BBE4303 FOREIGN TRADE MANAGEMENT

FOREIGN TRADE MANAGEMENT

Mrs. M. Mokholokoe
National University of Lesotho
IEMS

National University of Lesotho
Institute of Extra Mural Studies
P/B A47
Maseru 100
Lesotho
+266 22322038
+266 22310433

<Insert TOC using “References – Table of Contents” function in Word. Ensure your headings and sub-headings using the suggested style>.

TABLE OF CONTENTS

ACKNOWLEDGEMENTS

<Insert list of those organizations and personnel who have assisted in the creation of the course.>

COURSE OVERVIEW

INTRODUCTION

This course focuses on international trade strategy in a changing global environment. The evolution of international business and the current global business environment are analysed. Trade technology, competitiveness and national policy are related to international business strategy. National business environment and cultures are analysed with emphasis on international strategy. Key aspects of doing business overseas are viewed, emphasizing international strategy in action. Students will develop a broad vision of foreign trade and its likely future challenges as well as practical skills in strategic analysis.

COURSE GOALS

	Upon completion of the Foreign Trade Management you will be able to: 1. Understand the environment (trade, policy and law) in which international business operate considering the concept of global village.

REQUIRED READINGS

Reading	Suranovic, S. (2010). *International trade: Theory and policy*. Rao, D. P. S. (2008). *International business environment*. Himalaya publishing.

ASSIGNMENTS AND PROJECTS

Assignment	Continuous assessment shall be based on two test and one assignment.

ASSESSMENT METHODS

Assessment	Continuous assessment which consists of two tests and one assignment will depend on the best two which shall weigh 33% of the overall assessment, while final examination shall weigh 67% of overall assessment.

COURSE SCHEDULE

<Refer to tutorial letter for further details>

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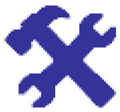
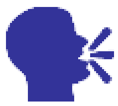
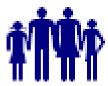
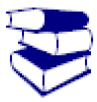
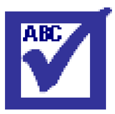
Margin icons

While working through this **Error! Use the Home tab to apply Guide Type to the text that you want to appear here.** you will notice the frequent use of margin icons. These icons serve to “signpost” a particular piece of text, a new task or change in activity; they have been included to help you to find your way around this **Error! Use the Home tab to apply Guide Type to the text that you want to appear here.**.

A complete icon set is shown below. We suggest that you familiarize yourself with the icons and their meaning before starting your study.

 Activity	 Assessment	 Assignment	 Case study
 Discussion	 Group activity	 Help	 Note it!
 Outcomes	 Reading	 Reflection	 Study skills
 Summary	 Terminology	 Time	 Tip

LEARNER SUPPORT

Note: This section should be included in self-paced or paper-based courses that provide tutor/facilitator support and/or web and email support for the students.

ACADEMIC SUPPORT

<Insert the following information if relevant>

- How to contract a tutor/facilitator (Phone number, email, office hours, etc.).
- Background information about the tutor/facilitator if he/she does not change regularly. Alternatively provide a separate letter with the package describing your tutor/facilitator's background.
- Description of any resources that they may need to procure to complete the course (e.g. lab kits, etc.).
- How to access the library (either in person, by email or online).

HOW TO SUBMIT ASSIGNMENTS

<If the course requires that assignments be regularly graded, then insert a description of how and where to submit assignments. Also explain how the learners will receive feedback.>

TECHNICAL SUPPORT

<If the students must access content online or use email to submit assignments, then a technical support section is required. You need to include how to complete basic tasks and a phone number that they can call if they are having difficulty getting online>.

UNIT 1: EVOLUTION OF INTERNATIONAL BUSINESS

UNIT OUTCOMES

Outcomes	• Outcome: 1 Understand what international business is and why it is important. • Outcome -2 Appreciate the dramatic internationalization of markets. • Outcome -3 Understand the five drivers, all based on change, that are leading firms to internationalize their operations.

UNIT 2: GLOBALIZATION AND THE BUSINESS ENVIRONMENT

UNIT OUTCOMES

Outcomes	• Outcome -4 Recognize the key arguments for and against the globalization of business. • Outcome -5 Appreciate that international business has a long and important history in the world's development. • Outcome -6 Explain the reasons for entering foreign markets.

UNIT 3: THEORIES OF INTERNATIONAL TRADE

UNIT OUTCOMES

Outcomes	• Outcome 1: Outline the theories that attempt to explain why certain goods are traded internationally.

UNIT 4: COMMERCIAL POLICIES IN THE CONTEXT OF ECONOMIC INTEGRATIION

UNIT OUTCOMES

Outcomes	• Outcome1: Learn the different methods used to assess a tariff. • Outcome 2: Measure, interpret, and compare average tariffs around the world

UNIT 5: COMMERCIAL POLICIES (Cont.)

UNIT OUTCOMES

Outcomes	• Outcome -1 Outline the United Nations as an institution and its relevance to international business. • Outcome -2 Describe the purposes of the two global monetary institutions, the IMF and the World Bank. • Outcome -3 Discuss the purpose of the World Trade Organization and its impact on international business. • Outcome -4 Discuss the purpose of the World Trade Organization and its impact on international business.

UNIT 6: STANDARDIZATION AND DISTRIBUTION IN INTERNATIONAL ENVIRONMENT

UNIT OUTCOMES

Outcomes	• Outcome -1 Explain the international market-entry methods. • Outcome -2 Explain why there are differences between domestic and international marketing. • Outcome -3 Discuss why international marketing managers may wish to standardize the marketing mix. • Outcome-4 Discuss the importance of distinguishing among the total product, the physical product, and the brand name. • Outcome-5 Describe the activities of a foreign freight forwarder. • Outcome -6 Outline the export documents required

UNIT 7: FOREIGN INVESTMENT

UNIT OUTCOMES

Outcomes	• Outcome - 1 Explain the size, growth, and direction of foreign direct investment. • Outcome -2 Explain several theories of foreign direct investment.

UNIT 8: REGIONAL ECONOMIC INTEGRATION

UNIT OUTCOMES

Outcomes	• Outcome - 1 Identify the levels of economic integration and the effectiveness of the major trading blocs.

UNIT 9: INTERNATIONAL FINANCIAL MARKETS AND MONETARY SYSTEM

UNIT OUTCOMES

Outcomes	• Outcome -1 Describe the international monetary system's evolution. • Outcome – 2 Discuss how foreign exchange is quoted. • Outcome -3 Describe the factors that influence exchange rate movement. • Outcome -4 Outline the approaches to exchange rate forecasting. • Outcome -5 Discuss the influence of currency exchange controls on international business.

ASSIGNMENT

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TOPIC 1.4

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UNIT SUMMARY

Summary	<Unit Summary here>

CHAPTER ONE: INTERNATIONAL TRADE- THEORIES AND EVOLUTION OF INTERNATIONAL BUSINESSES

What is International Trade?

This refers to the movement of goods and services across borders . However, it is not limited to goods and services only but can include the movement of labour, financial instruments and capital as well.

International Trade is Mostly Prompted by the following:

(a) ***Technological differences between countries;*** this refers to the efficiency in which a particular country can organize its resources to produce a certain quantity of a commodity or service.
(b) ***Differences in resource endowments;*** the resources here refer to capital (machinery, equipment, etc.), human capital (human resource) and natural resources abundance across countries.
(c) ***Differences in demand between countries;*** this can be reflected by tastes, income levels, etc.
(d) ***Existence of economies of scale;*** this stems from the fact that some countries have declining costs as output increases.
(e) ***Government policies;*** refers to policies that countries put in place or adopt in order to promote trade with other countries.
(f) ***Geographical or gravity factors*** such as common language, common border, colonial legacy as well as distance from markets

Most importantly, countries engage in international trade in order to address macroeconomic issues such as; poverty, unemployment, slow economic growth, macroeconomic imbalances (e.g. trade deficits, debt burdens, acquiring foreign reserves and increasing consumption possibilities as well).

Globalization

The ideology behind international trade can best be understood through the concept of globalization. ***Globalization*** refers to the integration/interconnectedness of markets in the global economy.

1.2.1 Phases of Globalization

The world has experienced three periods of rapid globalization, 1870–1914, 1945–1980, and 1980 to the present.

(i) ***Globalization in 1870–1914***: resulted from the Industrial Revolution in Europe and the opening of new, resource-rich, but sparsely populated lands in North America, South America, and South Africa. These lands received millions of immigrants and vast amounts of foreign investments, principally from England, to open up new lands to food and raw material production. These settlements grew rapidly during this period by exporting increasing amounts of food and raw materials to Europe in exchange for manufactured goods. This period of modern globalization came to an end with the breakout of World War I in 1914.
(ii) ***Globalization in 1945-1980:*** This second period and rapid globalization phase which started with at the end of World War II. It was characterized by the rapid increase of

international trade as a result of the dismantling of the heavy trade protection that had been put in place during the Great Depression of 1929.

(iii) ***Globalization in 1980-present:*** this globalization revolution is different in terms of speed, depth, and immediacy resulting from the tremendous improvements in telecommunications and transportation. There has been a massive international capital flows resulting from elimination of most restrictions on their flow across national boundaries, as well as by the participation of most countries of the world. This is what makes today's globalization that much more pervasive and dramatic than earlier periods of globalization. The recent (2008–2009) global financial and economic crisis, the deepest of the postwar period, only slowed down the march of globalization temporarily.

1.2.2 Advantages of Globalization:

Advantages of globalization can be observed through the following:

(i) ***Improved means of communication:*** seen through the ability to connect instantly with any corner of the world by cellular phones, telephones, e-mails, WhatsApp, Facebook and teleconferencing. We can also travel anywhere in the world incredibly fast.

(ii) ***Converging tastes:*** More and more people around the world generally like the same things, e.g. WhatsApp, Facebook, etc.

(iii) ***Goods and Services Consumed:*** goods we consume are either made abroad or have many imported parts and components. Many services we use are increasingly provided by foreigners. For instance, (i) the medication we in Lesotho is approved by the World Health Organisation. (ii) the Chemotherapy and Oncology Services to Lesotho patients are provided abroad (India and South Africa). (iii) We consume commodities like petroleum, gold and silver products, coffee and many more even though we do not produce them.

(iv) ***Business Competition:*** Though protectionist policies still persist, most local firms are now competing with businesses across the globe.

(v) ***Labour Force Migration:*** millions of workers at all skills levels migrate around the world and thousands and thousands of jobs have moved from advanced countries to emerging economies like China and India.

(vi) ***Financial Markets:*** the financial markets are highly globalized. We invest in companies anywhere in the world and purchase financial instruments (stocks and bonds) from any company from anywhere in the world. This provides companies and individuals with opportunities for higher returns and risk diversification. For instance, many pension funds are invested abroad and a financial crisis in one financial centre quickly spreads across the world at the click of a mouse. Again, we can exchange currencies easily and quickly regardless of the country we are in.

1.2.3 Disadvantages of Globalization

(i) ***Slow economic growth and high unemployment:*** although labour migration generally leads to the more efficient utilization of labour, it also leads to job losses and lower wages for less-skilled labor in advanced nations and harms/causes a "brain drain" for the nations of emigration. Moreover, it has caused slow and unstable economic growth prospects.

(ii) ***Trade Protectionism in Advanced Countries***: with globalization nations have imposed restrictions on the free flow of trade. There have been an increasing competitive challenges that advanced countries face from the leading emerging market economies (particularly China and India) has exacerbated this situation. The example of the on-going trade war between China and US.

(iii) ***Globalization can ruin local economies:*** There is a movement that wants to buy local - especially organic foods.

(iv) ***Extreme Exchange Rates Fluctuations***: Globalization has led to financial and economic instability and dampened growth in advanced and emerging markets alike—disrupting the pattern of international trade and specialization and can lead to unstable international financial conditions throughout the world. They have also led to renewed calls for reforms of the present international monetary system and for more international coordination of economic policies among the leading economies.

(v) ***Deepening Poverty in Many Developing Countries***: Even though many developing countries, especially China and India, have been growing very rapidly, some of the poorest developing nations, particularly those of sub-Saharan Africa, face deep poverty, unmanageable international debts, economic stagnation, and widening international inequalities in living standards. There are today more than 1 billion people (about one-sixth of the world population) who live on less than $1.25 a day! A world where millions of people starve each year not only is unacceptable from an ethical point of view but also can hardly be expected to be peaceful and tranquil.

(vi) ***Resource Scarcity, Environmental Degradation, Climate Change, and Unsustainable Development and Growth***: Both the rich countries and poor countries are now threatened by resource scarcity, environmental degradation, and climate change. The supply rigidities in producing nations has seen prices of petroleum and other raw materials rising sharply during the past few years, and so has the price of food. In South Africa for instance a number of mines have been closing due to depleted natural resources. Moreover, we are witnessing very dangerous climate changes that have increasingly dramatic effects on life on earth (draught, floods, etc.).

1.2.4 Globalization and the Business Environment

The globalization process impacts businesses in a sense that, it includes among others integration of markets, production, technology and investment. In recent years, a company can view the entire world as one country for its business operations. Such companies plan for their business not only in national markets but also venture in globally and view themselves as a global company. Employees of such companies are trained in worldwide operations. They make investment based on the feasibility of world-wide projects and procure raw materials, human resources and other inputs from the various parts of the world where they are available at low prices and good quality.

Globalization of business entities has the following features:

(i) Planning and operating to expand business throughout the world.

(ii) Removing the differences between domestic and foreign markets.

(iii) Buying and selling goods and services from one country to another in the world.

