



Brief Resume'

PROF. ABDUL HAMID MOHAMED is currently the Deputy Director of the Institute of Small & Medium Enterprises (ISME), Universiti Malaysia Kelantan (UMK), A company director, consultant and a former Assoc. Professor at the International Business School (IBS), Universiti Teknologi Malaysia, Kuala Lumpur his areas of expertise includes marketing management, integrated marketing communications and presentation skills and communications and international trade & business. Currently he is a part-time lecturer in Marketing Management, in the MBA programme of IBS-UTM. He is also frequently invited to lecture in promotions management, marketing management, global marketing, services marketing and international trade & business at the Graduate Business Schools of other public and private universities.

He has five years administrative government agency experience, 16 years academic and 17 years corporate, management, entrepreneurial, local as well as international business experience and exposure. He was a Senior Lecturer at the Faculty of Communications and Media Studies, Universiti Teknologi Mara (UiTM) prior to joining TV3. He was instrumental and a pioneer in the setting up of TV3, Malaysia's first commercial TV station and its marketing department in 1983 where he had served 10 years in various senior management posts. He was also a pioneer board member of MEGA TV, Malaysia's first cable TV. He also ventured into outdoor advertising, TV production and event management businesses.

He is also a PR, marketing consultant and business adviser to a few entrepreneurs and small medium industries and occasionally conducts strategic marketing and strategic planning workshops. He was an Associate Consultant with Perception Management Sdn Bhd, Consultant/Trainer of Final Spot Sdn Bhd, and currently sits as Director of Contract Advertising Sdn Bhd, JJ Vision Sd Bhd and The Otomotif College.

A recipient of the Outstanding Alumnus Award 2008 conferred by the Lyceum of the Philippines University, Manila, Rep. of the Philippines

A widely traveled person, he has delivered several talks and papers on marketing, advertising and media communications locally and abroad. He is truly experienced in public as well as corporate management. He has written several MBA level strategic marketing cases.

He holds an M.A. Communications (Advertising/Marketing) from Michigan State University, USA (1980) and a B. Sc Journalism from the University of Lyceum, Philippines (1975).

January 2010

**UNISEL GRADUATE SCHOOL OF MANAGEMENT
UNIVERSITI INDUSTRI SELANGOR**

Course: International Trade and Business - PMM 5363
Program: MBA
Lecturer: Prof. Abdul Hamid Mohamed
Semester: July – Nov 2010
Recommended Text: Hill, Charles W.L., *Global Business Today*, 6th. Edition,
McGraw Hill-Irwin, 2009

Course description:

This course discusses trade and business in the global context and the challenges faced in ever changing economic, political and technological environment; the development of multinational enterprise and foreign direct investment and their effects on host country's economy; roles played by international agencies such as GATT, WTO, World Bank and IMF in facilitating international trade, economic groupings and integrations (NAFTA, EU, ASEAN) and the costs and benefits of these integrative arrangements. The course also includes various approaches and strategies in expanding businesses into international markets.

Objectives of the course:

- Students will be able to understand the global business environment and their impacts on the operations of their organizations
- Understand the practice of international trade for export and imports
- To be able to analyze international business opportunities

Learning outcomes:

On successful completion of the course, students would be able to:

- To read the global business environment and assist them to make decisions with regards to business operations in organizations.
- To understand the process and practice of international business – export and import, INCOTERMS.
- To recognize and respond to politico-social issues as well as past, present, and future scenarios, problems and procedures of international business activities in foreign markets, including the emphasis on comparative differences in markets

