its many subsidiary overseas divisions, transferred $ 21 billion to low-tax jurisdictions, which makes about half of all sales from the company in North America. At the same time, taxes that did not reach the US budget are estimated at $ 4.5 billion. As a result, Microsoft's activities through its own subsidiaries in Puerto Rico, Ireland and Singapore contributed to the reduction of its effective tax rate from 35% (the base tax rate on profits in the US) to only 4%.*

*Another American company, Hewlett-Packard (HP), for tax optimization purposes actively used mechanisms of intracompany lending through its subsidiaries registered in low-tax countries. For example, to reduce aggregate tax payments, HP used in-house loans from affiliated business units in Belgium and the Cayman Islands.*

*Tax avoidance* is a behavior model of an individual or a legal entity when it does not become a taxpayer for various reasons. The two possible ways are: 1) to conduct legal activities permitted by law that do not lead to taxation and 2) to use methods prohibited by law (for example, to evade company registration or tax registration). In the latter case, tax avoidance will be classified as illegal.

## Topic 10 Review Questions

1. Provide the main categories and concepts concerning ITP.
2. List and describe the main operations to minimize taxes.
3. Describe the tax residency of individuals.
4. Explain the tax residence of legal entities.
5. Explain the essence of international double taxation.
6. Describe the methods and tools for eliminating double taxation.
7. What is tax avoidance and what are its consequences?

# TOPIC 11. LEGAL EXECUTION OF AGREEMENTS IN INTERNATIONAL BUSINESS

## Legal Regulation of Transactions

International business involves the development of cooperation between partners located in different countries in many areas, in particular: foreign trade activities, international investment cooperation, international industrial cooperation, international scientific and technical cooperation, etc. At the same time, signing various agreements with foreign counterparties, it is advisable to examine the national and international legal norms applicable to future transactions. Sources of law governing international transactions are:

– national legislation, in particular, the system of normative acts regulating the FEA of economic entities (domestic legal norms);

– international agreements, conventions, rules applicable if the given country is a counterparty to them or officially recognized them for use (norms of conventional law);

– established traditions of relations between the subjects of law in the relevant field of international business (norms of international legal custom).

Knowledge of the specifics of the legislation of the country of the counterparty, international legal norms and established customs in a particular area of international activity will help to avoid controversial situations in the process of execution of the transaction, as well as reduce legal risks in case of their occurrence.

International organizations (the UN, the ICC, the World Trade Organization (WTO), etc.) play an active role in foreign trade, seeking to create conditions for trade so that a participant in FEA of any state can be guided by a universal regulatory framework when signing contracts with partners from other countries.

A very significant achievement in the unification of legislation in the field of international sale of goods is the signing of the UN Convention on Contracts for the International Sale of Goods (Vienna Convention), which was adopted at the international conference of the UN convened specifically for this purpose in Vienna on March 10 till April 11, 1980. By the number of delegations represented at it, the conference became one of the most significant international forums ever convened on similar issues. The Convention entered into force on January 1, 1988. In the USSR, the Convention entered into force on September 1, 1991. Since December 24, 1991, Russia acquired all the rights and obligations of the USSR under multilateral treaties, the membership of the former Soviet Union in the UN passed to the Russian Federation. Consequently, the agreements concluded from September 1, 1991 by entities whose commercial firms and enterprises are located in Russia apply the provisions of the Vienna Convention, which has become an integral part of the legal system of the Russian Federation.

The Vienna Convention contains detailed rules on all major issues of contracts for the international sale of goods. It consists of four parts: “Sphere of Application and General Provisions”, “Formation of the Contract”, “Sale of Goods”, “Final Provisions” and contains 101 articles.

The legal form that mediates international commercial transactions is an *international trade transaction*, which refers to a contract between two or more parties located in different countries for the supply of goods, the performance of work or the provision of services in accordance with the terms agreed by the parties.

A prerequisite for a foreign trade transaction is its consummation with a foreign partner (counterparty). Accordingly, the international character of the contract arises from the fact that its parties (subjects) are commercial firms and enterprises located in different countries. A necessary condition for the emergence of a full-fledged international commercial contract is the existence of entities capable of expressing their will to oblige themselves to acquire rights and assume responsibilities (to coordinate their will). In confirmation of this ability, subjects of international commercial negotiations present documents showing their legal capacity (certificates, extracts from registration logs and charters, powers of attorney, etc.).

### International Commercial Transaction Procedure

The contract serves as the main commercial document defining the mutual relations of the participants and the main means of regulating business relations in the sphere of foreign trade turnover.

*Under the preliminary contract*, the parties undertake to conclude in the future the main contract on the conditions stipulated by the preliminary contract. The preliminary contract is concluded in the form established for the main contract, and if the form of the main contract is not established, then in writing. Non-compliance with the rules on the form of the preliminary contract entails its invalidity. After signing the preliminary contract or in its absence, the next stage of the conclusion of the contract is the conclusion of the main contract.

The preliminary contract specifies the period in which the parties undertake to conclude the main contract. If such a period is not specified in the preliminary contract, the main contract shall be concluded within one year from the date of the conclusion of the preliminary contract.

In cases where the party that has entered into a preliminary contract, evades the conclusion of the main contract, the other party has the right to go to court with the requirement of forcing to conclude the contract. The party unreasonably refusing to conclude a contract must compensate the other party for the damages caused.

Thus, the counterparties at the stage of forming the conditions of the preliminary contract should take into account all their interests, thereby taking care of the further proper execution of the contract and obtaining the corresponding commercial benefit as a result of concluding a particular transaction with foreign partners.

*An international commercial contract* may be concluded by drawing up a single document signed by the parties. Before concluding an agreement, the subjects of business relations negotiate the terms of the transaction. The ideal way to conclude an agreement is to meet partners “face to face” and sign an agreement directly in one particular place. In this case, the parties that know each other better draw conclusions about the business reputation, solvency and seriousness of the intentions of their future partner. However, due to the geographical remoteness of potential partners from each other, an agreement may be concluded by sending one of the parties a business proposal for concluding an agreement to another party, which is called an *offer*. The person directing the offer is called the *offeror.* Not every proposal related to the conclusion of a contract is considered an offer. Not recognized as an offer of various kinds of price lists, prospectuses, tariffs, advertisements. Consent to the proposal to conclude a contract (acceptance of the proposal) is called an *acceptance,* and the person from whom it proceeds is called the *acceptor.*

An offer sent to a specific person must be received by the offeree. If after the dispatch of the offer the market conditions or other conditions have changed, the offeror has the right to withdraw the offer if the offeree has not yet received it. If the notice of withdrawal of an offer has been received earlier or at the same time as the offer itself, the offer shall be considered as not received. From this it follows that as long as the offer does not arrive at the counterparty, it does not entail any legal consequences. In addition, until the offer is received by the offeree, the offeror himself is not legally bound by the offer made by him, which can be cancelled by him. For this, it is necessary that the message on the cancellation of the offer reaches the counterparty earlier or simultaneously with the arrival of the offer to him, i.e. it is necessary to cancel or withdraw the offer with the most rapid means of communication. For example, if the offer was sent by letter, then it should be cancelled by telegram or message by teletype.

The offer received by the counterparty may be accepted or rejected. The contract is recognized as signed at the time of acceptance from the person who sent the offer. *Acceptance* is the answer of the person to whom the offer is addressed, on its acceptance. The moment when the acceptance takes effect predetermines the moment of conclusion of an international commercial contract. The countries of the Roman-Germanic legal system link the conclusion of a contract with the arrival of acceptance to the offeror. In the Anglo-Saxon system of law, it is considered that a contract is concluded at the time of departure of acceptance. A similar idea was also reflected in the Vienna Convention, in accordance with which the conclusion of a contract takes place at the time (and, consequently, in the place), where the acceptance entered into force upon receipt by the offeror.

Acceptance must be complete and unconditional. Otherwise, it is not necessary to say that an agreement has been reached between the counterparties on all the issues raised in the offer. If the counterparty accompanies the acceptance of the offer with reservations, such a response is recognized as a rejection of the offer and at the same time a new offer. At the same time, the Vienna Convention considers additional or different terms of payment, quality and quantity of goods, place and time of delivery, volume of responsibility of one of the parties to the other or settlement of disputes to significantly change the terms of the offer.

The silence of the party to which the offer was sent is not an acceptance unless otherwise follows from the law, the custom of business turnover or from the previous business relations of the parties.

The party that sent the offer may set a deadline for waiting for the result, which must be determined in the offer in a way that does not allow for different interpretations, for example: “With the answer in Moscow no later than March

10”. The period of time during which the counterparty may accept the offer is set taking into account the circumstances of the transaction, including taking into account the “speed of the used means of communication.” When the written offer does not specify a time limit for acceptance, the contract is considered to be concluded, if the acceptance is received by the person who sent the offer, before the expiration of the period established by law or other legal acts.

In cases where a timely notice of acceptance is received with a delay, the acceptance is not considered late if the party who submitted the offer does not immediately notify the other party about late receipt of the acceptance. If the party that submitted the offer immediately informs the other party about the receipt of its acceptance that was received late, the contract is considered to be signed.

Similarly, when the person planning to accept the offer has changed their intention and decided to withdraw the acceptance: if the notice of withdrawal of the acceptance was received by the person sending the offer earlier acceptance or at the same time, the acceptance is not received. Otherwise, the acceptance is considered received, and the contract is signed.

Trade negotiations can also take place by exchanging letters of intent, conducting preliminary negotiations, and signing preliminary agreements. The preliminary agreement can have serious evidentiary value for clarifying the will and intentions of the parties in the event of a dispute. In addition, this evidence serves as a basis for clarifying the subject of the contract and its economic and legal purpose.

According to the Vienna Convention, the terms of the contract for the international sale and purchase are usually divided into *essential* and *non-essential.* Any offer must include all the essential terms of the contract and contain the final decision of the bidder to bind themselves with such a contract, subject to acceptance of his proposal. This requirement allows you to distinguish the offer from the call to the offer, as well as from the offer in which the person who made it, reserves the right to make the final decision on receiving an answer to the offer.

The contract is considered to be signed if the parties have reached agreement on all essential points. Significant are such clauses of the contract, non-fulfillment of which by one party results in non-acceptance of goods, termination of transaction and losses (name of the parties to the transaction, subject and object of the contract, price and basic terms of delivery signatures and seals of the parties). If a non-essential condition is violated, the other party does not have the right to refuse to accept the goods and terminate the transaction, but may only require performance of obligations and recovery of damages (guarantees and claims, shipping, arbitration, force majeure, etc.). The set of material and non-material conditions may vary depending on each specific transaction.

The law of different states unequally determines the conditions that are essential for a particular type of contract, including international commercial contracts. If according to the law of some states the essential, or necessary, terms of commercial contracts are the subject matter, delivery time and price (of the Roman-German legal system), then in the countries of the Anglo-Saxon legal system, to sign such a contract it is sufficient to agree on its subject; as for the price, if not agreed by the parties, the buyer is obliged to pay a reasonable price. Articles 455 and 506 of Civil Code of the Russian Federation provide that the essential terms of the supply contract are the name and quantity of the goods, as well as the delivery time. Such conditions as the price and quality of the goods, as a general rule, are not essential by virtue of the law.

