



# UNIT - 3

## THE ECONOMICS AND LOGISTICS OF GLOBAL BUSINESS

### Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Describe the complexities of doing business in a global context
- ✓ Discuss trends in global business

## Unit 3

# The Economics and Logistics of Global Business

### Managing Multiple Currencies

#### Domestic vs. Transactional Currencies

Complexities with managing currencies and cash are expected as you undertake business on a global scale. While the majority of trade transactions are currently done in U.S. dollars, the Euro is also gaining acceptance in international trade opportunities.

Whatever you choose to use, importers and exporters are busy converting from **domestic currencies** (such as a regional form of the dollar) to **transaction currencies** (such as U.S. dollars and Euros). The continued stability and reliability of U.S. dollars and Euros is expected, as is their availability. As China's economy continues to grow, their currency is also likely to have an increased presence in global business.

#### The Currency Conversion Process

If, for example, you are an importer purchasing in U.S. dollars, you need to purchase enough U.S. currency to pay for your upcoming transaction. Then an exporter, upon receiving payment, might also have to sell U.S. dollars in order to acquire domestic currency. Although some companies will create accounts in currencies they use most, this is not widely available just yet. Risk occurs (along with the opportunity to continue to make money) during these transactions, especially where money prices are volatile.

#### Test your knowledge

What is your domestic currency?

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Will you prefer to use U.S. dollars, Euros, or something else in global business?

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Will your decisions make purchasing easier or more complicated for your customers?

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## Mitigating Your Risks

Without cash flow, your business cannot thrive. If you have big receivables, and large sums of money tied up in contracts or potential deals, you can quickly run into trouble in global business where it's more difficult to secure financing than in your domestic market.

**Small businesses** tend to manage on their cash flow, where they are doing regular transactions (cash) and the revenue must be coming in to the business (flow) within short and predictable timeframes.

**Larger businesses** tend to look for financing, so larger corporations and global enterprises will be very active in mitigating their risk. Small businesses have less complicated operations and thrive when their cash flow is healthy. In entering the global marketplace, small businesses may forge joint ventures or partnerships which can quickly move them into the larger business arena, so they might be on a steeper learning curve when it comes to their financial risks.

**Trade financiers** have access to products, services, and other specialists to help their clients secure adequate cash flow and working capital throughout a trade transaction. Check with other global businesses in your industry or your domestic areas to get references for experienced, well-respected referrals.

## Basics of Trade Finance

### Introduction

When commercial terms have been met by an exporter or seller, there are instruments and techniques available that ensure the secure and prompt payment of currency due. Trade finance is necessary given the numerous jurisdictions involved in transactions, the fluctuations in currency values, and the impacts of different methods of payment (including checks and requests from purchasers to extend terms or credit).

One helpful advance in payments is the extension of electronic transfer and its increased acceptance. Instead of waiting for several weeks for a check to clear after its deposit in the bank, an electronic payment can be sent and received almost instantly. This is one result of advances in communication and trade systems being adopted around the globe, and in particular through trade financiers.

## Financing

There are many opportunities to provide financing for parties in a trade transaction, and are available from sellers, buyers, and banks. These are key in the resources available through what are called **trade finance instruments**.

A financing request can come at any stage of a trade transaction, from production events that take place well before shipping, to settlement costs post-delivery, and with many places in between. The ability of an exporter (or seller at any stage along the supply chain, for that matter) to provide attractive financial arrangements can be a powerful competitive advantage, and help to retain customers in addition to attracting new ones. It's also an excellent example of added value.

One additional complexity to financing includes purchases by credit cards. While they allow for almost instant access to cash, each credit card company has its own rules about managing sales, returns, and shipping. In addition to trade banks, there are large companies (including GE Capital and UPS Capital) who are very active in financing international trade arrangements.

## Mitigating Risk

Any entrepreneur understands that there is risk involved in managing a business. There are also benefits in working with trade financiers who have developed a range of mitigation processes and procedures that help secure the conduct of parties involved in international commerce.

**Risk mitigation** requires that trade financiers and the banks also minimize their own risks. There are many types of risks that can be mitigated, including financial crisis in either country, civil unrest, or commercial risks (including insolvency or breach of contract by the buyer or seller).

For banks, this is done through credit insurance. There are also several tools that trade financiers use, which are described below.

**Secure conduct** is critical in carrying out business, and is also important in reducing the overall risk of individual transactions. For example, documentary letters of credit are very effective at shifting the obligation to pay from an importer (which could be a small business) to an established international bank. Doing so reduces the risk in the transaction for small business in an example of credit enhancement.

Other examples of credit enhancement include payment undertakings that are transitioned from a local bank situated in a highly volatile market to a large global financial institution positioned in a secure market.