Graduate students will submit a term paper; 12-18 pages, typed, single-spaced

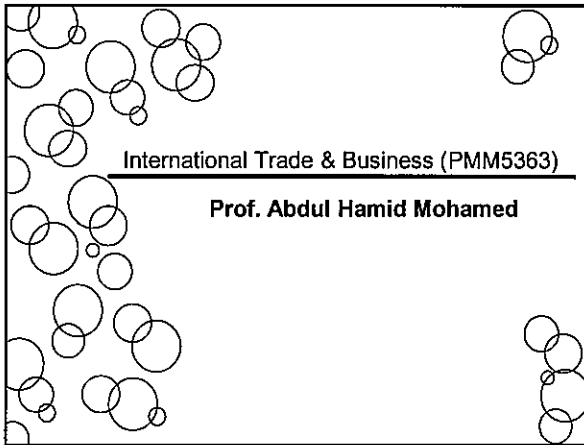
Tentative Class Schedule:

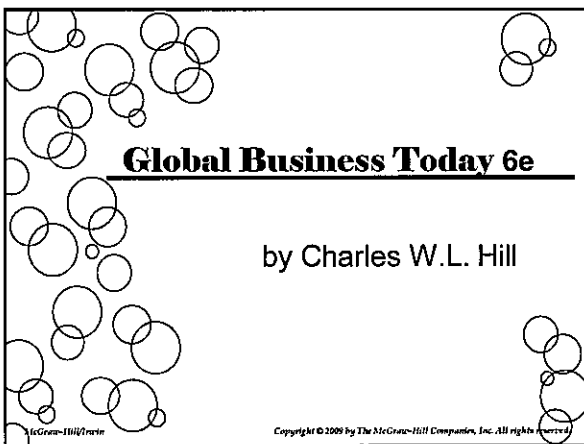
Week	Date	Time	Topics	Chapter
1	09 Jan	9.00am-5.00pm	Overview of globalization Drivers of globalization Issues of globalization	1
			Differences in Political Economy Economic system Differences in culture Culture, society and Nation State Religious and ethical system Culture and international business	2 3
2	23 Jan	9.00am-5.00pm	Ethical issues in international business – human rights, corruption, environmental issues, pollutions and implications to international business	4
			International Trade theory Free trade, Absolute advantage, Comparative Advantage, Heckscher-Olin Theory, Leontief Paradox, National Competitive Advantage, Porter's Diamond	5
3	13 Feb	9.00am-5.00pm	Political Economy and International Trade, Instruments of Trade policy – tariff, subsidies, import quotas, barriers to international trade, Government intervention, Development of	6

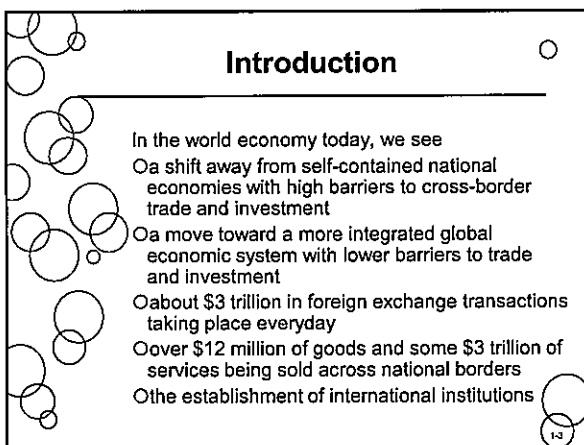
			World Trading System -GATT, WTO Foreign Direct Investment, needs for FDI, benefits and cost of FDI	7
			Regional Economic Integration EU, NAFTA, ASEAN, MERCOSUR Case for and against regional economic integration Foreign Exchange Market Economic Theories of Foreign Exchange Rate	8 9
4	27 Feb	9.00am- 5.00pm	International Monetary System, IMF and its roles, World Bank, Gold Standard, Collapse of Fixed Exchange Rate System, Floating Exchange Rates, Pegged Exchange Rates	10
			Strategy for International business: -global expansion, global standardization strategy, Localization strategy, strategic alliance	11
5	20 Mar	9.00am- 5.00pm	Entering Foreign Markets: Basic entry decisions Entry modes – exporting, licensing, franchising, joint ventures, wholly owned subsidiaries	12
			Exporting, Importing and Counter trade: Export and import activities, INCOTERM, strategy, export and import financing, export assistance, export and import banks, Countertrade: meaning – types, pros and cons	13