Of course, the proposal may contain other conditions besides the above, however, in the absence of the latter, the proposal will not be considered an offer, leading to the conclusion of the contract if accepted by the offeree. These conditions can be made in separate articles of the contract, but each of them must be considered when concluding a contract of sale.

The contract subject to *state registration* shall be considered concluded from the moment of registration, unless otherwise provided by law.

On the other hand, the contract may be entered into by bidding. The contract is with *the person who won the auction.*

In Russia, there are no additional requirements as to the execution of contracts, such as: specific form requirement, registering with specialized agencies, etc. These requirements are mainly dispositive in nature and become mandatory only because of the incorporation of their provisions into the contract of counterparties. At the same time, in the Russian Federation, the original is the copy of the contract certified by the authentic signatures of the authorized persons of the organizations that have entered into the contract. Some regulatory bodies (customs, tax, credit organizations, etc.) also require the presence of a seal at the place where the contract is signed by the Russian counterparty. Facsimile and any other copies of foreign trade contracts are legally binding if the content and form of the contract does not contradict the law, but they cannot be recognized as the original of the contract.

After the conclusion of the contract, all previous negotiations, preliminary documents and correspondence about it can be considered invalid, and references to them in court will not be considered evidence.

The contract may be *modified* or *terminated* by simple agreement of the parties. At the same time, a written contract, which contains a provision requiring that any amendment of the contract or its termination by agreement of the parties be made in writing, cannot be changed or otherwise terminated.

In case of violation of the terms of the contract by one of the parties, the damaged party may *terminate* it. But at the same time termination of the contract is automatically impossible. A declaration of termination is valid only if it is made to the other party by means of a notice. If the damaged party does not declare termination of the contract, it remains in force.

At the request of one of the parties, the contract may be modified or terminated *by a court decision* only if there is a significant violation of the contract by the other party or in other cases stipulated by Civil Code of the Russian Federation, other laws or the contract. A violation of a contract by one of the parties is recognized as significant, which entails for the other party such damage that it largely loses what it was entitled to expect when concluding the contract.

The requirement to amend or terminate the contract may be filed by the party to the court only after receiving the refusal of the other party to the proposal to amend or terminate the contract, or not receiving a response within the time specified in the proposal or established by law or contract, and if it is not available – then in 30 days' time limit.

In the event of a unilateral refusal to perform the contract in full or in part, when such a refusal is allowed by law or by agreement of the parties, the contract shall be deemed terminated or amended, respectively.

When a contract is changed, the obligations of the parties remain in a modified form. Upon termination of the contract, the obligations of the parties shall terminate. In the event of a change or termination of the contract, the obligations of the parties are considered modified or terminated from the moment the parties enter into an agreement to amend or terminate the contract, and when the contract is changed or terminated in a court of law – from the moment the court decision on amending or terminating the contract comes into force.

The parties do not have the right to demand the return of what was performed by them under the obligation until the moment of changing or terminating the contract, unless otherwise provided by agreement of the parties.

If the reason for the termination of the contract was a substantial breach of contract by one of the parties, the other party is entitled to demand compensation for damages caused by the amendment or termination of the contract.

## Contract Content

Under Russian law, international sales transactions are concluded only in writing (Civil Code of the Russian Federation, Art. 162).

An international sale agreement must contain a number of necessary conditions. These conditions can be made in separate articles of the contract, but each of them must be considered when concluding a contract of sale. The structure and sequence of articles of the contract may be different. It depends on the nature of the goods and the terms of the contract. The approximate structure and content of the articles of the contract of sale are as follows.

1. *Title and number of the contract*. It should be noted that the name of the contract must correspond to the essence of the relationship and determine the type of contract in each particular case. The contract number is assigned by agreement of the parties in the order of registration of documents by one of the parties, most often at the place of the contract. In some cases, the number may contain registration data of two parties, i.e. be double.

2. *Preamble and definition of the parties*. The drafting of the contract must begin with an indication of the place and date of its signing, as well as with the designation of the parties.

3. *The subject of the contract*. In this section of the contract, it is necessary to clearly establish the set of actions determining the type and nature of the conditions of the transaction being concluded, i.e. the object of the contract, namely the purchase, sale, lease, contract, guarantee, provision of services, technology transfer. In the same section the object of operations is indicated. Indicate the full commercial name of the product, the range, size, model,

completeness, country of origin of goods and other data necessary to describe the product, including references to international and / or national product standards. In addition to the detailed description, brand and trademarks, state standard specification (GOST - *Russia*), technical standard (TU – *Russia*) can be used, which are necessary for the subsequent identification and classification of goods.

4. *Quantity of goods.* The quantity of goods to be transferred to the buyer is provided for in the purchase and sale agreement in the appropriate units of measurement or in monetary terms. The agreement on the quantity of goods can be reached by establishing the determining procedure for it in the contract. If the contract of sale does not make allowance for determining the quantity of goods to be transferred, the contract is not considered to be signed (Civil Code of the Russian Federation, Art. 465).

When determining the quantity of goods in the contract, the parties must agree upon:

- quantity units;
- measures and weights system;
- quantity establishing procedure.

5. *Quality of goods.* This section of the contract specifies the type of document confirming the quality of the goods supplied. Reference may be made to the attached quality certificate issued by the manufacturer or by an independent competent organization.

According to the customs legislation of the Russian Federation, the goods declared for importation into the customs territory, subject to mandatory certification, must have a certificate of conformity and a mark of conformity issued or recognized by an authorized body. Certificates of conformity are submitted to the customs authorities along with the customs declaration.

When importing goods into the Russian Federation, their quality, in addition to the certificate of conformity, may be confirmed by permits from other regulatory authorities.

6. *Price and payment terms.* Price in the contract is indicated in the monetary units of a certain currency for a specific unit of measurement of goods. The choice of the unit of measurement for which the price is established depends on the nature of goods and on the practices established in trading these goods on the world market. Upon delivery of goods of different quality and range, the price is set for a unit of each type, grade, brand separately.

When a commodity price is fixed in a contract, determining its basis for the place of delivery is of great importance. The *price basis* determines whether expenses related to shipping, insurance in transit, loading and unloading, warehousing, including the cost of packaging, packaging, labeling are included in it. The price basis is determined by applying the relevant term for INCOTERMS 2010 (for example, FAS, FOB, CIF, DDP, etc.) with an indication of the point of delivery of the goods.

The currency in which the price of the goods is set is called *price currency.*

When considering the *terms of payment,* the following points are usually established: payment currency, the method and procedure for calculating the goods supplied, the list of documents submitted for payment, protective measures against unreasonable payment delay or other breaches of contract terms.

*Payment currency* is the currency in which payment is made for goods, and it may or may not coincide with the contract price currency. If the payment currency is the same as the price currency, then during the execution of the contract, the contracting parties do not need to transfer one currency – the price currency – to another currency – payment currency. Therefore, in this case, there is no question about the exchange rate of currencies. If the price currency and the payment currency do not match, then the contract must specify the exchange rate and the method for determining it.

The parties usually set specific terms of payment in the contract. If the deadlines are not set directly or indirectly, then the payment is made after a certain number of days after the seller has received confirmation from the buyer that the goods have been placed at his disposal; under other conditions of delivery – within a certain number of days after notification of the buyer about the shipment of goods (depending on international trade practices).

Five main forms of payment for the goods supplied are widely used in the international trade practice:

- cash payment (payment by invoice);
- check form of payment;
- bill form of payment;
- letter of credit;
- collection.

The place of payment of the price may be important in terms of the fulfillment by the buyer of his primary responsibility in the conditions of existence in some countries of strict measures of state regulation and control with regard to the transfer of foreign currency abroad. Therefore, counterparties should choose a place of payment that would be minimally affected by this regulation.

7. *Basic terms of delivery*. The basic terms of delivery determine the obligations of the seller and the buyer for the delivery of goods, the moment when the risk of accidental loss of goods from the seller to the buyer passes, and the numerous costs associated with transporting the goods are clearly distributed between them. They are expressed in certain terms, the interpretations of which are given by the ICC in the International Rules for the Interpretation of Trade Terms (INCOTERMS). These conditions are called basic because they establish the basis of the price of goods depending on whether the costs of transportation, customs clearance, etc. are included in the price of goods or not.

The edition of INCOTERMS 2010 contains 11 basic terms of delivery. Although INCOTERMS are extremely important for the implementation of the contract of sale, a large number of problems that may arise in such a contract are not considered at all, for example, transfer of ownership, other property rights, breaches of agreement and the consequences of such violations, as well as exemption from liability in certain situations. It should be emphasized that INCOTERMS are not intended to replace the terms of the contract required for a full contract of sale either through the inclusion of regulatory conditions or individually agreed terms.

8. *Date and time of delivery*. Parties agree upon the *delivery time* and the time periods stipulated in the contract, during which the seller must transfer the object of the transaction to the buyer.

There are various ways to establish delivery times:

– determination of the fixed calendar day of delivery (date, month, quarter and the interval between dates);

– determination of the period during which the delivery must be made.

The use of special terms to determine the delivery time: “immediate delivery”; “without delay”; “from stock”; “goods available on site”; “as ready”; “as the consignment of a consignment of goods (of a specified weight, size, etc.)”; “during the summer”; “after the opening of the season of navigation.”

If the delivery is carried out in batches and stretches over a long period of time, it is advisable to provide for a *delivery schedule* with clear instructions on which goods, how many, and in what period it is intended to deliver. Along with the definition of delivery periods, a schedule for the delivery of goods (ten-day, daily, hourly, etc.) can be established.

9. *Packaging and labeling of goods.* Sections on packaging and labeling are included in the contract when, by the nature of goods, packaging is necessary. In this article of the contract, it is necessary to determine the type and nature of the

package, its quality and dimensions, methods for marking each place of packaging (importer details, contract number, weight and overall characteristics of places, number of places in a batch, lot number), methods of payment for packaging.

Packaging requirements for the delivered goods may be minimal if the packaging is to ensure the safety of goods only during its transportation. Usually the contract stipulates:

– outer packaging (boxes, cardboard boxes, barrels, containers, etc.);
– inner packaging, inseparable from the goods.

Marking may have a different look. The main thing is that it should contain shipping information, directions to transport organizations on how to handle the goods transported, warning of dangerous goods.

10. *Delivery and acceptance of goods*. Goods delivery refers to the transfer of goods by the seller in the possession of the buyer in accordance with the terms of the contract of sale. As a result of such a transfer, the buyer gets the opportunity to exercise complete control over the goods (delivery of documents of title to him). The cost of delivery includes the cost of weighing, counting, labeling, packaging, etc.

*Acceptance* is the verification of compliance of the quality and completeness of the product with its characteristics and technical conditions specified in the contract.

In this section, first of all, the exact place of actual acceptance of the goods is established, which can be selected both in the seller’s country and in the country of the buyer.

In the practice of international trade, there are two methods of acceptance of the actually delivered goods:

– selective method;
– method of checking all delivered goods.

Delivery-acceptance of the goods is made by quantity (weight) and quality of the goods. Terms of delivery of goods in quantity and quality, as a rule, do not match. The buyer is usually required to make a quantitative acceptance immediately upon arrival of the goods. Longer periods are often set for quality acceptance.