## Export Credit Agencies

Financial institutions can also provide specific risk mitigation solutions in partnership with government entities that are commonly called ECA's, or **export credit agencies**.

ECA's can manage international trade risks such as:

- ✓ **Commercial risk:** Associated directly with the trading partner, including insolvency.
- ✓ **Bank risk:** A type of commercial risk specific to the bank acting on behalf of a trading business.
- ✓ **Sovereign or country risk:** Related to the country connected to the foreign bank or trading partner. These include risks of a political nature or events like an economic crisis.
- ✓ **Currency or foreign exchange risk:** Related to volatility of currencies, including how they can make a transaction more or less profitable for the importer or exporter.

## Documentation

Recordkeeping and transaction tracking is facilitated through technology and includes ready access to accurate and highly detailed information. This can include tracking shipping information step-by-step, reporting the specifics of financial details, and tax tracking.

As the speed at which we can conduct international business increases, the demand for real-time information increases. Complete visibility offers opportunities for importers and exporters to offer support, solutions, and even amended financing options to their clients.

## Getting Paid

The most common forms of payment in the global market are open account, documentary collections, and documentary letters of credit. We will discuss each of these forms in this session, followed by a few additional methods that you may also encounter.

## Open Account

In cases where trade is taking place between stable and secure markets and between trusted partners, an open account transfer takes place from the buyer to seller. It can be completed at the time of order or at the time of delivery.

## **Documentary Collections**

When a bank acts as an intermediary, they are facilitating payment to the exporter once shipping documents have been presented to the intermediary bank. These documents can include paperwork confirming transfer of title of the cargo, as well as confirmation of shipment. They can also include a bank draft.

In comparison to an open account, the documentary collections process does offer some risk protection to both parties. In this method, the importer knows that the exporter doesn't receive any money without the exporter having presented documents to a third party, and the exporter knows that once shipping is underway, payment will be issued.

Documentary collections are commonly transacted, and although they do not eliminate all risk, having the bank as an intermediary does offer some assurances to exporters and importers alike.

## **Documentary Letters of Credit**

These are considered the most secure instrument in trade-finance as they protect the interests of both buyers and sellers. The banks serve as facilitator for payment once they are presented with the shipping documents, but they are held to a higher standard and must verify that terms and conditions have been fully executed. This process includes a detailed review of the documents presented, with particular attention to verifying descriptions of the goods, inspection certificates, transportation certificates, customs clearances, and then releasing payment.

## **Confirmed Documentary Letters of Credit**

If an exporter remains uncomfortable with a transaction, and is concerned about receiving full payment even with a documentary letter of credit, they can enlist the services of a bank in their country that they trust to confirm the documentary letter of credit. Instead of relying on the documentary letters of credit that might be processed by an unknown or untrusted bank to the exporter, their trusted bank will also review the documentation, allowing the exporter to receive funds once the confirmation is issued.

## **Sight or Term Payments**

Whether documentary letters of credit are used or not, purchases can be set up as sight or term payments. With payment at sight, the payment takes place as soon as documents are presented. Term payments mean that, as agreed between buyer and seller, payments are future dated. Terms may be set up as payable 60 days following sight, based on the shipment date, or based on operating days after the goods are placed on a ship.

## Trade Finance

When an exporter needs capital, or an importer needs to extend payment terms to allow for time to sell the newly acquired goods, trade finance can be arranged. The provisions of financing extend beyond importers and exporters. As older style trade-finance offerings evolve, the opportunities to secure financing can be arranged at several different junctions. Some providers of trade finance, including related technology, are indicating that over the course of a trade deal, there are anywhere from five to over 40 opportunities where financing can be provided.

In large scale operations, financing extends well beyond buyers and sellers. Large transactions can sometimes challenge the financial resources of banks and even governments, particularly in what are termed as emerging markets. Trade finance can facilitate lending money to banks over extended periods.

## Trade Finance and Technology

Accessibility of goods and services through international trade is evolving rapidly, pushed along by the needs of financiers, banks, importers, exporters, and people involved in all aspects of business, and helped enormously by the Internet.

Sophisticated trading resources, including **trade-financing solutions and trading platforms**, have been deployed globally and are used in the most sophisticated markets. This includes software developed by companies like Oracle with their global trade management (GTM) software (<http://www.oracle.com/>) as well as GTNexus (<http://www.gtnexus.com/>). We do not recommend or endorse these companies, but rather mention them as a basis for further investigation.