(iv) Establishing manufacturing and distribution facilities in different parts of the world.

(v) Product planning and development are based on market consideration of the entire world.

(vi) Factors of production and inputs like raw materials, machinery, finance, labor, managerial skill; are taken from the entire world.

(vii) Global orientation in strategies, organizational structure and managerial experience.
(viii) Setting the mind and attitude to view the entire world as a single market for business.

Why do companies globalize their operations?
Five major kinds of drivers, all based on change, are leading international firms to globalize their operations:

(i) ***Political:*** Preferential trading arrangements that group several nations into a single market have presented firms with significant marketing opportunities. Many firms have moved swiftly to gain access to the combined markets of these trading partners, either through exporting or by producing in the area. Two other aspects of this trend are contributing to the globalization of business operations: (1) the progressive reduction of barriers to trade and foreign investment by most governments, which is hastening the opening of new markets by international firms that are both exporting to them and building production facilities in them, and (2) the privatization of much of the industry in formerly communist nations and the opening of their economies to global competition.
(ii) ***Technological:*** Advanced technology and managerial competence in some countries also act as a pull factors for business firms from the home countries. Technology permits increased flow of ideas and information across borders, enabling customers to learn about foreign goods. Cable and satellite TV systems in Europe and Asia, for example, allow an advertiser to reach numerous countries simultaneously, thus creating regional and sometimes global demand. Global communications networks enable manufacturing personnel to coordinate production and design functions worldwide so that plants in many parts of the world may be working on the same product. The Internet and network computing enable small companies to compete globally, because they make possible the rapid flow of information regardless of the physical location of the buyer and seller.
(iii) ***Market:*** (1) When the domestic markets do not promise a higher rate of profits, the companies search for foreign markets which promise for higher rate of profits. Some of the domestic companies expand their production capacities more than the demand for the product in the domestic countries. These companies are forced to sell their excess production in foreign countries. (2) When the size of the home market is limited either due to the smaller size of the population due to the lower purchasing power of the people, companies globalize their business operations.
(iv) ***Cost:*** Economies of scale to reduce unit costs are a common management goal. One means of achieving them is to globalize product lines to reduce development, production, and inventory costs. Management can also move production or other parts of the company’s value chain to countries where costs are lower. Companies are also attracted by good quality labour at a cheaper cost.
(v) ***Competitive:*** When there is a severe competition in the home country, companies which could not meet the competition of the strong companies in the domestic markets, start entering the foreign markets. Thus, new firms, many from newly industrialized and developing countries, have entered world markets in automobiles, computers, and electronics, for example. Another competitive driving force for globalization is the fact that companies are defending their home markets from competitors by entering the competitors’ home markets to distract them.
(vi) ***Resource:*** resource seeking companies such as those in the mining and agricultural business may locate to countries where these resources are available

1.2.5 The Globalization Process of Businesses

Globalization of an existing business does not take place in one phase. It happens gradually through an evolutionary approach. Various companies pass through different stages of globalization. However, in case of many companies, the initial attitude towards international business is passive and they get into the international business in response to some external influence. The following are the stages in globalization of an existing business:

(i) A domestic company exports to foreign countries through dealers or agents.

(ii) A domestic company then exports to foreign countries on its own.

(iii) Slowly the domestic company becomes an international company by establishing production and marketing operation in different countries of the world.

(iv) After some time, the domestic company replaces the foreign company in the foreign country with all the facilities including research and development and full-fledged with qualified human resources.

(v) Finally, the domestic company becomes a true foreign company by serving the needs of foreign customers just like a host countries company serves.

1.2.6 Impacts of Globalization on Businesses

(i) Establishment of international alliances or coalitions, which link firms of the same industry based in different countries. These alliances have resulted in establishment and enforcement of international policies and agreements, thus, effecting an increase in the establishment of harmonious relationships among companies. These also strengthens the industry where specific companies belong to, thus, reinforcing their bond that would enable them to come up with strategies for further improvement and development.

(ii) Development and improvement of the whole organization in order to address challenges or problems. The need to configure and coordinate globally in complex ways creates some obvious organizational challenges, such as organizational structure, reporting hierarchies, communication linkages, and reward mechanisms. So, there is need to develop, improve, innovate, and adopt new strategies and methods in relation to systems modification to enable adjustment to the changes and challenges being encountered by the organization.

(iii) Establishment of government relations. In the globalized era, the selection of foreign market to enter and the mode of entry largely depend on the negotiations with the foreign governments concerned. This is because the international business must be able to make negotiations and agreements with the government concerned, in order to comply with necessary requirements and encourage harmonious relationships.

1.2.7 Challenges to Globalisation of Business

For example, the current Covid-19 pandemic has disrupted global supply chains and hindering production in countries that have hitherto relied on supplies from china. Companies may now move to localise their production by either diversifying their input supply sources or initiating domestic supply value chains. Movement of people has also been hindered as countries moved to close borders and airports to international movement of people to stem the spread of virus hindering business tourism and supply of certain goods that are considered non-essential

1.3 THEORIES OF INTERNATIONAL TRADE

The Theories of International Trade seek to explain as to why countries or nations trade with each other. They seek to provide answers to the following questions:

(i) What is the basis for trade and what are the gains from trade? Individual, firms and nations voluntarily engage in trade only if they can benefit from trade. But how are gains from trade generated? How large are the gains and how are they divided among the trading nations?

(ii) What is the pattern of trade? That is, what commodities are traded, which commodities are exported and imported and to which or from which countries/regions or continents?

1.3.1 THE THEORY OF MERCANTILISM

This is an economic theory and practice that was dominant in some modernized parts of Europe (Spain, France and England) during the 16th to the 18th century. The theory is premised on the belief that a country's wealth is derived from ***its ability to accumulate precious metals*** such as gold and silver. These metals were, in the mercantilists' view, the only source of wealth. As such, the government established economic policies that promoted exports and discouraged imports. For example, import restrictions such as import duties, quotas, and tariffs reduced imports significantly. On the other hand, the government introduced export subsidies which lead to an increase in exports. These acts created what is known as **trade surplus** (favorable balance of payment of balance of trade). All in all, the believed that foreign trade (trading across borders) is more beneficial than domestic trade (trade within the country). Moreover, job creation was high due to increased exports.

The theory has several shortcomings; (a) it embraces a narrow view of trade, by seeing trade as a **Zero-Sum** game. To them trade was not for mutual benefit but one country gains (exporting country) at the expense of the other country (importing country). (b) Another outcome of mercantilism was the generation of benefits for certain economic groups, such as domestic merchants, artisans, and shippers, albeit at a cost to other groups such as consumers and emerging industrialists. (c) Excess money supply (money in circulation) is always inflationary. Therefore, Mercantilism resulted in an increase in the general price levels.

Although the mercantilist era ended in the late 1700s, its arguments live on. Many people still argue that exports are "good" for a country because they create jobs, while imports are "bad" because they transfer jobs from the importing country to other nations. Similarly, a "favorable" trade balance still means that a nation exports more goods and services than it imports. In balance-of-payments accounting, exports bring foreign currency into country while imports that causes the outflow of the foreign currency.

1.3.2 THE THEORY OF ABSOLUTE ADVANTAGE BY ADAM SMITH

Adam Smith came up with an ideology that would fully replace mercantilism due to the flaws that are inherent to it. Smith posits that trade between countries is solely based on the ***absolute advantage***. He asserts that, for 2 countries to be able trade with each other, both countries should gain, i.e. there should be **mutual benefit**. The theory says that if country A is more efficient[1] than country B in the production of commodity X, but less efficient than B in the production of commodity Y, both countries can benefit from trade by specializing in the

[1] Efficiency in this regard refers to the cost of production. So, if the country is able to produce a commodity at the lower cost it is said to be more efficient in the production of that particular commodity.

production of the commodity of which it has absolute advantage. Consequently, each country will benefit by specializing in the commodity in which it has an absolute advantage and obtain the other commodity through trade. The benefit derives from obtaining the imported commodity at a lower real cost through trade than through direct production at home.

Example;
Suppose that there are two countries Lesotho and Eswatini which produce cloth and wine. Supposing that in Lesotho it takes **30 days** to produce a **bolt of cloth** and **120 days** to produce a **barrel of wine**, whereas in Eswatini it takes **100 days** to produce **a bolt of cloth** and only **20 days** to produce a **barrel of wine**. (Each commodity is assumed to be identical in both countries, which ignores the problem of the likely quality differences of products involved in trade).

Table 1: Production of wine and cloth in Lesotho and Eswatini

Days of labour required to produce	**Country**	
	Eswatini	Lesotho
Cloth (1 bolt)	100	30
Wine (1 barrel)	20	120

Lesotho has an absolute advantage in cloth production – it can produce a bolt of cloth at a lower real cost than can Eswatini – whereas Eswatini has an absolute advantage in wine production. Thus, the two countries can gain from trade if Lesotho can specialize in the production of cloth and sell it to domestically and export some to Eswatini. In the same manner, Eswatini should specialize in the production of wine and export some to Lesotho.

1.3.3 THE THEORY OF COMPARATIVE ADVANTAGE BY DAVID RICHARDO

David Ricardo (Principles of Political Economy, 1817) posits that, a mutually beneficial trade is based on ***"comparative advantage"*** not "absolute advantage" as per Smith's postulates. He asserts that, a mutually beneficial trade can occur even in the absence of absolute advantage. This implies that, even though one country can have an absolute advantage over another in the production of both commodities, both countries can still benefit from trade. According to Ricardo, if country A has an absolute advantage in the production of commodity X and Y than country B, both countries can benefit from trade if each country can specialize in the production of and export the commodity in which it has a higher comparative advantage and import the commodity in which it has a lower comparative advantage.

Example;
Suppose that there are two countries Lesotho and South Africa which produce Water and Maize. Supposing that in Lesotho it takes **12 days** to produce a **ton of maize** and **3 days** to produce a **kilolitre of water**, whereas in South Africa it takes **4 days** to produce a **ton of maize** and only **2 days** to produce a **kilolitre of water**. (Each commodity is assumed to be identical in both countries, which ignores quality associated challenges).

Table 2: Water and Maize Production in Lesotho and South Africa

Days of labour required to produce	**Country**	
	Lesotho	South Africa

Maize (1 ton)	12	4
Water (1Kilolitre)	3	2

Clearly, South Africa has an absolute advantage in the production of both commodities. Comparing production of the 2 commodities in the two countries it can be observed that, it is comparatively more expensive for Lesotho to produce maize than water (12 days versus 3 days). Similarly, it is comparatively more expensive for South Africa to produce water than maize (4 days versus 2 days).

In the absence of trade, in Lesotho 1 kilolitre of water will exchange for 0.25 tons of maize (because they require equal amounts of labor) while 1 ton of maize will cost 4 kilolitres of water. In the same manner, 1 kilolitre of water will exchange for 0.5 tons of maize in South Africa and 1 ton of maize will exchange for 2 kilolitre of water. This implies that, Lesotho should specialize in the production of water and sell it to South Africa whereas South Africa can specialize in the production of maize and sell it to Lesotho.

1.3.4 INTERNATIONAL PRODUCT LIFE CYCLE

This theory aims at explaining as to why a product that begins as a nation's export eventually becomes its import.

It acknowledges that due to innovations in trade patterns, a product passes through full life cycle from the internationalization stage to standardization. To elaborate this, consider the following example; suppose there is new product which has been introduced by firms in any of the industrialized nations (say USA), but because more new products have been successfully introduced on a commercial scale in the United States, let us examine the IPLC as it applies to this country.

(i) ***Stage One:*** In the early stages of the product life cycle, the design and the production methods are changing. By being close to the market, management can react quickly to customer feedback and more easily provide local repair services. For a while, American firms will be the only manufacturers of the product; overseas customers, as they learn of the product, will therefore have to buy from American firms. The export market develops as the manufacturer ships products to customers who are based overseas.

(ii) ***Stage Two:*** Foreign production begins- overseas consumers, especially those in developed nations, have similar needs and the ability to purchase the product. Export volume grows and may become large enough to support local production, especially in larger markets. The technology for producing the good has become fairly stable, and if the innovator is a multinational firm, it will often be sending its subsidiaries new-product information with complete details on how to produce it. Where there are no affiliates, foreign managers, as they learn of the product, will obtain licenses from the innovating company for producing the product (or else they may initiate efforts to imitate or invent around the innovator's technology in order to capture the market opportunity). Foreign production will begin, which also provides advantages of reduced costs for transportation and local communication. The American firm will still be exporting to those markets where there is no production, but its export growth will diminish as licensing and foreign direct investment substitute for exports as sources of supply to various international markets.

(iii) ***Stage Three***: Foreign competition in export markets- later, as early foreign manufacturers gain experience in marketing and production, their costs will fall. Saturation of their local markets will cause them to look for buyers elsewhere. They may even be able to undersell the American producers if they enjoy an advantage such as lower labor or raw material costs. In this stage, foreign firms are competing in export markets, and as a result, American export sales will continue to decline. By this stage, the innovating American firms may have developed newer versions of the product and begun scaling back production of the original product in order to begin focusing instead on the newer innovations.

(iv) ***Stage Four:*** Import competition- If domestic and export sales enable foreign producers to attain the economies of scale enjoyed by the American firm, they may reach a point where they can compete in quality and underprice American firms in the American market. From that point on, the U.S. market will be served exclusively (or nearly so) by imports. Televisions, footwear, and DRAM (dynamic random access memory) semiconductor chips are examples of such products. This provides increasing pressure on the innovating company to achieve product innovation and improvement, which may correspondingly initiate a new IPLC.