The result of acceptance is documented.

11. *Insurance.* Depending on the terms of the contract, the obligation to insure the goods lies either on the seller or on the buyer. This article provides the following points:

- what kind of cargo is subject to insurance;
- what risks the cargo is insured against;
- who provides insurance;
- whose benefit cargo insurance is.

In order to avoid possible complications in the contract, it is very important to specify all insurance conditions.

Typically, cargo insurance is carried out within the value of the goods on the CIF plus 10%. But the goods may be insured for a larger value.

12. *Penalties.* Contracts usually provide for a number of penalties through which the buyer encourages the seller to fulfill his obligations and is protected in case of possible commercial risks.

Penalties increase depending on the duration of the breach of obligations.

The contract also establishes the maximum value of the fine, depending on the value of goods not delivered on time. When discussing the size of penalties, two types of damage should be considered:

- obvious damage;
- lost profit.

Along with penalties, the contract may provide for the right of the parties to recover damages. Moreover, such a penalty does not exempt from the fulfillment of obligations under the contract.

13. *Force major*. This article of the contract provides for exemption from liability due to the occurrence of force majeure circumstances. These circumstances include:

– natural disasters (earthquakes, floods, fires, epidemics, etc.);

– political and trade-political situations (wars, strikes, embargoes, etc.).

This section indicates the time limit for force majeure and provides their agreed list.

The contract usually specifies the deadline for force majeure. If a force majeure lasts longer than the period agreed upon and specified by the parties in the contract, then each party has the right to refuse to further fulfill its obligations under the contract, and neither side has the right to demand compensation from the other party.

14. *Arbitration (the procedure for the settlement of possible disputes).* This article of the contract must specify the place and name of the arbitration, set the terms for the parties to arbitration. It should be borne in mind that the arbitration clause of a contract is recognized to be legally valid regardless of the validity of the contract, of which it is an integral part.

15. *Other conditions*. Other terms and conditions may include reservations for the amendment and the procedure for modifying the contract. This article of the contract may contain requirements to ban re-export of goods to third countries, stipulate the conditions for the allocation of additional costs, advertising of this product, confidentiality, patent reservations, as well as conditions for the transfer of rights and obligations under the contract to third parties.

16. *The final wording, the language of the contract and correspondence.* Usually, in this part of the contract, it is indicated in what languages and in how many copies this contract is signed with the proviso that all copies have the same

legal force.

If the parties from the very beginning do not specify in which language the correspondence will be conducted, then according to the custom established in the practice of international trade, the language of correspondence between the parties becomes the language in which the offer to make a deal is made.

It also indicates the time of *the contract entry into effect.* Usually the contract comes into force from the moment of its signing.

17. *Legal addresses and signatures of the parties.* The legal addresses of the parties are indicated. This data is certified by the signature of the person authorized to sign this contract and the seals of the parties.

### Topic 11 Review Questions

1. What are the main legal documents in the field of unification of legislation in the field of international sale of goods?
2. Describe the procedure for international commercial transaction.
3. What are the "essential and non-essential" terms of an international commercial transaction?
4. Explain the procedure for termination of an international commercial transaction.
5. Retell the content and structure of a contract (for example, the contract of sale).

# TOPIC 12. FEATURES OF INTERNATIONAL BUSINESS MANAGEMENT OF DIFFERENT COUNTRIES

## Business Culture and Ethics in International Business

*Business culture* can be defined as a system of values and norms within national boundaries which form the basis of commercial activity and shape the behavior of people and companies in a given country.

In the study of national business cultures, the most important are language and education, social values and attitudes, social institutions, religion and material culture. These elements are present in any society, but their manifestation in a particular country and, therefore, their impact on doing international business with this given country can be unique. The interaction of national business cultures is relevant for the negotiation process in the export and import of goods (services), when investing abroad, when entering into foreign economic contracts, for the communicative process within a JV or branch with multinational personnel.

The components of business culture are ethics of business communication and business etiquette. The term *ethics* is derived from the Greek word *ethos, i*.e. custom, character. In broader terms, this term is called the doctrine of morality and ethics. At the same time, righteousness in the traditional interpretation is understood as the internal setting of the individual to act according to their conscience and free will, as opposed to morality, which, by law, is an external requirement for the individual behavior.

The concept of *ethics* refers to the behavior of individuals. In the narrow sense, ethics is an aggregate of individual's beliefs about the correctness of his behavior and decisions. Under the influence of ethical standards that guide company employees in making individual decisions (and, in general, when doing business), business ethics is formed. The concept of *ethical behavior* in most cases refers to behavior that is consistent with generally accepted social norms.

*Business communication* is formed in the process of doing business. It represents a certain type of social relations and is expressed in the establishment and development of necessary contacts, the exchange of information, conditioned by the needs of joint economic activities.

Factors conditioning differences in the business culture of different countries are: social culture, religion, political philosophy, economic philosophy, education, language.

The list of above factors is open, although sufficient to understand the place and role of business culture in international business. For example, the influence of political and economic philosophy on culture is manifested in the fact that in different countries such values as freedom, justice, and private initiative are understood differently.

One of the most important elements of business culture is language. In a company with representatives of different cultures (for example, in a JV), the language barrier can lead to inconsistency, and more broadly – to the lack of a "team spirit". In the last decade, English is practically the only international language in business.

Business culture is a vivid manifestation in *business communication*. When negotiating in international business, knowledge of the national style of negotiation can help to understand the approaches to the formation of the delegation in the negotiations, the specificity of the decision-making mechanism, the degree of delegation of the authorities, etc. Knowledge of the national specificity of negotiation will help to avoid perception errors, make a more favorable impression on the partner, and establish long-term partnerships with them. The most pronounced national styles of negotiation are Western, Eastern, Arabic and Latin American. At the same time, representatives of specific countries may also have their own characteristics in business communication.

The *social structure of society* rests upon the foundations of social organization. Despite the fact that the social structure includes various aspects, for a deeper understanding of business culture it is necessary to analyze individualistic and collective approaches to business organization in greater detail.

Each company has its own business culture. It is the sum of all beliefs, ways of thinking, values and norms on which basis employees of the company make their decisions. The corporate culture of the company is formed after the foundation of the company during its development. Its main task is to implement the internal integration of all employees and successfully work in their markets.

In modern Western civilization, the individualistic approach is of paramount importance; it implies the person's personal abilities, talent, and opportunities, while belonging to a particular class in society is often ignored. Such an approach can have both positive and negative aspects. In the USA, great importance is attached to entrepreneurial initiative and individual abilities which ensure the leadership of this country in such industries as the production of personal computers (*Apple Inc*.), software (*Microsoft Corporation*), retail (*WalMart Stores, Inc*.), biotechnology (*Amgen Inc*.), many of which were founded by individual entrepreneurs. The success of these companies is due, among other things, to the personal qualities and abilities, talent of the people who founded them.

Collective approach is fundamentally different from ways of doing business discussed above. In Japan, the Land of the Rising Sun, the personal status of a person is determined by the status of the group of people which they belong to. According to some researchers, the Japanese tend to associate themselves with the company or business structure they work for, more than the type of their professional activities. For the Japanese, the fact that they belong to one group or another is very important, and this feature can be successfully applied in management. With this approach, a person (an employee) very closely associates the company's victories with their own personal achievements.

Collective approach reduces the motivation of employees to change their place of work, so in Japan there is a mechanism of lifelong hiring and over time it contributes to the accumulation of experience, reputation, and also the establishment of professional relations exclusively in the field of specialization of the company. This approach allows managers, who are supposed to pass through all the steps of the career ladder (from the most initial positions to the leading ones), perform their functions most efficiently and skillfully, since they are not only theoretically, but also practically well aware of the problems and opportunities of their organizations.

*Religion* is a special form of awareness of the world, conditioned by belief in the supernatural. It includes a set of moral norms and types of behavior, rituals, religious activities and the unification of people in organizations (church, religious community). The system of ethical and moral norms and values is often the product of a particular religion.

*Business etiquette* is a more or less strictly regulated protocol that formalizes service relations in the process of doing business and is based on the norms of behavior adopted in a particular society.

The effectiveness of international business and the achievement of goals set by entrepreneurs largely depend on the ability to build interpersonal relationships with partners, employees and consumers. Of particular importance in this process is taking into account the peculiarities of business behavior due to the system of values and ethnocultural specificity of another country.

Business etiquette is manifested both at the verbal level (in speech etiquette, manifested in greeting, appeal, gratitude, apology, etc.) and at non-verbal level (in wordless communication, in which the facial expressions, various poses, gestures, movements of a person are important, etc.).

Non-verbal communication is important in business communication. This method of communication is used in all cultures and languages of the world. Most different types of gestures in many countries can be perceived differently.

*Case 39. A "thumb up" gesture in most countries means that "everything is fine", but in Brazil and Greece this gesture is considered indecent or obscene. Another example is the tradition of establishing visual contact during negotiations. In Western countries, it is believed that if a partner is not making eye contact, then he or she is hiding something, and should not be trusted. On the contrary, in a number of Asian countries, direct eye contact with the interlocutor is like an affront, and testifies to the aggressive mood of the partner.*

Knowledge of non-verbal communication methods and local specificity is very important because it allows one to achieve more in business negotiations, and helps to avoid unnecessary difficulties and misunderstandings between partners.

*Education* plays a crucial role in the life of society. Modern education allows people to acquire competences and skills, including those necessary for running a business. Education complements the role of the family in society, because school has not only academic, but also an educative function. School helps young people to acquire the norms and moral ethics adopted in society, to realize its social structure, the history of their country, etc.

From the point of view of international business, education plays an important role in determining the competitive advantage of a nation. Highly educated, skilled labor is an important determinant of the economic growth of any state. Michael Porter notes that after the end of World War II, Japan possessed practically nothing but highly skilled workforce. However, according to Porter, Japan had a rich heritage in the field of education, which allowed it to educate high-quality specialists and highly skilled labor. In Japan, he noted, a lot more engineers come out of technical universities every year than in the United States. Education in primary and secondary schools is based on high standards in mathematics and science. Primary and secondary school education is extremely competitive. Japanese schoolchildren have the same knowledge in math as American college students.

Apart from the issues of employment and dismissal, cross-cultural differences in the ethics of company behavior in relation to employees include wages and ensuring working conditions. For example, a company must comply with the rules governing the duration of the working day and wages established by national law. However, in Japan, tradition requires that younger employees of the company do not leave the office as long as their senior colleagues remain at work. At the same time, in the USA, as a rule, it is the manager who last leaves the office.

Ethical problems are also related to how employees of a company build relationships with each other, with buyers, competitors, shareholders, suppliers, intermediaries, etc. Ethical issues, for example, arise in such areas as negotiation, contracting. Cross-cultural differences in business practices cause additional ethical challenges for employees of companies involved in international business. Representatives of different cultures have different evaluations of the ethical nature of certain actions. Thus, in a number of countries, small bribes and gifts are part of normal business practice. Not to mention the problems of corruption, for which, to a greater or lesser extent, individual countries and representatives of their business world are notorious.