## Test your knowledge

**Lots of people incorrectly think that a letter of credit is equivalent to cash. Discuss the differences between the two.**

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**Discuss the features of a documentary letter of credit and the process involved in obtaining payment under a letter of credit.**

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**Discuss the ways in which payment facilitation with a documentary letter of credit is different than a cash transaction.**

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**The Logistics of Global Business**

Staff Training Solutions

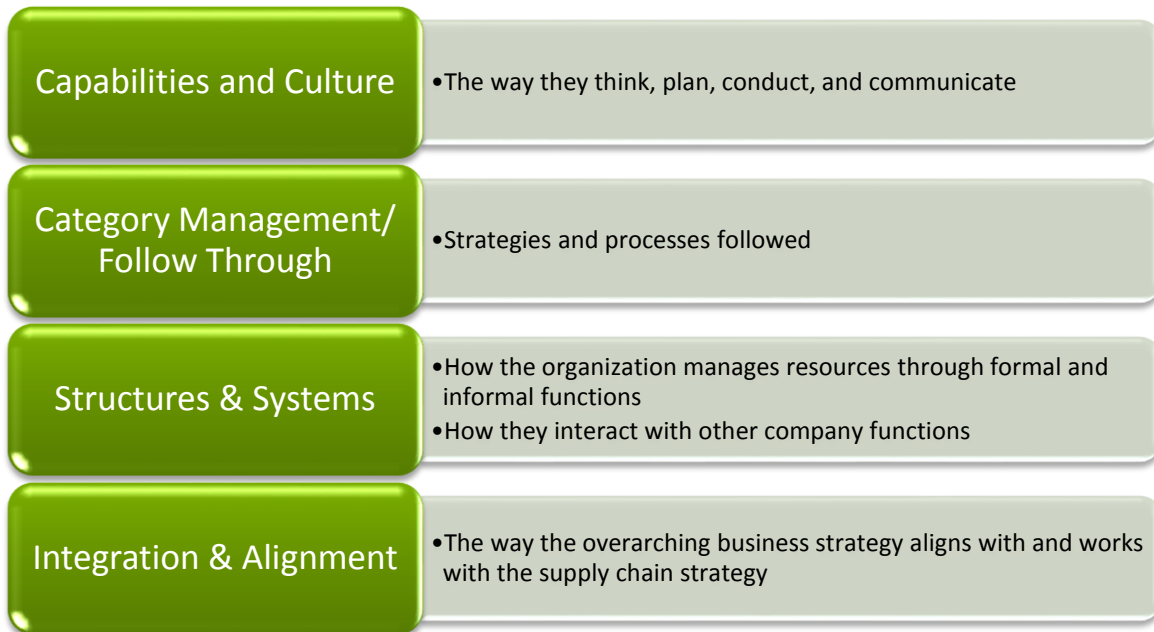
**Introduction to Supply Chain Management**

**Supply Chain Management**

Supply chain management has evolved at a rapid rate in order to provide expertise needed to run and lead profitable companies. You might hear other terms for supply chain management, including materials management.

Effective supply chain management processes deliver huge value to companies, regardless of the industry. Leaders in supply chain management can find large savings in operations functions, and lowering the costs of products sold.

In terms of global purchasing excellence, there are four areas identified that cause leading supply chain managers to get the best results.



Of all the areas that supply chain management has influence over, it is the ways that specialists think, plan, conduct, and communicate that have the greatest financial return for the company.

### **The Need for Excellence in Supply Chain Management**

Procurement that excels in each of the four dimensions creates notable value for the company, but there is more to do. As the business environment continues to change, there is also instability in economies, world politics, and resource allocation to consider, all of which lead to a demand for closer management.

Consider that just 40 years ago there was not an easy way to make an overseas purchase, expedite payment, and fulfill an order within the same hour. However, in most regions today, it's expected and quite normal.

The impact of the last financial crisis was hugely amplified because of the amazing pace of integration occurring around the globe. The other side of that financial crisis has been the emergence of much bigger influences on business and economics demonstrated by countries such as China and India.

### **The Supply Chain**

The supply chain, in simple form, involves coordination and support for all the functions involved from getting raw materials to delivering them to the end user. The supply chain looks like this for products:



### The Supply Management Leader

One way for the organization to really benefit from its supply chain is to assign a chief supply officer at the same level of senior marketing, engineering, and operations leaders. This will facilitate the communication needed for success, and demonstrates senior management’s commitment to the process.

A supply management leader has four key responsibilities:

- ✓ **Leadership** in identifying new opportunities in the marketplace and bringing them to the attention of the organization for follow through.
- ✓ **Identifying** opportunities to reduce costs through adequate outsourcing.
- ✓ **Managing** systems and relationships with proper interpretive mechanisms in place.
- ✓ **Creating** strategies, systems, and options, including packages of value for the company that may encompass multiple departments and teams. This includes seeking and creating revenue opportunities.

### Test your knowledge

Identify the areas in your organization that demonstrate efficient supply chain management practices.

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Identify up to three areas in your organization that do not demonstrate efficient supply chain management practices.