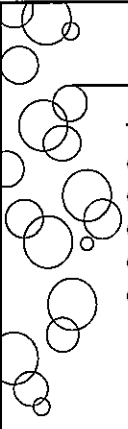
6	03 Apr	9.00am– 5.00pm	Global Production Outsourcing and logistics Make or buy decisions, Reasons for outsourcing? Advantages Strategic alliance with suppliers Managing global supply chain	14
			Global Marketing and R & D Market segmentation Product attributes – cultural differences, economic development Distribution Strategy Communication strategy, promotion strategy, Pricing strategy	15
			Global Human Resource Management: Staffing policy – expatriate managers Training for expatriate managers Compensations International Labor Relations	16
			Project Presentations	
7	07 May	9.00am– 12.00	FINAL EXAMINATION	

ASSESSMENT	
Participation	10%
Mid-Term Exam or Assignment	20
Project Paper & Presentation	30
Final Exam	40
Total	100








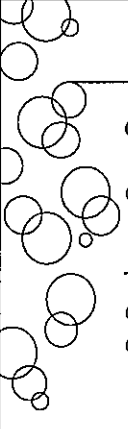


Introduction

The effects of this trend can be seen

- in the cars people drive
- in the food people eat
- in the jobs where people work
- in the clothes people wear
- in many other ways






What Is Globalization?

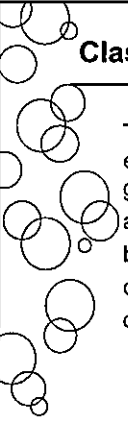
Question: What is globalization?

- Globalization refers to the trend towards a more integrated global economic system

Two key facets of globalization are:

- the globalization of markets
- the globalization of production







Classroom Performance System

The trend away from distinct national economic units and toward one huge global market is known as

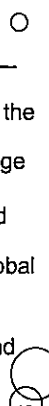
- Internationalization
- Economic integration
- Globalization
- Privatization






The Globalization of Markets

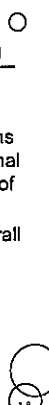
- The globalization of markets refers to the merging of historically distinct and separate national markets into one huge global marketplace
- In many markets today, the tastes and preferences of consumers in different nations are converging upon some global norm
- Examples of this trend include Coca Cola, Starbucks, Sony PlayStation, and McDonald's hamburgers






The Globalization of Production

- The globalization of production refers to the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of factors of production (labor energy, land, and capital)
- The goal for companies is to lower their overall cost structure or improve the quality or functionality of their product and gain competitive advantage
- Examples of companies doing this include Boeing and Vizio

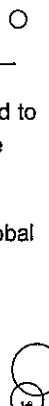


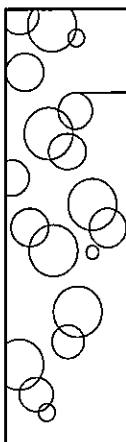


The Emergence of Global Institutions

Several global institutions have emerged to

- help manage, regulate, and police the global market place
- promote the establishment of multinational treaties to govern the global business system




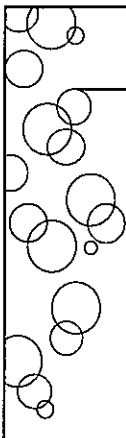


The Emergence of Global Institutions

Notable global institutions include


- the World Trade Organization (WTO) which is responsible for policing the world trading system and ensuring that nations adhere to the rules established in WTO treaties
 - In 2008, 151 nations accounting for 97% of world trade were members of the WTO
- the International Monetary Fund (IMF) which maintains order in the international monetary system

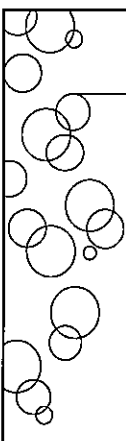




The Emergence of Global Institutions

- the World Bank which promotes economic development
- the United Nations (UN) which maintains international peace and security, develops friendly relations among nations, cooperates in solving international problems and promotes respect for human rights, and is a center for harmonizing the actions of nations




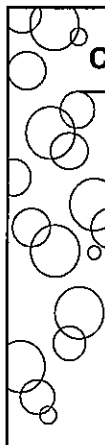


Drivers of Globalization

Question: What is driving the move toward greater globalization?

