Chapter 1: **Nature And Scope** of **Strategic Management**

Strategy:

► *Determination of basic long-term goals and objectives,*

► *Adoption of courses of action to achieve these objectives, and*

► *Allocation of resources necessary for adopting the courses of action*.

Features of strategy

(i) Strategy is a relative combination of actions aimed at to meet a particular condition to solve certain problems, or to achieve a desirable end.

(ii) Strategy is a major course of action through which an organization tries to relate itself with environment to develop certain advantages which help in achieving its objectives.

(iii) Strategy may involve contradictory action. As the strategic action depends on environmental variables, an organization may take contradictory actions either simultaneously or with a gap of time.

(iv) Strategy is forward looking and it has orientation towards future. Strategic action is required in a new situation.

Illustration:

Some people think that Coca-Cola's rumoured change in Coke's formula in the mid-1980s was such a ploy. The implication is that Coca-Cola had not intended to really change the formula. Instead, they publicized their plan to change formula, introduced a new product with a different formula that tasted a lot like a competitor's product, and finally graciously conceded to continue producing the old formula product when the public demonstrated a preference for it over the new—"similar to a competitor's— " formula. (Incidentally, this was in fact a ploy, it was to rank among the top by any business. Coca-Cola reaped an immediate increase in market share of about 15 percent that thrust them once again into unquestioned dominance in the huge U.S. soft drink market).

Illustration: A Case Study of WalMart

Introduction

In any organization, strategy management is the key to its success. Without a proper strategy, it is difficult for any industry to survive irrespective of its size. Success of most of the major corporate organizations can be attributed to superior strategic planning and implementation. The same is true of WalMart, the largest retail company in the history of world. The case described herein lays bare some of the significant aspects of WalMart's strategic management.

Strategic decisions are those that differentiate on organization from its competitors in a way that is sustainable in future. Porter has advocated that a business decision can be classified as strategic if it involves some innovation and difference that results in sustainable advantage.

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WalMart's Business Model

By 2002, WalMart had over 12 lakh employees with growth rate of 11.2%. It operates 4150 retail facilities globally. The key components of the Wal-Mart strategy includes firm infrastructure like frugal culture, no regional offices and pleasant work environment. WalMart terms its employees as associates. Manager compensation is linked to profit of store operated by him. The workforce of the company is not unionized. Technology being vital to an organization, WalMart is well equipped with technological innovations like POS, store performance tracking, real time market research and satellite system. Procurement measures like hard nosed negotiations, centralized buying, planning packets, etc. helps achieve the goal of providing goods and services on cheap prices. The other factors that increase the margin of profit for Wal-Mart are inbound logistics, with frequent replenishment, automated DCs cross docking, pick to flight, hub and spoke system. It has big stores in small towns with monopoly in the market at low rental costs, local prices, concentric expansion, merchandising in brand name, private labels, little space for inventory and store within store. Less is spent on advertising and prices are fixed low. All these factors combine to increase the profit margin through bulk sales.

WalMart Strategy

Dominance of WalMart in retailing is due to a number of factors like its business model which is still a mystery and not letting its competitors know of its weaknesses. It thrives on three generic strategies consisting of Focus strategy, Differentiation strategy and Overall Cost Leadership. It has firm infrastructure, well equipped human resources and technological superiority. The company is financially very strong and is capable of standing still in time of crisis. WalMart operates on low price strategy operated as every day low prices (EDLP) which builds trust among the customers. It sells at lower price but increases profits by increasing the volume. This ferociously increases the competition in the market and WalMart competes with all its competitors till it is dominant in the market.

WalMart has taken over many international as well as domestic stores. For instance, it took over 122 Woolco stores in Canada, 21 Wertkauf stores in Germany and 229 ASDA units in the UK. The takeover strategy keeps the company at forefront as well as minimizes the number of competitors. The company has made dramatic impact since 1962 when Sam Walton first started his business through its low cost and over expanding strategy.

Sustainability in Discount Retailing

WalMart makes the consumers addicted by convincing them that its prices are lower than the other stores. It does so by advertising that "We have lower prices than anyone else" and placing a "opening price point". The opening price point is the lowest price in the store which is kept at high visibility which makes consumers believes that products in this store are really cheaper. With its visionary goal of attaining zero waste status and reaching 100% renewable energy has planned to launch a number of sustainability initiatives such as Imitation (increasing profits by increasing the supply), Substitution (reducing demand for what a firm usually provides by shifting the demand elsewhere) and Hold-up (diverting value to customers, suppliers or complementors who have some bargaining leverage resulting in tough negotiations and vertical integration).

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Through the aforementioned strategic management techniques, WalMart has succeeded in developing network of 7800 stores, employing 2 million associates and serving more than 100 million customers every year.

Q. Strategies are always the outcome of rational planning.

***False** - Strategies are not always the outcome of rational planning, they emerge from what an organization does without any formal plan.*

Q. Strategic management as a way of thinking

True - Strategic management is a philosophy – a way of thinking. It is an intellectual process. Strategic management requires a broad base of leadership throughout the organization and asks everyone to think as a leader.

Q. vision and sense of the future are an inherent part of strategic management?

This statement is **True** *as strategies are constantly reinventing the future creating windows on the world of tomorrow vision and a sense of the future are an inherent part of strategic management*.

***Q. Environmental analysis consists of internal analysis and not external analysis**:*

False

Environmental analysis consists of both internal and external analysis.

Q. The age old maxim has changed from "let the seller beware" to "let the buyer beware"

False

The age old maxim has changed from "let the buyer beware" to "let the seller beware"

Q. Human capital includes explicit knowledge while knowledge capital includes implicit knowledge?

***No,** Human capital includes predominantly implicit knowledge while knowledge capital includes explicit knowledge.*

Levels of Strategy

i. Corporate-Level Strategy
ii. Business-Level Strategy
iii. Functional-Level Strategy

McKinsey analysis discovered four quite distinct phases of strategic management evolution.

In **Phase 1,** financial planning, management focuses on the preparation of budgets with an emphasis on functional operations.

In **Phase 2,** planning is very "now" oriented. Current operations and characteristics are stressed in analysis of the firm and there is little attention to or patience for considering operational options or development of strategic changes.

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In **Phase 3,** external oriented planning, requires a significant change in management viewpoint. Planners are required to adopt an external orientation and tools and procedures for environmental and internal assessment.

In **Phase 4,** strategic management evolves as top management and senses the need to more heavily invest in the planning process

Strategic thinking *is one which generates creative, environmentally relevant ideas and concepts about how to turn them into systematically managed action plans.*

i. Strategic thinking requires factual and logical input data because it is competitively dangerous to base strategy formulation on erroneous information.

ii. Long-held assumptions should be identified and analyzed to make sure they still apply.

iii. The manager attempting to think strategically should be committed to conservation of the organization's resources. A greater degree of creativity is required when one must conserve resources.

iv. Strategic thinking must be done without setting patterns which competitors can identify and anticipate.

Illustration 1:

Reliance has shifted to more creativity, innovation and new ways of looking at business and doing it in novel ways. The earlier concepts of having highly specialized departments and developing specialization of labour is losing its credibility. Organizations are becoming more responsive, flexible, and adaptable to changing business situations. In such an environments that are charged with high level of competition, developing competitive edge for survival and growth has become imperative for companies.

Illustration 2:

ITC began a tobacco company. Over the years, it has diversified into paper (ITC Bhadrachalam), hotels (Welcome Group), food (ITC Agro), and garments (Wills Lifestyle) in order to take advantage of changing environments and to achieve its growth objectives.

Benefits of Strategic Management (IOC EMID)

i. **I**mprovement in Financial benefits of Organization
ii. **O**ffsetting Environmental Uncertainty
iii. **C**larity in Objectives and Direction
iv. Organisational **E**ffectiveness
v. **M**otivation and Satisfaction
vi. **I**mproved Quality of Decisions
vii. **D**iscipline

Limitations of Strategic Management (UNIC)

i. **U**ncertain Predictions
ii. **N**on-Flexibility
iii. **I**mplementation
iv. **C**ontribution of Strategic Management

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Strategic Management Process June' 12 <u>8 Marks</u>

i. Setting Organizational Mission and Objectives
ii. Environmental Analysis
iii. Organisational Assessment
iv. Identification of Strategic Alternative
v. Choice of Appropriate Strategy
vi. Implementation of Strategy
vii. Performance Evaluation and Control

For performance evaluation and control to be effective managers must obtain clear, prompt and unbiased information from people below them in company's hierarchy. Using this information, manager compare what is actually happening and what was originally planned in formulation stage. The evaluation and control of performance completes the strategic management process. Based on the performance results, management may need to make adjustment in strategy formulation, in implementation or in both.

Globalization coupled with liberalization and technological advancements have made the concept of national boundaries irrelevant from the business perspective because most of the products can be bought and sold any where in the world no matter how large or small the enterprise is.

A firm's decision to adopt strategies for global business depends on two factors:

i. Extent of cost pressures to denote the demand on a firm to minimize its per unit costs; and

ii. Extent of pressures for local responsiveness to denote to make a firm to tailor its strategies to respond to national-level differences in terms of variables like customer preferences and tastes, government policies, and business practices.

Types of Strategies for Global Business

i. Global Strategy
ii. International Strategy
iii. Multidomestic Strategy
iv. Transnational Strategy

Risks in Global Business

i. Political and Regulatory Risks
ii. Cultural and Managerial Risks

Reasons for doing Business Globally → June' 14 <u>5 Marks</u>

i. Market Saturation
ii. Foreign Competition
iii. Trade Deficit
iv. Foreign Programme
v. New Markets
vi. Business Adversities
vii. Fiscal Concessions
viii. Savings in Costs
ix. Utilise Full Capacity
x. Avail Product Technology, Raw-Materials, etc.

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xi. Developing and Testing New Products

Issues in Global Business (LOP Resource Allocation)

i. **L**eadership
ii. **O**rganisational Aspects
iii. **P**lans and Policies
iv. **Resource Allocation**

Knowledge management *is a process which helps the enterprises to identify, select, arrange, extend and transfer important information and specialised knowledge***.**

Elements of Knowledge Management

i. Creation of Knowledge
ii. Sharing of Knowledge
iii. Utilisation of Knowledge

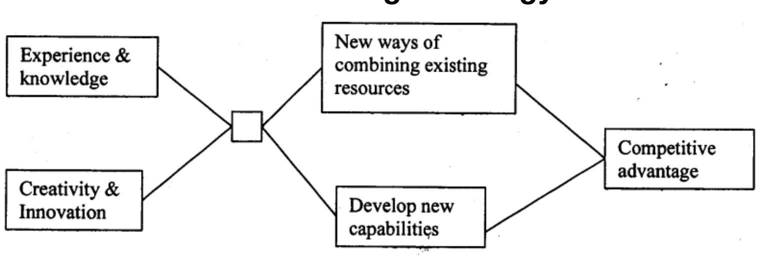
Implementation of Knowledge Management Programme → Dec' 13 <u>8 Marks</u>

i. **Defining Knowledge Management Strategy**
   a. *What to Share*
   b. *Why to Share*
   c. *How to Share*
   d. *Whom to Share*

ii. **Organizing Knowledge Management Programme**
   a. *Providing Budget for Sharing Knowledge*
   b. *Communicating the Value of Sharing Knowledge*
   c. *Choosing Technology for Sharing Knowledge*
   d. ***Selecting Methods of Sharing Knowledge***
      i. *Serial Transfer*
      ii. *Near Transfer*
      iii. *Far Transfer*
      iv. *Strategic Transfer*
      v. *Expert Transfer*
   e. *Measuring of Performance*

iii. **Reinforcement for Knowledge Management**
   a. *Introduce New Incentives*
   b. *Provide Support Knowledge Sharing*

Innovation and Knowledge Strategy



<u>Chapter 2</u>: <u>Environmental Scanning and Internal Appraisal Analysis</u>

An organization's environment consists of two parts:

(i) the macro environmental dimensions i.e. economic, technological, legal, political,

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socio-cultural and, global; and

(ii) the micro environment which refers mainly to the industry within which it operates (for multi-business firms, the industry is usually considered in the activity in which the firm generates the majority of its revenue).

Environmental scanning *analysis is concerned with identification and analysis of environmental influences individually and collectively to determine their potential. It is a holistic exercise which includes a view of environment i.e., 360 degree coverage.*

Illustration:

Duncan has classified the relevant components of environment for an organisation into five categories: consumer component, supplier component, competitor component, socio-political component and technological component. On the other hand, Glueck has grouped the environmental factors into six broad categories: economic, government-legal, market competitive, supplier, technological and geographic and social. D .R. Singh, while analyzing environmental issues taken up by multinationals, has emphasized the following factors: economic situation, political situation, and financial situation. He has further classified the political situation into industrial development policy, foreign investment policy, corporate taxation policy, import-export policy, industrial licensing, foreign exchange control, and capital issue control.

An analytical classification of various environmental factors are as follows: **(PEST G)**

Political-legal environment,

Economic environment,

Socio-cultural environment,

Technological environment, and

Global environment.

Economic Environment

General Economic Conditions

a. *Economic System*
b. *National Income and its Distribution*
c. *Monetary Policy*
d. *Fiscal Policy*

Q. **A policy/system that deals with the tax structure and governmental expenditure is called:** *Fiscal Policy*

While analyzing the factor market aspect of economic environment, following considerations should be taken into account. (FIRM NP)

a. **F**inancial Facilities
b. **I**nfrastructure Facilities
c. **R**aw Materials and Supplies

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d. **M**anpower and Productivity
e. **N**atural Resources
f. **P**lant and Equipment

While <u>analyzing the economic environment,</u> the organization intending to enter a particular business sector may consider the following aspects:

1. The economic system to enter the business sector.
2. *The stage of economic growth and the pace of growth.*
3. *The level of national and per capita income.*
4. *The incidents of taxes, both direct and indirect.*
5. *The infrastructure facilities available and the difficulties thereof.*
6. *Availability of raw materials and components and the cost thereof.*
7. *The sources of financial resources and their costs.*
8. *Availability of manpower-managerial, technical and workers available and the wage structures*.

Political-legal environment can be divided into the following two parts:

1. Promoting environment; and
2. Regulatory environment.

Thus, in <u>analyzing political-legal environment,</u> an organisation may broadly consider the following aspects:

i. Influence political system of the business;

ii. Approaches of the Government towards business i.e., restrictive or facilitating;

iii. Facilities and incentives offered by the Government;

iv. Legal restrictions such as licensing requirement, reservation to a specific sector like public sector, private or small-scale sector;

v. Restrictions in importing technical know-how, capital goods and raw materials;

vi. Restrictions in exporting products and services; Restrictions on pricing and distribution of goods; Procedural formalities required in setting the business; Economic and Financial Sector Reforms.

<u>Socio-Cultural Environment</u> covers the following:

i. Expectations of the society from the business;
ii. Attitudes of society towards business and its management;
iii. Views towards achievement of work;
iv. Views towards authority structure, responsibility and organizational positions;
v. Views towards customs, traditions, and conventions etc.;
vi. Labour mobility and level of education.

Forecasting Techniques → Dec'13 <u>8 Marks</u>

i. *Trend Extrapolation Technique*
ii. *Historical Analogy Technique*

iii. *Delphi Techniques*
iv. *Econometric Models*
v. *Cross-Impact Analysis Technique*
vi. *Scanning and Monitoring Technique*
vii. *Survey Technology*
viii. *Business Barometer Technique*
ix. *Time Series Analysis Technique*
x. *Regression Analysis*
xi. *Input-Output Analysis*

Limitations of Forecasting (SIT)

i. *Set of Assumptions or Axioms*
ii. *Inadequate Reliability of Forecast*
iii. *Time and Cost Factor*

Porter's Five Forces Model of Industry Analysis

i. *Intensity of Rivalry among Competitors*

ii. *Power of Buyers*

Illustration:

Goodyear, sells tyres directly to the people who use them in their cars and two wheelers. Industrial buyers include the companies which purchase the firm's product or service to be used as a component in its product. The automobile manufacturers who put Goodyear tyres on new cars would be one group of its industrial buyers. Commercial customers include other companies that sell Goodyear's products to consumers.

Illustration:

A large retailer (commercial buyer) with a loyal customer base and high volume of sales of the product in question may be able to virtually dictate price, shipping arrangements, order quantity, quality level, and other factors to its vendors.

On the other hand, an automobile manufacturer could have a powerful bargaining position over a tyre maker or the entire tyre industry if a large volume of tyres was sought for installation on a popular auto line. Of course, the tyre maker would prevent itself from becoming too dependent on one buyer by strenuously developing similar relationships with other companies. Toyota uses multiple sourcing—buying from several producers of the same components—to prevent dependency on too few suppliers. Thus, it has a strong bargaining position on matters of price, quality, delivery times, etc., as its suppliers compete with one another to gain favour with its buyers.

iii. *Power of Suppliers*

iv. *Substitute Products*

v. ***Potential Entrants***

a. *Low economies of scale*

b. *Undifferentiated products in an industry lead to new entrants*

c. *Low capital requirements*

d. *Low switching cost*

e. *Easy access to distribution channels.*

f. Low familiarization costs

Strategic Group Mapping

Depending on what similarities exist, industry participants can be organized by them into a set of strategic groups. For mapping strategic groups, the best bases for organizing participants are key dimensions of competition.

The following steps are involved in the construction of strategic group mapping:

i. Identification of two important competitive characteristics which strategically differentiate firms in an industry from one another;

ii. Plot the firms on the two-variable map;

iii. Draw circles around the firms that are clustered together;

iv. Indicate potential movement of firms with arrows.

The exercise of strategic group map is supported by the users because of its following merits:

i. Identification of major and indirect rivals;

ii. Picturing the competitive playing field;

iii. Identification of open niches;

iv. Identification of competitor moves;

v. Improved understanding of differential effects of external trends;

vi. Identification of better/worse positions.

Despite several merits, the strategic group maps exercise possesses the following major limitations:

i. It is more useful in fragmented industries;

ii. It is often difficult to meaningfully use it in consolidated industries;

iii. It is only two-dimensional;

iv. It offers a macro view of competitive rivalry;

v. It does not provide clear role of mobility barriers (which restrict movement between groups).

Internal Scanning of the Firm

Internal analysis in general involves two stages:

1. Internal financial analysis, and
2. Internal functional analysis.

Identification of Major Functional Areas

Marketing

i. Products/services
ii. Price
iii. Promotion
iv. Distribution
v. New product development

Personnel and Union Relations (JJ PUST AA)

i. **J**ob analysis factors—Necessary skills; all necessary jobs;
ii. **J**ob evaluation factors—Appropriate pay scales; adequacy of benefits
iii. **P**erformance evaluation
iv. **U**nion-management relations—Unions representing employees; bargaining positions;
v. **S**easonal factor
vi. **T**urnover rate
vii. **A**bsenteeism rate
viii. **A**ttitude of employees, managers

Production:- of <u>FIPP Quality level</u> Goods

i. **F**acilities and equipment—Capacity level; per-unit costs of manufacturing; obsolescence;
ii. **I**nventory—Turnover level; costs and trends.
iii. **P**rocurement—Sources; quality of inputs; constant lead times.
iv. **P**lanning and scheduling
v. **Quality level**—Defective units; inspection costs; re-manufacturing costs;

Research and Development

i. Demand for R&D.
ii. Facilities and equipment.
iii. Market and production inputs.
iv. Planning and scheduling.

<u>SWOT Analysis</u>

i. Strengths: Attributes of the organization that are helpful in achieving the objective.

ii. Weaknesses: Attributes of the organization that are harmful in achieving the objective.

iii. Opportunities: External conditions that are helpful in achieving the objective.

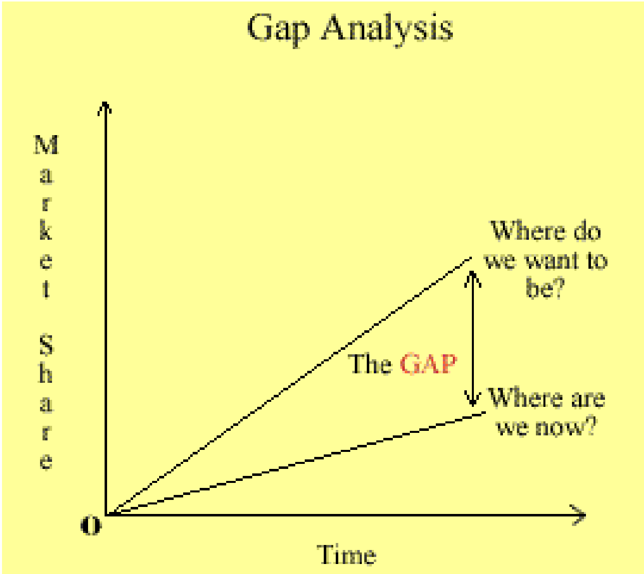
iv. Threats: External conditions that are harmful in achieving the objective.