## The USA in the International Business

*Fig. 29 – US National Symbols*

The US economy has long been distinguished by high profitability of enterprises, labor market flexibility, as well as potential to create jobs. The American version of capitalism until very recently was one of the most successful and competitive models of macroeconomic development, characterized by liberal business philosophy, low level of government involvement in the sphere of competence of the private sector, effective management, based on the priority of individual values and on the speed of decision making. Due to the success in economic development achieved in the 1980s-1990s, the American model of organization and business was considered one of the most progressive in the world.

Nevertheless, it was the specifics of American business that initiated the birth and development of the first global crisis of modern times, the trigger for which was the overly liberal situation in the US mortgage and financial markets in the first decade of the XXI century.

Thus, promotion of high-risk entrepreneurial activity, low degree of regulation of business processes and elimination of the government from direct entrepreneurial activity, i.e. all that was previously considered to be the merits of the American model of development and business, became its main disadvantages with the onset of the global crisis of 2008-2009.

Despite the difficulties of the post-crisis stage, indicated mainly by the reduction of employment and a significant drop in the dynamics of economic development, the US economy at the beginning of 2019 is in a fairly stable competitive state. For example, in 2018, the United States topped the WEF rating of the most competitive countries in the world. The world's top 20 largest companies in *Fortune Global 500* in 2018 include nine US companies. Entrepreneurial spirit, profit orientation and innovative character, the desire to retain achieved benefits throughout the global economic space – all these features of American-style business are still relevant.

The development of the US economy and the global business expansion of American economic entities have a solid scientific and technical foundation and theoretical base. The course of the government is constantly adjusted to reflect the changing situation in the national and global economy. Thanks to the success of its economic development, the USA at one time gained the upper hand in the sphere of ideology, laying down the principles of liberal market capitalism in the global system of world economic relations. Dominance in the modern world economy provides the USA with strategic advantages practically in all spheres of activity, including those indirectly connected with the economy. The unsurpassed scientific and technical potential of the country, supported by attracting leading scientists and practical specialists from various regions of the world to the USA, multiply America's successes manifold. In the United States, conditions for the pursuit of business and science, education and medical care have been created and are constantly improving, which continues to attract foreigners to the country. American universities and business schools are world leaders of various ratings of educational and scientific institutions of the world, and the United States is unrivaled in the area of health care expenditures (about 15% of GDP). American TNCs are among the most powerful in the world, but only in terms of their production potential and the level of technology development. The United States has embarked on the path of sustainable development and post-industrialism based on new information technologies. The country's specialization in the world economy is changing accordingly. The United States is a forge of world technology and a leading global service provider.

In business development of the United States priority is currently given to high-tech manufacturing (aerospace, biotechological and pharmaceutical industry, microelectronics), as well as the service sector, in which finance (banking, insurance), management consulting, R&D and information technology are the key. Thus, among the world leaders in these areas are American companies *Boeing, Pfizer, Johnson & Johnson, Intel, Citibank, Wells Fargo, PricewaterhouseCoopers, Apple, Google* and *Microsoft*. It should be noted that American companies have succeeded in businesses that have a network effect (in this case, companies' revenues grow due to a significant increase in consumers accessing such "network structures"), as exemplified by *Microsoft, Google, Citibank, PricewaterhouseCoopers*.

At the same time, in traditional industries and the service sector, American companies do very well in the field of international business. Thus, in the field of fast food in the world market, one of the leaders is *McDonald's*, and in the soft drinks industry *Coca-Cola* and *PepsiCo* have gained worldwide fame. It is worth noting that globalization has its unofficial synonyms: "McDonaldization" and "Coca-Colalization", which further emphasizes the characteristic feature of the activities of American companies in foreign markets, i.e. the use of a global business strategy.

*Case 40. When Coca-Cola entered the Chinese market in 1928, the name of the product was not officially translated into Chinese. However, some Chinese merchants did this on their own, conveying the sounds of "ko-ka-ko-la" in hieroglyphs. Unfortunately, they did not think about the meaning of the inscriptions; as a result, names like "bite wax tadpole" were born. Coca-Cola marketers sifted through 200 different hieroglyphs, but all in vain – they could not make a beautiful phrase. As a result, they had to change the sounds to "ko-ku-ko-le", which translates as "a mouthful of happiness".*

*Case 41. The "Big Mac" index was proposed by The Economist magazine in 1986. It is based on the theory of purchasing power parity which reflects the correlation of national currencies by their purchasing power to a specific set (basket) of goods (services), but instead of a basket, a standard hamburger is considered which contains a sufficient amount of food components and is offered by McDonald's in all countries. According to its creators, the "Big Mac" index makes it possible to determine the real exchange rates of exchange currencies (regardless of inflation) of 57 countries of the world. According to a number of experts, the Big Mac index makes it possible to see the disparity between the currencies of countries with similar income levels. Others criticize this approach, pointing out the difference in the wages of workers, rent and other expenses. In addition, in some countries, McDonald's is viewed as a restaurant rather than a fast-food cafe. And in India, instead of "Big Mac", the price of "Mac Maharajah" with chicken instead of beef is considered, although, according to the publication, it does not matter, since the share of the cost of meat in the total cost of a hamburger is less than 10%.*

The position of *United Airlines* and *American Airlines* (the latter merged with *US Airways*), as well as *Delta*, is strong in the global passenger air transportation market. In the global automotive industry, *Ford Motors* occupies a most stable position, which has long ago departed from the former strategic visions of its founder H. Ford (one black car for all), and uses a transnational strategy to penetrate foreign markets, adapted to the needs of specific consumers living in different countries.

*Case 42. Before the advent of tablet computers, the emphasis in the development of portable computers for Internet access was made on netbooks – inexpensive, low-performing devices with rather inconvenient keyboard and small (about 10 inches) screen. The respective segment had its leaders: companies Acer, Asus, HP, Dell, Samsung, Sony, Toshiba and Lenovo, which produced netbooks based on Intel or AMD processors and Microsoft or Linux software. It was believed that the future of the computer industry belonged to netbooks, due to growing consumer mobility and the rapid development of social networks. At the same time, netbooks were extremely inconvenient to use: their soft was slow and poorly adapted to the computer architecture of a lower level compared to traditional laptops; their keyboard and screens were tiny, which was not very popular with consumers. In addition, because of their folding configuration, netbooks were inconvenient to work on the move (for example, when on public transport). This feature of netbooks was noticed by Apple, then headed by Steve Jobs. As an alternative for consumers, Apple in 2010 came up with iPad, which was cheap, but no less functional. Neither was a direct replacement for the netbook. However, consumers immediately recognized the usefulness of these devices and turned their back to netbooks. IPod, the first of Apple players, faced a similar situation (Fig. 30).*


*Fig. 30 – The first iPod*

## European Union Countries in International Business

*Fig. 31 - EU symbol and map*

It is worth noting that the market economy of free competition, originally traditional for European capitalist states, underwent major changes in the twentieth century. For a long time, state-owned or closely associated with the state sector companies dominated in Western Europe. A return to the unchanged conservative values of capitalism began only in the early 1980s.

In the world of international business, the United Kingdom and Ireland are represented primarily in the field of finance and management consulting (London is the world's largest financial center). The British banks *HSBS Holding*, *Barclays*, *Lloyds* and *RBS*, the financial company *Prudential* and *Aviva Insurance* (both are British), as well as the *Irish Association*, specializing in management, information technology and outsourcing, are among the world's largest global companies. In addition, British pharmaceutical companies *GlaxoSmithKline* and *AstraZeneca* are widely known in the pharmaceutical industry, and *Vodafone* is one of the largest companies in Europe in the telecommunications market representing the UK. In addition, British companies are successfully engaged in international business and in traditional sectors of the economy, such as: power engineering (*BP, Centrico, SSE*); retail (*Tesco*); Automobile building (*Rover, Rolls Royce*), Irish building materials producer *CRH* is also one of the world leaders in its segment. Moderate taxes, qualified personnel, the use of advanced science and technology, flexible labor market in the absence of excessive trade union ambitions – all of these are the main competitive advantages of Ireland and the UK in the field of international business.

In Germany, the priority was given to the decentralization of the economy, with a large role of both large private companies and banks (*Siemens, Allianz, Bayer, Commerzbank, TUI*, etc.) and small and medium-sized businesses. Even the state-owned railways in the recent past were transformed here into a joint-stock company *DB Group*. In turn, the state guarantees high standards of social and transport infrastructure, but it does not interfere too much with business activity of entrepreneurs. It is worth noting that the German diversity of social market economy is based on small and medium-sized businesses (German *Mittelstand*).

Nevertheless, German companies representing large business are widely known in the international arena. Thus, in the world market, Germany holds strongest positions in mechanical engineering, including the automotive industry (*Volkswagen, BMW, Daimler*) and energy engineering (*Siemens, Robert Bosch, ThyssenKrupp, RWE*), in the chemical and pharmaceutical industry (*BASF, Bayer*), finance and insurance (*Deutsche Bank, Commerzbank, DZ Bank, Allianz, Munich Re*), wholesale and retail trade (*Metro, Edeka, Phoenix Pharmahandel*), energy (*E.ON*). All of the above companies are privately owned.

Similarly to Germany, *Austria* has a model of development of the economy and business, with the priority of private forms of entrepreneurial activity with a strong social and infrastructural policy of the state.

On the contrary, in *France*, it is the state sector of the economy that has the most prestigious and profitable work in particular honor. Social market economy in its French version means a significant care of the state over the economy, a high level of social guarantees for numerous civil servants and limited support for private entrepreneurship. The flagships of the French economy are companies whose share is still owned by the state – *Renault, Air France, SNCF, France Telecom*, etc. At the same time, the country has one of the most developed health and social welfare systems in the world. Small and medium-sized businesses in France, which represent the private sector of the economy, due to the peculiarities of the development model oriented to the active role of the state, are not too competitive in foreign markets. Leaders of large French businesses are mainly private companies such as *Totale*, *GDF Suez*, *Electricite de France* in the energy sector, *BNP Paribas, Credit Agricole* and *Societe Generate* in banking, *AHA* and *CNP Assurance* in insurance, *Peugeout* and *Michelin* in automotive and tire manufacturing, *Carrefour* and *Auchan* in retail, *Bouygues* and *Lafarge* in construction and building materials, *Vivendi* in the media business, Sanofi in pharmaceuticals, Alstom in transport engineering.

In the countries of Southern Europe – *Italy, Greece, Spain and Portugal*, the model of economic and business development also implies a strong role of the state. Of the most competitive world-class companies in Southern Europe, only Italian and Spanish ones are in *Fortune Global 500* list due to the large scale of the economies of these two countries. In the area of finance, banking and insurance, these are *Unicredit Group, Exor* and *Assicurazioni Generali* (Italy), as well as *Banco Santander, Banco Bilbao* and *Mapfre* (Spain). The high-tech sector of the economy is represented by the Italian aerospace company *Finmeccanica*, the Spanish *Iberdrola* – one of the world leaders in the use of renewable energy sources, as well as telecommunications companies *Telecom Italia*, *Telecom Iberia* and *Telefonica*. In the traditional industries – energy equipment manufacturing and construction *Italian ENI* and *Enel*, Spanish *Gas Natural Fenosa, Repsol* and *ACS* are in the list of the largest companies in the world.