1.3.5 The Global Strategic Rivalry Theory of International Trade

This theory was developed in the 1980s by such economists as Paul Krugman and Kevin Lancaster as a means to ***'examine the impact on trade flows arising from global strategic rivalry between Multi-National Corporations***.' It explores the notion that in order to stay viable, firms should exploit their competitive advantage globally and try to keep it sustainable. According to this view, firms struggle to develop some sustainable competitive advantage, which they can then exploit to dominate the global marketplace. The theory focuses more strategic decisions that firms adopt as they compete internationally. These decisions affect both international trade and international investment. Companies such as Caterpillar and Komatsu, Unilever and Protect & Gamble, and Toyota and Ford continually play cat-mouse games with one another on a global basis as they attempt to leverage their own strengths and neutralize those of their rivals.

Firms competing in the global marketplace have numerous ways of obtaining a sustainable competitive advantage. There are many ways in which a firm can hold a competitive advantage, including:

(i) Owning Intellectual Property Rights: Intellectual property laws confer a bundle of exclusive rights in relation to the particular form or manner in which ideas or information are expressed or manifested, and not in relation to the ideas or concepts themselves. The term "intellectual property" denotes the specific legal rights which authors, inventors and other intellectual property holders may hold and exercise, and not the intellectual work itself. Owning intellectual property rights boosts one's worth. It is this difference which works as strategic rivalry.

(ii) Investing in Research and Development: Investment in research and development is the surest way to reach the top of invention, innovation and patent ownership. Thomas Alva Edison said, Genius = 1 percent inspiration + 99 percent perspiration. He encouraged all people to offer hard work. R&D is perspiration with flash of inspiration. To excel rivals, R&D capability is needed. For instance, American firms spend around $500 billion on R&D annually, much of it on computing and communications. Most of this money went into making small incremental improvements and getting new ideas to market fast. IBM, GE and Microsoft are leaders in their chosen field because of their R&D commitments.

(iii) ***Achieving Economies of Scale or Scope:*** Achieving economies of scale or scope is in fact leveraging your existing strengths. Scale economies help reduce cost, pass the benefit to consumers and expand market share. It is very important that your capacity is fully utilized.

(iv) ***Exploiting the Learning Curve:*** Learning curve refers to a relationship between the duration of learning or experience and the resulting progress. Businesses that use learning curve excel well as they learn to cut cost and add value faster than others and outsmart competitors. A company can reduce overall unit cost by 20 to 30% each time it doubles output, if learning curve effect works well. So, if the first unit costs $ 1000, the next costs $ 700 to $ 800, the fourth unit costs $ 490 to $ 640 and so on. A host of factors, like a fall in fixed cost of production per unit, rise in dexterity levels and nuances of handling shop floor issues and quantity discounts on purchase owing to large volume orders help reduce cost per unit. Such cost advantages would threaten new entrants. So cost leadership results from learning curve effect which could be a strategic advantage.

(v) ***Strategic Alliances:*** A Strategic Alliance is a formal relationship formed between two or more parties, usually those in the same business line (i) as horizontals competing with each other in the same or different geographies or (ii) as verticals serving each other in complementary mode, to pursue a common goal or meet a critical business need while remaining independent organizations. One alliance partner might bring products, distribution channels or manufacturing capability and the other project funding, capital equipment, knowledge, expertise, or intellectual property. The alliance's emphasis is 'synergy' and 'competitive advantage'. A good example of strategic alliance is the alliance between Qantas and British Airways. Qantas is the largest private airline in Australia and has solid air route throughout the Asia Pacific region, likewise British airways had strong network within Europe, North Atlantic's, and North America. By forming an alliance in 1993, both companies strategically positioned themselves to have a strong worldwide network.

(vi) ***Mergers and Acquisitions:*** This refers to deals involving buying, selling and combining of different companies that can form a new company to usher in a fast track collective growth. Merger is a tool used by companies for the purpose of expanding their operations often aiming at an increase of their long-term profitability. An acquisition, also known as a takeover, is the buying of one company (the 'target') by another. An acquisition may be friendly or hostile. A smaller firm may also acquire a larger or longer established company and keep its name for the combined entity. This is known as a reverse takeover.

1.3.6 Country Similarity Theory of International Trade

The theory was developed by a Swedish economist Steffan Linder in 1961, as he tried to explain the concept of intra-industry trade. Linder's theory proposes that consumers in countries that are in the same or similar stage of development would have similar preferences. In this firm-based theory, Linder suggests that companies first produce for domestic consumption. When they explore exporting, the companies often find that markets that look similar to their domestic one, in terms of customer preferences, offer the most potential for success. Linder's country similarity theory then states that most trade in manufactured goods will be between countries with similar per capita incomes, and intra industry trade will be common. Simply, this theory describes the idea that countries with comparable qualities are mainly likely to trade with each other. These qualities might include the level of development, savings rates, and natural resources, among others.

The country similarity theory is based on the following principles:

(i) If two countries have related require patterns, then their customers would claim the same goods with alike degrees of value and superiority.
(ii) Since the majority of products are developed on the required patterns in the domestic market, other countries with related required patterns due to a cultural or economic comparison would be their normal trade partners.
(iii) Countries with the proximity of geological locations would also have better trade compared to the far-away ones.

The theory further states that most trade in manufactured goods will be between countries with similar per capita incomes, and intraindustry trade will be common. This theory is often most useful in understanding trade in goods where brand names and product reputations are important factors in the buyers' decision-making and purchasing processes.

Most trade today occurs seems to occur/take place among related countries –

(i) Same per-capita income
(ii) Comparable communications/allocation systems
(iii) Same language / traditions / belief / tastes etc.

Similarity countries with the above aspects allow their products and services to be sold without difficulty in each other's markets.

Country similarity theory was developed by a Swedish economist named **Steffan Linder**. Country similarity refers to what? Is it similarity of location or culture or political/ economic interests or technological capability (that is acquired advantage) or natural advantage or lack of it? Traditional trade theories speak of difference in demand or supply conditions or both as a necessary condition for trade between countries. That is, the traditional trade theories are built upon differences. But the **country similarity theory** is built of identical features of nations in trade. 8 out of top 10 trading partners of the USA are developed economies. Globally 11 out of 12 largest players in world trade are developed nations.

- **Developed countries trade more with developed countries**: Products of a developed country match demand and user conditions of another developed country only. Hence the similarity in development pace decides trade between countries. The reasoning is that a developed country introduces a new product and similarly developed countries find the product quite useful and hence go for the same. This is because needs become more or less common in countries with similar levels of development. The industrialized countries produce more; hence peoples' spend power is high; the power is apportioned between domestic and foreign goods, both of course catering to similar need satisfaction.
- **Countries in same cultural milieu trade more amongst themselves**: Countries in same cultural milieu will have similar demands as for as cultural products/services like family functions, rites, rituals, entertainments, religious ceremonies and so on. Cross country offerings are more. Countries with no similarity either by cultural, technological or other basis may not trade. While countries in the northern hemisphere trade intensively inter se, countries in the southern hemisphere do not trade intensively. The reason is that no historic ties amongst the countries. Perhaps the traders do not want to taste new shores.

- **Countries in similar geo-features trade more with each other**: Countries in similar geo-features like ecological or climatic factors will mutually cater to cross border demands. A kind of cross-border monopolistic competition emerges with firms vying for cross-country market share with the thrust on product differentiation.
- **Countries with similar political and economic interests trade more inter se:** Trade between countries with similar political and economic interests is more common than between countries that differ. Cuba and US are in the same continent, but due to political ideological differences they scarcely trade for over 5 decades. Cuba is a good source of supply of sugar. But US prefers not to taste Cuban sugar. EU countries amongst themselves pulled down all protectionist impediments to trade and intra-regional trade is highest, because they have similar geo-features.
- **Intra-industry trade abetted by similarity factor**: Similarly placed countries capabilities as well as needs happen to be similar. So, quite a lot of intra-industry trade among these similarly placed countries happens. US exports good lot of road vehicles and imports much road vehicles as well too. Needs are same across the nations. Offerings are also same across the nations, but product differentiation is built through top gear promotion. Intra industry trade happens because of sheer dispersed desire for foreign brands. Intra industry trade accounts for approximately 40 per cent of world trade.

Steffan Linder believed that international trade of manufactured goods occurred between countries at the same stage of economic development that shared the same consumer preferences. Therefore, the country similarity theory consists of the value that most trade in manufactured goods should be between nations with similar per capita income, and that intra industry trade in manufactured goods should be common.

CHAPTER TWO: CURRENT GLOBAL BUSINESS ENVIRONMENT

2.1 COMMERCIAL POLICIES IN THE CONTEXT OF ECONOMIC INTEGRATIION

Commercial policies are used to protect domestic industries, domestic agriculture and for Balance of Payment (BOP) Purposes.

In our exposition of the theory of international trade, we realised that countries, if not all individuals in the countries, generally gain from trade. However, the important question is whether or not free trade best for all? It is in this regard that we are going to learn about the effects of various trade barriers in the economy. Examples of trade barriers are quotas, tariffs, import duties, subsidies, etc.

2.1.1 The Effects of Tariffs on International Trade

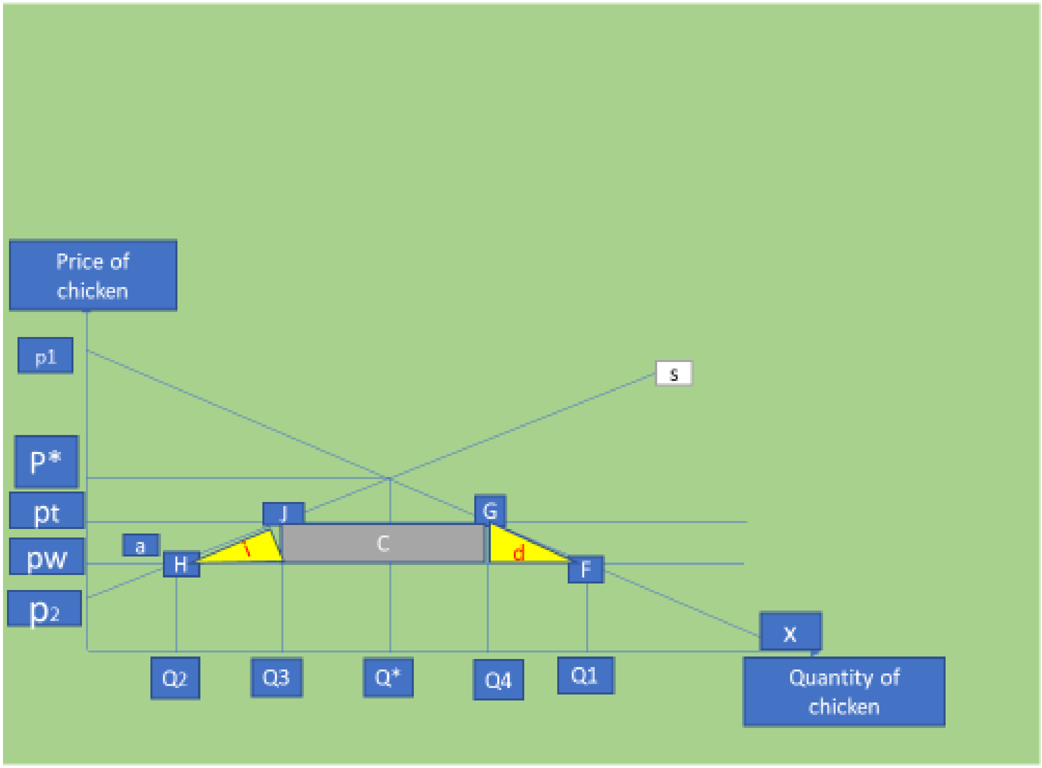
Tariff: is a tax or duty levied on the traded commodity as it crosses a national boundary. An import tariff is a duty on the imported commodity, while an export tariff is a duty imposed on the exported commodity. Import tariffs are relatively common. Tariffs can be ad valorem, specific and compound.

- ***Ad volarem tariff;*** is expressed as a fixed percentage of the value of the traded commodity. E.g. it can be 10% per tray of eggs imported. If a tray of eggs costs M30.00. when ad valorem tax is imposed, the try will cost M33.00
- ***Specific tariff;*** is expressed as affixed sum per unit of the traded commodity. E.g. can be M2.00 per tray of eggs imported. The tray of eggs will therefore be M32.00
- ***Compound;*** is the combination of ad valorem and specific tariffs. E.g. A tray of eggs will be M35.00 (M30 + 10% of M30 + M2.00).

To understand the impact of tariffs on trade, consider the following example;

DIAGRAM 1

Diagram 1: Effects of a tariff on a small open economy



Suppose the Lesotho's consumption of chicken is supplied by both the local (domestic) firms and imports. From the diagram;

Q = the quantity of Chicken,

P_c= price of chicken

X_c= demand curve of chicken

S_c= Supply Curve of chicken

Before Tariff (assumes open economy without restrictions)

World price of chicken is P_W, assume that Lesotho has a comparative disadvantage in production of chicken and imports chicken from the rest of the world at a lower price, P_W, compared to domestic price, p*. This will benefit Basotho consumers and cause domestic demand for chicken to increase from Q* to Q_1. Domestic production (supply) of chicken will decline from Q* to Q_2, but chicken imports Q_1 -Q_2 will be used to fill this gap.