Situational Analysis

Situational analysis is an exercise which involves great deal of gathering, classifying, analysis and understanding of information. This consists of three separate processes:

1. External environmental analysis;
2. Internal environmental analysis; and
3. The development of the organization‘s mission, vision, values, and goals.

GAP analysis *is the process of identifying the gap between the optimized allocation and integration of the inputs and the current level of allocation. It involves determining, documenting and approving the variance between business requirements and current capabilities. In it attention is first focused on the gaps* *between the actual or anticipated values that certain variables take on and the values that are most desirable.*



Planning of GAP

The planning gap may be divided into the following four elements:

- ***i.*** ***Usage Gap***
  - a. *Market Potential*
  - b. *Existing usage*
- ***ii.*** ***Product Gap***
- ***iii.*** ***Competitive Gap***
- ***iv.*** ***Market Gap***

Key Elements of Value Chain Analysis

A value chain can be described as the full range of activities which are required to bring a product or service from conception through the different phases of production to its delivery to final consumers.

There are four elements in the value chain :

- i. Design and Product Development
- ii. Production
- iii. Marketing
- iv. Consumption/Recycling.

Porter identified that the activities of a business could be grouped under two broad headings:

- **i.** ***Primary Activities***
  - *a. Inbound logistics*
  - *b. Operations*
  - *c. Outbound logistics*
  - *d. Marketing and sales*
  - *e. Service*
- **ii.** ***Support Activities***
  - *a. Procurement*
  - *b. Technology Development*

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c. *Human Resource Management*

d. *Firm Infrastructure*

Following are the sequential steps in a value chain analysis:

1. Segregate a market/organisation into its key activities under each of the major headings in the model;

2. Assess the potential for adding value via cost advantage or differentiation, or identify current activities where a business appears to be at a competitive disadvantage;

3. Determine strategies built around focusing on activities where competitive advantage can be sustained.

BCG-Matrix

It provides a framework for allocation of resources among different business units:

- **i.** Cash Cows
- **ii.** Stars
- **iii.** Question Mark
- **iv.** Dogs

Business process re-engineering → June' 13

It can be defined as the analysis and design of workflows and processes within and between organizations. It is basically the critical analysis and radical redesign of existing business processes to achieve breakthrough improvements in performance measures business process re-engineering is also known as business process redesign, business transformation or business process change methodology.

VIMP

Objectives of Business Process Re-engineering (ER)

- *i.* ***E****limination of Redundant Processes*
- *ii.* ***R****eduction in Cycle Time*

Steps for Business Process Re-engineering (DIMIB)

- i. ***D****eveloping business vision and process objective*
- ii. ***I****dentifying the process to be redesigned*
- iii. ***M****easuring the performances of existing processes*
- iv. ***I****dentification of the opportunity for application of information technology*
- v. ***B****uilding prototype of new processes*

The following principles are suggested for re-engineering:

i. Organise around outcomes, not tasks: Design a person's or a department's job around an objective or outcome instead of a single task or series of tasks.

ii. Capture information once and at the source: Instead of having each unit develop its own database and information processing activities, the information can be put on a network so that all can access it.

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iii. With computer-based information systems, processes can now be re-engineered so that the people who need the result of the process can do it themselves.

iv. People or departments that produce information can also process it for use instead of just sending raw data to others in the organization to interpret.

v. With modern information systems, companies can provide flexible service locally while keeping the actual resources in a centralized location for coordination purposes.

vi. Instead of having separate units perform different activities that must eventually come together, have them communicate while they work so that they can do the integrating.

vii. Put the decision point where the work is performed and build control into the process: The people who do the work should make the decisions and be self-controlling.

Chapter 3: Planning and Formulation

Vision

A vision statement should answer the basic question, ***"What do we want to become?"*** It concentrates on future; it is a source of inspiration and it provides clear decision-making criteria. Vision basically refers to mental perception of the kind of environment that an organization aspires to create with a broad time frame.

Illustration:

i. *Dhirubhai Ambani had set the vision of making Reliance Industries the biggest private sector company in India.*

ii. *"To be global leader in developing of professionals specializing in corporate governance".*

A. The vision is a forward looking exercise of what an organization wants to become in future, the mission states what the organisation is and why it exists.

B. While vision places emphasis on visionary long-term concept of the organization with very high level of achievement, mission deals mostly with how the organization will interact with various stakeholders' products / services it offers and the way these are offered.

Mission

Mission is the answer of basic question, What is our business? It is the guiding principle that drives the processes of goal and action plan formulation. Mission should focus on long-range economic potentials, attitude toward customers, product and service quality, employee relations, and attitudes toward owners.

Illustration: The Institute of Company Secretaries of India

To continuously develop high calibre professionals ensuring good corporate governance and effective management and to carry out proactive research and development activities for protection of interest of all stakeholders thus contributing to public good.

Goals and objectives *are the end results which an organization strives for. Thus, goal and objective consists of a projected state of affairs which a person or a*

system intends to achieve. It is the desired end-point in some sort of assumed development. Objectives and goals are more precise than vision and mission.
The basic objective of a business organization may be to earn profit. This may be quite a broad objective. In order to achieve this broad objective, some specific objective may be set, for example, amount of profit to be achieved in a particular period.

The objectives and goals may differ from each other in the following dimensions:

- **i.** Time
- **ii.** Specification
- **iii.** Focus
- **iv.** Measurement

An organization may consider the following guidelines for setting of objectives:

- *i. Objectives must be very clear and unambiguous.*
- *ii. Objectives must be set taking into account the various factors influencing their achievement.*
- *iii. Objectives should be consistent with organizational mission and vision statements.*
- *iv. Objectives should be rational and realistic.*
- *v. Objectives should be achievable and must provide challenge to those responsible for achievement.*
- *vi. Objectives should be result oriented.*
- *vii. Objectives should be desirable for those who are responsible for the achievement.*
- ***viii.** Objectives should be consistent with time period.*
- *ix. Objectives should be periodically reviewed.*

Broadly strategies may be divided into number of categories such as:

i. **Offensive Strategies**
   - a. *Concentration Postures or Strategies*
   - b. *Market Penetration*
   - c. *Market Development*
   - d. *Product Development*
   - e. *Horizontal merger*
   - f. *Niching*
     - *i. Lower Cost*
     - *ii. Differentiation*

ii. **Integration Strategies**
   - *a. Backward Integration*
   - *b. Forward Integration*
   - *c. Horizontal Integration*
   - *d. Vertical Integration*

iii. **Diversification Strategies**
   - a. Concentric Diversification or Related Diversification
   - b. Conglomerate Diversification or Unrelated Diversification

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c. Internal Diversification
d. External Diversification
e. Vertical and Horizontal Diversification

Rationale for Diversification and Integration

Certain forces cause integration and diversification to be favorable strategies for some businesses. They are as follows: **(FII's P.O. PASS)**

i. ***F**aster Growth*
ii. ***I**ncrease in Profitability*
iii. ***I**ncrease Control*
iv. ***P**sychological Pressure*
v. ***O**ptimal Size*
vi. ***P**rofitability*
vii. ***A**ccess to Resources*
viii. ***S**tability*
ix. ***S**haring Activities*

Cost of Diversification

i. *Cost of Ignorance about New Areas*
ii. *Cost of Neglecting the Core Business*
iii. *Cost of Co-operation*

4. Defensive Strategies

i. Retrenchment Strategies
   a. *Shallow Retrenchment*
   b. *Deep Retrenchment*

ii. Divestment Strategies
   The three fundamental types of divestment are
   a. *Sell-off*
   b. *Spin-off*
   c. *Split-off*

iii. Liquidation
   a. *Voluntary Closure*
   b. *Assignment*
   c. *Insolvency*

5. Other Strategies

i. Joint Venture
ii. Harvesting
iii. Mergers and acquisitions strategies

***Strategies*:**

Offensive strategies: *are those strategies which are employed by management to reach goals related to increase in sales or market share, and in some cases, profitability.*

Focus strategies: *are those which are designed to help an organization target a specific niche within industry.*

Integration strategies: *seek mainly, but not exclusively, to acquire a service or* *product by merging with or acquiring the prior provider. Therefore, the process of integration should be implemented within a framework of goals that spells out the limits of such evaluative criteria*

Diversification strategies: *refers to those strategies in which growth objectives is sought to be achieved by adding new products or services to the existing product or service line.*

Defensive strategies: *Very often the strategist is forced to control the firm's operations. Except for the rare attempt by a firm's owners to simplify their lives by shrinking their business's size, contraction is usually a defensive response to adversity.*

Q. ***Name the strategy which was popularized by Boston consulting Group (BCG) and refers to the systematic removal of cash and other assets from a slow growth or declining business.***

Answer:- *Harvesting*

Evaluation of Strategic Alternatives

Broadly speaking, we can classify the evaluation approach in the following categories:

i. Simple Approach
ii. Analytical Models Approach.

Selection of Best Alternative

The selected strategy should be consistent with the—

a. Organization's environment,
b. Internal capabilities and characteristics,
c. Available resources, and
d. Risk preferences.

Each of the above criteria is discussed in detail as under:

i. *Consistency Tests*
    a. *Environmental Factors*
    b. *Internal Characteristics*
    c. *Resource Availability*
    d. *Risk/Return Preference*
ii. *Clarity of Goals*
iii. *Timing*
iv. *Flexibility*
v. *Management Commitment*

Effective global strategy establishes the competitive advantage for an organization in terms of the following four factors:

i. *Differences among countries in the cost of production;*
ii. *Demographic differences among foreign markets;*
iii. *Different roles of foreign governments in the competitive system;*

Strategic planning *refers to the process of developing and analyzing the organization's mission, overall goals, general strategies, and allocating resources. A strategy is a course of action created to achieve a long-*

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term goal.

Characteristics of Strategic Planning

The general attributes of strategic planning may be summarized as follows:

i. Strategic planning is a top management activity, i.e., top managers are actively involved in it.

ii. Top management gains commitment from other levels of managers to implement strategic planning, while the top management is committed to it.

iii. Strategic planning is a long range activity.

iv. It deals with basic and fundamental questions about the company‘s purpose, mission, objectives and goals, the customers, the method to reach the customers and the company‘s position in the market, its industry and society.

v. Strategic planning should clearly define where does the company stand and where should it go.

vi. It provides proper direction for operational planning and day-to-day strategic decisions.

vii. It enlightens the manager about the most consistent course of action available to him in the given situation and in the context of the company‘s strategy.

viii. Strategic planning inculcates a sense of coherence and momentum to an organization‘s action, decisions approaches and attitudes.

ix. It provides a sense of purpose and direction to both strategic planning and cohesion in operation.

x. It sets trends and direction for managerial actions.

Strategic Planning and Operational Planning

i. Strategic planning guides the choice among the broad directions in the organization and the general allocations of its managerial, financial and physical resources over future specified period of time. **Operational planning focuses** on the ways and means by which each of the individual functions may be programmed.

ii. Strategic planning takes into account the **external environment** and tries to relate the organization with it. **Operational planning focuses** on **internal organizational environment** so as to make the effective use of given resources.

iii. Strategic planning precedes the operational planning as the latter is primarily the implementation of the former. Since Strategic planning sets trends and direction for managerial actions, its time horizon is **usually quite large, say, five years or so. Operational planning** is concerned with **short-term programmes** implementing step by step progress towards basic organizational goals.

iv. Strategic planning is usually **conducted by top level management** and other specified planning staff in the organization. **Operational planning** is usually spread over a wide range within the organization and is generally **performed by operating managers** with the help of the subordinate staff.

Strategic Planning and Tactical Planning

The following are the distinction between strategic planning and tactical planning:

i. Strategic planning is carried out at the highest level of management and is concerned with decisions in the perview of that level. However, the tactical planning is related to lower level of management.

ii. Strategy formulation is a continuous but regular process. Tactics on the other hand are determined periodically with a fixed time schedule.

iii. Strategic decisions-making is influenced by personal values of executives while such values exercise little influence of tactical decision-making.

iv. Strategic problems are generally unstructured and non-repetitive while tactical problems are structured and often repetitive in nature.

v. Strategies are intended to last for long periods of time while tactics covers a shorter duration.

vi. Strategic formulation requires large amounts of information which is derived from the external environment while tactical decision-making requires internally generated data which is of historical nature.

vii. In strategic formulation the number of people involved is less in contrast with tactical decision-making wherein large number of managers and workers are involved.

viii. The scope of strategies is usually broad and has fewer details than tactics.

ix. Strategies are formulated from a corporate point of view whereas tactics are developed primarily from a functional view-point.

Strategic Decision Making

Strategic decision making is the core of strategic management. Strategic decision is a major choice of an action concerning committing of resources with a view to achieve organizational objectives. It has the following features:

i. Strategic decision is a major choice of action which affects the entire organization or major parts of it.

ii. It affects the long-term prosperity of the organization because the commitment is for long-term.

iii. It involves commitment of large amount of resources i.e., human, financial and physical in implementing the chosen strategic option.

iv. Because of high-level of futurity, a strategic decision is made after analyzing various factors both within the organization and its environment.

v. Since a strategic decision has major impact on the organization on long-term basis, it is made by top management which has much wider perspective of the organization and its environment.

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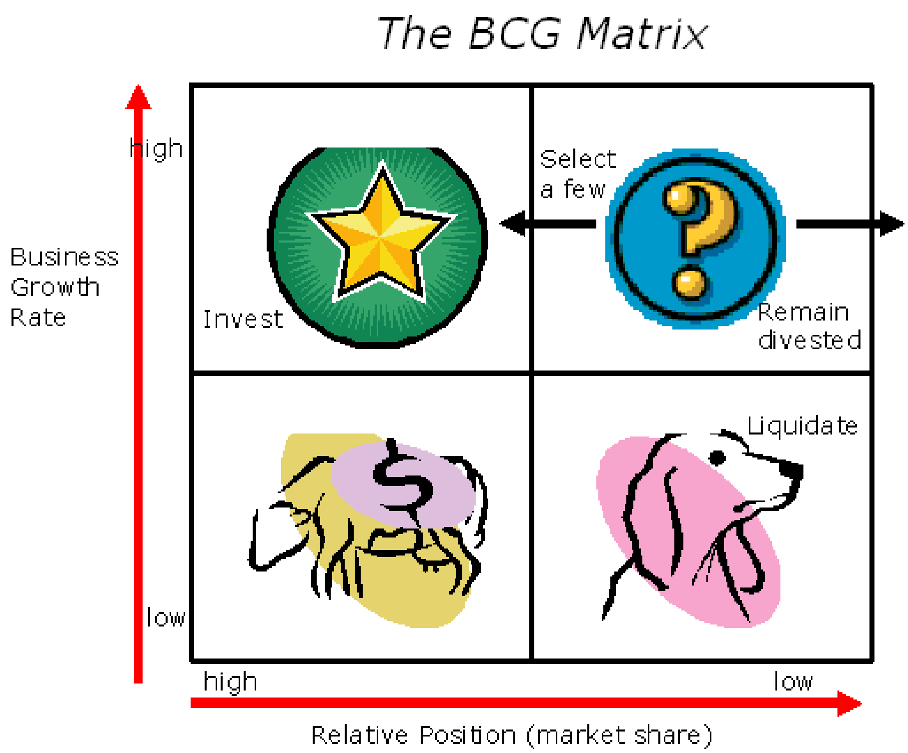
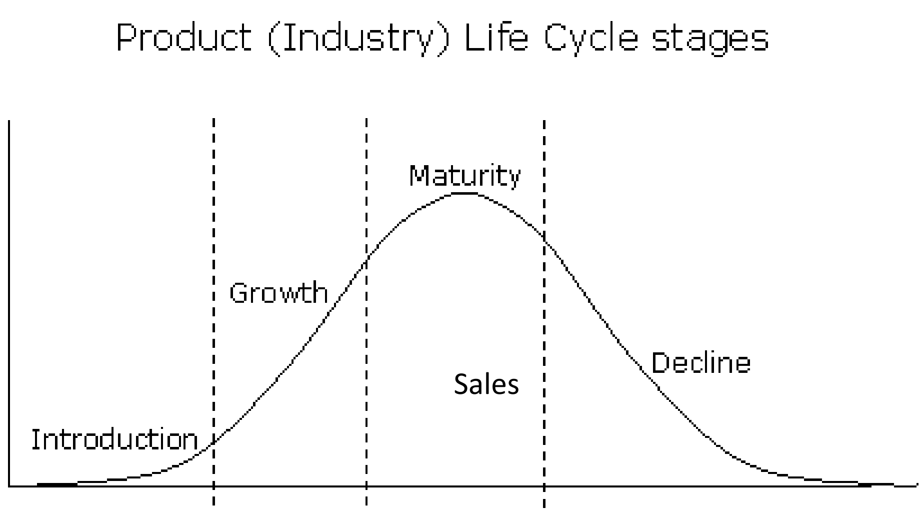


BCG Growth Share Matrix



i. ***Introduction Stage Strategies:*** *During this stage the firms investments are high and profit margins are negative.*

ii. ***Growth Stage Strategies:*** *During this stage, growth begins to occur. The firms get a risk taking capability and due to this at times quality shortfalls start occurring*

iii. ***Maturity-Stage Strategy:*** *As more and more competitors enter the market, efficiency and profit-generating ability become major concerns as products enter the maturity stage.*

iv. ***Decline-Stage Strategies:*** *When a product reaches the point where its markets are saturated, an effort is often made to modify it so that its life cycle is either started renew or its maturity stage extended.*

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Decisions are described as—individual, group, organization, institutions and global. These are explained below:

1. Individual Context

a. Rational Decision Model Approach

b. Intuitive Approach

c. Adaptive Approach

2. Group Context

a. Group Model

b. Elite Theory

3. Organization Context

a. Systems Model

b. Organizational Process Model

4. Institutional Context

5. Global Context

Effective global strategy establishes the competitive advantage for an organization in terms of the following four factors:

i. Differences among countries in the cost of production;

ii. Demographic differences among foreign markets;

iii. Different roles of foreign governments in the competitive system;

iv. Cross-country differences in goals, resources and ability to monitor foreign competitors.

Chapter 4: Implementation and Control

Strategy formulation *is largely an intellectual process whereas strategy implementation is more operational in character. Strategy formulation requires good conceptual, integrative and analytical skills but strategy implementation requires special skills in motivating and managing others.*

Organizational structure *refers to the method of allocating duties and responsibilities to individuals, and the ways these individuals are grouped together into units, departments and divisions.*

Strategy Implementation—Supporting Factors

An effective implementation of strategy in an organization needs multiple supporting factors. Some of these factors include the following:

- **i.** Action Planning
- **ii.** Organizational Structure
- **iii.** Human Resource Factors
- **iv.** Annual Business Plan
- **v.** Monitoring and Control

Issues in Strategy Implementation (LOC RFC PPP)

An organization is confronted with a number of issues in the process of strategy implementation. Some of the important issues are discussed as follows:

- **i.** **L**eadership
- **ii.** **O**rganisational Structure and Strategies
- **iii.** **C**ommunication Strategy
- **iv.** **R**esource Allocation
- **v.** **F**unctional Policies
- **vi.** **C**hallenges to Change
- **vii.** **P**roject implementation
- **viii.** **P**rocedural implementation
- **ix.** **P**re-implementation Evaluation Strategy

Organizational structure *refers to the method of allocating duties and responsibilities to individuals, and the ways these individuals are grouped together into units, departments and divisions.*

McKinsey framework shows that there is a multiplicity of factors which influence an organization's ability to change. Comment. → June' 12 ***<u>10 Marks</u>***

It is correct. McKinsey developed the 7-S framework management model which organize seven factors to organize a company in an holistic and effective way with the objective to diagnose the causes of organization problem and formulate program for improvement due to the implementation of the strategy which are associated with change in the organization.

The framework rests on the proposition that effective organizational change is best understood in terms of the complex relationship between strategy, structure, systems, style, skills, staff and shared values (super ordinate goals)- the seven S"s.