*The Nordic countries* have historically focused on Social Democratic values, on business and society partnership, on redistributing revenues in favor of low-income citizens, so there the social market economy was originally a "welfare economy". Nevertheless, entrepreneurial initiatives were strongly supported at the state level. Reducing taxes and encouraging competition has revived the entrepreneurial spirit of business entities, which by the 1990s had already become major players at the global level (*Nokia, Ericsson, Lego, Maersk*, *Carlsberg*, etc.). The strength of the activities of companies representing the countries of Northern Europe is a niche specialization in world markets due to the product differentiation strategy. Although Scandinavian and Finnish companies are often forced to adapt to the conditions of international business dictated by large countries, they feel confident enough in their narrow segments of the world market because they have quite substantial competitive advantages that enhance the overall global competitiveness of the Nordic countries.

*Case 43. Many companies representing the countries of Northern Europe hold leading positions in individual niches of the modern world market. Thus, the Danish NOVO Nordisk produces almost half of medical insulin, providing substantial assistance to patients with diabetes, whose number on the planet is about 350 million people. The company has high shares profitability that reaches 30%. Other Danish companies are also strong in terms of niche specialization: Lego is number 1 company in the world of children's plastic tinker toys; Oticon enjoys deserved fame as a manufacturer of hearing aids. Finnish Nokia is one of the world leaders in the smartphone market; Swedish Ericsson occupies stable competitive position in the field of telecommunication equipment manufacturing. Finland, in addition, can be proud of such world-renowned companies of the world level as Cope (elevators and escalators), Rovio (computer games), Nokian Tires (car tires), and its national airline Finnair tops the list of the safest air carriers of the world. Sweden is strong in mechanical engineering, typical representatives of which are Sandvik (machinery and equipment for the mining industry) and Volvo (cars, trucks and buses). Norway, which possesses colossal energy resources, has a world-class company Norsk Hydro.*

## Japan in International Business

*Fig. 32 – Mount Fuji, pagodas and sakkura: national symbols of Japan*

The engine of economic growth in Japan in the second half of the XX century was the accelerated development of exports based on the clearly undervalued national currency. Essentially, the model of development that was laid by the Americans in the late 1940s-early 1950s, flourished in Japanese economy until the end of the XX century, although by that time the world had already changed drastically. At one time, Japan was able to make the necessary changes in the post-war macroeconomic strategy, abandoning the already mastered production of cheap imitations of Western goods, based on low prices and low wages. A little later, Japan achieved world leadership in operational efficiency, with an emphasis on competition based on low costs and high quality products. However, now in a competition based only on economies of scale and product quality, Japan is no longer able to surpass its rivals. For Japanese managers, a new time of change is coming due to the introduction of a model based on innovation and a well-developed strategy.

The problems characteristic of the Japanese economy as a whole affected the positions of Japanese companies and banks in the world of international business. So, in the 1980s ten largest banks in the world included mostly Japanese credit institutions, but at the present time the positions of Japanese international banks are not the same: they no longer have global leadership (the only exception, perhaps, is *Sumitomo Bank*). Gradually, electronics companies are also losing their leading positions: so, if Sony used to be invariably innovative in nature, now it has too many competitors (including those from Europe, the USA, the Republic of Korea and the PRC) which present a variety of innovative products, against the background of which the Japanese company is no longer so interesting for consumers.

Japan's position in international business has traditionally remained strong in the automotive industry (*Toyota, Nissan, Honda, Mitsubishi, Suzuki, Mitsui, Mazda*, *Subaru* and other Japanese companies jointly produce the most cars in the world), electronics and electrical engineering, including medical equipment (here *Hitachi, Sharp, Toshiba, Panasonic, Sony, Ricoh, NEC, Canon, Fujitsu* and others are strong), finance and insurance (most famous are *Sumitomo Mitsui Financial Group, Sumitomo Life Insurance, MS&AD Insurance Group and Nomura Holding*), car tire production (*Bridgestone*). The Japanese, like the Americans, are focusing on economies of scale and a global or transnational strategy to enter foreign markets. The corresponding competitive advantage of the Japanese style of conducting international business, based on the emphasis on quality, low costs and innovative products, continues to bring success to a number of national companies in the global system of global economic relations.

Thus, even the current difficulties in the national economy do not interfere with Japanese companies, many of which are globally competitive enough to be leaders in certain segments of the world market for goods (services). Competitive positions of the Japanese are further enhanced if they use advanced American or European designs and technologies, enter into SAs (*Renault-Nissan*) with foreign companies, or acquire the rights to relevant innovative developments (as *Sony* acquired in its time a division of the Swedish *Ericsson*, which produced mobile phones).

**PRC in International Business**

*Fig. 33 – China, the world leader in economic growth*

As a result of the economic reforms, the PRC has become one of the largest powers in the world with a highly diversified economy and great potential for development. The PRC ranks first in the world in terms of the scale of foreign trade, it has the largest gold and foreign exchange reserves, and the use of Chinese currency in international operations is growing.

The essence of the Chinese transformation was the transition from planned to market economy. A distinctive feature of the Chinese reform strategy was the gradual nature of the changes, the preservation at the initial stage of the transformation of the basic elements of the former (command-administrative) economic system with the gradual introduction of the principles of market competition and the consistent formation of market institutions.

In terms of GDP, since 2010 China has been the second biggest world economy, outrivaled only by the United States.

China currently accounts for more than 12% of world exports – more than any other country in the world. Nominal exports grew by an average of 17% each year from 1990 to 2012, thanks to China's entry into the WTO in 2001.

The commodity structure of China's exports is becoming more complex and sophisticated. If in the first half of the 1980s primary products dominated in the export (agricultural products, petroleum, minerals), since mid-1980s export of industrial goods has increased. Initially, this group of goods (1980–1990s) was represented mainly by labor-intensive products (clothes, shoes, toys, etc.), then capital-intensive products become more significant exports, and after joining the WTO export specialization of the PRC shifted towards products with a high proportion of added value. The share in export bulk of engineering industries in the 2000s increased by almost 50%, while the products of high-tech industries (computers, electronics, aerospace technology, telecommunications equipment, etc.) account for about 1/3 of all exports. Having entered the WTO, the PRC began to gradually lose its competitive advantage in the export of labor-intensive products.

China accounts for 10% of imports in the world, and the growth in demand for raw materials from Chinese factories has become the driving force of growth in the countries that supply these raw materials, including Australia and Brazil.

In the last 10 years Chinese imports have seen a sharp increase in demand for minerals, especially for fuel resources. In addition, China has established itself as a net importer of agricultural products. The volume of agricultural imports from the United States (soybean, cotton, leather, and hides) increased significantly. However, along with the growth of imports, there is an increase in the scale of financial support for agriculture and the increased specialization of China in world trade in agricultural products (export of fruits, vegetables and other labor-intensive crops).

The share of processing trade, which in China was in the import of components and the export of finished products, in the total export volume fell to 30%, whereas in the early 2000s it amounted to more than a half.

The leading trade partners of China are presented in Table 16.

The conditions for doing business in the PRC are constantly improving. The legal framework for entrepreneurship is improving, for Chinese private firms and foreign companies, access is available to previously closed areas of activity (this was one of the conditions for China's accession to the WTO). Economic life in the country is increasingly subject to the laws of the market.

**Table 16**

**China's Leading Trade Partners in 2017 ($ billion)** [50]

| Position | Country | Turnover |
|---|---|---|
| 1 | USA | 461,1 |
| 2 | Hong Kong | 259,9 |
| 3 | Japan | 229,8 |
| 4 | The Republic of Korea | 224,9 |
| 5 | Taiwan | 153,2 |
| 6 | Germany | 130,1 |
| 7 | Australia | 94,3 |
| 8 | Malaysia | 80,5 |
| 9 | Vietnam | 71,8 |
| 10 | Singapore | 65,6 |
| 15 | Russia | 55,9 |

The difficulty of doing business in the PRC by foreigners is the need to establish their network of "guanxi" relations. The term "guanxi" can be defined as a system of informal, friendly, clan, family-kinship ties. They are part of the traditional culture; they are the basis of any relationship. As in any Asian society, "personal ties" play a pivotal role in all affairs. Many questions are solved by personal relations, and not in the course of formal procedures. Ignoring established traditions it is impossible to succeed In China.

*Case 44. Avon, cosmetics company, was initially unable to obtain permission to carry out direct sales in the territory of the PRC due to the distrust of the Chinese authorities to this way of trading. Then Avon turned for help to the head of the Hong Kong East Asian Bank,*

[50] Source: https://kitaygid.ru/politika/tovarooborot-kitaya

*David Lee, who had the necessary connections in the Chinese government. On his recommendation, Avon was able to obtain a license from the Bureau of Light Industry in South China. For his mediation, David Lee received 5% of the share capital of the company.*

At the turn of XX-XXI centuries the process of internationalization of Chinese companies began. The number of Chinese TNCs in the ranking of the largest companies in the world according to *Fortune Global 500* is increasing year after year. In 2018, Top-20 of the ranking included 3 companies occupying 2-4 places in terms of revenue in the world, which was outrivaled only by the United States.

In the oil and gas sector of the PRC economy, *CNPC, Sinopec, CNOOC, Sinochem* hold leading positions; in the power generation sector, five state corporations are represented: *Huaneng (CHNG), Datang, Huadian, State Electricity Corporation, State Electricity Investment Corporation*; the nuclear industry is monopolized by such state corporations as *China National Nuclear Corporation, China Nuclear Engineering Corporation, China Guangdong Nuclear Power Corporation*; in the banking sector, the main market share belongs to the state banks *Industrial and Commercial Bank of China, China Construction Bank, Agricultural Bank of China, Bank of China*; in the field of railway construction and transportation, the only players are *China Railway Construction* and *China Railway Group*; three state-owned enterprises dominate the telecommunications sector: *China Mobile, China Telecom, China Unicom*; major automotive companies are the *Shanghai Automobile Corporation, Dongfeng Corporation, First Automobile Corporation, Changan Automobile Group, Beijing Automobile Company, Guangdong Automobile Company*; the shipbuilding industry is represented by *China State Shipbuilding Corporation, China Shipbuilding Industry Corporation*.

Many Chinese companies that started with the production of simple parts, components and other orders for foreign TNCs, gradually began to specialize in the production of more complex components, eventually mastering new industries, such as the production of mobile phones, automotive components, aircraft industry.