After Tariff (an open economy with restrictions)

Assume that government of Lesotho imposes tariff (T) to chicken imports. The quantity of chicken imports is represented by Q_3-Q_4, a decrease. This would not affect world price of chicken (because Lesotho is a small economy). However, the domestic price of chicken will increase from p_w to p_t.

Other Effects

1. **Production Effect**

The tariff raises the domestic price above world price and the producers are encouraged to produce more. As a result, the supply of chicken will increase from Q_2-Q_3. This is called protective effect of a tariff; protecting small chicken industry in the country.

2. **Consumption Effect**

The tariff raises the price that consumers pay and encourages them to reduce their demand (consumption) of chicken by Q_1-Q_4.

3. **Effect on Imports and BoP**

Quantity of imports has declined from Q_2-Q_1 To Q_3-Q_4. The only price that changes is the domestic price and world price will remain at P_w.

Lesotho's expenditure before tariffs was Pw(Q1-Q2), but expenditure after tariff imposition is Pw(Q3-Q4); because Lesotho's expenditure on imported chicken has declined, that will have positive effect on Lesotho's trade balance.

4. **Revenue Effect**

Before tariff imposition, no revenue was collected but after tariff imposition, revenue collected will be area c. If the tariff was so large that the quantity demanded of imports becomes zero, there won't be any government revenue and this tariff is called prohibitive tariff.

5. **Consumers' Surplus**

P_1FPw = before tariff imposition, consumers surplus will fall to P_tGP_1; reduced by area (abcd) from the diagram.

6. **Producers' Surplus**

Before tariff = P_wHP_2, which is the area above supply curve and market price. After tariffs, surplus increased by area a to P_tP_2J.

7. Deadweight Loss

The deadweight (societal loss) comprises of areas (b) which is incurred as producers over-produce and (d) which is caused by the consumers under-consuming. Total deadweight loss is the sum of the two areas (b+d).

2.1.2 The Effects of a Quota on International Trade

This is a nontariff barrier which limits the physical volume of the imported commodity. Unlike tariffs, quotas do not have any impact of the price of the imported commodity. In most cases quotas are imposed on agricultural products.

To understand the impact of quota on trade, consider the following example;

DIAGRAM 2

Suppose the country's consumption of commodity X is supplied by both the local (domestic) firms and imports. From the diagram;

X = the quantity of commodity X,

P_x= price of X

D_x= demand curve of X before the imposition of a quota

D'_x= demand curve of X after the imposition of a quota

S_x= Supply Curve of X

Initially, the domestic consumption for commodity X was at point B (or it consumes AB units of X), at price, $P_x = 1$. At this point the domestic supply of X is AC; this implies therefore that the country imports CB units of X.

Suppose that the quota is imposed on the importation of X, the demand function will shift to the right to D'_x, price of X will increase to $P_x = 2.5$. This price is higher than the one before the imposition of the quota. A restriction on the amount of imports will put pressure on the local supply. In this case an increase in demand for domestic production of X will lead to an increase in prices. Increase in price will lead to a decline in quantity demanded of X. Demand will decline from AB to $G'H'$; of which imports constitute $J'H'$ units and domestic supply $G'J'$ units. This implies therefore that the local (domestic) supply of X will increase from AC to $G'J'$ due to an imposition of the quota and reduces quantity imported of X. It is noteworthy that, unlike a tariff, a quota does not yield any income to the government.

2.1.3 Other Non-Tariff Policies

1. Voluntary Export Restraint (VER)

This is also a nontariff barrier. It operates in such a way that an importing country induces another country to reduce its exports of a commodity "voluntarily", when its exports possess a threat to the entire domestic industry. VER is not as effective as an import quota in the sense that it is administered by the exporting country unlike a quota which administered by an importing country. As such a country might reluctantly agree to reduce its exports. Furthermore, the rule applies only to major exporting countries, leaving a room or a door open for other nations to replace part of the exports of the major suppliers.

2. Technical, Administrative and other Regulations

International trade has also been hampered by numerous technical, administrative and other regulations. These include safety regulations and health regulations that require hygienic production and packaging of imported food products, and labelling requirements showing origin and content. In some cases, the laws that force the government to buy from domestic suppliers have been enacted as a way of hindering trade or imposing restrictions on trade.

3. **Production subsidies**

If a government intends to increase output in an industry, economists claim that a first-best solution is to provide a subsidy to producers rather than to impose a tariff. It increases production significantly and leaves consumption unchanged. Subsidies are usually not a common approach to increasing domestic production because they are politically motivated. Moreover, just like a quota, production subsidies do not generate income for the government, but the taxpayers have to provide the funds for a subsidy.

4. **Export Subsidies**

The issues presented thus far suggest that government regulation of international trade is intended solely to restrict imports. Although that remains the dominant form of intervention, governments sometimes attempt to encourage exports through subsidies. This may occur because of a desire to improve a country's balance of trade account (or balance of payments account), to provide aid to an economically promising industry, or help a depressed region in which an export industry is located. The subsidy may be a simple cash payment to exporters. The export subsidy will not only encourage local firms to produce more for international markets but will also causes the domestic products to be relatively cheaper in the world (international) market.

5. **International Cartels**

An international cartel is an organization of suppliers of a commodity located in different nations (or a group of governments) that agrees to restrict output and exports of the commodity with the aim of maximizing or increasing the total profits of the organization. The most famous international cartels are OPEC (Organization of Petroleum Exporting Countries), and the International Air Transport Association, a cartel of major international airlines.

2.2 COMMERCIAL POLICIES

2.2.1 Reciprocal Trade Agreement Act (RTAA)

Remember that commercial policies are used to protect domestic industries, domestic agriculture and for Balance of Payment (BOP) Purposes.

During the early 1930s, the world trade in general and exports in from USA in particular declined significantly due to the following reasons:

a) A great reduction in economic activities globally due to the great depression;
b) Increase in the import duty in America, caused by the implementation of the Smoot-Hawley Tariff Act in 1932. This resulted in decline in the production of goods and services; the economies of scale in production was also compromised.

To reverse the effects of reduced world trade, countries such as the US devised means that would help to boost the world trade. The number of Acts and Institutional Agreements were put in place. These include Trade Agreement of 1934 (also known as the Reciprocal Trade Agreement Act (RTAA). The Act was founded on the principle that a full permanent domestic recovery depends in part on a revised and strengthened international trade.

This Act provided for the negotiation of tariff agreements (bilateral agreements) between the USA and separate nations particularly the Latin American Countries. It served as an institutional reform which authorized the President to negotiate with foreign nationals to reduce tariffs in return for reciprocal reductions in the tariffs in USA.

The introduction of this Act managed to reduce mutual tariffs and import duties to lower rates than those that were set by Smoot-Hawley Tariff Act; hence, improved global trade liberalization, as most countries started to realise the gains from trade. This agreement also led to the establishment of other international trade corporations and concrete institutions on world trade.

These institutions are organizations constructed by a group of countries in to achieve a common goal that functions to "provide stability and meaning to international trade.

OR

Institutions are a collection of norms that "regulate the relations of individuals to each other."

OR

Institutions as organized collections of basic rules and written codes of conduct that limit and direct the decisions that members can make.

The institutions that were established to improve international trade include;

2.2.2 The World Trade Organization (WTO)

Following the Uruguay Rounds of Negotiations that went over eight rounds, the World Trade Organization (WTO), replaced GATT in 1995. GATT itself came into effect on 1 January 1948 as a treaty that provides rules and norms on trade between countries. The WTO is headquartered in Geneva, Switzerland and aims at reducing or eliminating trade barriers and restrictions worldwide to help producers of goods and services, exporters, and importers conduct their business by reducing costs. The WTO is a rules-based, member-driven organization with decisions negotiated by all the member governments. It negotiates member agreements to establish rules for equitable trade rules that limit the possible actions governments may take in their trade relationships, thereby increasing trade flows. It has 153 members.

In order to be able to undertake its operations WTO has established five basic principles on which the global trade system rests. These are:

- ***Trade without discrimination;*** this requires that nations treat all WTO members equally. This implies that if one nation grants another nation a special trade deal, that deal has to be extended to all WTO members. It also infers that foreigners and locals should be treated equally. In practice, this means that imported goods, once they are in the market, should not face discrimination.
- ***Freer trade, gradually, through negotiation;*** lower trade barriers encourage trade growth. WTO agreements establish "progressive liberalization" through gradual changes. Developing economies are given longer to adjust.
- ***Predictability, through binding and transparency***; predictability helps businesses know what their real costs will be. The WTO operates with tariff "bindings," or

agreements to not raise a specific tariff over a given time period. Such promises are as good as lowering a tariff because they give business people realistic data. Transparency, making trade rules as clear and accessible as possible, also helps business people anticipate a stable future.

- ***Promotion of fair competition;*** although WTO may be described as a "free trade" organization, and it certainly does work toward trade liberalization, the WTO also realises that trade relationships among nations can be exceedingly complex. Many WTO agreements support fair competition in agriculture, services, and intellectual property, discouraging subsidies and the dumping of products at prices below the cost of their manufacture.
- ***Encouragement of development and economic reform;*** three-quarters of WTO members are developing economies and those transitioning to market economies. These nations are active in the WTO's current Doha Development Agenda or extended conference. One of Doha's goals is that developed countries provide market access to goods from the very least developed countries and increase technical assistance for them. Developed countries have started to allow duty-free and quota-free imports for many products from the least developed countries, but agriculture remains a difficult area in which to build agreement.

Since its establishment the following milestones have been achieved;

(i) Reduction in tariffs to significant levels.
(ii) Increased trade dispute resolutions between member countries.
(iii) Improved regulations the operations of Foreign Direct Investment.
(iv) Liberalisation of global financial services which brings trade in banking, insurances and securities into a multi-lateral trading.
(v) It has fostered the development of agreement on telecommunications, i.e. it advocated for countries to open their telecommunication markets to competition.

2.2.3 World Bank

The World Bank was established in 1944 along with the International Monetary Fund (IMF) at the Bretton Woods meeting in order to address development issues. Membership in the World Bank Group falls under two major institutions; the International Bank for Reconstruction and Development (IBRD) (focuses on middle-income nations), as well as International Development Association (IDA) (which focuses on poorest nations). World Bank functions as a non-profit cooperative for its member-nations and enables developing nations to borrow funds at low rates.

IDA provides interest-free loans, called credits, and grants for development projects, with the largest number of projects in the water, sanitation and flood protection, transportation, health, education, agriculture, and law and justice sectors.

2.3 STANDARDIZATION AND DISTRIBUTION IN INTERNATIONAL ENVIRONMENT

2.3.1 *International Standards* – are strategic tools and guidelines aimed at ensuring that the business operates efficiently, increases their productivity and help companies to access new markets (both domestically and internationally). Standards are a necessary condition for international trade, i.e. in order for the companies to engage in international trade, they have to conform to a set of standards, especially those related to the International Organisation of Standards (ISO) and the Standard International Trade Classification (SITC).

Standards also ensure the safety and quality of the products and service. They reassure the consumers that the products are safe to use, reliable and are good for the environment. They provide the following information:

a) Materials used in production;
b) The processing stage;
c) Market practices and the use of the product;
d) Importance of the commodities.

2.3.2 Distribution in International/Foreign Trade

It refers to the movement of commodities from the domestic producers to the ultimate consumers in the foreign/international markets.

Types of exporting channels

a) **Direct exporting channel**: manufactures/producers/firms sell directly to the international market. It is used mostly by firms which have considerable export businesses that have been exporting for a long time.
b) **Indirect exporting channel**: manufacturers/producers/firms sell indirectly to the international markets. It is used mostly by firms which have just been engaged in exporting activities.

Exporting firms use the following alternatives to penetrate the foreign markets:

2.3.3 *International marketing middleman*: which comprises:

i. **Export Merchants**: importers who buy directly from foreign producers for re-packing and re-selling e.g. Lesotho Sugar Packers (LSP).
ii. **Export/trading houses**: They provide services for businesses seeking international experts to receive or deliver goods and services. Basically, they purchase and sell products for other businesses mostly foreign businesses.
iii. **Trading Companies**: buy specialized range of products, broke and coordinate delivery of products to customers.
iv. **Export drop shipping**: help customers to order products from international companies and earn commission on the order placed. Keep little/no inventory at all. The ordered goods are directly delivered from the source (foreign company) to the consumer.
v. **Agents/Brokers**: buy and sell imported goods for others.

2.3.4 Cooperative exporting organisation: carry on exporting activities on behalf of a group of people usually members of the organisation. The organisation is partly under the administrative control of the manufactures. It may be undertaken in two forms:

- **Piggyback marketing**: two or more firms represent one another's complementary (non-competing) products in their respective target markets.
- **Exporting Combinations**:

MARKETING ENVIRONMENT AND INTERNATIONAL DISTRIBUTION

The nature of the distribution system in a market is generally influenced by the relevant business environment. The within-country channels of distribution vary considerably from one country to another. Moreover, a distribution channel that might be working best in one market may be inappropriate in another market.

The distribution channel/selection may be influenced by the following factors:

a) Product characteristics
b) Market and consumer characteristics
c) Middleman characteristics
d) Competitor's characteristics
e) Environmental characteristics
f) Company characteristics and objectives

The international logistics also play a profound role in international distribution hence the competitiveness of the firm. It encompasses the entire range of operations concerned with product movement. The logistic management entails:

i. Inventory management
ii. Transportation
iii. Order processing
iv. Materials handling and warehousing
v. Fixed facilities location

IMPORT AND EXPORT PRACTICES AND PROCEDURES

Import and export practices and procedures differ from country to country. It depends upon the import policy, the statutory requirements and customs of different countries. Import trade is controlled by the government. Importers and traders need to be well versed with the cultural issues in the destination and source country. For example, how you negotiate and conclude deals in the western countries may differ significantly with how it is conducted in the Arab world.