According to the framework, there is a multiplicity of factors which influence an organization"s ability to change and understand as to how the 7-S model mechanism works. In general terms, the proposition of the 7-S model suggests that there are multiple factors which influence an organization"s ability to change and its proper mode of change. Since the variables are interconnected, significant progress cannot be made in one area unless corresponding progress is made in other areas too. It is imperative to know what each „S" means and what is its implication. The 3S"s across the top of the model are described as Hard S"s and 4S"s across the bottom of the model are less tangible, more cultural in nature and some time neglected in major change efforts and mergers and were termed as soft Ss by McKinsey.

McKinseys 7-S Framework

- **i.** Strategy
- **ii.** Structure
- **iii.** System
- **iv.** Style
- **v.** Staff

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vi. Skills
vii. Shared Values (Super-ordinate Goals)

Activating Strategy

Activation is the process of stimulating an activity so that it can be performed successfully. Activation of strategy is required because only a small number of people are involved in the strategy formulation while its implementation involves a good number of people within the organization. Activation of strategies requires the performance of the following activities:

i. **Institutionalization of strategy**
   a. *Strategy Communication*
   b. *Strategy Acceptance*
ii. Formulation of Action Plans and Programs
iii. Translating General Objectives into Specific Objectives
iv. Resource Mobilization and Allocation

Some of the problems which are encountered in the process of resource allocation are as follows:

i. *Power play*
ii. *Commitments of past*
iii. *Resistance to changes*

Structure of an organization can influence its strategy formulation process. It is because organization"s structural form (line and staff, matrix, market or product differentiation etc.) can affect internal communication, interpersonal relations and other strategic perspectives. Companies with organization system based on advanced information technology can use the latest IT trends to support and hence influence the strategy formulation.

Functional Structure

The functional structure is based on specialization of functions. This leads to economies of scale and specialization which increases operational efficiency and organization efficiency, economic flexibility and greater motivation to the people having attached to their area of speciality. The structure is suitable to firms operating single or related business.

There are certain **limitations** of this form of organization structure due to the following reasons: → **June' 14 <u>5 Marks</u>**

i. *Lack of responsibility*
ii. *Complex activity*
iii. *Lack of responsiveness*
iv. *Line and staff conflicts*

Divisional Structure (SCHEMe)

Divisional structure offers the following advantages to an organization:

i. ***S****trict financial control*
ii. ***C****are for strategic task*
iii. ***H****igh efficiency level*
iv. ***E****nhancement of morale*

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v. ***M**anagement by exception*

Despite various advantages, divisional structure form of organization has **certain disadvantages** also. Some of them are discussed as under: **(C4)**

i. *Costly affair*
ii. *Competition between divisions*
iii. *Coordination problem*
iv. *Change of priorities*

Matrix Organization Structure

Matrix structure is one where each project and product becomes strategic. It is the realization of two dimensional structure which emanates from two dimensions authority i.e. pure project structure and functional structure. Authority flows vertically within functional department while authority of project manager flows horizontally crossing the vertical lines.

A matrix organization structure offers following <u>advantages</u>:

i. *Direct relations*
ii. *Quality decision*
iii. *Participative management*

A matrix organization structure has following **<u>disadvantages</u>:**

i. *Conflicts and confusions*
ii. *Delayed decisions*
iii. *High degree of integration*

Q. The activities are grouped according to the types of products manufactured or different market territories as the organizations began to grow by expanding variety of functions performed is called: *Divisional Structure*

Procedural Implementation

A procedure refers to a series of related task which make-up a chronological sequence. It is an established way of performing the work to be accomplished. The major procedural requirements involved in the strategy implementation process are discussed as under:

i. Licensing Requirements
ii. FEMA Requirements
iii. Foreign Collaboration Procedures
iv. Capital Issue Requirements
v. Import and Export Requirements

Behavioural Implementation

Behavioural implementation is concerned with those aspects of strategy implementation which have influence on the behaviour of the people in the organization. Some of the issues which are relevant for behavioural implementation of strategy in an organization are discussed as under:

i. Leadership → *It is the ability to persuade others to achieve the defined objectives willingly and enthusiastically*

ii. Organizational Culture

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Organizational Culture *is defined as a set of assumptions, beliefs, values and norms which are shared by people and groups in the organization and control the way they interact with each other and with stakeholder outside the organization.*

Charles Hardy divided the organisation culture in the following four types:

i. *Power Culture*
ii. *Role Culture*
iii. *Task Culture*
iv. *Person Culture*

Organisation culture affects the following aspects of the organization:

i. *Objective setting*
ii. *Work ethics*
iii. *Motivational pattern*
iv. *Organizational process*

The organizational culture should be made as a facilitating factor in strategy implementation. The following alternatives have been suggested for implementation in relation to strategy and culture:

i. *Ignore corporate culture*
ii. *Adopt a strategy to suit corporate culture*
iii. *Change corporate culture to suit strategic requirements*
iv. *Change the strategy to fit the corporate culture*

iii. Organization Development (OD)

Organization development *refers to long-term effort supported by top management to improve an organization"s problem-solving and renewal process through effective management of organizational change.*

iv. Values and Ethics → *Values represent basic convictions that a specific mode of conduct is personally or socially preferable to an opposite mode of conduct. Ethics is concerned with moral principles or set of values about what conduct ought to be.*

v. Corporate Governance

According to ICSI *Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders."*

A good corporate governance code usually contains the following matters:

i. *Constitution of Board of Directors*
ii. *Disclosure of Information*
iii. *Management practices*

vi. Corporate Social Responsibility → *It is a tool used by business and industry to align operations with social and environmental values.*

vii. Organizational Politics → *Politics can be referred to as actions for seizing, holding, extracting and executing of power by individuals and groups for achieving personal goals. The organization decisions are affected because of organizational politics in such a way that they constitute to personal goals rather than organizational goals.*

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Behavioural Implementation (COO in LOV)

***i. C**orporate Social Responsibility:** It is a tool used by business and industry to align operations with social and environmental values.*

***ii. O**rganizational culture:** It is a set of assumptions, beliefs, values and norms which are shared by people and groups in the organization and control the way they interact with each other and with stakeholder outside the organization.*

***iii. O**rganizational Development:** It refers to long-term effort supported by top management to improve an organization"s problem-solving and renewal process through effective management of organizational change.*

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***vi. V**alues and Ethics:** Values represent basic convictions that a specific mode of conduct is personally or socially preferable to an opposite mode of conduct. Ethics is concerned with moral principles or set of values about what conduct ought to be.*

Marketing Strategy

- **i.** *Pricing*
- **ii.** *Distribution (Place)*
- **iii.** *Promotion*
- **iv.** *New Product Development*

Human Resource Management (HRM) and Union Relations Policy

It has the following elements:

- i. Job Analysis
- ii. Staffing Plan
- iii. Payroll Budget and
- iv. Union Relations Strategy

  Setting union relations strategy involves:
  - ***a.*** *Relationships between Strategy and the Union Contract*
  - ***b.*** *Formal or Informal Negotiations*
  - ***c.*** *Preparation of Negotiation Proposals*

Research and development strategy has four primary components:

- i. *Research and* Development Goals
- ii. Intensity of Research and Development
- iii. Market and Production Coupling
- iv. Research and Development Budget

The major elements of strategic programming are as follows: (PEPE DIPSS)

i. **P**reparation of short-term plan

ii. **E**valuation of results

iii. **P**reparation of master plans

[Type text]

iv. **E**valuation of strategies

v. **D**eveloping alternative strategies

vi. **I**dentification mission.

vii. **P**reparation of medium term plan.

viii. **S**etting Objectives.

ix. **S**election of optimal alternatives

Limitations of Strategic Program

The major limitations of strategic programme to an organization originates from its limited application to certain conditions which are summarized as under:

i. *Required Conditions*
ii. *Falling visibility of Mechanistic Organizations*
iii. *Planning Problems*
iv. *Difficulties with command and control*

*A **Budget** is a tool used for both planning and control. At the beginning of the period, the budget is a plan or standard; at the end of the period, it serves as a control device to help management measure its performance against the plan so that future performance may be improved.*

Master Budget

Components of Master Budget are the following:

i. *Operating Budget*
ii. *Sales Budget*
iii. *Purchase Budget*
iv. *Operating Expenses Budget*
v. *Financial Budget*

Zero-Based Budgeting (ZBB)

Zero-based budgeting is a technique of planning and decision-making. It may be defined as a planning and budgeting process which requires each manager to justify his entire budget request in details from scratch and shift the burden of proof to each manager to justify why he should spend any money at all. This approach requires that all activities be analyzed in decision packages which are evaluated by systematic analysis and ranked in order of preference.

Budget as an Early Warning System

Budgets provide a kind of early warning system that, when compared to actual results, can inform when something is going wrong which needs immediate attention. When expenditures exceed budget, several things can be done to get back on track as:

i. *Review the budget*
ii. *Freeze spending*
iii. *Postpone new projects*
iv. *Lay off employees and close facilities*

***Procedures prescribe** the chronological sequence of performing various tasks which are required to complete an activity. A procedure includes how each task in an organization* *will take place, when it will take place and by whom it is to be performed.*

Since procedures are used very frequently it should be developed in such a way as to contribute positively in performing various activities. The following guidelines may be adopted for developing good procedures:

i. *Based on facts*
ii. *Stability*
iii. *Flexibility*
iv. *Updated Procedures*
v. *Minimum Procedures*
vi. *Procedures as a System*

Strategic control is "the critical evaluation of plans, activities, and results, thereby providing information for the future action". Strategic control focuses on the dual questions of whether: (1) the strategy is being implemented as planned; and (2) the results produced by the strategy are those intended." There are four types of strategic control:
premise control, implementation control, strategic surveillance and special alert control.

Role of Strategic Control

When strategic control is undertaking properly, it contributes to the following specific areas:

i. *Measurement of Organizational Progress*
ii. *Feedback for Future Actions*
iii. *Linking Performance and Rewards*

Role of Organisational Systems in Strategic Control

Strategic control operates in the context of various organizational systems. It is observed that an organization develops various systems which help in integrating various parts of the organisation. The following are the major organizational systems:

i. *Information System*
ii. *Planning System*
iii. *Development System*
iv. *Appraisal System*
v. *Motivation System*

Control Process (RS. MCA)

The control process consists of the following steps:

i. ***R****e-enforcement of Corrective Action*
ii. ***S****etting Performance Standards*
iii. ***M****easuring Actual Performance*
iv. ***C****omparison of Actual Performance against Standards*
v. ***A****nalysing Variance*

Strategic Control Techniques

Strategy formulation is based on certain assumptions. In fact, there is a time gap between strategy formulation and its implementation. Sometimes the strategy formulated may not work effectively as devised by the strategists. In order to

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overcome this situation the following strategic control techniques are followed:

i. *Premise Control*
ii. *Strategic Momentum Control*
   a. *Responsibility Control Centers*
   b. *Underlying Success Factors*
   c. *Generic Strategies*
iii. *Strategic Leap Control*
   a. *Strategic Issue Management*
   b. *Strategic Filed Analysis*
   c. *Systems Modeling*
iv. *Implementation Control*
   a. *Monitoring Strategic Thrusts*
   b. *Milestone Review*
v. *Strategic Surveillance*
vi. *Special Alert Control*

There are three kinds of strategic changes that most of the companies pursue:

1. Business process re-engineering (BPR) is the redesign of the business processes and the associated systems and organizational structures to achieve a dramatic improvement in business performance. The business reasons for making such changes could include poor financial performance, external competition, and erosion of market share of emerging market opportunities.

ii. Restructuring is another kind of change that strategic management use to implement strategic change to improve the performance. It may be: (a) reducing the level of differentiation and integration by reducing divisions, departments or hierarchy levels; (b) by reducing the number of employees to bring the operating cost.

Restructuring and downsizing becomes necessary due to:

i. Unforeseen changes in business environment;

ii. New technological development;

iii. Reduction in demand;

iv. Excess production capacity;

v. High bureaucratic and operating costs;

vi. Improving the competitive advantage;

iii. Innovation: Innovation is the process by which organizations use their skills and resources to create new technologies or goods and services so that they can change and better respond to the needs of their customers. Innovation can lead organizations to change that they want, it can also lead to the kind of change, they do not want.

Various Factors necessitating organizational change may be:

i. External Factors; and
ii. Internal Factors.

Planned Change

Bringing change in a planned manner is the prime responsibility of all managers who are forward looking. It aims to prepare a total organization, or a major portion of it, to adapt to significant changes in the re-organization goals and direction. Planned change attempts to the aspects of the organization which are closely interrelated i.e. technology, task, structure, people, etc.

i. *Technology Related Changes*
ii. *Task Related Changes*
iii. *Structure Related Changes*
iv. *People Related Changes*

Process of Strategic Change

Management of organizational change is a complex issue. It involves formidable exercise on the part of management. The various steps involved in a planned change, may include - identifying need for change, elements to be changed, planning for change, assessing change forces, actions for change and feedback.

i. *Identifying Need for Change*
ii. *Elements to be Changed*
iii. *Planning for Change*
iv. *Assessing Change Forces*
   a. *Actions for Change*
   b. *Unfreezing*
   c. *Changing*
   d. *Refreezing*
v. *Feedback*

Resistance to Change → June' 13

i. ***Individual Resistance***
   a. *Economic Factors*
   b. *Psychological Factors*
   c. *Social Factors*
ii. ***Group Resistance***
iii. **Resistance of Organisation to Change**
   a. *Counting Past Successes*
   b. *Stability of Systems*
   c. *Resource Limitations*
   d. *Sunk Cost*
   e. *Inter-organisational Agreement*

Determining the Need for Strategic Change

Strategic managers are to determine the type and magnitude of change appropriate for an organization. Sometimes, this need is obvious when divisions are fighting or when competitors introduce a product which is clearly superior to the company. There are two main requirement of such an analysis:

i. *Assessing the Extent of Change*
ii. *Identifying Obstacles to Change*

Managing Strategic Changes

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The basic problem in managing change is to overcome people resistance successfully. **Problems of:- <u>LET</u> <u>OPC</u> overcoming resistance to change can be managed in the following ways:**

i. ***L**eadership*
ii. ***E**ducation and Communication*
iii. ***T**raining and Psychological Counselling*
iv. ***O**btaining commitment*
v. ***P**articipation*
vi. ***C**oercion or Edict*

Tactics of Change Management

Tactics refer to the specific measures or ways of action/management style to implement the change strategy. The common basic tactics for change are the following:

i. *Changes in Organization Routines*
ii. *Symbolic Activity in Managing Change*
iii. *Selection Interviews*
iv. *Behaviour of Change Agents Themselves*
v. *Language Used by Change Agents*

Chapter 5: Performance Evaluation

List out some of the performance indicators used by the organization?

Some of the important performance indicators used by the organization are:

i. Competitive advantage
ii. Financial performance
iii. Quality of service
iv. Flexibility
v. Resource utilization
vi. Innovation.

Measures of Corporate Performance

1. Earning Per Share (EPS)

$$\frac{\text{Net Profit}}{\text{No. of Shares outstanding}}$$

***2.* Return on Investment (ROI)**

$$\frac{\text{Net Operating Profit}}{\text{Total Investment}}$$

***3.* Return on Equity (ROE)**

$$\frac{\text{Net Income}}{}$$

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Shareholders' Equity

4. Economic Value Added (EVA)

EVA = Net Operating Profit After Tax – Cost Charges for Capital Employed

***5.* Market Value Added (MVA)**

The formula for MVA is:

MVA = V – K
Where:

— MVA is market value added

— V is the market value of the firm, including the value of the firm's equity and debt.

— K is the capital invested in the firm.

***6.* Shareholder Value**

The balanced score card (BSC) *is a strategic planning and management system that is used extensively in business and industry, government, and non-profit organizations worldwide to align business activities to the vision and strategy of the organization.*

The balanced scorecard suggests the following four perspectives:

i. Learning and Growth Perspective
ii. Business Processes Perspective
iii. Customer Perspective
iv. Financial Perspective

Measuring Divisional Performance → PRISE

Responsibility centers are used to isolate a unit so that it can be evaluated separately from the rest of the corporation. Each responsibility centre has its own budget and is evaluated on its use of budgeted resources. Responsibility centre is headed by the manager responsible for the center's performance. Each centre uses resources to produce goods or services.

i. **P**rofit Centers
ii. **R**evenue Centers
iii. **I**nvestment Centres
iv. **S**tandard Cost Centers
v. **E**xpense Centres

Problems in Measuring Performance

i. Short-term Orientation
ii. Goal Displacement

Standard cost *is computed for each operation on the basis of historical data in evaluating the center's performance. Standard cost for each unit when multiplied by the number of units produced result in the expected cost of production which is compared with actual cost.*

Strategic Incentive Management

This reduces the likelihood of agency problems i.e., employees prefer to increase their incentives rather than building shareholders value. The following approaches are used by organizations to match measurements and rewards with explicit strategic objectives and timeframes.

i. Weighted-factor method
ii. Long-term evaluation method
iii. Strategic-funds method

Q. ***The method which compensates managers for achieving objectives set over a multiyear period is called:*** *Long term evaluation method*

Strategic Audit

Strategic audit refers to a checklist of questions, by area or issue which enables a systematic analysis of various corporate functions and activities to be made. This is a type of management audit and is useful as a diagnostic device to pin-point corporate wide problem areas and to highlight organizational strengths and weaknesses. It also helps to determine why certain areas create problems for a company and help to generate solutions to these problems. It is not an all-inclusive list, but it presents many of the critical questions needed for a detailed strategic analysis of any business organization.

The following are the common area in which a common strategic audit can be undertaken:

i Evaluation of current performance
ii. Review of corporate governance
iii.Scan and assess the external and internal environment
iv.Analysis of strategic factors (SWOT)
v.Strategic alternatives
vi.Implementation of strategies
vii.Evaluation and control.

Chapter 6: Risk Management

Risk is an exposure of uncertainty of outcome, whether positive opportunity or negative threat, of actions and events. It refers to the uncertainty that surrounds future events and outcomes. It is the expression of the likelihood and impact of an event with the potential to influence the achievement of an organization's objectives.

The term risk has been expressed in various forms as under:

i. The chance of loss
ii. The probability of loss,
iii. Uncertainty
iv. The dispersion of actual from expected result
v. The probability of any outcome different from the one expected.

Potential risk events can be associated with the following range of source categories:

i. Political

ii. Regulatory
iii. Customers
iv. Environmental
v. Economic
vi. Commercial / Strategic
vii. Financial
viii. Public Health / Safety
ix. Infrastructure Planning / Design
x. Procurement / Contractual
xi. Assessment of IPR
xii. Construction, Operation and Maintenance
xiii. Asset Failure
xiv. Support Service Failure
xv. Security of Assets, Litigational
xvi. Organisational
xvii. Natural Events

Components of Cost of Risk

Cost of risk has multiple components. The important components includes the following:

a. *expected losses*
b. *cost of loss control*
c. *cost of loss financing*
d. *cost of internal risk reduction*
e. *cost of any residual uncertainty*

Types of Risks

Risks may be broadly classified under the following types:

i. **Systematic Risk**
ii. **Unsystematic Risk**
iii. **Market Risk**

Some of important factors which are associated with the market risk are as discussed below:

(i) *Equity Risk:* It is the risk which changes the share prices.

(ii) *Interest Rate Risk:* It is the risk which changes the interest rates.

(iii) *Currency Risk:* It is the risk which changes the foreign exchange rates.

(iv) *Commodity Risk:* It is the risk which changes the commodity prices (e.g. grains, metals).