*Case 45. Until 1995, the company Huawei Technologies, specializing in the production of telecommunications equipment, worked with mobile operators exclusively in the rural regions of China, but already had in mind the goal of becoming one of the largest global players in its segment. The first step in the direction of internationalization of the company was the execution in the 1990s of the order for a small Hong Kong company Hutchison Telecom, communication services operator. In Hong Kong at that time there was a demand for devices that allowed changing the operator company without changing the telephone number. European suppliers of equipment offered to implement this innovation for six months. This gave Huawei a chance to develop a similar technology in three months and thus declare itself in the foreign market. Fulfillment of an order in a shorter period opened Huawei access to the Hong Kong market and marked the beginning of the process of successfully internationalizing the company. This was followed by the promotion of the company to the markets of Thailand, the United Arab Emirates, where Huawei focused on new companies in the field of mobile communications and offered them their developments as soon as possible. In 1999, it carried out the installation of equipment in Thailand in just 60 days, turned the Thai newcomer in this field into the largest mobile operator in Thailand. In the United Arab Emirates, Huawei is ahead of its main competitors – Motorola and Ericsson in the development of 3G technology, offering it at a lower price. After completing orders for the development of a 3G mobile communication system in Hong Kong, Mauritius, Malaysia, Huawei decided to enter the European market. The first order for the development of a 3G mobile communications system in Europe was received from the Dutch company Telfort BV, which previously collaborated with Ericsson. Using the tactics of the "pioneer" offering new products before its competitors and at a lower price, Huawei entered the league of the world's largest manufacturers of telecommunications equipment (with a world market share in 2018 at 15.8%, it is in second place in the world), acquired a reputation as a company with a high innovation rating. Huawei Technologies has been successfully operating in the Russian market: since July 2018 occupying the first place there, with a share of 24.4%.*

Any JV or large project in China has always required transfer of technology to the Chinese partner (a condition which the PRC was forced to reject after joining the WTO). The stage of partnership with a foreign investor was held, in particular, by *Haier* (with German *Liebherr*), *TCL* – partnerships with Hong Kong and Taiwan, *Hisense* - with *Matsushita Electric* and *ATT*, China Worldbest collaborated with *DuPont, BASF, Hearst*.

*Case 46. The most well-known example of this strategy is Lenovo, which acquired an IBM unit for the production of personal computers in 2005. This transaction accelerated the internationalization of the company and allowed it to become a global player in a short period of time (in 2012, Lenovo held the second place in the world market (15%) in terms of sales). The acquisition of IBM has opened distribution channels in 160 countries owned by IBM for Lenovo, as well as the right to use the well-known Think brand for five years, and brought about a number of other benefits.*

China has established its own companies that have copied the world's best practices in various industries (Fig. 34).


*Fig. 34 – Lookalike Companies in China*

Chinese companies, as a rule, compete at the expense of lower cost in the production of high-tech products, while many of them have certain (albeit insignificant) technological advantages in comparison with foreign competitors (*Huawei*, *Lenovo*, *BOE*). Other companies rely on a wide range of products offered at a lower price than those of competitors (*Goodbaby*, for example, whose range of strollers, car seats, cradles and playpens are four times wider than those from the nearest competitor), or find unique market niches (the company *Haier* owns more than 60% of the market of mini-refrigerators in the USA). Most Chinese companies are characterized by high labor intensity (work goes in three shifts), rapid adaptation to changing demand and requirements for their products, careful tracking of competitors' strategies, and the implementation of the principle of "continuous innovation" (within 24 hours). Many companies, even at the stage of their formation, have the goal of becoming global players.

*Case 47. Wanxiang Company began its move towards the world market with the production and export of universal nodes for cars. Constantly focusing on improving quality and reducing costs, Wanxiang managed to outrun many Chinese competitors and receive orders for the production of universal nodes from large automotive component suppliers such as Delphi, Bosch, and Visteon, eventually becoming the largest manufacturer of universal hubs in the world. Gradually, Wanxiang expanded its product line by moving to the production of other parts of the transmission, the braking system, and finally the entire chassis. The rapid growth in the American market allowed Wanxiang to move from the third-tier supplier category of small components to the first-tier supplier category for Ford and GM. Since 2003, Wanxiang has managed the American Manufacturing Fund, created to absorb US automaker manufacturers. The company then proceeded to conduct M&As transactions in other regions of the world, and by 2005 it had acquired or established 30 companies in eight countries, including the USA, the United Kingdom, Germany, Canada and Australia*[51].

[51] Source: Emerging Multinationals in Emerging Markets / Ravi Ramamurti Jitendra V. Singh, eds. / Cambridge University Press, 2009; The Globalization of Chinese Companies: Strategies for Conquering International Markets / Shengjun Liu, Arthur K. Yeung, Waldemar Pfoertsch and Katherine Xin, eds. / Wiley, 2011; Williamson, P.J., Ming Zeng. Chinese Multinationals: Emerging through New Global Gateways / Cambridge University Press, 2009.

## Latin American Countries in International Business

Latin America includes 33 sovereign states with the total population of 627 million people.

All Latin American countries belong to the group of developing countries, except Haiti, which is the LDC. However, the structure of the economy and the level of economic development of Latin American countries are heterogeneous. There is a group of prosperous countries with rapidly developing economies: Brazil, Mexico, Argentina and Chile. The economies of other states in the region, which possess significant reserves of either mineral or agricultural raw materials, depend on the development of the relevant industries. For example, the oil and gas sector plays an important role in the economies of Venezuela, Bolivia, and Trinidad and Tobago, Ecuador rests upon oil production of bananas cultivation, Guatemala, Costa Rica rely upon sugar industry, etc. A number of island states live by developing tourism and offshore activities (the Bahamas, Antigua and Barbuda, etc.).

For virtually all states of the region, agriculture has historically been an important sector of the economy, providing employment for the population and bringing considerable income, including via export supplies. Latin America is the world's leading region for a variety of agricultural products: sugar, coffee, bananas, oranges and other types of fruits, soybeans, various types of vegetables, wine, etc. Moreover, we should not forget about the significant role of livestock in a number of Latin American countries (Argentina, Brazil, Uruguay, Paraguay, etc.).

Metallurgy is also an important industry in a number of countries. So, Brazil has huge reserves of such natural resources as niobium (being actually a monopolist), iron ore, manganese, bauxite, tin, nickel, aluminum, etc. It enters the top ten countries – steel producers. Chile is the leading copper producer in the world, and Peru is leading in silver production. Jamaica is developing large deposits of bauxite, etc.

Machine-building industry in Latin America does not have strong competitive advantages. For example, electronics and electrical engineering are developing in Mexico, Brazil, and in a number of Central American states, but to a greater extent due to the presence of foreign TNCs in this industry. In general, it is worth noting that in Mexico there are a lot of assembly plants of foreign TNCs. Only foreign concerns are represented in the car building in Latin America. Brazil has achieved some good results only in the aircraft industry: *Embraer* is the leading aircraft manufacturer not only in Latin America, but also among the top five manufacturers of regional aircraft.

The main export goods of Latin American countries are agricultural products, minerals, as well as a limited range of industrial production. Latin American imports mainly consist of various industrial and consumer goods.

The largest TNCs in Latin America are *Elektrisola* (US multinationals in Mexico in the field of metallurgy), *Telefonica de Brasil* (Spanish TNCs in telecommunications), *BBVA Bancomes* (US transnational bank in Mexico), *CEMEX* (Mexico, cement), *Companhia Vale do Rio Doce* (Brazil, mining and development), *Petroleo Brasileiro* (Brazil, oil), *America Movil* and *Telefonos De Mexico* (Mexico, telecommunications), *Petroleos De Venezuela* (Venezuela, oil), *Metalurgica Gerdau* (Brazil, metals), *FEMSA, Gruma* and *Grupo Bimbo* (Mexico, food industry).

Another characteristic feature of modern Latin America is the increased state intervention in the economy of the region. At the turn of the century Latin America saw a new phenomenon: *left turn*. In a number of countries in this region left-wing leaders and parties come to the polls, but not by revolutionary means like in Cuba in 1959. The left turn is a response to the failures of the market management system (including in the field of social policy) and calls for strengthening the role of the state as a market regulator. This is manifested in the tightening of the rules and regulations for the conduct of the economic activities of companies, and in the foreign economic policy of states. The left turn also led to the fact that Latin American governments began to pay more attention to the development of infrastructure and social initiatives. Budget funds are insufficient for the construction of roads, new power plants, etc., so the Latin American countries attract foreign operators to implement large-scale projects.

One of the most liberal is the economy of Chile, which is also recognized as the most competitive state in Latin America. The middle position was occupied by such countries as Brazil and Argentina. The most radical states are the countries of “socialism of the XX century,” which are part of the Bolivarian Alliance for the Peoples of America (ALBA), such as Venezuela, Bolivia, Ecuador and Nicaragua. In these countries, state power penetrated practically all spheres of life, companies were nationalized in key sectors, price controls appeared on the domestic market, government intervention in companies’ FEA increased, foreign trade guidelines, investment policies changed, etc.

## Russia in International Business

Russia’s participation in foreign trade is to a large extent determined by the high level of natural resources endowment. In 2017, Russia ranked sixteenth in the list of world commodity export leaders. Since Russia is traditionally characterized by a positive trade balance, in the list of the largest importers its position is more modest, but also quite weighty: it ranks 21st.

About 70% of total exports are accounted for mineral products (primarily, crude oil, petroleum products and natural gas). The share of machinery and equipment in the country’s exports is small, which makes it necessary to speak about the low level of demand for these goods abroad.

A common prerequisite for the transnationalization of Russian companies was the state-led policy of openness of the national economy, which created the necessary economic conditions for wider participation of Russian companies in the global economy. An important prerequisite for the transnationalization of Russian companies was the restoration of separate chains of cooperative supplies within the Commonwealth of Independent States (CIS) to use outdated production facilities and the formation of new sales markets.

*Fig. 35 – Russia: a look from the XX century*

Enterprises within individual industries developed extremely unevenly. Against the background of unfavorable economic conditions, some showed high growth rates and profits, actively occupying large-scale market niches. Others at the same time fell into disrepair.

In 2018, according to the data of RosBusinessConsulting, the Top-10 largest companies in Russia in terms of revenues include: *Gazprom* (oil and gas), *Lukoil* (oil and gas), *Rosneft* (oil and gas), *Sberbank of Russia* (finance), *Russian Railways* (transport), *Rosteh* (investments), *VTB* (finance), *X5 Retail Group* (trade), *Surgutneftegaz* (oil and gas), *Magnit* (trade), *Rosseti* (electric power industry). At the same time, private capital, which is present in almost all sectors of the economy, is actively strengthening its position in the market. Four companies from the list above were even ranked among the world's largest companies in *Fortune Global 500* in 2018 (*Gazprom* ranked 49, *Lukoil* ranked 63, *Rosneft* ranked 115, *Sberbank* took place 205). At the same time, in terms of the number of national companies – world leaders, Russia is noticeably inferior not only to the USA, Japan, Germany, France and China, but also to smaller countries.

The CIS countries became the original sphere of application of capital of Russian companies, but this was not connected with the flight of capital from Russia. This is explained by the fact that the investment climate of these countries is in many respects similar to the investment climate in Russia. An important factor stimulating the activity of Russian companies in the CIS countries is the desire to restore the cooperative ties that were destroyed as a result of the collapse of the USSR. Another thing that enhances and promotes Russian business in the CIS countries is Russian language, common history and tolerance for the existence of non-transparent corporate structures in a difficult political situation.

North American market is very attractive for Russian companies in terms of product sales and access to advanced technologies. However, the entrance to it is one of the most difficult in the world and requires a large amount of capital.

The expansion of Russian capital to the countries of Asia, Africa and Latin

America is noticeably inferior in terms of both volume and industry investment activity compared with Europe and the CIS.

Analysis of the activities of Russian companies abroad shows that all of the above reasons underlay the internationalization of domestic business. Additional revenue growth was achieved through the export mechanism, which made it possible to make a profit due to a significant difference in prices for products in the domestic and global markets. This was characteristic of *Gazprom*, oil companies, producers of other types of raw materials in Russia. Over time, exporters began to invest in sales, transportation, processing and other areas of production with higher value added, providing for greater efficiency.