The practices and procedures involve the following:

a) **Trade enquiry**: is a written request from the intending buyer or its agent for information regarding the prices and terms on which the exporter will be able to supply goods.
b) **Procurement of import license**: this license can either be general or specific. The general license allows the importer to buy goods from any country, whilst specific license allows importer to purchase goods from specified countries.
c) **Obtaining the foreign exchange**: importers should make payments using currency of the exporting country.
d) **Placing indent or order:** Contains the instructions from the importers pertaining the quantity and quality of good required as well as the methods for forwarding them. Indents/orders are of two types:
    i. ***Open order*** – the necessary particulars of the commodities are not mentioned.

ii. ***Confirmatory indent/order*** – an order is placed subject to the confirmation by the importers' agent.

e) **Dispatching a letter of credit**: the exporters have to ensure that there is no risk of non-payment. Thus, the exporter usually requests a letter of credit from the importer.

f) **Obtaining the necessary documents**: upon the receipt of the letter of credit, the exporter arranges for shipment of goods and send an advice note to the importer immediately after the shipment of goods. The exporter then draws the bill of exchange on the importer for the import value of goods. Other shipping documents such as the bill of landing, invoice insurance policy, customer invoice, etc. are also attached to the bill of exchange. These documents are forwarded to the importer through a foreign exchange bank. In the past, the expectation was that the foreign exchange bank should have a branch or an agent in the importer's country for collection of payments. In recent years however, payments can be made at the banks even if they do not have branches or agents in the importer's country,

g) **Custom formalities and clearing of goods**: after receiving the documents of the title of the goods, importers have to make sure that the goods are cleared by the customs authorities.

h) **Making the payment**: the mode of time of making the payment is determined by the terms and conditions as agreed earlier by importers and exporters.

i) **Closing the transaction**: after the goods have been received, the importer and the exporter closes their transaction,

In cases where the goods have been damaged in transit, the insurance company (appointed by the exporter) will have to compensate the importer.

2.3.4 DEFINITION OF TERMS

i. **Letter of credit**: a tool used in international trade especially in cases where the buyer and the seller have no prior history of transacting with one another. It provides the seller with the guarantee that he will receive a certain amount of money (as stipulated in the letter of credit) from the buyer once the items bought have been delivered. If the buyer is not able to pay for the goods purchased, the bank (the one issuing the letter of credit) will be required to pay the amount of the purchase.

ii. **Bill of landing**: a legal document between the shipper (exporter) of goods and carrier which provides information on the type and quantity of the goods being carried, as well as its destination. It acknowledges that the goods have been landed for shipment. It contains the terms of contract of carriage. It also serves as a document of the title to the goods.

iii. **Certificate of origin**: a document attesting that goods in a particular export shipment are obtained, produced, manufactured or processed in a particular country.

iv. **Bill of exchange**: a non-interest bearing and unconditional order that binds one party to pay a fixed sum of money to another party either immediately or at a predetermined future date, for payment of goods and services received.

v. **Commercial invoice**: a custom document. It is used as a custom declaration provided by the corporation that is exporting an item across international borders.

2.5 FOREIGN INVESTMENT

It is important to note that, international business is a relatively new discipline and is extremely dynamic. The following are some of the terminologies used to differentiate various forms of international businesses:

(a) **International business;** is business whose activities are carried out across national borders. It includes not only international trade and foreign manufacturing, but service industries such as transportation, tourism, advertising, construction, retailing, wholesaling, and mass communications; e.g. FNB.
(b) **Foreign business:** denotes the operations of a company outside its home or domestic market. This term is often used interchangeably with international business.
(c) **Global Company (GC):** is an organization that attempts to standardize and integrate operations worldwide in most or all functional areas.
(d) **International company (IC):** is a global or multidomestic company.
(e) **Multinational Corporation (MNC) or Multinational Enterprise (MNEs)**: is a business which has facilities and other assets in at least one country other than its home country. Such companies have offices and/or factories in different countries and usually have a centralized head office where they coordinate global management. Examples are Nike, Coca-Cola, Toyota, Samsung, etc.
(f) **Multidomestic Company (MDC):** this is a multinational corporation that operates on a localized management structure. Instead of centralizing and making all decisions from one primary location, the multinational corporation decentralizes. It allows managers, presidents or their equivalents and others in the country of operation to make the decisions.

Foreign investment can be into two categories: portfolio investment and foreign direct investment (FDI).

(a) **Portfolio Investment:** refers to the investment in a company's stocks, bonds, or assets, with the intention of obtaining a return on the funds invested. The investor does not have direct control over the firm's operations or management. Typically, investors in this category are looking for a financial rate of return as well as diversifying investment risk through multiple markets.

(b) **Foreign Direct Investment:** is an investment made by foreign nationals into the country. It involves establishing operations or acquisition of tangible assets, including stakes in other businesses. It is normally done by companies not governments.

Businesses that make foreign direct investment are often called Multi-National Corporations (MNCs) or Multinational Enterprises (MNEs). The investment takes the form of either greenfield (new investment in real assets) and brownfield (buying existing business, replenishing, servicing or maintain ageing old real assets).

2.5.1 Foreign Direct Investment

A country's FDI can be both inward and outward; ***inward FDI*** refers to investments coming into the country, while ***outward FDI*** are investments made by companies from that country into foreign companies in other countries.

FDI usually comes in 3 forms:

a) **Horizontal FDI** – The Company carries out some activities abroad as well as domestically i.e. they make a direct investment by creating new foreign enterprises which offer the same services though they are based and operating in different countries. These companies are called Subsidiary Companies.

b) **Vertical FDI** – different but related activities from the investor's main business are established or acquired in a foreign company that supplies parts or raw materials for the manufacturing company to make its products.

c) **Conglomerate FDI**: when the company makes an FDI in a business that is totally unrelated to its existing business in its home country.

Other Terminologies USED to Describe Types of FDI;

a) **Backward Vertical FDI:** Happens when the firm which has production facilities in another country provides inputs for a firm's domestic production processes. It acts as its supplier. Most backward vertical FDI has been in extractive industries (oil extraction, tin and copper mining, etc.). The objective has been to provide inputs into a firm's downstream operations (oil refining, aluminum smelting and fabrication, tin smelting and fabrication).

b) **Forwards Vertical FDI:** happens when an industry abroad sells the outputs of a firm's domestic production processes. For example, when Volkswagen entered the US market, it acquired a large number of dealers rather than distribute its cars through independent US dealers

c) **Greenfield:** occurs when multinational corporations enter developing countries to build new factories or stores- these new facilities are built from scratch. There are several reasons why a company opts to build its own new facility rather than purchase or lease an existing one. (a) A new facility offers the maximum design flexibility and efficiency to meet the project's needs, whereas the existing facility often forces the company to adjust based on the present design. (b) Additionally, all capital equipment needs to be maintained. New facilities are typically much less costly to maintain than used facilities. (c) If the company wants to advertise its new operation or attract employees, new facilities also tend to be more favorable.

d) **Brownfield:** occurs when an entity purchases or leases an existing facility to begin new production. Brownfield investment is usually less expensive and can be implemented faster. However, the disadvantages thereof are as follows (a) Even if the premises had been previously used for a similar operation, it is rare that a company looking finds a facility with the type of capital equipment and technology to suit its purposes completely. (b) If the property is leased, there may be limitations on what kinds of improvements can be made. (c) company may have to deal with many challenges, including (a) existing employees and outdated equipment.

How Governments Can Encourage and Discourage FDI

(a) Governments can discourage FDI by imposing;

i. **Ownership restrictions:** governments can specify ownership to keep the control of local markets or industries in their citizens' hands.
ii. **Tax rates and sanctions:** A company's home government usually imposes these restrictions in an effort to persuade domestic companies to invest in the local market rather than in foreign ones.

(b) How governments encourage FDI;

Governments seek to promote FDI in order to expand the domestic economy and attract modern technologies, business know-how, and capital to their country. However, it may still try to manage and control the type, quantity, and even the nationality of the FDI to achieve their domestic, economic, political, and social goals. The following are some of the strategies employed by governments in order to encourage FDI;

i. **Financial incentives:** the government usually offers businesses a combination of tax incentives and loans in order to invest in the country. It may also offer a combination of insurance, loans, and tax breaks (tax holidays) in an effort to promote FDI.
ii. **Infrastructure:** The government may improve or enhance local infrastructure—in energy, transportation, and communications—to encourage specific industries to invest. This also serves to improve the local conditions for domestic firms.
iii. **Administrative processes and regulatory environment:** the government may streamline the process of establishing offices or production in their countries. By reducing bureaucracy and regulatory environments, these countries appear more attractive to foreign firms.
iv. **Invest in education:** countries seek to improve their workforce through education and job training. An educated and skilled workforce is an important investment criterion for many global businesses.
v. **Political, economic, and legal stability:** Host-country governments seek to reassure businesses that the local operating conditions are stable, transparent (i.e., policies are clearly stated and in the public domain), and unlikely to change.

Advantages of FDI

a) **It is a source of external capital:** which can lead to economic growth and development. For example, in constructing a factory, the investor will need local resources such as equipment, labour and raw materials (or processed materials) thus generating income to the owners of these resources. Once it has been established, it will employ more people and will utilize some of the local materials and services. This will create jobs to some businesses as well.

b) **Tax revenues:** once operational, it will have to pay tax to the government. Tax revenue will be collected from factory employee income (Pay as You Earn-PAYE), tax on company income (company tax) and tax from the sale of its products (VAT). The government can in turn use the taxes mobilized for economic infrastructure and to carry out some of its obligations.

c) **Employment creation:** It creates new jobs and opportunities which in turn increases the buying power of the people hence economic growth.

d) **It may lead to development of new industries:** Sometimes the local firms can develop a strategic alliance with a foreign investor to help develop a new industry in the developing country.

e) **Increases Productivity:** It exposes national and local governments, local businesses and citizens to new business practices, management techniques and technology which can result in increased productivity of the workforce.

f) **Promotes human resource development:** the on the job trainings and sharing experiences increases the overall human capital development. Moreover, it helps the country to identify skills that are needed in the labour market so that it can channel its resources towards acquisition of such skills.

Disadvantages of FDI

a) **Hinders Domestic Investment:** Investors tend to direct their resources to international markets rather than invest in their home countries. It can also hinder domestic investment since the potential investors (domestically) usually lack the expertise and enough capital to compete with foreign firms.

b) **It is costly:** Investing in another country is more costly relative to domestic investment and exporting the produce. It requires a lot of money for consultations, market research and setting up the premises where the company will be operating from.

c) **May result in modern-day Economic Colonialism:** Many developing countries have been colonized in the past, the worry is that FDI would result in some kind of modern-day economic colonialism, which makes the host countries to be vulnerable to exploitation by foreign companies.

Foreign Direct Investment and Multinational Enterprises/Multinational Corporations

Foreign direct investment in Multinational Enterprises is characterised by the following:

(a) Under MNEs, FDI can occur even without the movement of funds from one country to another. In most cases, MNEs exchange proprietary knowledge (technology, skills, etc.) or physical capital (machinery, equipment's, etc.) against equity claims on a host country firm. Sometimes it occurs through reinvested earnings of existing affiliates of foreign firms.

(b) FDI normally originates from the select oligopolistic industries of the certain (home) countries and flows into the same industries belonging to the other (host) countries. The goods and services that MNEs produce overseas are overwhelmingly those that they produce at home. However, MNEs are increasingly engaging in the international production networks in which different stages of the production process of a good takes place in different countries.

(c) MNEs are more attracted towards industries with notably, high levels of R&D relative to sales; large share of professional and technical workers in their work forces; products that are new and /or technically complex; and products with high levels of differentiations. They tend to concentrate their activities in more competitive or dynamic sectors (e.g. electronics, communication equipments and industrial machinery), as well as in mature sectors where economies of scale, branding and advertising determine market share (petroleum products, chemicals, automobiles, food and beverages and consumer durables).

(d) Even though there has been an increase in R&D in recent years that MNEs do outside their own countries, the new products and processes are overwhelmingly created by the R&D made at the firms' headquarters.

(e) The global operations of most of the MNEs are not geographically diversified. They are mostly concentrated in a group of wealthy industrialized countries, which have experienced a convergence in their income levels, consumption and technological capabilities and another group of more advanced developing countries (India, China, Brazil, South Africa, Russia).

(f) The quality of FDI differ due to the differing motives of MNEs' cross-border operation, divergence in the competence, strategies and scope of MNE operations and differences in the nature of firm-specific assets accessed/possessed.

(g) Lastly, as opposed to the Greenfield FDI by which a new plant is set up from the scratch, the mergers and acquisitions account for a substantial share of the world FDI flows, especially under MNEs.

2.5.2 THEORIES OF FOREIGN DIRECT INVESTMENT

1. MacDougall-Kempt Hypothesis

This was first developed by MacDougall in 1958 and further elaborated by Kempt in 1964. The hypothesis is premised on the following assumptions;

- There are 2 countries A and B; the investing (A) and the host country (B).
- The price of capital is equal to its marginal productivity.
- Capital moves freely from the country in which is abundant to the country in which it is scarce. In this way the marginal productivity of capital will eventually equalize between the 2 countries.
- The markets are perfectly competitive.