(v) *Credit (Finance) Risk:* It is the risk which changes the credit prices/spreads.

iv. **Business Risk**

a. *Price Risk*

b. *Credit Risk*
c. *Pure Risk*

v. Purchasing Power Risk
vi. Interest-Rate Risk
vii. Financial Risk
viii. Default Risk
ix. Investment Risk
x. Inflation Risk

xi. Operational Risk

Important forms of operational risks are discussed as follows:

a. *Process Risks*
b. *People Risks*
c. *Technology Risks*

xii. Industry and Services Risks
xiii. Political Risks
xiv. Systems Risks
xv. Legal Risks
xvi. Disaster Risks

Elements of Risk in Business

The risk elements can also be classified as under and referred to as the 10 Ps.:

i. Premises
ii. People
iii. Policy
iv. Planning
v. Procedure
vi. Purchasing
vii. Processes
viii. Product
ix. Performance
x. Protection

Risk management *refers to identification of opportunities and avoiding or mitigating losses. It is a logical and systematic process of establishing the context, identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process, in a way which enables an organisation to minimise losses and maximise opportunities.*

Objectives of risk management is:

i. To provide a structured framework for more effective strategic planning
ii. To ensure maximising of opportunities and minimisation of losses
iii. To contribute to improved organisational efficiency and effectiveness
iv. To optimise the use of resources
v. To provide senior management with a concise summary of the major risks affecting the organisation and a mechanism to ensure that appropriate resources are directed towards areas of high risk
vi. To provide a framework for ensuring that unavoidable risks are adequately insured

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vii. *To improve the level of accountability in the organisation*
viii. *To identify and prioritise potential risk events*
ix. *To help in developing risk management strategies and risk management plans*
x. *To analyse and report identified risk events*
xi. *To find ways to identify and evaluate risks*
xii. *To develop strategies and plans for risk management strategies.*

The traditional role of the risk manager as corporate steward is evolving as organizations face an increasingly complex and competitive business environment. Do you agree? Discuss briefly? → June' 14 ***6 Marks***

Yes, I agree with the statement, as today the risk manager is a key member of the senior executive team in an organisation who helps to define business opportunities from a risk-return perspective, presents unique ways of looking at them, has direct input into the configuration of products and services, and ensures the transparency of all the risks. Innovation necessitates new yardsticks for measuring and monitoring the resulting activities.

Broadly speaking the major aspects which are covered in the scope of risk management include the following:

i. *Strategic Decisions*
ii. *Program and Project Level*
iii. *Operational level*

Effective risk management helps to improve performance objectives by contributing to:

1. Better service
2. Reduction in management time
3. Increased likelihood of change initiatives being achieved
4. More focus internally on doing the right things properly
5. Better basis for strategy setting
6. Achievement of competitive advantage
7. More efficient use of resources
8. Reduced waste and fraud, and better value for money
9. Improved innovation
10. Better management of contingent and maintenance activities.

Risk Management Process

Management of risks starts with identification of risk and its quantification. It consists of a series of individual steps that must be accomplished in managing risks.

The process of risk management broadly consists of the following steps:

1. Risk Identification
2. Risk Assessment
3. Risk Measurement and Analysis
    i. Qualitative Analysis

ii. *Semi-Quantitative Analysis*
iii. *Quantitative Analysis*

4. Risk Evaluation
5. Risk Treatment
6. Risk Monitoring and Review.

Trade Off between Risk and Return

A fundamental investment concept is the trade-off between risk and return. This concept is based on two realities i.e., investments and investment performance.

First, all investments carry some degree of risk, the reality that one could lose some or all of his money when he buy shares, bonds, mutual funds or other investments. Second, not only different types of investments carry different levels of risk, but the more risk one assume, the greater the investment return one is likely to achieve.

1. The return earned on investments represents the marginal benefit of investing.
2. Risk represents the marginal cost of investing.
3. A trade off always arises between expected risk and expected rate of return.

Measurement of Risk and Return

A brief outline of the **Techniques of risk analysis** are discussed below:

V. R. is CBSC's SSD

i. ***V****alue at Risk Analysis*
ii. ***R****ange*
iii. ***C****o-efficient of Variation*
iv. ***B****reak Even Analysis*
v. ***S****tandard Deviation*
vi. ***C****ash Flow at Risk Analysis*
vii. ***S****ensitivity Analysis*
viii. ***S****imulation Analysis*
ix. ***D****ecision Tree Analysis*

Components of ERM

According to COSO framework,* there are the following eight interrelated components of risk management: *RISI *Control Activities for* ***Components of ERM***

i. ***R****isk assessment*
ii. ***I****nternal environmental*
iii. ***S****etting of objectives*
iv. ***I****nformation and Communication*
v. ***Control Activities***
vi. ***E****vent identification*
vii. ***R****isk Response*
viii. ***M****onitoring by the Board*

COSO-II has suggested that Enterprise Risk Management should take place at four levels namely:

i. *Entity*

ii. *Division*
iii. *Business Unit*
iv. *Subsidiary*

Enterprise risk management in an organization provides enhanced capability to:

PEMILA RS.

i. ***P**rovide integrated responses to multiple risks*
ii. ***E**nhance risk response decisions*
iii. ***M**inimize operational surprises and losses*
iv. ***I**dentify and manage cross-enterprise risks*
v. ***L**ink growth, risk and return*
vi. ***A**lign risk appetite and strategy*
vii. ***R**ationalize capital*
viii. ***S**eize opportunities*

Responsibilities on Risk Management

For effective risk management in an organization, it is essential to specify the responsibilities at various levels of management. A brief outline of responsibility in this regard is summarized as follows:

i. *Board of Directors*
ii. *Chief Executive Officer*
iii. *Risk Officer*
iv. *Internal Auditors*
v. *Other Personnel*

Strategies for Risk Mitigation → Dec' 12 <u>8 Marks</u>

Once risks have been identified and assessed, the strategies to manage the risk fall into one or more of the following categories:

i. *Transfer Risk*
ii. *Tolerate Risk*
iii. *Reduce Risk*
iv. *Avoid Risk*
v. *Combine Risk*
vi. *Sharing Risk*
vii. *Hedging Risk*

<u>Chapter7:</u> <u>Management Information Systems</u>

The main purpose of MIS is to provide timely, specific and accurate information at all levels in an organization. To achieve this goal, different types of information systems are devised by the organizations.

Evolution of MIS

As far as its evolution is concerned, it can be linked to the following four disciplines.

1. Management Accounting
2. Management Science / Operational Research

3. Management and Organization Theory
4. Computer Science

Elements of MIS

i. Management
ii. Information
iii. System

Management Levels and Their Information Needs

The levels of management consist of top, middle, and first line management (supervisory). The activities in the organizations are of three types:

i. **Top Level** (Strategic Planning) **E.UU. PASS (Think like:- Top Mgt want only those people who have European Union Pass Certificate)**

The strategic planning information often have the following characteristics.

a. **E**xternal Data
b. **U**nexpected Information
c. **U**nstructured format
d. **P**redicted nature
e. **A**d hoc Basis
f. **S**ummary Form
g. **S**ubjectivity

ii. **Middle Level** (Tactical Level) **BUCS P**

a. ***B**oth External and Internal Sources*
b. ***U**nexpected Findings*
c. ***C**omparative Nature*
d. ***S**ummary Form*
e. ***P**redictive Nature*

iii. **Supervisory Level (**Operational)

The major **characteristics of <u>Information Systems</u>** are as follows : **(Compare)**
<u>PRE</u> <u>GD</u> on <u>IS</u> for finding Characteristics of IS

i. ***P**redictability*
ii. ***R**epetitiveness*
iii. ***E**mphasis on the past*
iv. ***G**reat accuracy*
v. ***D**etailed nature*
vi. ***I**nternal origin*
vii. ***S**tructured form*

Characteristics of <u>MIS</u> (Compare)

CCE vs S. MURTI vs CFF (SC)

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Some of the main characteristics of MIS based on above definitions are listed as under:
i. ***C**omprehensiveness*
ii. ***C**o-ordinated*
iii. ***E**nhance Productivity*
iv. ***S**ub-systems*
v. ***M**odularity*
vi. ***U**ses Established Quality Criteria*
vii. ***R**elevant Information*
viii. ***T**ransformation of Data into Information*
ix. ***I**ntegration*
x. ***C**onforms with Managers' Styles and Characteristics*
xi. ***F**eedback*
xii. ***F**lexibility*
xiii. ***S**elective Sharing of Data*
xiv. ***C**omputerized*

Misconceptions OR Myths about MIS

Let us clarify some of the misconceptions or "myths" about MIS:

1. *Any computer based information system is a MIS.*
2. *Any reporting system is MIS.*
3. *MIS is a management technique.*
4. *MIS is a bunch of technologies.*
5. *The study of management information system is about the use of computers*
6. *More data in reports means more information for managers*
7. *Accuracy in reporting is of vital importance*

Basic Requirement of Computer based MIS

The basic requirements of a computer based MIS in an organization are listed as below:
i. *Hardware*
ii. *Software*
iii. *Database*
iv. *Procedures*
v. *Operations Personnel*

Approaches of MIS Development

For developing MIS in an organisation, the following three approaches are generally used.

i. Top down approach
ii. Bottom up Approach
iii. Integrated Approach

Pre - Requisites of an Effective MIS

The pre-requisites of an effective MIS are nothing but mainly its resources and management support. These are described in the following section :

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a. Qualified Systems and Management Personnel

The personnel‟s of the MIS comprises of atleast two category of personnel viz.:

(i) Systems, Communication, and Computer Experts; (ii) Management Experts

b. Database

The main feature of database is that all subsystems will utilize the same database kept in different files. The other important features of databases are:

i. *Avoiding uncontrolled data redundancy and inconsistency*
ii. *Program-Data Independence*
iii. *Flexible Access to shared data*
iv. *Reliability*
v. *Centralized Control of Data*

c. Support of Top Management

d. Control and Maintenance of MIS

e. Evaluation of MIS

Computer and Its Effect on MIS → IIM *Widened Scope for IEC*

The effects of applying computer technology to information systems can be listed below:

i. ***I**ncrease in Speed of Processing and Retrieval of Data*
ii. ***I**ntegrates the Working of Different Information Sub-systems*
iii. ***M**ore Comprehensive Information*
iv. ***Widened Scope of Analysis***
v. ***I**ncreased the Effectiveness of Information Systems*
vi. ***E**xpanded Scope of use of Information System*
vii. ***C**omplexity of System Design and Operation*

Constraints in Operating A MIS

i. Non-availability of experts
ii. Difficulty usually faced by experts, in selecting the sub-systems of MIS, to be designed and operated upon first.
iii. Source of availability of experts for running MIS effectively, is not always known to management
iv. MIS is non-standardised one.
v. Non-availability of co-operation from staff.
vi. Non-availability of heavy financial resources required for running the MIS effectively.
vii. Turnover of experts is quite high.
viii. It is difficult to quantify the benefits of MIS, so that it can be easily comparable with cost.
ix. Perceptional problems as its utility is not readily perceptible by many users.

Limitations of MIS

i.Quality of Output of MIS is governed by quality & qty of Input & Processes
ii. MIS is not a substitute for effective mgt rather an imp tool in hands of executives for decision making & problem solving
iii. Lack of Flexibility

iv. Cannot provide tailor made Info
v. Takes only Quantitative factors, ignores qualititative factors (e.g. Morale & Attitude of Members in org)
vi. Less useful for Non Programmed Decisions
vii. Effectiveness reduces due to Culture of Hoarding Info
viii. Effectiveness decreases due to Frequent Changes in Top Mgt

Q. DSS (Decision Support System) are more targeted than MIS system. Comment?

Yes, DSS are more targeted than MIS system. MIS systems provide managers with routine flow of data and assist in the general control of the organization. In contrast, DSS are slightly focused on a specific decision of classes of decision such as routing, querying, on three basic parameters which are given below:

i. *Philosophy*
ii. *System Analysis*
iii. Design

Core Capabilities of DSS

A DSS is required to possess the following core capabilities:

i. *Representations*
ii. *Operations*
iii. Memory aids
iv. *Control aids*

	Management Information System (MIS)	***Decision Support System (DSS)***
1.	Information form of a MIS is **periodic, and based on demands.**	Information form of DSS is **interactive.**
2.	Information **formats are pre-specified and fixed.**	DSS information formats are **adhoc, flexible and adaptable.**
3.	Providing **structured information to end users.**	Providing **integrated tools, data, models, and languages to end users.**
4.	**Little** analytical capability	**More** analytical capability
5.	It supports **structured decisions** for operational and tactical planning and control.	It supports the **semi-structured and unstructured decisions** for technical and strategic planning and control.
6.	It provides **indirect support designed to many managers.**	It provides **direct support tailored to the decision making styles of individual managers**.

	Executive Information System	*Decision Support System*
1.	It **directly supports the value added work** in the organization. It is relevant for top management.	It provides **information, models or tools for decision making.**
2.	Its **users are the people who do value added work** which requires special skills.	Its **users are analysts, managers and other professionals.**
3.	EIS is in the forms of summary reports and graphics. EIS combines both internal and external information.	It provides tools for analysing data and building models and helps in analysing the alternatives.
4.	Examples of EIS are (i) system to **generate** competitive bids (ii) system to support loan approval process.	The examples of DSS are (i) system **help** insurance people to test alternatives (ii) system analyzing characteristics of customers who pay bills promptly.
5.	Its common **features** are (i) **user friendly interface** (ii) user friendly methods of analyzing data.	Its common **features** are (i) user **controlled interaction** with computers (ii) **information systems are applied to semi-structured tasks.**

Expert Systems: It is a knowledge intensive computer program which captures the expertise of a human in a limited domain of knowledge and experience. The users of an expert system are the people who do value added work which requires a special skill or expertise. It provides tools, information, structured methods for decision making.

Examples of expert system:

i. System which generate competitive bids.

ii. System to help sales people and suggest the best choice for the customer.

iii. System which helps in diagnose of failures may be machine or human being.

iv. Systems to support a loan approval system.

v. Systems to support training in specialized areas where experts are in scarcity.
vi. System to find price inconsistencies between different equity markets.

Advantages of Expert System	**Limitations of Expert system:**

It provides more than one alternatives for the considerations of executives for making decisions. It provides more logical and rational justifications for decision making since it acts like an expert in the concerned areas. It makes available consistent decisions because it is based on rules than on personal whims and prejudices. It saves the user"s time.	Expert systems are sometimes overrated. Expert systems can be expensive to develop and maintain. It is difficult to elicit the knowledge of experts. It lacks common sense. Expert system cannot learn. The validation of expert systems can be difficult. It is limited to certain problems and unsuitable to complex managerial problems. It is a costly exercise in terms of time and resources.

Enterprise Resource Planning (ERP) → June 13, 2 Marks

ERP system is actually a process or approach which attempts to consolidate all of a company's departments and functions into a single computer system that services each department's specific needs. It is, in a sense, a convergence of people, hardware and software into an efficient production, service and delivery system which generates profit for the company.

Benefits of ERP → June' 14 <u>8 Marks</u>

Characteristics of ERP

i. *Flexibility*
ii. Modular and Open System Architecture
iii. *Comprehensive*
iv. *Beyond the Company*
v. *Best Business Practices*
vi. *Simulation of Reality*

<u>Chapter 8:</u> <u>Internal Control Systems</u>

Internal control is a prescription and practice of a system by management. Internal control comprises the plan of organisation and all of the coordinated methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency and encourage adherence to prescribed managerial policies.

Classification of Internal Control

Internal control can broadly be classified into two categories viz.:

1. Accounting controls/financial controls, and

2. Administrative controls

Elements of Internal Control → PARAM SOOPS

The essential requirements for the success of a business are the implementation of organisational objectives, plans and philosophy. With this end in view the following may be considered as the elements of internal control.

i. ***P**ersonnel*
ii. ***A**uthorisation and approval*
iii. ***R**ecords and Reports*
iv. ***A**ccounting Controls*
v. ***M**anagement*
vi. ***S**egregation of duties*
vii. ***O**rganisational structure*
viii. ***O**bjectives and Policy Statements*
ix. ***P**rotection of assets*
x. ***S**upervision*

Characteristics of Effective Internal Control

i. There should be proper **delegation of authority, responsibility and duties** within the organisation

ii. Appropriate **monitoring system should exist for an analysis of performance** and taking immediate corrective measures.

iii. In built facilities should exist for checking, cross checking and reconciliation of data by experienced employees including internal audit personnel, to ensure reliability, adequacy and correctness of all recorded transactions.

iv. The **internal control system should not be expensive** but should be **commensurate with the benefits to be derived.**

v. **There should exists a system of authorisation** and record procedures to provide reasonable accounting control over assets, liabilities, revenue and expenditure.

vi. Selection procedures are carefully screened to ensure that **only qualified people are employed.**

vii. There should be plan of organisation which provides the segregation of functional responsibilities and allocation of duties in such a way that none is responsible for the entire transaction.

viii. **Evaluation of control system is periodically done by internal auditors** and weakness revealed therein are brought out suitably for improvements.

ix. Control should be a continuous process and control measures should not be static but dynamic.

x. Control measures should be well conceived and operate with maximum efficiency and should not taken as substitutes for judgement.

Objectives and Scope of Internal Control

1. To ensure the orderly and efficient conduct of business.

2. To ensure that transactions are executed in accordance with management's general or specific authorization.

3. To ensure that all transactions are promptly recorded with the correct amount, in the appropriate accounts.

4. To ensure that access to assets is permitted only in accordance with management's authorization.

5. To ensure accountability for assets.

6. To ensure that the policies laid down are adhered to.

7. To ensure confidence of reliability to the users of information.

8. To ensure that the things take appropriate shape and finish at the shop floor and are corrected by timely actions through feedback information.

9. To present or detect errors and frauds.

Limitations of Internal Control Systems

i. cost of a control procedure should not be disproportionate to the potential loss due to fraud or error.

ii. Most of the controls tend to be directed at anticipated types of transactions and not at transactions of unusual nature.

iii. The potential for human error due to carelessness, distraction, mistakes of judgement or the misunderstanding of instructions cannot be ruled out.

iv. The possibility of circumvention of controls through collusion with parties outside the entity or with employees of the entity may be present.

v. The possibility that a person responsible for exercising control could abuse that responsibility.

vi. The possibility that procedures may become inadequate due to changes in conditions and compliance with procedures may deteriorate.

vii. Manipulations by management with respect to transactions or estimates and judgements required in preparation of financial statements.

Techniques of Internal Control

The following methods are adopted for Internal Control in modern organisation:

1. *Internal Check*
2. *Internal Audit*
3. *Flow Charts*
4. *Internal Control Questionnaire*
5. *Inter firm a*nd Intra firm Comparisons.

***"Internal check**—a system under which the accounting methods and details of an establishment are so laid out that the accounts and procedures are not under the absolute and independent control of any person - that on the contrary, the work of an*

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employee is complementary to that of another and that a continuous audit of the business is made by the employees".

	Internal Check	***Internal Audit***
(i)	It is an arrangement of allocated in such a way that the of one person is automaticall checked by another.	It is an independent review of operations and records.
(ii)	There is no special staff to carry-out the system of internal check. It represents the arrangements of duties of the staff in a particular manner.	For carrying out internal audit, normally separate staff is engaged specially for the purpose.
(iii)	The objective of internal check is to reduce the errors and frauds.	The objective of internal audit is to discover the errors and frauds, if any.
(iv)	It represents a process under which the work goes on uninterruptedly and checking too is more or less automatic.	The internal auditor has to see as to how far the work is correct and done according to the specified rules.

Q. How does an Internal audit assists the members of the organisation in the effective discharge of their responsibilities?

Internal audit furnishes the members with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed. It is implied that an internal auditor has to go beyond the books of accounts records to appraise the quality of various activities of the organisation. He is not to confine himself to the routine search for clerical errors in accounting documents but has to conduct an appraisal of the various operational functions and provide advice and recommendations on the activities and operations reviewed by him. According to the modern concept of internal auditing, the internal auditor should also be engaged in the task of carrying out a review of operations.

The major Functions and responsibilities of internal auditor can be described as under:

i. Reviewing and appraising operating controls
ii. Review of compliance with policies, plans and procedures
iii. Review of custodianship and safeguarding assets
iv. Economical and efficient use of resources
v. Accomplishment of established objectives and goals
vi. Detection of frauds
vii. Review of relevance and reliability of information
viii. Review of organisational structure
ix. Training other company officials
x. Compliance with Statutory Rules and Regulations

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Internal Auditing and Statutory Auditing

Following are the **Features of Internal Audit vis-à-vis Statutory Audit: PARSI MNOPQR**

i. ***P****rincipal areas of interest*
ii. ***A****pproach*
iii. ***R****esponsibility*
iv. ***S****cope*
v. ***I****ndependence*
vi. ***M****ethod of appointment and interests served*
vii. ***N****ature of Work*
viii. ***O****bjectives*
ix. ***P****erformance*
x. ***Q****ualification*
xi. ***R****eporting*

Co-ordination between Internal and External Auditors

i. Co-ordination Areas
ii. *Common Interests*
iii. *Review of the Work of Internal Auditor by the External Auditor*
iv. *Specific Evaluation*
v. *Responsibility*
vi. *Problems Associated with 'Close Working Relationship':*
   a. *Use of internal audit to reduce external audit costs*
   b. *The effect of the audit plan*
   c. *Motivation of internal auditors*

Flow Chart is a graphic presentation of a process or a system. It may be defined as a graphic representation of the flow of operations and documentations in their correct sequence from the initiation of transaction to its final entry in the books.