*Case 48. As of early 2012, LUKOIL had refineries in Ukraine, Romania, Bulgaria, and Italy. The sales network of the LUKOIL Group covered 26 countries, including Russia, CIS countries and Europe (Azerbaijan, Belarus, Belgium, Bulgaria, Hungary, Georgia, Italy, Cyprus, Latvia, Lithuania, Luxembourg, Macedonia, Moldova, Poland, Romania, Serbia, Slovakia, Turkey, Ukraine, Finland, Croatia, Montenegro, Czech Republic, Estonia), as well as the USA, and had 183 tank farms with a total reservoir capacity of 2.7 million m$^3$ and 5,994 filling stations (including gas stations operating under franchise agreements). It should be noted that only 39% of gas stations accounted for Russia, the CIS accounted for 8.3%, Europe – for 39.4%, the Baltic countries – for 3.6%, the USA – for 9.8%. LUKOIL conducted geological exploration work in a number of countries outside of Russia – in Colombia, Kazakhstan, Saudi Arabia, Uzbekistan, Cote d'Ivoire, Ghana, Egypt and Venezuela, as well as preparing for oil production in Iraq.*

Creating a network of branches abroad through an internationalization mechanism provides for better access to the market and makes it possible to avoid paying too high customs duties. The presence of an extensive branch network makes it possible to competently use the tools of ITP to optimize fiscal payments to the budgets of the countries where these branches are located.

The desire to create and control own production chains is another reason for internationalization. To ensure the smooth operation of all enterprises, companies acquire producers and suppliers of raw materials.

The basis of the strategy of Russian companies' penetration into the economies of foreign countries are cross-border M&As. At the same time, Russian companies are mainly absorbing enterprises engaged in the same activities. Therefore, most of the cross-border operations are associated with the acquisition of enterprises engaged in the same activities as the buyer companies.

In addition, most of the FDI from our country is carried out by several major corporations that receive high export earnings which play a key role in financing the growth of their investment activity abroad. This is primarily the company energy and metallurgy. This is connected with another peculiarity of the foreign expansion of Russian business, which is that it is generally of a raw material nature.

Strengthening of the noted tendencies in the investment policy of the countries of the West turns out for Russian companies to face significant difficulties, and sometimes a breakdown in transactions to acquire shares in companies of these countries. Among the largest transactions involving Russian capital, which were not implemented under the influence of mainly the above-mentioned reasons, one can, for example, refer to the attempt of Russian *Severstal* in 2006 to unite with the Luxemburg metallurgical company *Arcelor*, the intentions of *Gazprom* to acquire the British gas distribution company *Centrica* in 2006, the intentions of *Sberbank* in 2009 to acquire the control package *Opel* of the Canadian *Magna*.

However, in some cases, the states do not directly prohibit the implementation of a transaction to acquire shares of local companies by Russian business, but create conditions that force the Russian investor to abandon the transaction of interest. An example is the situation that arose in July 2007, when the Italian authorities actually blocked the acquisition of *Aeroflot*'s shares of the Italian state-owned air carrier *Alitalia*, setting an excessively high price for the company's shares. Since 2014, due to the introduction of sanctions against Russia by a number of Western European states, by the USA, Japan, and others, the process of Russia's integration into the system of world economic relations has slowed down drastically.

## Topic 12 Review Questions

1. Explain the concepts of *business culture, ethics, business communication*. How are they applied in international business?
2. What are *cross-cultural differences* and why are they important in international transactions?
3. How does nonverbal communication affect the international activities of companies? Give examples.
4. Describe the features of the United States in the international business system. Give examples.
5. Describe the features of China in the international business system. Give examples.
6. Describe the features of Russia in the international business system. Give examples.
7. Describe the features of Latin American countries in the international business system. Give examples.
8. Describe the features of the North European countries in the international business system. Give examples.
9. Describe the features of the UK and Ireland in the international business system. Give examples.
10. Describe the features of Japan in the international business system. Give examples.
11. Describe the features of Germany and France in the international business system. Give examples.

## REFERENCES

### Books and articles


1. Ball, D., Geringer, M., Minor, M., McNett, J.M. International Business: The Challenge of Global Competition: 13th edition / McGraw-Hill Education, 2012.
2. Castells, M. The Information Age: Economy, Society and Culture, Vol. 1: The Rise of the Network Society: 2nd edition / Blackwell, 2009.
3. Cavusgil, S., Knight, G., Riesenberger, J. International Business: The New Realities: 4th edition / Pearson, 2017.
4. Civil Law: Textbook / S.P. Grishaeva, ed. / Yurist, 2004.
5. Daniels, J.D., Radebaugh, L.H., Sullivan D.P. International Business Environments and Operations: 15th edition / Pearson, 2015.
6. Digital Russia – New Reality. [Electronic Resource]. www.mckinsey.com/~/media/McKinsey/Locations/Europe%20and%20Middle%20East/Russia/Our%20Insights/Digital%20Russia/Digital-Russia-report.ashx.
7. Drucker, P.F. Innovation and Entrepreneurship: Practice and Principles / Collins, 1993.
8. Dyakin, B.G. International Business. Volume 6. The Processes Occurring in the Global Economy: The Role of International Business. Monograph / TEIS, 2013.
9. Eklund, K. Nordic Capitalism: Lessons Learned // World Economic Forum DAVOS, 2011. [Electronic Resource]. www.globalutmaning.se/wp-content/uploads/sites/9/2011/01/Davos-The-nordic-way-final.pdf.
10. Emerging Multinationals in Emerging Markets / Ravi Ramamurti Jitendra V. Singh, ed. / Cambridge University Press, 2009.
11. Federal Law of 30.11.1994 No. 51-ФЗ. Civil Code of the Russian Federation. Part one.

12. Federal Law of 26.01.1996 No. 14-ФЗ. Civil Code of the Russian Federation. Part two.
13. Federal Law of 11.04.1997 No. 48-ФЗ On a Simple and Transfer Bill of Exchange.
14. Griffin, R.W., Pustay, M.W. International Business: a Managerial Perspective: 5th edition / Prentice Hall, 2007.
15. Hill, C., Hult, M. Global Business Today: 9th edition / McGraw-Hill Education, 2016.
16. Hill, C., Hult, M. International Business: Competing in the Global Marketplace: 11th edition / McGraw-Hill Education, 2016.
17. Holden, N.J. Cross-cultural Management: A Knowledge Management Perspective / Pearson Education 2002.
18. Hult, M., Closs, D., Frayer, D. Global Supply Chain Management: Leveraging Processes, Measurements, and Tools for Strategic Corporate Advantage: 1st edition / McGraw-Hill Education, 2013.
19. Imai, M. Kaizen: The Key to Japan’s Competitive Success / McGraw-Hill, 1986.
20. International Business: Textbook / V.A. Chernenko, ed. / Publishing House of St. Petersburg State University of Service and Economics, 2017.
21. International Business: Textbook / V.K. Pospelov, ed. / INFRA, 2014.
22. International Business: Theory and Practice: a Textbook for Bachelors: A Textbook for University Students Enrolled in Economic Fields and Specialties / A.I. Pogorletsky, S.F. Sutyrin, eds. / Urait, 2014.
23. Klimovets, M.V. New Business Model of International Entrepreneurship // Outsourcing, 12, 2016.
24. Lewis, R. When Cultures Collide: Leading Across Cultures: 3rd edition / Nicholas Brealey International, 2006.

25. Liuhto, K., Sutyrin, S.F., Blanchard, J.M. The Russian Economy and Foreign Direct Investment / Routledge, 2017.
26. Marinov, M.A., Ali, M.Y., Ammar, N., Sutyrin, S.F., etc. Research Handbook of Marketing in Emerging Economies / Edward Elgar Publishing, 2017.
27. Mauri, T. The Leader's Mindset / Morgan James Publishing, 2016.
28. Nordstrom, K., Ridderstrale, J. Funky Business Forever: How to Enjoy Capitalism: 3rd edition / Pearson Education, 2007.
29. Oded, S., Yadong, L., Tailan, C. International Business: 3rd edition / Routledge, 2014.
30. Pavlov, P.V., Makarova, E.L. Supply Chain Management of the Aviation Industry Enterprise // Vestnik VSU. Series: economics and management, 2, 2017.
31. Peters, T. Re-Imagine!: Business Excellence in a Disruptive Age / DK Publishing, 2006.
32. Peters, T. The Excellence Dividend: Meeting the Tech Tide with Work that Wows and Jobs that Last / Vintage, 2018.
33. Porter, M.E. On Competition: Updated and Expanded edition / Harvard Business School Publishing, 2008.
34. Porter, M.E. The Competitive Advantage of Nations // Harvard Business Review, 68, 1990.
35. Porter, M.E., Takeuchi, H., Sakakibara M. Can Japan Compete? / Perseus Publishing, 2000.
36. Provision of the Central Bank of the Russian Federation of 03.10.2002 No. 2-П “On Cashless Payments in the Russian Federation”. Part III. [Electronic Resource]. www.law.ru/npd/doc/docid/901830578/modid/99.
37. Ricardo, D. On The Principles of Political Economy and Taxation / London: John Murray, 1817.

38. Ricks, D.A. Blunders in International Business: 4th edition / Blackwell Publishing, 2007.
39. Samuelson, P., Stolper, W. Protection and Real Wages // The Review of Economic Studies, 9(1), 1941.
40. Sanders, T. The Likeability Factor. How to Boost Your L-Factor and Achieve Your Life's Dreams / Crown Business, 2006.
41. Schwab, K. The Fourth Industrial Revolution / Crown Business, 2017.
42. Shlyk, N.L. International Business: The Basics of Modern Development: Textbook / Khabarovsk, 2016.
43. Smith, A. An Inquiry into the Nature and Causes of the Wealth of Nations / The University of Chicago press, 1976.
44. Sonnenberg, F. Booksmart: Hundreds of Real-World Lessons for Success and Happiness / Createspace Independent Publishing Platform, 2016.
45. Tax Code of the Russian Federation. [Electronic Resource]. ivo.garant.ru/#/document/10900200/paragraph/1:0.
46. The Globalization of Chinese Companies: Strategies for Conquering International Markets / Shengjun Liu, Arthur K. Yeung, Waldemar Pfoertsch and Katherine Xin, eds. / Wiley, 2011.
47. United Nations Convention on Contracts for the International Sale of Goods (Vienna 04/11/1980). [Electronic Resource]. www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf.
48. Wild, J.J., Wild, K.L. International Business: The Challenges of Globalization: 8th edition / Pearson, 2015.
49. Williamson, P.J., Ming Zeng. Chinese Multinationals: Emerging through New Global Gateways / Cambridge University Press, 2009.