When a company from country A decides to invest in country B, output in country A is going to decline due to movement of capital out of the country. However, the national income is not going to be affected as long as the country earns income from the capital invested abroad. This income is equivalent to the marginal productivity of capital times the foreign amount of capital. As long as the income received from capital investment abroad is greater than the loss of output, country A will continue to invest abroad because it enjoys greater national outcome than the prior to the foreign investment. Country B also realises increased national income as a result of the inflows of foreign investment. All in all, the foreign direct investment leads to improved welfare in both countries.

2. The Industrial Organisation Theory

This theory was first developed by Stephen Hymer (1976) and is based mainly on oligopolies or imperfect markets in which the investing firm operates. Assumptions;

- There are 2 countries A and B; the investing (A) and the host country (B).
- The markets are characterised by oligopolistic behaviour i.e they are imperfect.

Hymer posits that the multinational corporation is a typical oligopolistic firm possess some superiority and looks for an imperfect market that it can control with the aim of maximizing profits. Despite the fact that this multinational firm is faced with challenges (Such as language barriers, culture, legal system, consumer's preferences, etc), it possesses some specific advantages that outweigh these challenges. From Hymen's point of view, the firm has an advantage when it comes to technology advances which help the firm to produce a new product which is different from existing ones. The advanced technology in production coupled with knowledge helps the firm to develop new special marketing skills, superior organisational and management set-up and improved methods of processing. This theory hypothesises that these advantages can effectively be transferred from one unit to another irrespective of the geographical location or distance. Since the market is imperfect and that the rival firm is technologically disadvantaged, the international firm harvests huge profits. The firm realises more profits by establishing its subsidiary companies in the foreign country than it would if it was engaged in exporting or licensing agreements.

3. Eclectic Paradigm (Aka O-L-I Paradigm)

This theory was developed by Dunning (1983) and is described as a combination of the imperfect market-based theories of FDI such as industrial organisation theory, internalisation theory and the location theory to explain why a firm opens a foreign subsidiary. It postulates that, at a given point in time, the stock of foreign assets owned by a multinational firm is determined by;

- a combination of a firm's specific or ownership advantages vis-a-vis other firms (O),
- The extent of location bound endowments. This relates to the fact that there are some location advantages in using a firm's ownership advantages in a foreign location (L),
- The extent to which these advantages are marketed within the various units of the firm (I). This implies that it is more beneficial to internalize these advantages rather than to use the market to transfer them to foreign firms.

These three elements are known as the O-L-I advantages. Dunning asserts that the configuration of the O-L-I advantages vary from one country to another; and from one activity to another. Foreign investment will therefore be greater where the configuration is more pronounced. He further introduced the “dynamised add-on” variable to his theory, a variable of strategic change which may either be autonomous or a strategically induced change.

The international production during a particular period of time would then be the sum of the strategic responses of the firm to the past configuration of the O-L-I and to changes in such configurations as a sequel to exogenous and endogenous changes in the environment. The example of the autonomous change in strategy may be that a firm makes investment more in innovatory activities because of greater O-advantages. O-advantages are firm specific. They may be enjoyed over domestic and foreign competitors and are in the form of tangible and intangible assets. They lead to reductions in a firm’s production costs and allow it to compete with firms in a foreign country. Examples of the O-advantages include advanced technology, management skills, access to or control over raw materials, brand name, and marketing skills, and scale economies.

The firm can decide to invest more in a particular country because the L-advantage. The L-advantage of different countries play a significant role in determining which country will play host to the activities of multinational corporations. The L-advantages may be in the form of form of access to protected markets, favorable tax treatments, lower production and transportation costs, cheap inputs for production, political stability, legal and cultural environments, etc.

Moreover, the firm may adopt different marketing strategies depending on the greater amount of I-advantage. These I-advantages make it more profitable for the firm to carry out transactions within (within the firm) than to depend on external markets. Similarly, the strategy induced change may be evident from the fact that a market seeing investment has a different O-L-I configuration from that of a resource-based investment. Ultimately, it is the varying configurations that shape the direction and pattern of FDI.

The essential feature in this theory is that all the three types of conditions must be satisfied before FDI can take place. Thus the “OLI trial of variables determining FDI and MNCs activities may be likened to a three-legged pot; each leg is supportive of the others, and the stool is only functional if the three legs are evenly balanced”. This implies therefore that a firm having ownership advantage and internationalization gains but no L-advantage in a foreign country, it is very likely to choose to increase its production at home and export its product(s) abroad.

Similarly, a firm having the O and L advantages will find it more profitable to produce abroad than to produce domestically and export its product(s); however, if there are no I-advantages then the firm will be better off licensing its ownership advantage to foreign firms.

2.5.3 INVESTMENT OPTIONS AVAILABLE FOR INDIVIDUALS AND BUSINESSES

(a) **Stocks:** When a person/business invest in a stock, he/it becomes one of the owners of a corporation. Stocks represent ownership shares, also known as equity shares. The profit earned or loses on a stock depends on the success or failure of the company, type of stock owned, and what's going on in the stock market overall and other factors.

There are 2 types of stocks:

- ❖ **Dividends -** When publicly owned companies are profitable, they can choose to distribute some of those earnings to shareholders by paying a dividend. Dividends can either be withdrawn as cash or reinvested in order to purchase more shares in the company. Many retired investors focus on stocks that generate regular dividend income to replace income they no longer receive from their jobs. Stocks that pay a higher than average dividend are sometimes referred to as "income stocks."
- ❖ **Capital gains** – these are the type of stocks that are bought and sold constantly throughout each trading day, and their prices change all the time. When a stock price goes higher than its purchasing price, it can be sold at a profit. These profits are known as capital gains. In contrast, if the stock is sold at a price lower than its purchasing price, a loss is incurred.

- The performance of an individual stock affected by what's happening in the stock market in general, which is in turn affected by the economy as a whole. For example, if interest rates go up an investor is more likely to make more money with bonds than with stock. As such, he/she might sell off stock and use that money to buy bonds. Meanwhile, if other investors feel the same way and behave in the same fashion, the stock market as a whole is likely to drop in value, which in turn may affect the value of the investments held.
- The stocks market performance can also be influenced by other factors, such as political uncertainty at home or abroad, energy, weather problems, or soaring corporate profits.
- The stock market can be highly volatile; as a result, asset allocation, or including different types of investments in your portfolio, is an important strategy. As an investor your goal should be to invest in several categories of investments at the same time, so that some of your money will be in the category that's doing well at any given time.
- Stocks can be bought or sold at any time if need be. In most cases, stock brokers are often engaged to facilitate this process. Stocks can also be bought or sold online, however, experts are the only ones encouraged to undertake this process, as it can be very risky.

(c) **Bonds:** A bond is a loan an investor makes to a corporation, government or other organization in exchange for interest payments over a specified period, plus repayment of principal at the bond's maturity date.

- There are a wide variety of bonds including Treasuries, agency bonds, corporate bonds, municipal bonds and more. Likewise, there are many types of bond mutual funds.
- When investing in bonds, the investor faces the risk of losing money, especially if there is a need to sell the bond before it matures. The prices of bonds mutual fund can

fluctuate, just as stock mutual funds do. However, the risk varies depending on the type of bond purchased.

- Bonds and bond mutual funds often can be an important component of a diversified investment portfolio.

(d) **Bank Products:** are provided by banks and credit unions. They are often safe (less risky) and a convenient way to accumulate savings.

  - Deposits at banks and most credit unions are insured.
  - Transaction (or checking) accounts and deposit accounts offer liquidity, making it easy access funds in times of need.
  - However, the interest earned from bank product tends to be lower than potential returns from other investments.

(e) **Annuities:** an annuity is a contract between an investor/policy holder and an insurance company in which the insurance company promises to make periodic payments during maturity of the investment.

- An annuity can be bought either with a single payment or a series of payments called premiums.
- Some annuity contracts provide a way to save for retirement. Others can turn policyholder's savings into a stream of retirement income. Still others do both.
- Annuities often have a variety of fees and expenses, such as surrender charges, mortality and expense risk charges and administrative fees.
- Annuities are also the safest and convenient way of investing as the insurance company bears most of the risk on behalf of the investor.
- They also have higher returns than bank products.

(f) **Retirement:** Saving for retirement, and managing income once one retire, are two important aspects of personal financial management.

- They usually have potential tax benefits. It reduces the amount of taxes owed on the income for the amount invested annually. It also allows one to defer or even avoid the taxes owed on the earnings that accrue on investments.
- There is an opportunity for your savings to compound over time. In other word, it produces earnings on earnings, creating a compounding effect not available in a regular savings account.
- They are less risky and convenient as the insurance company bears risks on behalf of the clients.

2.5.4 REGIONAL ECONOMIC INTEGRATION

This is the process by which two or more nation-states agree to co-operate and work closely together to achieve peace, stability and wealth. It has enabled countries to focus on issues that are relevant to their stage of development as well as encourage trade between neighbours. All in all, Regional economic integration refers to efforts to promote free and fair trade on a regional basis. There are four main types of regional economic integration;

a) **Free Trade Area:** this is the most basic form of economic cooperation. Member countries remove all barriers to trade between themselves but are free to independently determine trade policies with non-member nations.

b) **Customs Union:** this type provides for economic cooperation as in a free-trade zone. Barriers to trade are removed between member countries. The primary difference from the free trade area is that members agree to treat trade with non-member countries in a similar manner, e.g. The South African Customs Union (SACU).

c) **Common Market:** this type allows for the creation of economically integrated markets between member countries. Trade barriers are removed, as well as any restrictions on the movement of labour and capital between member countries. Like customs unions, there is a common trade policy for trade with non-member nations e.g COMESA (Common Market for Eastern and Southern Africa). In this case, workers no longer need a visa or work permit to work in another member country of a common market.

d) **Economic Unions:** This type is created when countries enter into an economic agreement to remove barriers to trade and adopt common economic policies. Like common markets, free mobility of labour and capital is allowed among member countries. However, it supersedes the common union in the sense that member countries can use the same currency. Example of the Economic Union is the European Union. Member countries use Euro as the common currency.

ADVANTAGES OF REGIONAL ECONOMIC INTEGRATION

a) **Trade creation:** these agreements create more opportunities to trade with another by removing the barriers to trade and investment. Reduction and removal of trade among member countries has resulted in cheaper prices for consumers. It also leads to high growth rates in the Least-Developing Countries (LDC) due to increased monetary gains.

b) **Employment opportunities:** the removal of restrictions on labour movements can result in the expansion of job-opportunities.

c) **Consensus and cooperation:** Regional understanding and similarities may also facilitate closer political cooperation. Moreover, it is easier to have consensus when smaller number of countries are involved. Regional understanding and similarities may also facilitate closer political cooperation.

d) **Economies of scale:** it leads to the expansion of the market for goods and services. This allows greater productivity especially for industries that produce goods that are easier and more efficient to produce. In other words, it increases efficiency in production.

e) **Increased welfare:** due to better production, enhanced consumption and improved standard of living.

DISADVANTAGES OF REGIONAL ECONOMIC INTEGRATION

a) **Less/hinder trade liberalization:** it increases trade barriers against non-member countries.

b) **Trade diversion:** Member countries may trade more with each other than with non-member nations. This may mean increased trade with a less efficient or more expensive producer because it is in a member country. In this sense, weaker companies can be protected inadvertently with the bloc agreement acting as a trade barrier. In essence, regional agreements have formed new trade barriers with countries outside of the trading bloc.

c) **Loss/ hinders Sovereignty:** requires member countries to give up some degree of control over key policies like trade, monetary and fiscal policies. Nations may find that they have to give up more of their political and economic rights. The higher the level of integration, the greater the degree of controls that needs to be given up particularly in the case of a political union economic integration which requires nations to give up a high degree of sovereignty.

EXAMPLES OF REGIONAL ECONOMIC INTEGRATION

In the past decade, there has been an increase in these trading blocs with more than one hundred agreements in place and more in discussion. A trade bloc is basically a free-trade zone, or near-free-trade zone, formed by one or more tax, tariff, and trade agreements between two or more countries. Some trading blocs have resulted in agreements that have been more substantive than others in creating economic cooperation. The following are some of the trade blocs in Africa majority of which Lesotho is affiliated to:

a) **Southern African Customs Union (SACU):** This is an African regional economic organisation founded in 1910. The member countries are Botswana, Lesotho, Namibia, Swaziland and South Africa. The member states maintain a common external tariff, share customs revenues and coordinate policies and decision-making on a wide range of trade issues.

SACU aims to maintain the free movement of goods and services amongst the member countries. It also provides for the common external tariff (the same quotas, tariffs and barriers to trade apply to all goods entering the area, regardless of which country within the area they are entering) and the common excise tariff to this common customs area.

All customs and excise collected in the common customs area are paid in the South African's National Revenue Fund. The revenue collected is shared amongst the member-states to the revenue-sharing formula.

b) **The Common Monetary Area (CMA):** This is aliened to the SACU. Its member countries are Lesotho, Namibia, South Africa and Swaziland. The South African Rand is the legal tender in all the member countries. However, each member state has control upon the issue and printing of its own currency, e.g. Lesotho – Loti, Namibia – Namibian dollar and Swaziland-Lilangeni.

The currencies are maintained at par with Rand. Thus, the South-African Reserve Bank is responsible for the monetary policy of the member countries.

CMA provides a framework of exchange rate and the monetary policies in the member countries.

c) **Southern African Development Community (SADC):** Is a regional economic bloc (community) comprising of South Africa, Lesotho, Namibia, Botswana, Swaziland, Zambia, Malawi, Zimbabwe, Mozambique, Angola, Madagascar, Mauritius, Tanzania, Democratic Republic of Congo and Seychelles. SADC was established in 1992.