Essential Qualities of a Flow Chart

A good flow chart should have the following features:

i. The outline of a flow chart should be simple, useful and legible. It should be so laid out that too many lines do not cut each other.

ii. The flow lines should be kept short to make it easier for the reader to follow the trail.

iii. There must be a balance between simplicity and relevance. While all relevant details should be included, all irrelevant information, unnecessary narration/abbreviations should not be there in a flow chart.

iv. A flow chart must show as to what is in process—various internal control systems and procedures must be depicted clearly.

v. A flow chart should be as self contained as possible. Cross references should be avoided as far as possible. This is possible only when the documents flowing from one chart to another are minimum.

vi. Flow charts should be complete upto the final disposal of the documents or information.

Inter-firm comparison is a technique of comparing the performances, efficiencies, costs and profits of various concerns in an industry for assessing its own performance and ascertaining the reasons for any difference in performances/ efficiencies etc. Inter-firm comparison has been used on a large scale with the objective of making choice of investment by potential investors or to assess the stage of performance of a particular organisation vis-à-vis that of others.

Intra-firm comparison, on the other hand, means comparison of two or more departments or divisions belonging to the same firm with the objective of making meaningful analysis for the purpose of increasing the effectiveness or efficiency of the departments or divisions involved.

Thus, both inter-firm and intra-firm comparison have the same objective with the difference that while former compares the performance of the firm with other firms, the latter compares the performance of its own division or departments.

Advantages of inter-firm comparisons

i. The extent of weakness or potential improvement is highlighted by the comparison and each firm may try to improve the productivity of its factors of production.

ii. The manufacturer is able to update ratios with trends and to maintain and improve his position in relation to that of other manufacturers.

iii. It ensures unbiased and specialised reporting on particular problems of the firm.

iv. It develops cost consciousness among the participating firms and they are cautious in this respect at all levels of management.

v. It helps Government in effecting price regulations.

vi. It enables the business firms to evaluate the data relating to operations of the competitors, especially their cost structure, revenue realisations, profitability etc.

vii. A sound information as opposed to vague reports and the necessary standardisation of methods used to arrive at such information reduces the possibility of unfair competition.

viii. It helps the Government, regulatory agencies and researchers in getting extremely useful data and quantitative information which is used to improve policies and conducting in-depth analytical studies and research.

ix. It stimulates self-criticism and also identifies the various responsibility centres

Limitations of Inter-firm Comparison

i. If information or ratios are not properly collected/computed before they are used, comparison will be rendered difficult and absurd results may emerge.

ii. Most of the member firms do not disclose the relevant data as they consider it confidential. Thus, the information supplied may not always be reliable for comparison or decision making purposes.

iii. The middle management may not be convinced with the utility of inter-firm comparison and hence may not take interest.

iv. Unless there is a uniform costing system among the members, the information may not be strictly suitable reliable for the purposes of comparison.

v. In the normal course, a suitable base for comparison may not be available.

vi. In any comparison, time factor is an important element, any inter-firm comparison, which ignores this, will lead to misleading results which are not comparable and as such the very purpose of this exercise will be frustrated.

vii. The inconsistencies in financial reporting are totally ignored. No adjustment are made for changes in the prices.

Audit of Internal Control System

The following may be considered as the steps in review and evaluation of a company's internal control and accounting procedures:

1. *Determination of the Established Controls*
2. *Text of Transactions*
3. *Documentation*
4. *Evaluation Process*
5. *Application of Substantive Tests*
6. *Documentation of Review*
7. *Reporting to Management*
8. *Follow-up*

PART B - Strategic Alliances

<u>Chapter 9:</u> <u>Nature and Scope of Strategic Alliances</u>

Strategic alliance has three distinguishing characteristics: → June' 13 ***<u>3 Marks</u>***

i. the two or more firms that unite to pursue a set of agreed goals remain independent subsequent to the formation of an alliance.

ii. the partner firms share the benefits of the alliance and control over the performance of assigned tasks.

iii. the partner firms contribute on a continuing basis in one or more key strategic areas e.g. technology, products and so forth.

Need for Alliances → SFM JUMP alliance with SSC

The record suggests that ten main strategic factors reduce the whys in most alliance equations:

1. ***S**atisfy customer demands*
2. ***F**ill knowledge gaps*
3. ***M**ake scale economies*
4. ***J**ump market barriers*
5. ***U**se excess capacity*
6. ***M**ake scope economies*
7. ***P**re-empt competitive threats*
8. ***S**hare R & D costs*
9. ***S**peed product introduction*

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10. ***C**ut exit costs*

Integrating Alliances into Corporate Strategy

Alliance strategy must be integrated into the overall corporate strategy and articulated in the strategic plan with a process for implementation. The entire process of developing and managing an alliance could be as follows;

a. Development of the strategic domestic or global plan

b. Development of the alliance plan

c. Alliance partner — search and selection

d. Development of the implementation plan

e. Execution of the implementation plan

Options analysis

Analyzing options involves decisions on strategy, philosophy, corporate personality and structure. The process could be as follows:

1. Consider whether the company should be looking for an alliance and if so, why?
2. List and prioritize the reasons.
3. Identify the options for alliance structures, considering cost, risk and the commitment to human resources.
4. Focus on specific structures, keeping in mind an understanding of the organization‘s corporate personality. For example, if the corporate personality requires complete control rather than collaborative team building ‗acquisition‘ may be the right alternative.
5. Relate the choices to the corporate strategy and strategic plan.

Advantages of Alliances

i. Rapidly move to decisively seize opportunities before they disappear.

ii. Respond more quickly to change.

iii. Adapt with greater flexibility.

iv. Increase a company‘s market share.

v. Gain access to a new market or beat others to that market.

vi. Quickly shore up internal weaknesses.

vii. Gain a new skill or area of competence.

Types / Different Forms of Strategic Alliances → Dec' 13, June' 13 <u>3 Marks</u> & June' 14 <u>5 Marks</u> → SFM AJMa L

- ***S**upply or purchase agreement.*
- ***F**ranchising.*
- ***M**anagement contract.*
- ***A**greement to provide technical services.*

- ***J**oint Venture.*
- ***Ma**rketing or distribution agreement.*
- ***L**icensing of know-how, technology, design or patent.*

Preparing for the Alliances

The important steps necessary for good alliance creation and management are: June' 13 → <u>10 Marks</u> DD<u>P</u> POC FNM

i. *Developing qualitative and quantitative partner criteria*
ii. *Developing a list of prospective partners*
iii. Partner Selection
- ***a.*** *Compatibility*
- ***b.*** *Capability*
- ***c.*** *Commitment*

iv. *Partner Analysis*
v. *Obtaining internal approvals*
vi. Creating an implementation plan
vii. Final predeal evaluation of all the relevant information
viii. *Negotiating the deal*
ix. *Managing the legal process*

Understanding Cross - Cultural Alliances → Dec'13 <u>5 Marks</u> CA SSC

The key obstacles to the success of cross-organizational relationships, are given below:-

i. ***C**oping with Increased Complexity*
ii. ***A**ligning Differing Orientations*
iii. ***S**hort-Term vs. Long-Term Focus*
iv. ***S**trategy vs. Operations*
*v. **C**ultural Integration*

Implementing and Managing the Alliances → Dec' 12, June' 13 <u>4 Marks</u> & Dec'13 <u>5 Marks</u>

Managing an alliance is relatively new art. Finding the right mix of management ingredients for success can be quite daunting. **Certain key success factors are: <u>MAFA</u>**

i. ***M**utual Trust*
ii. ***A**bility to companies*
iii. ***F**avourable business condition*
iv. ***A**lliance Autonomy*

Successful alliances generally share the following strategic <u>characteristics</u>: (Compare) June' 14 <u>5 Marks</u> DES DES

i. ***D**ynamic management structure*

ii. ***E**ncouragement of calculated initiatives*

iii.***S**ystematic task setting*

iv. ***D**evelopment of multi-manager roles* *v.* ***E****qual distribution of authority*

vi. ***S****treamlined communication channels*

The various <u>Factors</u> potentially conducive to successful alliances are: ***(Compare)***

1. Partnership should be based on an optimum balance of business strength and ownership amongst partners.

2. The partners to alliance should bring in complementary skills, and capabilities to the alliance.

3. Conflict of interests by virtue of market overlap should be minimal and avoided as far as possible.

4. A degree of autonomy, strong leadership, continual commitment and support should be present.

5. Alliance should be capable of building trust and confidence among partners.

6. Sensitive and empathetic approach to be followed while dealing with divergence of management styles and corporate culture.

<u>Chapter 10:</u> <u>Foreign Collaborations and Joint Ventures</u>

Difference between 'Strategic Alliance' and 'Joint Venture' → June' 13 <u>4 Marks</u>

Strategic Alliances → Dec' 12

i. Any arrangement or agreement under which two or more firms cooperate in order to achieve certain commercial objectives is referred to as strategic alliance.

ii. It is not a partnership, and neither company has legal power to control or obligate the other.

iii. it is a commitment by the two companies to provide capabilities or cross servicing in certain identified areas.

iv. Strategic alliances are motivated by considerations such as cost reduction, technology sharing, product development, market access etc.,

Joint Venture

i. It is an association of two or more individuals or business entities who combine and pool their respective expertise, financial resources, skills, experience, and knowledge in the furtherance of a particular project or undertaking.

ii. Joint Ventures are generally created for a single activity or project, and may have a limited time span.

iii. Joint Venture agreements, commonly referred to as a "JV", are typically formed either by individuals, business entities, corporations or partnerships.

iv. The contributions to the joint ventures are either in the form of money [capital], services, or physical asset(s), i.e. equipment or intellectual property [software, patents], etc., or a combination of all.

Modes of Joint Venture → Dec' 12 <u>5 Marks</u>

i. *Equity Joint Venture*
ii. Contractual Joint Venture

<u>Procedure</u>

1. Negotiating a Joint Venture Agreement
2. Purpose of Joint Venture
3. Contributions by Parties
4. Capital Structure
5. Management, Control and Administration
6. Continuity of Joint Venture
7. Issue of Further Capital
8. Operational Issues

Clauses in Joint Venture Agreement → June' 14 10 Marks

1. Technical Services
2. Deputation of technical personnel
3. Training of personnel of the Indian Company
4. Secrecy
5. Consideration
6. Prior Government approval
7. Duration of the agreement
8. Termination of the agreement
9. Force Majeure
10. Arbitration
11. Miscellaneous
12. Law applicable

Kinds of Restrictive Practices

Following are some of the restrictive practices being used in the foreign collaboration and technology transfer agreements.

i. *Restrictions after expiration of Industrial Property Rights or Loss of Secrecy of Technical Know-how*

ii. *Restrictions after Expiration of Arrangements*

iii. *Restrictions on Research and Development*

iv. *Non-Competition Clauses*

v. *Tying Arrangements* → ***June' 13 <u>6 Marks</u>***

vi. *Export Restrictions*

vii. *Direct Restrictions*

viii. *Indirect Restrictions*

ix. *Implied Restrictions*

xi. *Price Fixing*

xii. *Restrictions on Field of Use, Volume or Territory*

xiii. *Grant-back Provisions* → ***June' 13 <u>5 Marks</u>***

xiv. *Exclusive Sales and Representation Arrangements*

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xv. *Use of Quality Controls*

xvi. *Restrictions on Use of Personnel*

xvii. Restrictions on Publicity

Problems Associated with Technology Transfer → June' 14 <u>10 Marks</u>

Some of the problems faced by technology recipient companies are:

i. Identification of the required level of technology. For this purpose, the recipient may have to depend on the information, product bulletin supplied by the technology supplier company.

ii. There is no independent agency to advice on the latest technologies and the manner of obtaining such technologies, except through trade exhibitions, personal contacts etc.

iii. No technology supplier will transfer the technology being used by him. Rather, he may prefer to provide the second level of technology which has already been exploited by him.

iv. After identification, defining technology transfer in the agreement poses certain practical difficulties. Technology cannot be transferred in one lot through transfer of documents. This may have to be done through transfer of designs and drawings, supply of additions and improvements made by the technology supplier, providing the services of its experts and for training of Indian staff at the works of the technology supplier etc. All these aspects are to be properly and adequately covered in the technology transfer agreement.

v. The most difficult task in an imported technology is its indegenisation. While the technology supplier desires the recipient company to achieve the same level of quality to be able to compete in the National and Inter-national markets, the achievement of this goal bristles with practical difficulties.

Product quality depends upon the quality of inputs used and the processes adopted. Quality of raw materials and components available in the technology recipient country not being the same as the host country.

vi. The nature of technology transferred for the purposes of manufacture and sale poses another problem.

A buy-back provision can be a commercially successful proposition provided the product manufactured by the technology receipient company is competitive both in terms of quality and price.

vii. Technological support of an umbrella type is the emerging scenario in these days of inter-nationalisation of business and this provides technology transfer on a continuous basis.

viii. Long term business relationship can be built up provided that the technology supplier has a stake in the technology receipient company. This is now facilitated by the Government's liberalised policy towards foreign investment through automatic route and by FIPB, as part of new projects.

ix. Foreign investment is expected to bring in the various advantages of technology transfer, marketing expertise, modern managerial techniques and new possibilities for promotion of exports.

Indian Joint Ventures Abroad

The investments in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) abroad have been recognised as important avenues for promoting global business by Indian entrepreneurs in terms of foreign exchange earnings like dividend, royalty, technical know-how fee and other entitlements on such investments. They are also a major source of increased exports of plant and machinery and goods from India.

Reserve Bank has issued Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2000 to regulate acquisition and transfer of a foreign security by a person resident in India i.e. investment by Indian entities in overseas joint ventures and wholly owned subsidiaries as also investment by a person resident in India in shares and securities issued outside India.

The RBI has granted general permission to residents for purchase/acquisition of securities and sale of shares/securities so acquired –

a. out of funds held in RFC account; and

b. as bonus shares on existing holding of foreign currency shares.

General permission has also been granted to a person resident in India for purchase of securities out of their foreign currency resources outside India as also for sale of securities so acquired.

<u>Direct Investment Outside India</u>

Automatic Route

RBI has allowed any Indian party to make investment in overseas Joint Venture (JV)/Wholly Owned Subsidiary (WHO), not exceeding 400 per cent of the net worth of the Indian party as on the date of the last audited balance sheet.

The ceiling of 400 per cent of net worth will not be applicable where the investment is made out of balances held in Exchange Earners' Foreign Currency account of the Indian party or out of funds raised through ADRs/GDRs.

Such overseas investments will include contribution to the capital of the overseas JV/WOS, loan granted to the JV/WOS, and 100 per cent of guarantees issued to or on behalf of the JV/WOS. The investments are subject to the following conditions:

1. No guarantee is ‗open ended' i.e. the amount of the guarantee should be specified upfront, and

2. As in the case of corporate guarantees, all guarantees are required to be reported to Reserve Bank. Guarantees issued by banks in India in favour of WOSs/JVs outside India, would be outside this ceiling and would be subject to prudential norms issued by Reserve Bank from time to time.

3. Specific approval of the Reserve Bank will be required for creating charge on immovable property and pledge of shares of the Indian parent/group companies in favour of a non-resident entity.

4. The Indian party should not be on the Reserve Bank's Exporters caution list/list of defaulters to the banking system circulated by the Reserve Bank/ Credit Information Bureau (India) Ltd.

5. All transactions relating to a JV/WOS should be routed through one branch of an authorised dealer bank to be designated by the Indian party.

6. Valuation of the shares of the foreign company shall be as per the recommendations of the Investment Banker if the shares are not listed on any recognized stock exchange; or based on the current market captialisation of the foreign company arrived at on the basis of monthly average price on any stock exchange abroad for the three months preceding the month in which the acquisition is committed

Method of Funding → Dec' 12 <u>5 Marks</u>

Investment in an overseas JV/WOS may be funded out of one or more of the following sources:

i. drawl of foreign exchange from an Authorised Dealer Bank in India;

ii capitalization of exports;

iii. swap of shares;

iv. utilisation of proceeds of External Commercial Borrowings (ECBs)/Foreign Currency Convertible Bonds (FCCBs);

v. in exchange of ADRs/GDRs issued in accordance with the scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, and the guidelines issued there under from time to time by the Central Government;

vi. balances held in EEFC account of the Indian party; and

vii. utilisation of proceeds of foreign currency funds raised through ADR/GDR issues.

In respect of (vi) and (vii) above, the ceiling of 400 per cent of net worth will not apply.

General permission has been granted to residents for purchase/acquisition of securities in the following manner:

(i) out of funds held in RFC account;

(ii) as bonus shares on existing holding of foreign currency shares;

(iii) and when not permanently resident in India, out of their foreign currency resources outside India.

Investments in Financial Services Sector

An Indian party seeking to make investment in an entity engaged in the financial sector should fulfill the following additional conditions:

Provided that Indian party:

a. is registered with the appropriate regulatory authority in India for conducting the financial sector activities;

b. has earned net profit during the preceding three financial years from the financial services activities;

c. has obtained approval for investment in financial sector activities abroad from regulatory authorities concerned in India and abroad; and

d. has fulfilled the prudential norms relating to capital adequacy as prescribed by the regulatory authority concerned in India.

Eligibility Criteria *Trust*

i. The Trust should be registered under the Indian Trust Act, 1882;

ii. *The Trust deed permits the proposed investment overseas;*

iii. The proposed investment should be approved by the trustee/s;

iv. Authorised Dealer Bank is satisfied that the Trust is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;

v. The Trust has been in existence at least for a period of three years;

vi. The Trust has not come under the adverse notice of any Regulatory/ Enforcement agency like the Directorate of Enforcement, CBI etc.

Eligibility Criteria *Society*

- *The Society should be registered under the Societies Registration Act, 1860.*
- *The Memorandum of Association and rules and regulations permit the Society to make the proposed investment which should also be approved by the governing body/council or a managing/executive committee.*
- *The AD Category-I bank is satisfied that the Society is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;*
- *The Society has been in existence at least for a period of three years;*
- *The Society has not come under the adverse notice of any Regulatory/ Enforcement agency like the Directorate of Enforcement, CBI etc.*

Foreign Direct Investment (FDI) is a category of cross border investment made by a resident in one economy (the direct investor) with the objective of establishing an interest in an enterprise (the direct investment enterprise) i.e. resident in an economy other than that of the direct investor.

Procedure for Foreign Direct Investment

Foreign Direct Investment in India is governed by FDI Policy issued by the Government of India and Foreign Exchange Management Act, 1999 and Rules and Regulation made thereunder. Foreign Direct Investments (FDI) can be made under two routes—Automatic Route and Government Route.

RBI has given permission to Indian Companies to accept investment under automatic route without obtaining prior approval from Reserve Bank of India. However, investors will have to file the required document with the concerned Regional Office of the RBI within 30 days after issue of shares to foreign investors.

Under the Government Route

i. The Minister of Finance who is in-charge of FIPB would consider the recommendations of FIPB on proposals with total foreign equity inflow of and **below Rs.1200 crore.**

ii. The recommendations of FIPB on proposals with total foreign equity inflow of **more than Rs.1200 crore** would be placed for consideration of CCEA. The FIPB Secretariat in DEA will process the recommendations of FIPB to obtain the approval of Minister of Finance and CCEA.

iii. The CCEA would also consider the proposals which may be referred to it by the FIPB/

the Minister of Finance (in-charge of FIPB).

Companies may not require fresh prior approval of the Government i.e. Minister in-charge of FIPB/CCEA for bringing in additional foreign investment into the same entity, in the following cases:

i. Cases of entities whose activities had earlier required prior approval of FIPB/CCFI/CCEA and who had, accordingly, earlier obtained prior approval of FIPB/CCFI/CCEA for their initial foreign investment but subsequently such activities/sectors have been placed under automatic route;

ii. Cases of entities whose activities had sectoral caps earlier and who had, accordingly, earlier obtained prior approval of FIPB/CCFI/CCEA for their initial foreign investment but subsequently such caps were removed/increased and the activities placed under the automatic route; provided that such additional investment alongwith the initial/original investment does not exceed the sectoral caps; and

iii. The cases of additional foreign investment into the same entity where prior approval of FIPB/CCFI/CCEA had been obtained earlier for the initial/original foreign investment and prior approval of the Government under the FDI policy is not required for any other reason/purpose.