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How could you improve supply chain management practices in these areas?

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### Identifying and Meeting Documentation Requirements

#### Required Documentation

There are several pieces of documentation that can be part of any transaction, and each country will issue requirements as to what's needed to import or export in their particular area. Documents must be completed with great attention to details. A spelling mistake or missing details can completely halt a transaction. These can result in shipping delays, payment delays, and even having shipments rejected (especially at the border or as they are processed through customs).

Common documents include:

- ✓ **Invoice:** Clearly identifies the supplier and customer, price of transaction, and applicable taxes and duties.
- ✓ **Letter of Credit:** Outlines banking information and terms required to release/receive payment.
- ✓ **Bill of Lading:** Identifies the supplier, contents, delivery address, and transportation arrangements.
- ✓ **Certificate of Origin:** Clearly identifies the country of origin so that the shipment meets compliance and trade regulations.
- ✓ **Dangerous Goods Certificate:** Ensures that dangerous goods are authorized and properly identified for shipment.



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## Security and Safety

### Threats To and From Shipments

Security of shipments is and probably always will be an issue, depending on where you are trading, until international cooperation and governments are able to stop acts of treachery in their entirety. In addition to keeping shipments safe from physical damage, they must also be kept safe from theft, insurrection, riots, and other catastrophes.

**Threats to shipments** have been lessened with the development of containerization, where products are locked and secured at the suppliers' location. Steel containers, which can only be opened at customs and under supervision, are less likely to be vulnerable. An entire specialty within supply chain management has evolved to make sure that goods arrive safely at their destinations.

**Threats from shipments** include the potential for using transportation networks as a facilitation method for illegal activities, including the movement of illegal drugs, weapons, the slave trade, smuggling, and more. Advances in technology have allowed for more sophisticated scrutiny on incoming containers through things like electronic scanning and improved inspections. The C-TPAT (Customs-Trade Partnership Against Terrorism) is one program established in the United States where foreign suppliers can voluntarily participate in enhanced security measures.

Although voluntary security programs may demand additional paperwork, cost, or time, they can benefit the importer/exporter relationship when the results include a slightly faster shipment and efficient clearance at customs.

### Transporting Dangerous Goods

Another very relevant threat from shipments comes when hazardous goods are transported. There are special regulations and considerations in order to minimize the risks associated with products like toxic chemicals, corrosive goods, and flammable materials. These materials need extra precautions and special handling to ensure they are not released into the environment or putting people in harm's way. Some of these special handling methods may include extra insulation and double linings in rail cars or ships' cargo holds.

### Seeking Out Specialists

Compared to the regional, local way that most of our businesses start, global business requires that we get accustomed to longer distances, more regulation, and multiple border crossings as components are gathered, manufactured, and shipped as a complete unit. For these reasons, in addition to expertise in navigating the supply chain, logistics specialists have skill in freight issues and working with customs brokers and transporters. They can be a big part in keeping transportation costs down while increasing the efficiencies of the system.

## **Negotiating Market Entry**

### **Introduction**

A global business owner or manager is continually negotiating and starting trade deals and contracts. A cooperative atmosphere and strong relationships between potential partners is essential, and relies on interested partners approaching negotiations as a mutual benefit. Managers should be aware of the process, which normally occurs in four stages with two influential elements.

### **The Negotiation Process**

#### **Stage 1: Preparation**

Negotiators must understand the company's goals and vision. Negotiation strategy and each party's ability to be flexible will depend on whether both parties are considering a one-time arrangement, or whether this is the first step in a long partnership.

#### **Stage 2: Opening**

Each side states its opening position, which will include each party's desired terms and outcomes.

#### **Stage 3: Bargaining**

Bargaining strategies and approaches vary culturally. Some people are not fond of hard bargaining and will try to avoid conflict or call off negotiations if a dispute arises. Others see softer bargaining tactics as a sign of weakness and will take advantage of the other party.

#### **Stage 4: Agreement**

Negotiations at this stage are a success. The signing of the contracts signals the end of negotiations and the commencement of a working relationship.

### **Influencing Elements**

Two important elements in international business negotiations include **cultural elements** and **political-legal elements**.

**Negotiating styles**, just like all areas of communication, differ between cultures. Asian cultures concern themselves with protecting the other party from being embarrassed, and traditionally aim to meet the other party mid-way. Western negotiators often aim to win a negotiation, without concern for causing embarrassment to the other party.

**Political-legal elements** are peppered throughout many negotiations, and negotiators may hold political motives. A rigid position might be adopted to demonstrate that negotiators are representing the company's or government's interests. In addition, interest groups, unions, and associations might lobby government officials or governments to make sure that any agreements being negotiated also offer benefit to themselves.



### **Further Reading:**