SADC aims at achieving development peace, security, economic growth, to alleviate poverty, enhance the standard and quality of life of people of Southern African and support the socially disadvantaged through regional integration, built on democratic principles and equitable and sustainable development.

The community is guided by the following principles:

- ❖ Sovereign equality of all member-states;

- ❖ Solidarity, peace and security;
- ❖ Human rights, democracy and the rule of law;
- ❖ Equity, balance and mutual benefit;
- ❖ Peaceful settlement of disputes.

d) **African Union (AU):** is a continental union consisting of the 54 countries in Africa and was established in May 2001. Its mandate among others is to:

   i. Promote sustainable developments at the economic, social and cultural level as well as the integration of African economies.

   ii. Promote co-operation in all fields of human activity to raise the living standards of African people.

e) **The Common Market for Eastern and Southern Africa (COMESA):** This is Africa's largest regional economic organisation established in 1994. It has a free trade area and launched a custom union in 2009. It comprises of 21 member states- Burundi, Comoros, D.R. Congo, Djibouti, Egypt, Eritrea, Eswatini, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Somalia, Sudan, Tunisia, Uganda, Zambia and Zimbabwe. Member countries are bound to create and maintain;

   - ❖ Full free trade area guaranteeing the free movement of goods and services produced within COMESA and the removal of all tariffs and non-tariff barriers;
   - ❖ A customs union under which goods and services imported from non-COMESA countries will attract an agreed single tariff (Common External Tariff) in all COMESA Member States;
   - ❖ Free movement of capital and investment supported by the adoption of a common investment area so as to create a more favourable investment climate for the COMESA region;
   - ❖ Gradual establishment of a payment union based on the COMESA Clearing House and the eventual establishment of a common monetary union with a common currency;
   - ❖ Gradual Relaxation and Eventual Elimination of Visa Requirements leading to the Free Movement of Persons, Labour, Service, Right of Establishment and Residence.

f) **East African Community (EAC):** This was originally established in 1967, dissolved in 1977, and revived in 1999. The commune used to comprise of only 3 member states- Kenya, Tanzania and Uganda. However, Burundi and Rwanda became members in

2007, while South Sudan gained access in 2016. EAC's mandate includes among others to:

- ❖ Attain a sustainable growth and development of the partner States by promotion of a more balanced and harmonious development of the partner States.
- ❖ Strengthen and consolidate cooperation in agreed fields that would lead to equitable economic development within the partner States and would in turn, raise the standard of living and improve the quality of life of their populations.
- ❖ Promote sustainable utilization of the natural resources and taking of measures that would effectively protect the natural environment of the partner States.
- ❖ Strengthen and consolidate long-standing political, economic, social, cultural and traditional ties and associations between the people of the partner States, so as to, promote a people-centred mutual development of these ties and associations.
- ❖ Mainstream gender in all its endeavors and enhance the role of women in cultural, social, political, economic and technological development.
- ❖ Promote peace, security, and stability within, and good neighbourliness among the partner States.
- ❖ Enhance and strengthen partnerships with the private sector and civil society in order to achieve sustainable socioeconomic and political development.
- ❖ Undertake other activities calculated to further the objectives of the community, as the partner States may from time to time decide to undertake in common.

HOW DO THESE TRADE AGREEMENTS AND EFFORTS IMPACT INTERNATIONAL BUSINESSES?

(a) International businesses have benefited from the regional trade agreements by having more consistent criteria for investment and trade, as well as reduced barriers to entry. Companies that choose to manufacture in one country find it easier and cheaper to move goods between member countries in that trading bloc without incurring tariffs or additional regulations.

(b) The challenges for businesses include finding themselves outside of a new trading bloc or having the "rules" for their industry change as a result of new trade agreements. As a result, businesses have to monitor and navigate these evolving trade agreements to make sure that one or more agreements don't negatively impact their businesses in key countries.

CHAPTER THREE: KEY ASPECTS OF DOING BUSINESS INTERNATIONALLY

3.1 THE IMPACT OF LAWS AND REGULATIONS ON FOREIGN TRADE

Intellectual property rights (also known as the monopoly rights) are the rights given to persons over the creations of their minds such as inventions; literary and artistic works; designs; etc. They are intended to stimulate the creativity of the human mind and offer protection on the creativity, thus, allowing individuals to benefit from their innovations. Those who advocate for these rights argue that, unless the creators are legally entitled to capture the full social value of their inventions, they will not have sufficient incentive to invent. Thus, they offer financial incentives to the owners; Leads to economic growth and development; and they also offer some morality related benefits. The arguments that advocate for justification of intellectual property are divided into three major categories;

There are around seven types of property rights and are as follows;

(a) Patents: is an exclusive right granted for an invention. In other words, a patent is an exclusive right to a product or a process that generally provides a new way of doing something or offers a new technical solution to a problem. The patent owner has an exclusive right to prevent or stop others from commercially exploiting the patented invention. In other words, patent protection means that the invention cannot be commercially made, used, distributed, imported or sold by others without the patent owner's consent.

The patent owner may give permission to, or license, other parties to use the invention on mutually agreed terms. The owner may also sell the right to the invention to someone else, who will then become the new owner of the patent.

Patents are territorial rights. In general, the exclusive rights are only applicable in the country or region in which a patent has been filed and granted, in accordance with the law of that country or region.

The patent has the expiry date. The expiry of the patent marks the end of the protection of an invention and it can be commercially exploited without infringing the patent.

(b) Copyright: refers to the rights that creators have over their literary and artistic works regardless of the audience they are destined for. Works commonly protected by copyright throughout the world include: literary works such as novels, poems, plays, reference works and newspaper articles; computer programs and databases; films, musical compositions, and choreography; artistic works such as paintings, drawings, photographs, and sculpture; architecture; and advertisements, maps, and technical drawings.

Copyright laws aim to stimulate and foster individual creativity and disseminate it widely by making it available to the public. The copyright laws also affirm that the owner has the economic right to authorize or prevent certain uses in relation to a work or, in some cases, to receive remuneration for the use of his work (such as through collective management). The economic rights owner of a work can prohibit or authorize: its reproduction in various forms such as printed publication or sound recording; its public performance such as in a play or musical work; its recording in the form of compact discs or DVDs; its broadcasting by radios, cable or satellite; its translation into other languages; and its adaptation, such as a novel into a film screenplay.

In some countries there is no formal registration for copyrights, protection it is obtained automatically. However, some countries have voluntary registration systems which can be used to resolve disputes over ownership or creation, as well as to facilitate financial transactions, sales, and the assignment and/or transfer of rights.

(c) Industrial Design Rights: Allow the owner of a registered industrial design the right to prevent third parties from making, selling or importing articles bearing or embodying a design which is a copy, of the protected design. These rights are applied to a wide variety of products of industry and handicraft items: from packages and containers to furnishing and household goods, from lighting equipment to jewellery, and from electronic devices to textiles. Industrial designs may also be relevant to graphic symbols, and logos.

The industrial design rights are administered differently across various countries. The most used strategies for industrial rights are as follows; (a) in some countries, industrial designs are registered in order to be protected under industrial design law. (b) In other countries, they are protected under patent law as "design patents". (c) Other countries grant them without registration and are not time-bound and are called "unregistered industrial designs".

(d) Plant Varieties: this is also known as the Plant Breeder's Rights and is granted to a breeder of a new variety of plants. It gives the breeder an exclusive control or right to produce for sale and sell propagating material of the variety and prevent others from using the breeder's plant variety without his/her permission. With these rights, the breeder can choose to become the exclusive marketer of the variety, or to license the variety to others. In order to qualify for these exclusive rights, a variety must be new, distinct, uniform and stable. A variety is:

- New if it has not been commercialized for more than one year in the country of protection;
- Distinct if it differs from all other known varieties by one or more important botanical characteristics, such as height, maturity, colour, etc.;
- Uniform if the plant characteristics are consistent from plant to plant within the variety;
- Stable if the plant characteristics are genetically fixed and therefore remain the same from generation to generation, or after a cycle of reproduction in the case of hybrid varieties.

The breeder must also responsible for providing an acceptable "denomination" for the variety, which becomes its generic name and must be used by anyone who markets the variety.

In most countries plant variety rights are granted by national offices, after examination to prove their authenticity. Once they pass the test (new, distinctiveness, uniformity, ad stability) exclusive rights are granted for a specified period with annual renewal fees being required to maintain the rights.

It is important to note that patents and plant breeders' rights were overlapping and not mutually exclusive. This implies that an inventor cannot have both the patents and the Plant Varieties Rights simultaneously.

(e) Trademarks: is a sign that you can be used to distinguish a person's (or firm's) business' goods or services from those of other traders. It can be represented graphically in the form of your company's logo or a signature. Through a registered trade mark, the company's brand (or "mark") can be protected and other people would be restricted from using its name or logo. Letters, words, names, signatures, labels, devices, tickets, shapes and colour can be registered as a trade mark, but a mark must be distinctive and capable of distinguishing your goods or services from similar ones of other traders.

Trademarks are approved by relevant authorities in the country and can last indefinitely as long as it is renewed. If it is successfully registered, the firm is permitted to use the ® symbol next to its trade mark. Another common symbol associated with trade mark is ™ – this denotes that the mark is being used by the company as their trademark but it does not mean that the mark is registered or protected under the trade mark law.

(f) Trade Dress [11]**:** is a form of intellectual property that generally refers to characteristics of the visual appearance of a product or its packaging (or even the design of a building) that signify the source of the product to consumers. It consists of all the variety of elements that are used to promote a product or service. For a product, trade dress may be the packaging, the attendant displays, and even the configuration of the product itself. For example, many liqueur bottles have a unique shape designed for advertising rather than for any particular function. On the other hand, for service provision, trade dress may be the decor or environment in which a service is provided, for example, the distinctive decor of the Hard Rock Cafe restaurant chain. The trade dress aspect of packaging may be protected if an average consumer would likely to confuse the original product with another product which appears in similar dress.

Trade dress can be registered with the relevant authorities in order to receive protection from the federal courts.

(g) Trade Secrets: refers to any confidential business information which provides an enterprise a competitive. This confidential information may be sales methods, distribution methods, consumer profiles, and advertising strategies, lists of suppliers and clients, and manufacturing processes which are not generally known or are not comprehensively known by others and offers the business some economic advantage over its competitors or customers.

Trade secrets are usually protected without any formal registration and can be protected for an unlimited period of time. The determination of what information constitutes a trade secret depends on the circumstances of each individual case. However, there are some obvious types of trade secrets which the person can be put before the courts of law if they have been violated. Examples are unfair practices in respect of secret information such as industrial or commercial espionage, breach of contract and breach of confidence.

3.1 CONTRACT DISPUTES

It has been highlighted in the preceding section that the Intellectual Property Rights protect inventors against the misuse of their ideas or innovations. The question mostly asked is what will happen if these rights have been violated or if the contacts signed by those who have bought the ideas have been contravened? The subsequent section therefore provides information on how the misunderstanding between the owners of the ideas and the buyers can be resolved. The focus will be on the contract disputes and arbitration.

Contract Disputes:

Usually occurs when any of the parties in a contract has a disagreement regarding some of the contract terms or definitions. In order for a contract to be legally valid all parties need to have a solid understanding of every contract term and there has to be a mutual agreement. As a result, a contract dispute is usually considered as a breach of contract, meaning that another party has failed to perform duties that they have agreed to in the contract. There are two different types of contract breaches;

- **Material Breach:** occurs when one party fails to perform a contractual duty and the breach is so vital and deep that it makes the agreement or purpose of the contract irrevocable. When this breach occurs, the non-breaching party does not have to perform their end of the contract and can sue the breaching party for any damages caused by the breach.

- **Minor Breach:** this occurs when there is a breach of contract by one of the parties in the contract, but the breach is very minor and does not disrupt the heart (or main objective or function) of the contract. During minor breaching, both parties still continue with the remainder of the contract, but the non-breaching party may sue for damages caused by such contravention.

How to Avoid Contract Disputes

Here are tips for avoiding contract disputes:

- **Present every communication in writing**: It is highly possible to forget some contract terms within a day or two or even within a few hours as a result, continually document negotiations in writing every step of the way. In this way, it becomes easier to keep track of the history of offers, amount of product, prices, and other important terms.
- **All the parties should be clear of what the want**: It is difficult to have a suitable agreement if other parties involved are unclear as to the goal of the contract. The negotiating points should be clearly stated, such as selling price, product quantity, and other amounts. It is okay to work with price ranges and other estimates at first, but these need to be finalized to specific amounts during drafting of the contract.

- **Watch for any changes**: Be careful especially in cases where new negotiator or when a product changes are involved. Check for personnel credentials and double-check terms to avoid contract fraud.
- **Be very clear**: Define highly technical words or trade terms. This can help to avoid contract mistakes and misunderstandings.
- **Involve a contract attorney**: It helps to work with a professional, such as a lawyer or mediator if needed. This can help things run more smoothly during negotiations. Also, in the event of an actual contract dispute, having a lawyer on hand already can help minimize delays and additional legal disputes.

The contract disputes can be resolved in a number of ways the most common are the litigation courts of law and arbitration.

1. Litigation

This is a contest between and among persons, organization, and the state, which is authorized by law, in the court of justice, for the purpose of enforcing legal rights. The parties who involved in the litigation are called the litigants which included plaintiff, defendant, applicant, petitioner or respondent as long as the trial is ongoing.