Foreign Direct Investment Reporting

Reporting of Inflow

An Indian company receiving investment from outside India for issuing shares/ convertible debentures/preference shares under the FDI Scheme, should report the details of the amount of consideration to the Regional Office concerned of the Reserve Bank **not later than 30 days** from the date of receipt in the Advance Reporting Form.

Reporting of issue of shares

After issue of shares (including bonus and shares issued on rights basis and shares issued under ESOP) the Indian company has to file details **not later than 30 days** from the date of issue of shares.

Reporting of transfer of shares

Reporting of transfer of shares between residents and non-residents and vice-versa should be done **within 60 days** from the date of receipt of the amount of consideration.

Reporting of Non-Cash

In case of full conversion of ECB into equity, the company shall report the conversion to the Regional Office concerned of the Reserve Bank as well as to the Department of Statistics and Information Management (DSIM)

Reporting of FCCB/ADR/GDR Issues

The Indian company issuing ADRs/GDRs has to furnish to the Reserve Bank, full details of such issue **within 30 days** from the date of closing of the issue.

Imp → Amendment

FDI is prohibited in the following activities/sectors → LTC GRANT for Real State Business

*i. **L**ottery Business including Government/private lottery, online lotteries, etc.*

*ii. **G**ambling and Betting including casinos, etc.*

Foreign Technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery business and Gambling and Betting activities.

*iii. **T**rading in Transferable Development Rights (TDRs)*

*iv. Business of **C**hit Fund*

*v. **R**ailway Transport (Other than Mass Rapid Transport Systems)*

*vi. **A**tomic Energy*

*vii. **N**idhi company*

*viii. Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of **T**obacco or of **T**obacco substitutes*

*ix. **Real Estate Business** or Construction of Farm Houses*

Current FDI policy

FDI in India → Dec' 12 5 Marks

FDI in Retail → June' 13 5 Marks

Procedure for FDI governed by the FDI policy of GOI → Dec'13 10 Marks

Automatic Entry Route

100% FDI → NICE MPP of CAMAC st.

1. Foreign Investment in NBFC → RUPALI reads SFM, HFC, CFC & MVM

a. **R**ural Credit
b. **U**nder Writing
c. **P**ortfolio Management Services
d. **A**sset Management
e. **L**easing & Finance
f. **I**nvestment Advisory services
g. **S**tock Broking
h. **F**inancial consultancy
i. **M**erchant Banking
j. **H**ousing Finance
k. **F**actoring
l. **C**ustodian Services
m. **C**redit Rating Agencies
n. **F**orex broking
o. **C**redit Card Business
p. **M**oney Changing Business
q. **V**enture Capital
r. **M**icro Credit

2. **I**ndustrial Parks – New and Existing

3. **C**ivil Aviation → Airports

4. **E** Commerce activities
5. **M**ining
a. Mining & Exploration of metal and non – metal ores
b. Coal & lignite mining
6. **P**etroleum & Natural Gas
7. **P**harmaceuticals → Greenfield
8. **C**ash & Carry Wholesale Trading
9. **A**griculture & Animal Husbandry
10.**M**anufacturing
11. **Air Transport Services** → Helicopter Services
12. **C**onstruction Development: Townships, Housing, Built – up infrastructure

49% FDI → C.A.

1. Cable Networks
2. **Air Transport Services** → Scheduled Air Transport Service / Domestic Scheduled passenger Airline

26% FDI

Insurance

Govt Approval Route

100% FDI → MFN SC ST PT

1. **M**ining → Mining & Mineral separation of titanium bearing minerals & ores
2. Publication of **F**acsimile edition of **foreign newspaper.**
3. Up-linking of **Non - 'News & current Affairs'** TV Channels **(Compare)**
4. **S**ingle brand product retail trading
5. **C**ourier Services for carrying packages, parcels and other items.
6. Publishing / printing of **S**cientific and Technical Magazines / speciality journals / periodicals
7. **T**ea Plantation
8. **P**harmaceuticals → Brownfield
9. **T**est Marketing

74% FDI

Establishment & Operation of Setellites

51% FDI

Multi Brand Retail Trading

49% FDI

Private Security Agencies

26% FDI → TINNDe

1. **T**errestrial Broadcasting FM Radio
2. Publication of **I**ndian editions of foreign magazines dealing with news and current affairs (Invt by NRI & FII)
3. Up-linking of '**News & current Affairs'** TV Channels **(Compare)**
4. Publishing of **N**ewspaper and periodicals dealing with news & current affair (Invt by NRI & FII)
5. **De**fence

Part C – International Trade

Chapter 11: International Trade and Treaties

Mercantilism

The first reasonably systematic body of thought devoted to international trade is called "mercantilism" and it emerged in seventeenth and eighteenth century in Europe. For a predominant part of this period, mercantilist writers argued that a key objective of trade should be to promote a favourable balance of trade.

Exports of manufactured goods were considered beneficial, and exports of raw materials were considered harmful; imports of raw materials were viewed as advantageous and imports of manufactured goods were viewed as damaging.

Mercantilists advocated that government policy be directed to arranging the flow of commerce to conform to these beliefs. They sought a highly interventionist agenda, using taxes on trade to manipulate the balance of trade or commodity composition of trade in favor of the home country.

*A **"favourable" balance of trade** is one in which the value of domestic goods exported exceeds the value of foreign goods imported. Trade with a given country or region was judged profitable by the extent to which the value of exports exceeded the value of imports, thereby resulting in a balance of trade surplus and adding precious metals and treasure to the country's stock. Scholars later disputed the degree to which mercantilists confused the accumulation of precious metals with increases in national wealth. But without a doubt, mercantilists tended to view exports favorably* *and imports unfavorably.*

Adam Smith's Wealth of Nations

Smith argued that economic growth depended upon specialization and the division of labour. Specialization helped promote greater productivity—that is, producing more goods from the same resources, which is essential for achieving higher standards of living. According to Smith, the division of labour was limited by the extent of the market; in other words, small markets would not be able to support a great deal of specialization, whereas larger markets could.

Comparative Advantage

The theory of comparative advantage suggests that a country should export goods in the country in which its relative cost advantage, and not the absolute cost advantage, is greatest in comparison to other countries. Suppose that the United States can produce both shirts and automobiles more efficiently than Mexico. But if it can produce shirts twice as efficiently as Mexico and can produce automobiles three times more efficiently than Mexico, the United States has an *absolute* productive advantage over Mexico in both the goods but a *relative* advantage in producing automobiles. In this case, the United States might export automobiles in exchange for imports of shirts—even though it can produce shirts more efficiently than Mexico.

The practical import of the doctrine is that a country may export a good even if a foreign country could produce it more efficiently if that is where its relative advantage lies; similarly, a country may import a good even if it could produce that good more efficiently than the country from which it is importing the good. From Mexico's standpoint, it lacks an absolute productive advantage in either commodity, but has a relative advantage in producing shirts (where its relative disadvantage is least). This trade is beneficial for both the United States and Mexico.

GATT	WTO
The GATT was a set of rules, a multilateral agreement, with **no institutional foundation, only a small associated secretariat** which had its origins in the attempt to establish an International Trade Organization in the 1940s.	The WTO is a **permanent institution** with its own secretariat.
The GATT was applied on a **"provisional basis"** even if, after more than forty seven years, governments chose to treat it as a permanent commitment.	The WTO **commitments are full and permanent.**
The GATT rules applied to **trade in merchandise goods.**	In addition to **goods,** the WTO covers **trade in services** and trade-related aspects of intellectual property.

While GATT was a **multilateral instrument,** by the 1980s many **new agreements had been added of a plurilateral, and therefore selective in nature.**	The agreements which constitute the WTO are **almost all multilateral** and, thus, **involve commitments for the entire membership.**
GATT 1947 was an **institution as well as an agreement.**	WTO has replaced GATT 1947 as an institution, whereas GATT 1994 is GATT 1947 as amended until the Uruguay Round of Negotiations.
The **dispute settlement system was not faster, automatic** and susceptible to blockages.	The WTO **dispute settlement system is faster, more automatic,** and thus much less susceptible to blockages, than the old GATT system. The implementation of WTO dispute findings will also be more easily assured.
GATT has **contracting Parties,** underscoring the fact that officially GATT was a legal text.	The WTO has **members.**

Association of South - East Asian Nations (ASEAN)

The Association of South-East Asian Nations (ASEAN) was established on 8 August, 1967 in Bangkok by the five original Member Countries, namely, Indonesia, Malaysia, Philippines, Singapore, and Thailand. Brunei, Darussalam, Vietnam, Myanmar and Cambodia joined later.

Objectives

The ASEAN Declaration sets out the aims and purposes of the Association as under:

i. To accelerate the economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of South East Asian nations, and

ii. To promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries in the region and adherence to the principles of the United Nations Charter.

Fundamental Principles

i. Mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations;

ii. The right of every State to lead its national existence free from external interference, subversion or coercion;

iii. Non-interference in the internal affairs of one another;

iv. Settlement of differences or disputes by peaceful manner;

v. Renunciation of the threat or use of force; and

vi. Effective cooperation among themselves.

South Asian Association for Regional Cooperation (SAARC)

The South Asian Association for Regional Cooperation (SAARC) comprises Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka. The main goal of the Association is to accelerate the process of economic and social development in member states, through joint action in the agreed areas of cooperation.

Objectives

i. To promote the welfare of the peoples of South Asia and to improve their quality of life;

ii. To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realise their full potentials;

iii. To promote and strengthen collective self-reliance among the countries of South Asia;

iv. To contribute to mutual trust, understanding and appreciation of one another's problems;

v. To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields;

vi. To strengthen cooperation with other developing countries;

vii. To strengthen cooperation among themselves in international forums on matters of common interests; and

viii. To cooperate with international and regional organizations with similar aims and purposes.

Principles

i. Cooperation within the framework of the Association is based on respect for the principles of sovereign equality, territorial integrity, political independence, non-interference in the internal affairs of other states and mutual benefit.

ii. Such cooperation is to complement and not to substitute bilateral or multilateral cooperation.

iii. Such cooperation should be consistent with bilateral and multilateral obligations of the member states.

iv. Decisions at all levels in SAARC are taken on the basis of unanimity.

v. Bilateral and contentious issues are excluded from its deliberations.

South Asian Preferential Trading Area (SAPTA)

The basic principles underlying SAPTA are:

i. Overall reciprocity and mutuality of advantages so as to benefit equitably all Contracting States, taking into account their respective level of economic and industrial development, the pattern of their external trade, and trade and tariff policies and systems;

ii. Negotiation of tariff reform step by step, improved and extended in successive stages through periodic reviews;

iii. Recognition of the special needs of the Least Developed Contracting States and agreement on concrete preferential measures in their favour; and

iv. Inclusion of all products, manufactures and commodities in their raw, semi-processed and processed forms.

North American Free Trade Agreement (NAFTA)

NAFTA contains an ambitious schedule for tariff elimination and reduction of non-tariff barriers, as well as comprehensive provisions on the conduct of business in the free trade area. These include disciplines on the regulation of investment, services, intellectual property, competition and the temporary entry of businesspersons.

Objectives

1. Eliminate barriers to trade in, and facilitate the cross-border movement of goods and services between the territories of the Parties;

2. Promote conditions of fair competition in the free trade area;

3. Increase substantially investment opportunities in the territories of the Parties;

4. Provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;

5. Create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and

6. Establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

European Communities / European Union

The European Union

The European Union (EU) has four main institutions namely, the Council of Ministers, the European Commission, the European Parliament and the European Court of Justice. Other bodies such as the Economic and Social Committee and the Committee of the Regions have particular roles to play in the decision making process.

The Council of Ministers

The Council has following major responsibilities:

1. It is the Union's legislative body; for a wide range of EU issues, it exercises that legislative power in co-decision with the European Parliament;

2. It coordinates the broad economic policies of the Member States;

3. It concludes, on behalf of the EU, international agreements with one or more States or international organisations;

4. It shares budgetary authority with Parliament;

5. It takes the decisions necessary for framing and implementing the common foreign and security policy, on the basis of general guidelines established by the European Council;

6. It coordinates the activities of Member States and adopts measures in the field and *judicial cooperation in criminal matters.*

The European Commission

The Commission is the driving force in the Union's institutional system:

1. It has the right to initiate draft legislation and therefore presents legislative proposals to Parliament and the Council;
2. As the Union's executive body, it is responsible for implementing the European legislation (directives, regulations, decisions), budget and programmes adopted by Parliament and the Council;
3. It acts as guardian of the Treaties and, together with the Court of Justice, ensures that Community law is properly applied;
4. It represents the Union on the international stage and negotiates international agreements, chiefly in the field of trade and cooperation.

The European Parliament

The European Parliament is the democratically elected body whose 626 members (MEPs) are elected every five years. Working in Brussels and Strasbourg, Parliament scrutinises the activities of other EU institutions, passes the annual EU budget, and shapes and decides new legislation jointly with the Council of Ministers. The Parliament has a staff of 3,850.

The Parliament has three essential functions:

1. It shares with the Council the power to legislate, i.e. to adopt European laws (directives, regulations, decisions). Its involvement in the legislative process helps to guarantee the democratic legitimacy of the texts adopted;
2. It shares budgetary authority with the Council, and can therefore influence EU spending. At the end of the procedure, it adopts the budget in its entirety;
3. It exercises democratic supervision over the Commission. It approves the nomination of Commissioners and has the right to censure the Commission. It also exercises political supervision over all the institutions.

The European Court of Justice

Based in Luxembourg, the Court, which has a judge from each member state, adjudicates on all legal issues and disputes involving Community law. The judges, who sit for a period of six years, are assisted by nine advocates-general who give a preliminary ruling on each case before a final judgement. The Court deals with two main types of actions: those referred to it by national courts for rulings of interpretation of Community law; and those started by one of the other institutions (usually the Commission against a member state).

How European Union work?

EU countries set up bodies to run the EU and adopt its legislation. The main ones are:

1. *the European Parliament (representing the people of Europe);*
2. *the Council of the European Union (representing national governments);*
3. *the European Commission (representing the common EU interest).*

<u>Chapter 12</u>: <u>International Trade and Treaties (World Trade Organisation)</u>

Functions of WTO are as under:

i. To analysis world trade

ii. Administering trade agreements

iii. Acting as a forum for trade negotiations

iv. Settling trade disputes

v. Reviewing national trade policy

vi. Assisting developing countries in trade policy issues, through technical assistance and training programmes.

vii. Cooperating with other international organization.

viii. To explain WTO affairs to general public.

ix. Advising Government wishing to become member of WTO.

Principles of the Trading System

The principles in respect of trading system should be

i. Without discrimination:- *a country should not discriminate between its trading partners (they are all, equally, granted "most-favoured-nation" or MFN status); and it should not discriminate between its own and foreign products, services or nationals (they are given "national treatment");*

ii. Freer:- *with barriers coming down through negotiation;*

iii. Predictable:- *foreign companies, investors and governments should be confident that trade barriers (including tariffs, non-tariff barriers and other measures) should not be raised arbitrarily; more and more tariff rates and market- opening commitments are "bound" in the WTO;*

iv. More competitive:- *by discouraging "unfair" practices such as export subsidies and dumping products at below cost to gain market share;*

v. More beneficial for less developed countries:- *by giving them more time to adjust, greater flexibility, and special privileges.*

Trade Without Discrimination

Most – Favoured - Nation (MFN)

In the WTO it actually means non-discrimination — treating virtually everyone equally. What happens under the WTO is this, each member treats all the other members equally as most - favoured trading partners. If a country improves the benefits that it gives to one trading partner, it has to give the same best treatment to all the other WTO members so that they all remain most - favoured.

But there are some exceptions

Treating other people equally under the WTO Agreements, countries cannot normally discriminate between their trading partners. Some exceptions are allowed. For example, countries within a region can set up a free trade agreement that does not apply to goods from outside the group or a country can raise barriers against products from specific countries that are considered to be traded unfairly. And in services, countries are allowed, in limited circumstances, to discriminate. But the agreements only permit these exceptions under strict conditions.

National treatment

Treating foreigners and locals equally. Imported and locally produced goods should be treated equally — at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents.

National treatment only applies once a product; service or item of intellectual property has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment even if locally produced products are not charged an equivalent tax.

Predictability

Sometimes, promising not to raise a trade barrier can be as important as lowering one, because the promise gives businesses a clearer view of their future opportunities. With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition — choice and lower prices. The multilateral trading system is an attempt by governments to make the business environment stable and predictable. In the WTO, when countries agree to open their markets for goods or services, they bind their commitments. For goods, these bindings amount to ceilings on customs tariff rates.

The Agreements

For goods (under GATT)

i. Agriculture

ii. Health regulations for farm products

iii. Textiles and clothing

iv. Product standards (TBT)

v. Investment measures

vi. Anti-dumping measures

vii. Customs valuation methods

viii. Pre shipment inspection

ix. Rules of origin

x. Import licensing

xi. Subsidies and counter-measures

xii. Safeguards

For services (the GATS annexes)

i. Movement of natural persons

ii. Air transport

iii. Financial services

iv. Shipping

v. Telecommunications for sectors such as agriculture and services.

Basic Principles of GATS

i. All services are covered by GATS

ii. Most-favoured-nation treatment applies to all services, except the one-off temporary exemptions

iii. National treatment applies in the areas where commitments are made

iv. Transparency in regulations, inquiry points

v. Regulations have to be objective and reasonable

vi. International payments: normally unrestricted

vii. Individual countries' commitments: negotiated and bound

viii. Progressive liberalization: through further negotiations

The objective of the **Agriculture Agreement** is to reform trade in the sector and to make policies more market-oriented. This would improve predictability and security for importing and exporting countries alike. The new rules and commitments apply to:

i. Market access — Various trade restrictions confronting imports;

ii. Domestic support — Subsidies and other programmes, including those that raise or guarantee farm gate prices and farmers‘ incomes;

iii. Export subsidies and other methods used to make exports artificially competitive. The agreement does allow governments to support their rural economies, but preferably through policies that cause less distortion to trade. It also allows some flexibility in the way commitments are implemented. Developing countries do not have to cut heir subsidies or lower their tariffs as much as developed countries and they are given extra time to complete their obligations.

Distortion

Essentially, trade is distorted if prices are higher or lower than normal, and if quantities produced, bought, and sold are also higher or lower than normal — i.e. than the levels that would usually exist in a competitive market. For example, import carriers and domestic subsidies can raise crop prices on a country‘s internal market. The higher prices can encourage over-production, and if the surplus is to be sold on world markets, where prices are lower, then export subsidies have to be paid.
Governments usually give following reasons for supporting and protecting their farmers, even if this distorts agricultural trade:

i. to make sure that enough food is produced to meet the country‘s needs,

ii. to shield farmers from the effects of the weather and swings in world prices to preserve rural society.

General obligations and disciplines

The agreement covers all internationally-traded services — for example, banking, telecommunications, tourism, professional services, etc. It also defines four ways (or modes) of trading services:

Mode 1 **Cross-Border Supply**	Services supplied from one country to another (e.g. international telephone calls), officially known as ―cross-border supply‖.
Mode 2 **Consumption Abroad**	Consumers or firms making use of a service in another country (e.g. tourism), officially ―consumption abroad‖.
Mode 3	A foreign company setting up subsidiaries or branches to provide services in another

The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)

The TRIPs agreement covers five broad issues:

i. How basic principles of the trading system and other international intellectual property agreements should be applied

ii. How to give adequate protection to intellectual property rights

iii. How countries should enforce those rights adequately in their own territories

iv. How to settle disputes on intellectual property between members of the WTO

v. Special transitional arrangements during the period when the new system is being introduced.

How to protect Intellectual Property

Here the starting point is the obligations of the main international agreements of the World Intellectual Property Organization (WIPO) that already existed before the WTO was created:

i. The Paris Convention for the Protection of Industrial Property (patents, industrial designs, etc)

ii. The Berne Convention for the Protection of Literary and Artistic Works (copyright).