**Internet resources**

50. data.worldbank.org – World Bank World Development Indicators database of 2017 official website –

data.worldbank.org/indicator/BM.KLT.DINV.CD.WD?year_high_desc=true.
51. mergers.akm.ru/ – Information Agency AK&M official website (an organization authorized by the Federal Financial Markets Service of Russia to disclose information on the securities market).
52. top250.platts.com – S&P Global Platts official website – top250.platts.com/Top250Rankings.
53. www.aeroflot.ru – Aeroflot official website – www.aeroflot.ru/ru-en/about/aeroflot_today.
54. www.airbus.com – Airbus official website.
55. www.boeing.com – Boeing official website.
56. www.doingbusiness.org – Doing Business Database official website – www.doingbusiness.org/en/reports/global-reports/doing-business-2019.
57. www.fortune.com/global500 – Fortune Global 500 official website.
58. www.ikea.com – IKEA official website.
59. www.imf.org – International Monetary Fund official website.
60. www.interfax.ru – Interfax Information Agency official website.
61. www.mergers.ru – Information and Analytical Project "Mergers and Acquisitions in Russia" official website.
62. www.oecd.org – Organization for Economic Cooperation and Development official website.
63. www.pwc.com – PriceWaterhouseCoopers official website.
64. www.rbc.ru – Agency's RosBusinessConsulting official website.
65. www.rusimpex.ru –Russia-export-import official website.
66. www.un.org – The United Nations official website.
67. www.unctad.org – UN Conference on Trade and Development official website.
68. www.weforum.org – World Economic Forum official website.
69. www.wikipedia.org – The Free Encyclopedia official website.

70. www.wto.org – WTO’s official website.

**Online courses (Coursera Platform)**

71. International Business – www.coursera.org/learn/international-business.
72. International and Cross-Cultural Negotiation – www.coursera.org/learn/international-negotiation.
73. International Leadership and Organizational Behavior – www.coursera.org/learn/organizational-behavior.
74. Business Strategies for Emerging Markets – www.coursera.org/learn/business-strategies.
75. Management Skills for International Business – www.coursera.org/learn/management-skills-international-business.
76. Effective Business Presentations with Powerpoint – www.coursera.org/learn/powerpoint-presentations.
77. Leadership in 21st Century Organizations – www.coursera.org/learn/leadership-21st-century.
78. Gamification - www.coursera.org/learn/gamification.

## ANNEX. World's Leading Companies' Mission Statements

***WikiDictionary definition[52]:***

1. *Mission* is the main purpose of the organization, the highest concept in the hierarchy of goals. Mission is unattainable, it is not a goal, but the ultimate purpose, the reason for the company's existence, which predetermines absence of possibility of achieving it.

2. *Mission* is one of the fundamental concepts of strategic management.

3. *Mission* is the reason for existence of companies with positions meeting the needs of customers, the realization of competitive advantages, and motivation of the company's employees.

4. *Mission* is the main overall goal of the organization – a clear reason for its existence. *Goals* are developed to fulfill this mission.

5. *Mission* is the philosophy and purpose, the reason for existence of the organization.

***Retail brands mission statements*:**

1. **Marks & Spencer's** mission is to provide customers with the opportunity to purchase high-quality, stylish, comfortable and diverse clothing of all sizes *("to make aspirational quality accessible to all"*).

2. **WalMart's** mission is to give ordinary people the opportunity to buy things previously only available to the rich ("*to save people money so they can live better*").

3. **Mary Kay Cosmetics'** mission is to provide unlimited opportunity for women ("*to enrich the lives of women*").

4. **Target's** mission is to become the preferred place to make purchases thanks to innovative solutions, exceptional offers, exceeding all expectations of the buyer ("*We fulfill the needs and fuel the potential of our guests. That means making Target your preferred shopping destination in all channels by delivering*

[52] Source: https://ru.wikipedia.org/wiki/ Missiya_organizatsii.

*outstanding value, continuous innovation and exceptional experiences—consistently fulfilling our Expect More. Pay Less.® brand promise*”).

5. **The Home Depot’s** mission is to provide each customer with a high level of service, a wide range of products and competitive prices (“*to provide the highest level of service, the broadest selection of products and the most competitive prices*”).

6. **IKEA’s** mission is to improve people's daily life (“*to create a better everyday life for the many*”).

7. **Amazon’s** mission is to build a place where people can come to find and discover anything they might want to buy online (“*to be earth's most customer-centric company; to build a place where people can come to find and discover anything they might want to buy online*”).

8. **Best Buy’s** mission is to solve the unsatisfied needs of its customers with the help of savvy of their employees (“*to focus on better solving the unmet needs of our customers—and we rely on our employees to solve those puzzles*”).

9. **Gillette’s** mission is to surpass others in the quality, value-added personal care, and personal use products (“*This commitment to giving men the very best is carried into our line of personal care products, including deodorant and body wash. All designed for the unique needs of men – helping them to look, feel and be their best every day*”).

10. **Polaroid’s** mission is to improve the market of instant photography and digital equipment to meet the growing need of people to capture the faces of friends and family, dear to the heart places and funny moments of life (“*to continually offer products that ensure quality and maximize function, making for a continuum of Polaroid brand values. We deliver on the promise of simplicity and gratification for all*”).

11. **Levi-Strauss’** mission is “*to market and distribute the most appealing and widely worn apparel brands. Our products define quality, style and function.*

*We will clothe the world*".

***IT and Social brands mission statements:***

1. **Walt Disney's** mission is to make people happy ("*to entertain, inform and inspire people around the globe through the power of unparalleled storytelling, reflecting the iconic brands, creative minds and innovative technologies that make ours the world's premier entertainment company*").

2. **Facebook's** mission focuses on making its social networking web site an important part of community development ("*to give people the power to build community and bring the world closer together*").

3. **Google's** mission is "*to organize the world's information and make it universally accessible and useful*".

4. **Microsoft's** mission is to give everyone the opportunity to realize their full potential ("*to empower every person and every organization on the planet to achieve more*").

5. **Skype's** mission is to become a platform for people to communicate in real time ("*to be the fabric of real-time communication on the web*").

6. **YouTube's** mission is to provide fast and easy video access and the ability to share videos ("*to give everyone a voice and to show them the world*").

7. **Twitter's** mission is to instantly connect people everywhere ("*to give everyone the power to create and share ideas and information instantly without barriers*").

8. **Apple's** mission is "*to bring the best personal computing experience to students, educators, creative professionals and consumers around the world through its innovative hardware, software and Internet offerings*".

9. **Hewlett Packard's** mission is to contribute to technological progress for the benefit of the development and prosperity of mankind ("*to create technology that makes life better for everyone, everywhere — every person, every organization, and every community around the globe… With our*

*technology, you'll reinvent your world*").

10. **Nokia's** mission is "*to create the technology to connect the world…We push the boundaries of what is possible to create new ways of connecting people, things and services instantly and effortlessly. Building upon a foundation of integrity, quality and security, we help our customers navigate the complex choices of the connected world, to unlock its opportunities and provide extraordinary experiences in people's lives each day*").

11. **Sony's** mission is to experience the joy of inventing, developing and applying technologies that benefit society ("*to use our passion for technology, content and services to deliver kando, in ways that only Sony can*").

***<u>Sportswear brands mission statements:</u>***

1. **Nike's** mission is "*to bring inspiration and innovation to every athlete* in the world. *If you have a body, you are an athlete*".

2. **Adidas'** mission is to be the world's leading sports brand. Never equate quantity with quality. An athlete always comes first. ("*to become the best sports brand in the world. To that end, we will never equate quantity with quality. Our founder Adi Dassler was passionate about sports. For Adi, the athlete came first. He gave those on the field, the court and the track the unexpected and the little differences that made them more comfortable and improved performance. This is our legacy. This is what the brand stands for. This will never change*").

3. **New Balance's** mission is to be a leader in the production of high-quality sports products and goods for daily life, not forgetting about social responsibility ("*demonstrating responsible leadership, we build global brands that athletes are proud to wear, associates are proud to create and communities are proud to host*").

4. **Puma's** mission is to become the most desirable and sustainable in social, environmental and economic aspects of sport lifestyle company ("*Forever Faster**

*****_Forever Faster is more than being quick…to achieve one thing: to be the fastest sports brand in the world_”).

5. **Reebok's** mission is to become an integral part of the young hearts through sport, music and high technology (“_always challenge and lead through creativity_”).

6. **Umbro's** mission is to inspire and excite, to make converts for the wonderful world of football (“_to inspire and excite the world of football_”).

7. **Asics'** mission is “_to become the number one brand for the sports enthusiast. To accomplish this, we pledge to continue to make the best product; striving to build upon our technological advances and pushing the limits on what we can learn from the body and its needs in athletic gear. We pledge to bring harmony to the body and soul_”.

***<u>Food and Beverage mission statements:</u>***

1. **Coca-Cola's** mission is “_to refresh the world in mind, body and spirit; to inspire moments of optimism and happiness through our brands and actions; to create value and make a difference_”.

2. **Pepsi's** mission is “_to create more smiles with every sip and every bite*_
*****_We will create smiles for our consumers by offering them unique moments, delighting them with our products, entertaining them with our brands, making their lives more enjoyable_”

3. **Nestlé's** mission _of “Good Food, Good Life” is to provide consumers with the best tasting, most nutritious choices in a wide range of food and beverage categories and eating occasions, from morning to night”._

4. **Danone's** mission is “_to bring health through food to as many people as possible_”.

***<u>B2B brands mission statements:</u>***

1. **Boeing's** mission is to be at the forefront of aviation development, to be pioneers (“_to connect, protect, explore and inspire the world through aerospace_

*innovation*").

2. **Cisco's** mission is "*to enable people to make powerful connections - whether in business, education, philanthropy, or creativity. Cisco hardware, software, and service offerings are used to create the Internet solutions that make networks possible-providing easy access to information anywhere, at any time*".

3. **IBM's** mission is "*to lead in the invention, development and manufacture of the industry's most advanced information technologies, including computer systems, software, storage systems and microelectronics. We translate these advanced technologies into value for our customers through our professional solutions, services and consulting businesses worldwide*".

4. **Intel's** mission is to create and extend computing technology to connect and enrich the lives of every person on earth ("*to utilize the power of Moore's Law to bring smart, connected devices to every person on earth*").

5. **General Electric's** mission is "*to transform industry with software-defined machines and solutions that are connected, responsive, and predictive*".

6. **British Petroleum's** mission is to promote human progress through the manifestation of the following qualities: honesty, openness of transactions ("*to be a focused oil and gas company that delivers value over volume. We are pursuing our strategy by setting clear priorities, actively managing a quality portfolio and employing our distinctive capabilities*").

***<u>Car brand mission statements:</u>***

1. **BMW's** mission is "*to set trends in production technology and sustainability as an innovation leader with an intelligent material mix, a technological shift towards digitalisation and resource-efficient production. At the same time, flexibility and continuous optimisation of value chains ensure competitiveness*".

2. **Ford's** mission is to produce an affordable, efficient and reliable

automobile for everyone (“*to work together as a lean, global enterprise to make people’s lives better through automotive and mobility leadership*”).

3. **Toyota’s** mission is to make our customers feel the pleasure of high quality Toyota cars (“*to create vehicles that are popular with consumers*”).

4. **AVTOVAZ’s** mission is “*to create high-quality cars for our customers at affordable prices, bringing a stable profit to our shareholders, improving the welfare of our employees and increasing the value of our business for the benefit of the Motherland*”.

*Educational edition*

**Pavel V. PAVLOV**

# INTERNATIONAL BUSINESS

*Textbook*

Translated by *N.Kashirina*