

IPR Regulatory Policy, Tariff and Entry Modes of MNC

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The paper links the optimal IPR rate and tariff rate chosen by a less developed country (LDC) government to the mode of entry of a multinational corporation (MNC) in it. The MNC can either export or fragment the production structure by shifting assembly-line units to the LDC where the cost of assembling the product is lower. Under fragmentation, a commercial pirate can copy the product with a positive probability and the MNC incurs anti-copying investment to deter piracy. The results show that under different combinations of copying, the probability of the pirate and cost incentive of fragmentation of different equilibrium configurations can be chosen.

I Introduction

The present study discusses the issues related to optimal entry mode of a multinational company (MNC) to a less developed country (LDC) where the MNC can enter the LDC market either by exporting a finished good or by fragmenting the production structure and shifting the assembly-line units to the LDC market. A useful concept of product fragmentation was proposed by Hummels, *et. al.* (2001) where due to existence of various stages in production a country contributed only in a single stage of production in which it has specialization. Athukarola (2006) has defined production fragmentation as ‘the cross-border dispersion of component production/assembly within vertically integrated production processes.’ The paper also showed that “fragmentation trade” has generally grown faster than total world trade in manufacturing, the degree of dependence of East Asia on this new form of international specialization is proportionately larger than that of North America and Europe. One reason of the foreign firms to enter the East Asian countries like India via fragmentation mode of entry is to take advantage of the vast and cheap labour force of these economies¹ where labour-intensive activities like assembling of semi-finished goods can be outsourced. This can, however, cause diffusion of technology in upshot of which a commercial pirate² can enter the market to compete with the original product if Intellectual Property Right (IPR) protection is not strong. Thus, under fragmentation mode of entry, even if a firm benefits from low labour cost or any other type of comparative advantage by entering an LDC market, it can face a threat of piracy or illegal copying of the original good that erodes away his profit.

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