Copyright

The TRIPS agreement ensures that computer programmes will be protected as literary works under the Berne Convention and outlines how databases should be protected. It also expands international copyright rules to cover rental rights. Authors of computer programmes and producers of sound recordings must have the right to prohibit the commercial rental of their works to the public.

The agreement says performers must also have the right to prevent unauthorized recording, reproduction and broadcast of live performances (bootlegging) for no less than 50 years.

Patents

The agreement says patent protection must be available for inventions for at least 20 years. Patent protection must be available for both products and processes, in almost all fields of technology. Governments can refuse to issue a patent for an invention if its commercial exploitation is prohibited for reasons of public order or morality.

The World Intellectual Property Organisation (WIPO)

The World Intellectual Property Organization (WIPO) is an international organization dedicated to helping ensure that the rights of creators and owners of intellectual property are protected worldwide and that inventors and authors are, thus, recognized and rewarded for their ingenuity.

Through its member states and secretariat, WIPO seeks to:

i. Harmonize national intellectual property legislation and procedures.

ii. Provide services for international applications for industrial property rights.

iii. Exchange intellectual property information.

iv. Provide legal and technical assistance to developing and other countries.

v. Facilitate the resolution of private intellectual property disputes.

vi. Marshal information technology as a tool for storing, accessing, and using valuable intellectual property information.

Anti - Dumping, Subsidies

Binding tariffs and applying them equally to all trading partners (MFN) are key to the smooth flow of trade in goods. The WTO agreements uphold the principles, but they also allow exceptions — in some circumstances.

Three issues are important, namely

i. Actions taken against dumping (selling at an unfairly low price);

ii. Subsidies and special ―countervailing‖ duties to offset the subsidies;

iii. Emergency measures to limit imports temporarily, designed to safeguard domestic industries.

Anti - Dumping Actions

If a company exports a product at a price lower than the price it normally charges on its own home market, it is said to be ―dumping‖ the product. The WTO agreement does not pass judgment. Its focus is on how governments can or cannot react to dumping — it disciplines antidumping actions.

Anti - Dumping and Countervailing Duties

Countervailing duties (CVD) together with anti-dumping (AD) measures are often linked. Many countries handle the two issues under a single law, apply similar process to deal with them and give a single authority responsible for investigations.

Like anti-dumping duty, countervailing duty is charged on products from specific countries and therefore it breaks the GATT principles of binding a tariff and treating trading partners equally (MFN). The agreements provide an escape clause, but they both also say that before imposing a duty, the importing country must conduct a detailed investigation that shows injury to domestic industry.

Dumping is an action by a company. With subsidies, it is the government or a government agency that acts, either by paying out subsidies directly or by requiring companies to subsidize certain customers.

But the WTO is an organization of countries and their governments. The WTO does not deal with companies and cannot regulate companies' actions such as dumping.

Therefore the Anti-Dumping Agreement only concerns the actions governments may take against dumping. With subsidies, governments act on both sides: they subsidize and they act against each others‘subsidies. Therefore, the subsidies agreement disciplines both the subsidies and the reactions.

Subsidies and Countervailing Measures

This agreement does two things — it disciplines the use of subsidies, and it regulates the actions countries can take to counter the effects of subsidies. It says a country can use the WTO‘s dispute settlement procedure to seek the withdrawal of the subsidy or the removal of its adverse effects. Or the country can launch its own investigation and ultimately charge extra duty (known as countervailing duty‖) on subsidized imports that are found to be hurting domestic producers.

i. *Prohibited subsidies:* *S*ubsidies that require recipients to meet certain export targets, or to use domestic goods instead of imported goods, are prohibited because they are specifically designed to distort international trade, and are therefore likely to hurt other countries‘ trade. They can be challenged under the WTO dispute settlement procedure where they are handled under an accelerated timetable. If the dispute settlement procedure confirms that the subsidy is prohibited, it must be withdrawn immediately. Otherwise, the complaining country can take counter measures. If domestic producers are hurt by imports of subsidized products, countervailing duty can be imposed.

ii. Actionable subsidies: The complaining country has to show that the subsidy has an adverse effect on its interests. Otherwise the subsidy is permitted. The agreement defines three types of damage they can cause. One country‘s subsidies can hurt a domestic industry in an importing country. They can hurt rival exporters from another country when the two compete in third markets. And domestic subsidies in one country can hurt exporters trying to compete in the subsidizing country‘s domestic market.

iii. Non-actionable subsidies: These can either be non-specific subsidies, or specific subsidies for industrial research and pre-competitive development activity, assistance to disadvantaged regions, or certain types of assistance for adapting existing facilities to new environmental laws or regulations. Non-actionable subsidies cannot be challenged in the WTO‘s dispute settlement procedure, and countervailing duty cannot be imposed on subsidized imports.

Non - Tariff Barriers

Finally, a number of agreements deal with various technical, bureaucratic or legal issues that could involve hindrances to trade. These include:

i. Technical Regulations and Standards

ii. Import Licensing

iii. Rules for the Valuation of Goods at Customs

iv. Pre Shipment Inspection: further checks on imports

v. Investment Measures

Agreement on Pre-shipment Inspection

A further check on imports, pre shipment inspection is the practice of employing specialized private companies (or independent entities‖) to check shipment details —

essentially price, quantity and quality of goods ordered overseas. Used by governments of developing countries, the purpose is to safeguard national financial interests (prevention of capital flight and commercial fraud as well as customs duty evasion, for instance) and to compensate for inadequacies in administrative infrastructures.

The obligations placed on governments, which use pre shipment inspections, include non-discrimination, transparency, protection of confidential business information, avoidance of unreasonable delay, the use of specific guidelines for conducting price verification and the avoidance of conflicts of interest by the inspection agencies.

Rules of Origin

Rules of origin‖ are the criteria used to define where a product was made. They are an essential part of trade rules because a number of policies discriminate between exporting countries: quotas, preferential tariffs, anti-dumping actions, countervailing duty (charged to counter export subsidies), and more. Rules of origin are also used to compile trade statistics, and for made in‖ labels that are attached to products. This first-ever agreement on the subject requires WTO members to ensure that their rules of origin are transparent; that they do not have restricting, distorting or disruptive effects on international trade; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard (in other words, they should state what does confer origin rather than what does not).

Plurilaterals

For the most part, all WTO members subscribe to all WTO agreements. After the Uruguay Round, however, there remained four agreements, originally negotiated in the Tokyo Round, which have a narrower group of signatories and are known as plurilateral agreements‖. All other Tokyo Round agreements became multilateral obligations (i.e. obligations for all WTO members) when the World Trade Organization was established in 1995.

The four"plurilateral agreements" were:

- Trade in civil aircraft
- Government procurement
- Dairy products
- Bovine meat.

The bovine meat and dairy agreements were terminated in 1997.

What are the objectives of trade policy review?

The objectives of trade policy review are given hereunder:

i. *To increase the transparency and understanding of countries' trade policies and practices, through regular monitoring*

ii. *To improve the quality of public and intergovernmental debate on the issues*

iii. *To enable a multilateral assessment of the effects of policies on the world trading system.*

Following Ministerial Conferences have been held so far – SGS DC HG

*I. First Ministerial Conference at **S**ingapore on December 9-13, 1996* → ***June' 12*** ***__5 Marks__*** ***Dec'13*** ***__10 Marks__***

*II. Second Ministerial Conference at **G**eneva on May 18-20,* ***1998*** ***__(Compare)__***

*III. Third Ministerial Conference at **S**eattle on November 30 – December 3, 1999.*

*IV. Fourth Ministerial Conference at **D**oha on November 9-13, 2001* → ***June' 11*** ***__5 Marks__*** ***,*** ***June' 12*** ***__5 Marks__*** ***& Dec' 12*** ***__10 Marks__***

*V. Fifth Ministerial Conference at **C**ancun on September 10-14, 2003.*

*VI. Sixth Ministerial Conference at **H**ong Kong on December 13-18, 2005.* → ***Dec'13*** ***__10 Marks__***

*VII. Seventh Ministerial Conference at **G**eneva from 30 November to 2 December* ***2009*** ***__(Compare)__*** → ***Dec' 12*** ***__10 Marks__***

Singapore Ministerial Declaration on Trade in Information Technology Products

Ministers, representing Members of the WTO and States or separate customs territories in the process of acceding to the WTO, which have agreed in Singapore on the expansion of world trade in information technology products and which account for well over 80 per cent of world trade in these products ("parties") declared that

1. each party's trade regime should evolve in a manner that enhances market access opportunities for information technology products,

2. each party shall bind and eliminate customs duties and other duties and charges of any kind, within the meaning of Article II:1(b) of the General Agreement on Tariffs and Trade 1994, with respect to the following:
a. all products classified (or classifiable) with Harmonized System (1996) (HS) headings listed in Attachment A to the Annex to the Declaration; and

b. all products specified in Attachment B to the Annex to the Declaration, whether or not they are included in Attachment A;

Ministers also invited the Ministers of other Members of the WTO, and States or separate customs territories in the process of acceding to the WTO, to provide similar instructions to their respective officials, so that they may participate in the technical discussions and participate fully in the expansion of world trade in information technology products.

Geneva Ministerial Conference, __1998__

Ministers underlined the crucial importance of the multilateral rule-based trading system, reaffirmed the commitments and assessments made at Singapore, and noted that the work under existing agreements and decisions has resulted in significant new steps forward since the last Ministerial Conference. In particular, the Ministers welcomed the successful conclusion of the negotiations on basic telecommunications and financial services; took note of the implementation of the Information Technology Agreement and renewed their commitment to achieve progressive liberalization of trade in goods and services.

Expressing their concern over the marginalization of least-developed countries and certain small economies, Ministers recognized urgent need to address this issue which has been compounded by the chronic foreign debt problem facing many of them.

Seattle Ministerial Conference, 1999

The Third WTO Ministerial Conference was held in Seattle, Washington, USA between November 30 and December 3, 1999. The meeting was suspended without adopting any declaration. Mike Moore, the then Director General of WTO said that despite the temporary setback in Seattle, objectives remain unchanged

i. To continue to negotiate the progressive liberalisation of international trade;

ii. To put trade to work more effectively for economic development and poverty alleviation;

iii. To confirm the Central role that the rule based trading system plays for member Governments in managing their economic affairs cooperatively; and

iv. To organise the WTO on lines that more truly represent the needs of all members.

Doha Ministerial Conference, 2001

The WTO Doha Ministerial Conference recognising that the majority of WTO members are developing countries, Ministers urged to place their needs and interests at the heart of the Work Programme adopted in Declaration and continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development.

Work Programme

1. Market access for non-agricultural products
2. Relationship between trade and investment
3. Interaction between trade and competition policy
4. Transparency in government procurement
5. Trade facilitation
6. Trade, debt and finance and Trade and transfer of technology
7. Technical cooperation and capacity building
8. Least-developed countries
9. Special and differential treatment
10. Supervision of Negotiations

Ministers agreed that special and differential treatment for developing countries shall be an integral part of all elements of the negotiations and shall be embodied in the schedules of concessions and commitments and as appropriate in the rules and disciplines to be negotiated, so as to be operationally effective and to enable developing countries to effectively take account of their development needs, including food security and rural development.

Ministers agreed to negotiations to reduce or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers, in particular on products of export interest to developing countries. The negotiations to take fully into account the special needs and interests of developing and least-developed country participants, including through less than full reciprocity in reduction commitments, in accordance with the provisions of this declaration.

The negotiations and the other aspects of the Work Programme shall take fully into account the principle of special and differential treatment for developing countries. The Decision on Differential and More Favourable Treatment, Reciprocity and Fuller

Participation of Developing Countries.

Cancun Ministerial Conference, 2003

Reaffirming declarations made and the decisions taken at Doha; the progress made towards carrying out the Work Programme agreed at Doha and recommitting themselves to completing it fully, Ministers renewed their determination to conclude the negotiations launched at Doha successfully by the agreed date of 1 January, 2005. In pursuance of these objectives, Ministers welcomed the decision on implementation of Doha Declaration on the TRIPS Agreement and Public Health.

***Work Programme* → *SC* appoints *CS* *TANI* for *SRS* of Least Developed Countries**

1. **S**ervices negotiations
2. **C**ompetition
3. **C**ommodity Issues
4. **S**&D treatment
5. **T**RIPS non-violation
6. **A**griculture negotiations
7. **N**AMA negotiations
8. **I**nvestment
9. **S**mall Economies
10. **R**ules negotiations
11. **S**ectoral Initiative on Cotton
12. **L**east Developed Countries

Hong Kong Ministerial Conference, 2005

Agricultural Negotiations → Dec'13 – 10 Marks

1. The Ministers reaffirmed their commitment to the mandate on agriculture as set out in Doha Ministerial Declaration and to the framework adopted by the General Council.

2. On domestic support, Ministers noted that there will be three bands for reductions in Final Bound Total AMS and in the overall cut in trade-distorting domestic support, with higher linear cuts in higher bands. In both cases, the Member with the highest level of permitted support will be in the top band, the two Members with the second and third highest levels of support will be in the middle band and all other Members, including all developing country Members, will be in the bottom band. In addition, developed country Members in the lower bands with high relative levels of Final Bound Total AMS will make an additional effort in AMS reduction.

3. Ministers agreed to ensure the parallel elimination of all forms of export subsidies and disciplines on all export measures with equivalent effect to be completed by the end of 2013. Developing country Members will continue to benefit from the provisions of Agreement on Agriculture for five years after the end-date for elimination of all forms of export subsidies.

4. On food aid, Ministers reconfirmed their commitment to maintain an adequate level and to take into account the interests of food aid recipient countries. To this end, a safe box for *bona fide* food aid will be provided to ensure that there is no unintended impediment to dealing with emergency situations.

5. On market access, Ministers adopted four bands for structuring tariff cuts, recognizing the need to agree on the relevant thresholds - including those applicable for developing country Members. Developing country Members will have the flexibility to self-designate an appropriate number of tariff lines as Special Products guided by indicators based on the criteria of food security, livelihood security and rural development. Developing country Members will also have the right to have recourse to a Special Safeguard Mechanism based on import quantity and price triggers, with precise arrangements to be further defined. Special Products and Special Safeguard Mechanism shall be an integral part of the modalities and the outcome of negotiations in agriculture.

6. The Ministers reaffirmed their commitment, to ensure having an explicit decision on cotton within the agriculture negotiations. The commitment included that all forms of export subsidies for cotton will be eliminated by developed countries in 2006. On market access, developed countries will give duty and quota free access for cotton exports from least-developed countries (LDCs) from the commencement of the implementation period.

NAMA negotiations
Services negotiations
TRIPS negotiations

Geneva Ministerial Conference, 2009

The major provisions of Declarations adopted at the Ministerial Conference are given below:

There was strong convergence on the importance of trade and the Doha Round to economic recovery and poverty alleviation in developing countries and priority is being given to Agriculture and NAMA, it is important to advance on other areas on the agenda, including Services, Rules and Trade Facilitation.

LDC-specific issues were underlined as needing particular attention, including Duty-Free Quota-Free market access, cotton, and the LDC Waiver for Services. The particular needs of Small and Vulnerable Economies were also emphasized.

Capacity-building was seen as vital to addressing supply-side constraints. The importance of keeping up the momentum of Aid for Trade, including the Enhanced Integrated Framework, was stressed. There was wide agreement on the need to continue actively mobilizing resources and to keep up monitoring implementation of commitments.

There was broad agreement that the growing number of bilateral and regional trade agreements is an issue for the multilateral trading system. However, the idea of extending to all Members benefits offered in a regional context was questioned by some.

There were suggestions that while the WTO RTA transparency mechanism had worked quite well, there is still room for improvement, through making the mechanism permanent, highlighting better the common elements in different RTAs and introducing an annual review.

Ministers had a wide-ranging discussion on enhancing the institutional effectiveness of the WTO. Its monitoring and analytical work was widely seen to have been of particular value in helping to stave off protectionist responses to the crisis.
High value continues to be placed by members on transparency and inclusiveness in the WTO. Improving the institution's effectiveness should not compromise this principle.

The value of the Dispute Settlement System was underlined by many participants, with some urging that it be made more responsive to the needs and circumstances of poorer and smaller Members.

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Climate change was raised by many. The contribution the WTO can make through removing barriers to trade in environmental goods and services was widely endorsed. There were also warnings against "green protectionism".

Food security and energy security were also highlighted. Other items suggested for consideration included government procurement, competition and investment, though reservations were also expressed.

There was broad agreement that the WTO must remain credible in the face of emerging challenges. There were calls for deepening the WTO's relationship with other relevant international organizations, while respecting the WTO's mandates.

Role of WTO

In pursuit of the goal of sustainable growth and development for the common good, the Ministers envisaged a world where trade flows freely and renewed their commitment to:

i. A fair, equitable and more open rule-based system;

ii. Progressive liberalization and elimination of tariff and non-tariff barriers to trade in goods;

iii. Progressive liberalization of trade in services;

iv. Rejection of all forms of protectionism;

v. Elimination of discriminatory treatment in international trade relations;

vi. Integration of developing and least-developed countries and economies in transition into the multilateral system; and

vii. The maximum possible level of transparency.

<u>Chapter 14:</u> Anti - Dumping, Subsidies and Countervailing Duties (Anti - Dumping Duties)

What is dumping?

Dumping is, in general, a situation of international price discrimination, where the price of a product when sold in the importing country is less than the price of that product in the market of the exporting country. Thus, in the simplest of cases, one identifies dumping simply by comparing prices in two markets. However, the situation is rarely, if ever, that simple, and in most cases it is necessary to undertake a series of complex analytical steps in order to determine the appropriate price in the market of the exporting country (known as the "normal value") and the appropriate price in the market of the importing country (known as the "export price") so as to be able to undertake an appropriate comparison.

What is anti dumping? What is its purpose in International Trade?

Dumping is said to occur when the goods are exported by a country to another country at a price lower than its normal value. This is an unfair trade practice which can have a distortive effect on international trade. Anti dumping is a measure to rectify the situation arising out of the dumping of goods and its trade distortive effect. Thus, the purpose of anti dumping duty is to rectify the trade distortive effect of dumping and re-establish fair trade. The use of anti dumping measure as an instrument of fair competition is *permitted by the WTO. In fact, anti dumping is an instrument for ensuring fair trade and is not a measure of protection per se for the domestic industry. It provides relief to the domestic industry against the injury caused by dumping.*

Determination of dumping

Dumping is calculated on the basis of a "fair comparison" between normal value (the price of the imported product in the "ordinary course of trade" in the country of origin or export) and export price (the price of the product in the country of import).

Definition of industry

The domestic industry is defined as producers of a "like product" that is identical to, or in the absence of such a product, one that has characteristics closely resembling those of, the imported dumped product under consideration.

Determination of injury

The basic requirement for determinations of injury, is that there be an objective examination, based on positive evidence of the volume and price effects of dumped imports and the consequent impact of dumped imports on the domestic industry.

Under the rules, authorities must determine that the margin of dumping from each country is not *de minimis*, that the volume of imports from each country is not negligible, and that a cumulative assessment is appropriate in light of the conditions of competition among the imports and between the imports and the domestic like product.

Initiation and conduct of investigations

Agreement specifies that investigations should generally be initiated based on a written request submitted "by or on behalf of" a domestic industry. This "standing" requirement is supported by numeric limits for determining whether there is **s**ufficient support by domestic producers to conclude that the request is made by or on behalf of the domestic industry, and thereby warrants initiation.

Imposition of provisional measures

Authorities make a preliminary affirmative determination of dumping, injury, and causality before applying provisional measures, and the requirement that no provisional measures may be applied sooner than 60 days after initiation of an investigation.

Normal Value

The normal value is the comparable price at which the goods under complaint are sold, in the ordinary course of trade, in the domestic market of the exporting country or territory. If the normal value cannot be determined by means of domestic sales, the Act provides for the following two alternative methods:

i. Comparable representative export price to an appropriate third country.
ii. Cost of production in the country of origin with reasonable addition for administrative, selling and general costs and for profits.

Export Price

The export price of goods imported into India is the price paid or payable for the goods by the first independent buyer.

<u>Determination of Dumping</u>

Constructed Export Price

If there is no export price or the export price is not reliable because of association or a compensatory arrangement between the exporter and the importer or a third party, the export price may be constructed on the basis of the price at which the imported articles are first resold to an independent buyer. If the articles are not resold as above or not resold in the same condition as imported, their export price may be determined on a reasonable basis.