Jurisdiction

The party seeking redress should first seek remedy at the country in which the dispute has arisen. If not satisfied, then the case may be opened in the country of origin and/even taken to the International Court of Justice (ICJ) in Rome

Advantages of litigation

- Generally regarded as the highest quality decision making.
- Judges can compel the parties to comply with time frames and have powers to sanction for non-compliance
- Judges have the power to make orders to provide interim relief to protect a party's position pending the final judgment.
- There are well defined rights of appeal in cases where errors of fact or law are made.

Disadvantages of Using Courts to Resolve Disputes

- First of all, litigation is time consuming. Litigation process is a very complicated process. It needs to go through many steps and stages before the trial start.
- It is more benefit to wealthier party. Litigation is not a process of solving problems, but a process of winning arguments. Wealthier party can afford to hire an expensive but experienced and good lawyer to engage in the lawsuit. Judge and jury can be easily convinced by a good lawyer whom has strong convincing skill.
- It is not suitable for disputes involving technical issues. The fact that the judge may not have enough knowledge or experience with the subject matter of the dispute between the parties might result in wrong decisions and consequential appeals to higher forums.
- Proceedings are generally conducted in public.
- Costly if the dispute is not well managed or the other party seeks to delay the proceedings

2. ARBITRATION

This is a method of resolving disputes without going to court. In arbitration the dispute is submitted to a third party (the arbitrator) who resolves the dispute after hearing a presentation by both parties. The presentation may be just documents submitted to the arbitrator by each side and alter on an oral argument will be made in person. Each side will usually have an attorney to present or make the oral argument for them. Witnesses are often not required.

Advantages of Arbitration:

- The parties to the dispute usually agree on the arbitrator, so the arbitrator will be someone that both sides have confidence that he/she will be impartial and fair.
- The dispute will normally be resolved much sooner, as a date for the arbitration can usually be obtained a lot faster than a court date.
- Arbitration is usually less expensive. There are also lower costs in preparing for the arbitration than there are in for preparing for a trial. Partly this is due to the fact that the rules of evidence are often more relaxed than in a trial, so that documents can be submitted in lieu of having a witness come to trial and testify. For instance, if a claimant has several doctors who are out-of-state, the cost of bringing them to trial or going out-of-state to take their depositions may be prohibitive for trial, but in arbitration you can usually use just their records and reports.

- Unlike a trial, arbitration is essentially a private procedure, so that if the parties desire privacy then the dispute and the resolution can be kept confidential.
- If arbitration is binding, there are very limited opportunities for either side to appeal, so the arbitration will be the end of the dispute. That gives finality to the arbitration award that is not often present with a trial decision.

Disadvantages of arbitration:

- If the matter is complicated but the amount of money involved is not that much, the arbitrator's fee might be higher than the one expected at the end of the process making arbitration to be uneconomical. It may be cheaper to try the case before a judge, where medical evidence can be presented by affidavits instead of paying the doctor to testify.
- Rules of evidence may prevent some evidence from being considered by a judge or a jury, but an arbitrator may consider that evidence. Thus, an arbitrator's decision may be based on information that a judge or jury would not consider at trial.
- If certain information from a witness is presented by documents, then there is no opportunity to cross-examine the testimony of that witness.
- The standards used by an arbitrator are not clear, although generally the arbitrator is required to follow the law. However, sometimes arbitrators may consider the "apparent fairness" of the respective parties' positions instead of strictly following the law, which would result in a less favorable outcome for the party who is favored by a strict reading of the law.

CHAPTER FOUR: INTERNATIONAL FINANCIAL MARKETS AND MONETARY SYSTEM

4.1 Introduction

The international monetary system consists of institutions, agreements, rules, and processes that allow for the payments, currency exchange, and movements of capital across international borders that are required by international transactions. The following are some of the functions of the international monetary system: provides acceptable means of payment between the buyers and sellers in different countries; provides solutions on how the exchange rate fluctuations and its detrimental effects on other countries can be corrected; and provides guidance on how countries can be helped in cases where they experience income loss due to changes or low exports.

The international monetary system has evolved over time. In the 14th century, barter system was a predominant means of exchanging goods and services, both domestically and internationally. However, in the 16th century the mercantilists introduced "bullion" (silver and gold) as means of exchange. The main challenge of using silver and gold as means of exchange was that they were heavy to carry. Since then, there have been a number of developments in as far as currency is concerned. These developments have resulted to the use of bank notes and coins that we are using today. These developments have also resulted in countries having to use different currencies, and how one currency can be converted into another currency.

4.2 FOREIGN EXCHANGE MARKETS (FOREX Market)

Foreign Exchange: is money denominated in the currency of another country or the value of one currency in terms of another.

Foreign Exchange Markets: are the markets in which individuals, firms and banks buy and sell foreign currencies or foreign exchange.

a) **Individuals** demand for foreign currency arises when they visit another country and need to exchange their national currency for the currency of the country they are visiting.
b) **Firms** engage in foreign exchange when they want to import from other nations and may receive export earnings and earnings on foreign investments.
c) **Banks/commercial banks** operate as clearing houses for the foreign exchange demanded/supplied in the course of foreign transactions by nation's residents.
d) **The nation's Central Bank** which acts as the lender and buyer of the last resort when the nation's total foreign exchange earnings and expenditure are unequal. The Central Bank either draws down its foreign exchange reserves or adds to them.

The foreign exchange trading has been estimated to be above $100 billion per day. Most of the foreign exchange however, takes place through debiting and crediting bank accounts rather than through actual currency exchanges.

FUNCTIONS OF THE FOREIGN EXCHANGE MARKET

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

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

c) **Currency Arbitrage:** arbitrage is the simultaneous and instantaneous purchase and sale of a currency for a profit. For example, if a person who practise arbitrage notices that maybe the value of a euro is cheaper in Hong Kong than in New York, the trader could then buy euros in Hong Kong and sell them in New York for a profit.

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

4.3 THE FOREIGN EXCHANGE RATES

Foreign Exchange Rate: is the conversion of one currency to another or a price of one currency in terms of another currency.

Determinants of Foreign Exchange Rates:

a) Demand and supply of the currency: the higher the demand of the foreign currency, the higher will be the exchange rate, e.g. if the demand for the currency increases, the exchange rate will increase. The appreciation or depreciation of the domestic currency is linked to the level of demand and supply of the domestic commodities.

b) Inflation rate: lower levels of inflation lead to the appreciation of the domestic currency. Lower level of inflation implies that price of goods and services increases at a slow pace. On the other hand, countries with higher levels of inflation experience the depreciation of the currency.
c) Interest rate: higher interest rates in the economy result in higher returns to lenders relative to other countries. Higher interest rates will therefore attract foreign capital which will cause an increase in the exchange rate.
d) Fiscal Policy: especially the one related to fiscal or public debt.
e) Monetary Policy: An increase in money supply by the monetary authorities (Reserve Banks/Central Banks) causes inflation which ultimately leads to the depreciation of the domestic currency.

NB: Increase in Monetary Supply (MS) leads to a decline in the level of interest rates (interest rate is the opportunity cost of holding money). Interest rates decline in order to induce people to hold more money as opposed to alternative assets such as bonds, securities etc. As people hold more money, the demand for commodities will increase, which will in turn lead to an increase in prices.

f) Balance of Payments (BoP): remember BoP=X-M

If the country imports more that it exports, it experiences the balance of payment deficit. If the country imports more, it implies that it needs more currency to pay for imports that it receives through sale of exports. The excess demand for foreign currency lowers the country's exchange rate.

g) Terms of trade: This is the ratio of export prices to import prices, i.e. Px/Pm. If the country's exports prices rise by a greater rate than that of its imports prices the larger amounts of revenues from exports is mobilized. This will in turn results in an increase in the country's currency. The opposite is true.
h) Political stability and economic performance: political instabilities make a country to be less attractive to foreign investors. Investors will invest in countries that more stable in terms of politics and economic growth. This will lead to the depreciation of the domestic currency. In the same manner countries with less economic performance is unattractive to investors which may lead to the depreciation in the exchange rate.

4.4 CURRENCY EXCHANGE RATE RISKS INHERENT IN INTERNATIONAL BUSINESS

Foreign (currency) exchange risks are also known as the foreign exchange exposure. This refers to the risk associated with activities that involves a global firm in currencies other than its home currency. All in all, it is a risk that a foreign currency may move in a direction which may be financially detrimental to the global firm. There are 3 types of foreign exchange exposure:

a) **Transaction Exposure:** is associated with the effect that the exchange rate fluctuations have on the company's obligations to make or receive payments denominated in foreign currency in the future.
b) **Translation Exposure:** relates to the effect of currency fluctuations on the company's consolidated financial statements, particularly if it has foreign subsidiaries.

c) **Economic of Operating Exposure**: This is caused by the effect of the unexpected currency fluctuations on the company's future cash-flows. Global companies operate in different countries, but they use the same coordinated image or brand in the markets.

4.5 WHAT IS FOREX TRADING?

Forex is simply a network of buyers and sellers, who transfer currency between each other at an agreed price. Though it is done for practical purposes, the vast majority of currency conversion is undertaken with the aim of earning a profit. The amount of currency converted every day can make price movements of some currencies extremely volatile. It is this volatility that can make forex so attractive to traders: bringing about a greater chance of high profits, while also increasing the risk.

How do currency markets work?

- The forex market is run by a global network of banks, spread across four major forex trading centres in different time zones: London, New York, Sydney and Tokyo. Because there is no central location, you can trade forex **24 hours a day**.
- Most traders speculating on forex prices will not plan to take delivery of the currency itself; instead they make exchange rate predictions to take advantage of price movements in the market.

Example: if GBP/USD is trading at 1.35361. it implies that 1 pound is worth 1.35361 dollars. So, if the pound rises against the dollar, then a single pound will be worth more dollars i.e. a dollar becomes cheap. In this case you can buy a dollar (since it is weak). If the pound drops/depreciates, the dollar becomes more expensive. Hence, it would be profitable to sell it.

There are different types of echange rates such as direct exchange rate (when a domestic currency is echanged directly with a foreign one), and cross-exchange rate when a currency is echanged indirectly (for example, to get ethiopian birr equavalent of maluti, one needs to convert to dollar first).

However, keep in mind that, these currencies move in ordered pairs, e.g EUR/USD, USD/JPY, GBP/USD, EUR/GBP, etc.

What moves the forex market?

The forex market is made up of currencies from all over the world, which can make exchange rate predictions difficult as there are many factors that could contribute to price movements. However, like most financial markets, forex is primarily driven by the forces of supply and demand, and it is important to gain an understanding of the influences that drives price fluctuations here. So, forex investors should take into account actions by the following players:

(a) Central banks: they control the supply of currencies in the economy. As a result, a trader should be cognizant of significant announcement regarding money supply, especially those related to the currency of interest. If the central bank decides to inject more money into the economy, the value of its currency will decline.

(b) News reports: Investors (commercial banks, companies and other investors) always strive to put their capital into economies that have a strong outlook i.e they have positive future performance. So, if a positive piece of news hits the markets about a certain region, it will encourage investment and increase demand for that region's currency. Similarly, a piece of negative news can cause investment to decrease and lower a currency's price. This is why currencies tend to reflect the reported economic health of the region they represent.
(c) Market sentiment: is often a response to the certain news. This can also play a major role in driving currency prices. If traders believe that a currency is headed in a certain direction, they will trade accordingly and may convince others to follow suit, increasing or decreasing demand.
(d) Economic data: this is integral to the price movements of currencies for two reasons because it gives an indication of how an economy is performing, and it offers insight into what its central bank might do next.
(e) Credit ratings: investors always work towards maximizing the returns from a market, while minimizing their risk. So, they might also look at credit ratings when deciding where to invest. For example, a country's credit rating is an independent assessment of its likelihood of repaying its debts. A country with a high credit rating (can see a rise in price of its currency) is seen as a safer area for investment than one with a low credit rating (might see a decline in its currency).

How does forex trading work?

There are a variety of different ways that you can trade forex, but they all work the same way: by simultaneously buying one currency while selling another. Traditionally, a lot of forex transactions have been made via a forex broker, but with the rise of online trading you can take advantage of forex price movements using derivatives like CFD trading.

CFDs are leveraged products, which enable you to open a position for a just a fraction of the full value of the trade. Unlike non-leveraged products, you don't take ownership of the asset, but take a position on whether you think the market will rise or fall in value. Although leveraged products can magnify your profits, they can also magnify losses if the market moves against you.

Challenges inherent in forex trading

(a) Forex volatility: the high volume of currency trades each day translates to billions of dollars every minute, which makes the price movements of some currencies extremely volatile. You can potentially reap large profits by speculating on price movements in either direction. However, volatility is a double-edged sword – the market can quickly turn against you, so it's important to limit your exposure with risk-management tools.
(b) It involves a lot of guess work. If the investor could guess wrong, then the trade could move against you i.e. he could lose.
(c) It's useful to keep in mind that most forex transactions are made by banks, not individuals, and they are actually using forex to reduce the risk of currency fluctuation.

They use complex algorithms in their computerized trading systems to manage some of the risks. As a result, though individuals do not face ample risks, but they should learn on how to cushion themselves against the risks involved and that the losses are kept manageable.

(d) Risk of Ruin: Even where a trader/customer's medium to longer term view of the market may be ultimately correct, the trader may not be able to financially bear short-term unrealized losses and may close out a position at a loss simply because he or she is unable to meet a margin call or otherwise sustain such positions. Thus, even where a trader's view of the market is correct, and a currency position may ultimately turn around and become profitable had it been held, traders with insufficient capital may experience losses.