Margin of Dumping

Margin of dumping refers to the difference between the Normal Value of the like article and the Export Price of the product under consideration.

A Normal Value established on a weighted average basis may be compared to prices of individual export transactions if the Designated Authority finds a pattern of export prices that differ significantly among different purchasers, regions, time period, etc. The margin of dumping is generally expressed as a percentage of the export price.

Factors Affecting Comparison of Normal Value and Export Price

The export price and the normal value of the goods must be compared at the same level of trade, normally at the ex-factory level, for sales made as near as possible in time. Due allowance is made for differences that affect price comparability of a domestic sale and an export sale. These factors, *inter alia*, include physical characteristics, levels of trade, quantities, taxation and conditions and terms of sale.

Like Articles

Anti-dumping action can be taken only when there is an Indian industry which produces “like articles” when compared to the allegedly dumped imported goods. The article produced in India must either be identical to the dumped goods in all respects or in the absence of such an article, another article that has characteristics closely resembling those goods.

Dumping Investigation

A dumping investigation can normally be initiated only upon receipt of a written application by or on behalf of the “Domestic Industry”. In order to constitute a valid application, the following two conditions have to be satisfied:

The domestic producers expressly supporting the application must account for not less than 25% of the total production of the like article by the domestic industry in India; and

The domestic producers expressly supporting the application must account for more than 50% of the total production of the like article by those expressly supporting and those opposing the application.

Domestic Industry

Domestic industry means the Indian producers of like articles as a whole or those producers whose collective output constitutes a major proportion of total Indian production.

De Minimis Margins

Any exporter whose margin of dumping is less than 2% of the export price shall be excluded from the purview of anti-dumping duties even if the existence of dumping, injury as well as the causal link is established. Further, investigations against any country are required to be terminated if the volume of the dumped imports from that particular source are found to be below 3% of the total imports, provided the cumulative imports from all those countries who individually account for less than 3%, are not more than 7%.

Price Undertakings

The Designated Authority may suspend or terminate investigation if the exporter concerned furnished an undertaking to revise his price to remove the dumping or the injurious effect of dumping as the case may be. No undertaking can however be accepted before preliminary determination is made. No price undertaking may, however, be accepted in case it is found that acceptance of such undertaking is impracticable or is unacceptable for any reason.

Application Procedure

Specific authorization of the party providing the information is required, if the Designated Authority is satisfied about its confidentiality. The designated authority in India is Director General of Anti-Dumping – DGAD – in the Ministry of Commerce. Interested parties supplying information on a confidential basis are required to furnish non-confidential summaries thereof or a statement of reasons as to why such summarization is not possible. If the Designated Authority is not satisfied that the confidentiality is warranted or the provider of information is not willing to disclose it in a generalized form, then such information may be disregarded.

An application received by the Designated Authority is dealt with in following manner:

i. Preliminary Screening
ii. *Initiation*
iii. *Access to Information*
iv. *Preliminary Findings*

Investigation Process

The preliminary finding will normally be made within 150 days of the date of initiation.

i. Provisional Duty
ii. *Oral Evidence*
iii. *Final Determination*
iv. *Disclosure of Information*
v. *Time-limit for Investigation Process*
vi. *Termination*
vii. *Retrospective Measures*
viii. Review

Miscellaneous Provisions

i. *Appeal*
ii. *Refund of Duty*

Institutional Arrangement in India for Anti Dumping, Anti - Subsidy and Safeguard Action against Unfair Trade Practices

Anti dumping and anti subsidies & countervailing measures in India are administered by the Directorate General of Anti dumping and Allied Duties (DGAD) functioning in the Dept. of Commerce in the Ministry of Commerce and Industry and the same is *headed by the "Designated Authority". The Designated Authority's function, however, is only to conduct the anti dumping/anti subsidy & countervailing duty investigation and make recommendation to the Government for imposition of antidumping or anti subsidy measures. Such duty is finally imposed/levied by a Notification of the Ministry of Finance. Thus, while the Department of Commerce recommends the Anti-dumping duty, it is the Ministry of Finance, which levies such duty.*

Safeguard measures, on the other hand, are administered by another Authority namely, Director General (Safeguard), which functions under the Dept. of Revenue, Ministry of Finance. The Standing Board of Safeguards (chaired by the Commerce Secretary) considers the recommendations of the DG (Safeguards) and then recommends the impositions of the Safeguard Duty as it deems fit, to the Ministry of Finance which levies the duty.

Chapter 15: Anti - Dumping, Subsidies and Countervailing Duties (Subsidies and Countervailing Duties)

*In common parlance, the term **Subsidy means** money granted by the State or a Public Body to keep the prices of commodities under control. Subsidy may take the form of direct or indirect government grants on production or exportation of goods including any special subsidy on transportation of any product. Subsidy on exports in the exporting country may translate into what is known as Countervailing duty in importing country which is simply a duty on subsidized imports that are found to be hurting domestic producers.*

Subsidies and CVDS in SCM

Article 1 of the Agreement on Subsidies and Countervailing Measures (Agreement on SCM) defines subsidy as involving a financial contribution by a government or any public body within the territory of a member or any form of income or price support which confers a benefit on the recipient.

The financial contribution may involve:

i. Direct transfer of funds in the form of grants, loans or equity infusion or potential direct transfer of funds or liabilities e.g. loan guarantees; or

ii. Forgiveness of government revenue that is otherwise due e.g. fiscal incentives such as tax credits; or

iii. Provision of goods and services, other than general infrastructure or purchase of goods.

The following principles may determine whether a subsidy is specific:

i. Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.

ii. Where the eligibility for grant of subsidy is governed by objective criteria i.e. which are neutral and do not favour certain enterprises over others, which are economic in nature and horizontal in application, such as number of employees or size of enterprises etc and the eligibility is automatic; specificity shall not exist.

iii. If there are reasons to believe that a subsidy programme, though not specific in *accordance with the above principles, in fact is for use by a limited number of certain enterprises or for predominant use of certain enterprises or if the discretion is so used t*hat the benefits flow to certain enterprises, the subsidy shall be specific.

Specificity

Assuming that a measure is a subsidy within the meaning of the SCM Agreement, it nevertheless is not subject to the SCM Agreement unless it has been specifically provided to an enterprise or industry or group of enterprises or industries. The basic principle is that a subsidy that distorts the allocation of resources within an economy should be subject to discipline. Where a subsidy is widely available within an economy, such a distortion in the allocation of resources is presumed not to occur. Thus, only "specific" subsidies are subject to the SCM Agreement disciplines.

There are four types of "specificity" within the meaning of the SCM Agreement:
June' 13 <u>4 Marks</u>

i. Enterprise-specificity: *A government targets a particular company or companies for subsidization.*

ii. Industry-specificity: *A government targets a particular sector or sectors for subsidization.*

iii. Regional specificity*: A government targets producers in specified parts of its territory for subsidization.*

iv. Prohibited subsidies: *A government targets export goods or goods using domestic inputs for subsidization.*

Categories of Subsidies

i. Prohibited Subsidies:- SCM Agreement prohibits two categories of subsidies. The first is subsidies contingent, in law or in fact, whether wholly or as one of several conditions, on export performance ("export subsidies"). A detailed list of export subsidies is annexed to the SCM Agreement. The second is subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods ("local content subsidies"). These two categories of subsidies are prohibited because they are designed to affect trade and thus are most likely to have adverse effects on the interests of other Members.

ii. Actionable Subsidies:- Most subsidies, such as production subsidies, fall in the "actionable" category. Actionable subsidies are not prohibited. However, they are subject to challenge, either through multilateral dispute settlement or through countervailing action, in the event that they cause adverse effects to the interests of another Member. **There are three types of adverse effects:**

First, there is injury to a domestic industry caused by subsidized imports in the territory of the complaining Member. This is the sole basis for countervailing action.

Second, there is serious prejudice. Serious prejudice usually arises as a result of adverse effects (*e.g.,* export displacement) in the market of the subsidizing Member or in a third country market.

Finally, there is nullification or impairment of benefits accruing under the GATT 1994. Nullification or impairment arises most typically where the improved market access presumed to flow from a bound tariff reduction is undercut by subsidization.

iii. Non-Actionable Subsidies:- The **SCM Agreement creates three narrowly**

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defined categories of subsidies, which are non-actionable, i.e., which cannot be challenged multilaterally, or is subject to countervailing action. The three categories are:

i. Basic research and pre-competitive development subsidies. These subsidies cannot exceed a designated proportion of project costs and can only be used for certain expenditures in order to be non-actionable. **Research and development subsidies in the civil aircraft sector do not benefit from non-actionable status.**

ii. Assistance to disadvantaged regions. Regional aids are non-actionable provided that they are not limited to specific enterprises or industries within the region, that they are given pursuant to a general scheme of regional development, and that the region is disadvantaged by comparison with the Member as a whole in terms of objective criteria such as GNP *per capita* and unemployment.

iii. Assistance to adapt existing facilities to new environmental requirements. Such assistance must be on a one-time basis, be limited to 20 per cent of adaptation costs, and be available to all firms, which can adopt the new equipment and processes.

iv. Agricultural Subsidies:- The SCM Agreement does not prohibit export subsidies, which are consistent with the reduction commitments in the Agriculture Agreement, although they remain countervailable. Domestic supports consistent with the reduction commitments in the Agriculture Agreement are not actionable multilaterally, although they also may be subject to countervailing duties. Finally, domestic supports within the "green box" of the Agriculture Agreement are neither actionable multilaterally nor are they subject to countervailing measures.

A determination of a threat of material injury shall be based on facts and not merely on allegation. **In making a determination regarding the existence of a threat of material injury, the investigating authorities should consider, *inter alia*, such factors as:**

i. nature of the subsidy or subsidies in question and the trade effects likely to arise therefrom;

ii. a significant rate of increase of subsidized imports into the domestic market indicating the likelihood of substantially increased importation;

iii. sufficient freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased subsidized exports to the importing Member's market, taking into account the availability of other export markets to absorb any additional exports;

iv. whether imports are entering at prices that will have a significant depressing or suppressing effect on domestic prices, and would likely increase demand for further imports; and

v. inventories of the product being investigated.

Substantive Rules

A Member may not impose a countervailing measure unless it determines that there are subsidized imports, injury to a domestic industry and a causal link between the subsidized imports and the injury.

One significant development of the new SCM Agreement in this area is the explicit authorization of cumulation of the effects of subsidized imports from more than one

Member where specified criteria are fulfilled.

Duration and Review of Countervailing Duties

A countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization, which is causing injury. The authorities shall review the need for the continued imposition of the duty, where warranted, on their own initiative or, provided that a reasonable period of time has elapsed since the imposition of the definitive countervailing duty, upon request by any interested party, which submits positive information substantiating the need for a review. Interested parties shall have the right to request the authorities to examine whether the continued imposition of the duty is necessary to offset subsidization, whether the injury would be likely to continue or recur if the duty were removed or varied, or both. If, as a result of the review under this paragraph, the authorities determine that the countervailing duty is no longer warranted, it shall be terminated immediately.

A public notice of the initiation of an investigation shall contain, or otherwise make available through a separate report, adequate information on the following:

i. the name of the exporting country or countries and the product involved;

ii. the date of initiation of the investigation;

iii. a description of the subsidy practice or practices to be investigated;

iv. a summary of the factors on which the allegation of injury is based;

v. the address to which representations by interested Members and interested parties should be directed; and

vi. the time-limits allowed to interested Members and interested parties for making their views known.

Such a Public Notice or report shall, due regard being paid to the requirement for the protection of confidential information, contain in particular:

i. the names of the suppliers or, when this is impracticable, the supplying countries involved;

ii. a description of the product which is sufficient for customs purposes;

iii. the amount of subsidy established and the basis on which the existence of a subsidy has been determined;

iv. considerations relevant to the injury determination as set out in Article 15;

v. the main reasons leading to the determination.

Subsidies in Agreement on Agriculture

The right to use export subsidies is now limited to four situations:

i. export subsidies subject to product-specific reduction commitments within the limits specified in the schedule of the WTO Member concerned;

ii. any excess of budgetary outlays for export subsidies or subsidized export volume over the limits specified in the schedule.

iii. export subsidies consistent with the special and differential treatment provision for developing country Members; and

iv. export subsidies other than those subject to reduction commitments provided that they are in conformity with the anti-circumvention disciplines of the Agreement on Agriculture.

In all other cases, the use of export subsidies for agricultural products is prohibited.

Export Subsidy practices which are prevalent in the agricultural sector, notably:

i. Direct export subsidies contingent on export performance;

ii. Sales of non-commercial stocks of agricultural products for export at prices lower than comparable prices for such goods on the domestic market;

iii. Producer financed subsidies such as government programmes which require a levy on all production which is then used to subsidise the export of a certain portion of that production;

iv. Cost reduction measures such as subsidies to reduce the cost of marketing goods for export: this can include upgrading and handling costs and the costs of international freight;

v. Internal transport subsidies applying to exports only, such as those designed to bring exportable produce to one central point for shipping;

vi. Subsidies on incorporated products, i.e. subsidies on agricultural products such as wheat contingent on their incorporation in export products such as biscuits; and

vii. All such export subsidies are subject to reduction commitments, expressed in terms of both the volume of subsidized exports and the budgetary outlays for these subsidies.

Anti-circumvention

The anti-circumvention provisions include a definition of food aid in order that transactions claimed to be food aid, but not meeting the criteria in the Agreement, cannot be used to undermine commitments. Food aid that meets the specified criteria is not considered to be subsidised export hence is not limited by the Agreement on Agriculture.

Amber Box

For agriculture, all subsidies and other domestic support measures considered to distort production and trade (with some exceptions) fall into the amber box. The total value of these measures must be reduced.

Green Box

In order to qualify for the green box, a subsidy must not distort trade, or at most cause minimal distortion. They have to be government-funded (not by charging consumers higher prices) and must not involve price support. They tend to be programmes that are not directed at particular products, and include direct income supports for farmers that are not related to production. Green box subsidies are therefore allowed without limits, provided they comply with relevant criteria.

Some countries say they would like to review the domestic subsidies listed in the green box because they believe that some of these, in certain circumstances, could have an influence on production or prices. Some others, including some major players advocating general agricultural trade liberalization, have said that the green box should not be changed because it is already satisfactory.

Blue Box

The blue box is an exemption from the general rule that all subsidies linked to production must be reduced or kept within defined minimal (*de minimis*) levels. It covers payments directly linked to acreage or animal numbers, but under schemes, which also limit production, by imposing production quotas or requiring farmers to set aside part of their land. Countries using these subsidies say they distort trade less than alternative amber box subsidies.

At the moment, the blue box is a permanent provision of the agreement. Some countries want it scrapped because the payments are only partly decoupled from production. Others say it is an important tool for supporting and reforming agriculture, and for achieving certain non-trade objectives.

'Non - Trade' Concerns and **'Multifunctionality'**

The Agriculture Agreement includes provisions for important non - trade concerns such as food security, the environment, structural adjustment (which can include rural development) and so on.

Many exporting developing countries say multifunctionality is a form of special and differential treatment for rich countries. Several even argue that any economic activity — industry, services and so on — is equally multifunctional, and therefore if the WTO is to address this issue, it has to do so in all areas of the negotiations, not only agriculture. Some others say agriculture is special.

Insignificant Margin of Dumping or Amount of Subsidy

De minimis is defined in the Agreements as a subsidy of less than 1% of the export price, or a margin of dumping of less than 2% of the export price. In countervail investigations, for imports from developing country Members; *de minimis* is defined to be less than 2%, expressed as a percentage of the export price. Members will likely consider whether existing thresholds are appropriate both from a development and generic perspective.

Negligible volume level:

The ADA requires that investigations be terminated with respect to goods of a country when the dumped imports from that country represent less than 3% of the total imports of the like products in the importing country, unless countries, whose dumped imports that individually account for less than 3%, collectively account for more than 7% of the total imports of like products in the importing country. The ASCM requires that an investigation be terminated if the volume of subsidized imports or the injury is negligible.

Procedural Rules

A few of the more important innovations in the WTO SCM Agreement are identified below:

i. *Standing*
ii. *Preliminary investigation*
iii. *Undertakings*
iv. *Sunset*
v. *Judicial review*

Chapter 16: **Settlement of Disputes under WTO**

Rule - Based System

The WTO dispute settlement mechanism is a rule-oriented system where recommendations and rulings must aim at achieving a satisfactory settlement in accordance with the rights and obligations of the Members under the WTO Agreement. As a result, all solutions to matters formally raised under the consultation and dispute settlement provisions of the WTO agreements must not nullify and impair benefits accruing to any Member under those agreements.

Who Can Participate?

Only WTO Members can take part in dispute settlement under the WTO. WTO dispute settlement is not open to WTO observers, other international organizations, non-governmental organizations, local governments or private persons.

The WTO dispute settlement mechanism provides for three main ways of resolving disputes:

i. bilateral consultations;
ii. good offices, conciliation and mediation; and
iii. adjudication, including arbitration.

Complaint by more than one Member

More than one Member may request the establishment of a panel related to the same matter, in which case a single panel may be established to examine these complaints

Panelist selection process

Selection of panelists is made with a view to ensuring the independence of panel members, a sufficiently diverse background and a wide spectrum of experience. Citizens of WTO Members whose governments are parties to the dispute or third parties as defined in the DSU may not serve on a panel concerned with that dispute, unless the parties to the dispute agree otherwise. Panelists may be selected from an indicative list maintained by the Secretariat. WTO Members may periodically suggest names to be added to the list upon approval by the DSB. When a dispute is between a developing country Member and a developed country Member, the developing country Member may request that the panel include at least one panelist from a developing country Member.

Where more than one Member requests the establishment of a panel related to the same matter, the DSB should, whenever feasible, establish a single panel to examine these complaints taking into account the rights of all Members concerned.

The agreement describes in some detail how the panels are to work. The main stages are:

Before the first hearing: each side in the dispute presents its case in writing to the panel. Parties exchange written submissions, and the panel convenes at least two hearings where parties are entitled to present their views orally and the panel may ask clarifications and questions. Panels have the right to ask written questions. Third parties with a substantial interest in the matter before the panel, and who have notified their interest to the DSB, are to be granted an opportunity to be heard by the panel and make written submissions

Experts: if one side raises scientific or other technical matters, the panel may consult experts or appoint an expert review group to prepare an advisory report.

First draft: the panel submits the descriptive (factual and argument) sections of its report to the two sides, giving them two weeks to comment. This report does not include findings and conclusions.

Interim report: The panel then submits an interim report, including its findings and conclusions, to the two sides, giving them one week to ask for a review. Parties are again invited to make comments and may request an interim review meeting of the panel to further argue specific points raised with respect to the interim report.

Review: The period of review must not exceed two weeks. During that time, the panel may hold additional meetings with the two sides.

Final report: A final report is submitted to the two sides and three weeks later, it is circulated to all WTO members.

Panel reports have two main parts: the "descriptive part" and the "findings". The descriptive part is usually composed of an introduction, the factual aspects, the claims of the parties (also sometimes called "Findings Requested"), the submission(s) of the third party or parties, the main arguments of the parties and the specific arguments raised during the interim review stage. The "findings" part is composed of the findings as such and the conclusions and recommendations.

The report becomes a ruling: The report becomes the Dispute Settlement Body's ruling or recommendation within 60 days unless a consensus rejects it. Both sides can appeal the report (and in some cases both sides do).

Appeals

Either side can appeal a panel's ruling. Sometimes both sides do so. Appeals have to be based on points of law such as legal interpretation - they cannot reexamine existing evidence or examine new evidence.

The appeal can uphold, modify or reverse the panel's legal findings and conclusions. Normally appeals should not last more than 60 days, with an absolute maximum of 90 days.

The Dispute Settlement Body has to accept or reject the appeals report within 30 days and rejection is only possible by consensus.

How long to settle a dispute?

These approximate periods for each stage of a dispute settlement procedure are target figures - the agreement is flexible. In addition, the countries can settle their dispute themselves at any stage. Totals are also approximate.

45 days 6 months 3 weeks 60 days

Total = 1 year

60-90 days 30 days

60 days

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Consultations, mediation, etc.

Panel set up and panelists appointment

Final panel

report to parties

Final panel report to WTO members

Dispute Settlement Body adopts appeals report

(if no appeal)

(without appeal)

Appeal report

Dispute Settlement Body adopts appeals report

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