- There are two macro factors underlying the trend toward greater globalization
 1. declining trade and investment barriers
 2. technological change







Classroom Performance System

Coca-Cola, Sony Playstations, and McDonald's hamburgers are all examples of


- a) American products
- b) Global products
- c) Industrial products
- d) National products






Declining Trade and Investment Barriers


- International trade occurs when a firm exports goods or services to consumers in another country
- Foreign direct investment (FDI) occurs when a firm invests resources in business activities outside its home country
- During the 1920s and 1930s, many nations erected barriers to international trade and FDI to protect domestic industries from foreign competition





Declining Trade and Investment Barriers

- After WWII, advanced Western countries began removing trade and investment barriers
- Under GATT (the forerunner of the WTO), over 100 nations negotiated further decreases in tariffs and made significant progress on a number of non-tariff issues
- Under the WTO, a mechanism now exists for dispute resolution and the enforcement of trade laws, and there is a push to cut tariffs on industrial goods, services, and agricultural products



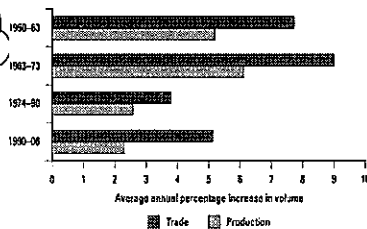
Declining Trade and Investment Barriers

- Lower trade barriers enable companies to view the world as a single market and establish production activities in optimal locations around the globe
- This has led to an acceleration in the volume of world trade and investment since the early 1980s

1-16

Declining Trade and Investment Barriers

Growth in World Merchandise Trade and Production, 1950 - 2006




1-17

The Role of Technological Change


- The lowering of trade barriers made globalization of markets and production a theoretical possibility, technological change made it a tangible reality
- Since World War II, there have been major advances in communication, information processing, and transportation

1-18



The Role of Technological Change


- The development of the microprocessor has lowered the cost of global communication and therefore the cost of coordinating and controlling a global organization
- Web-based transactions have grown from virtually zero in 1994 to \$250 billion in 2007 in the U.S. alone, and Internet usage is up from fewer than 1 million users in 1990 to 1.3 billion users in 2007
- Commercial jet aircraft and super freighters and the introduction of containerization have greatly simplified trans-shipment from one mode of transport to another



The Role of Technological Change

Question: What are the implications of technological change for the globalization of production?

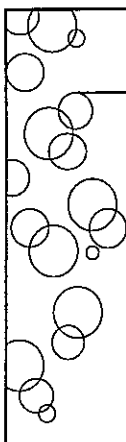
- Lower transportation costs make a geographically dispersed production system more economical and allow firms to better respond to international customer demands



The Role of Technological Change

Question: What are the implications of technological change for the globalization of markets?

- Low cost communications networks have helped create electronic global marketplaces
- Low cost transportation have enabled firms to create global markets, and have facilitated the movement of people from country to country promoting a convergence of consumer tastes and preferences



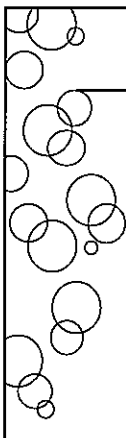
The Changing Demographics of the Global Economy ○

In the 1960s:

- the U.S. dominated the world economy and the world trade picture
- the U.S. dominated world FDI
- U.S. multinationals dominated the international business scene
- about half the world-- the centrally planned economies of the communist world-- was off limits to Western international business

Today, much of this has changed.

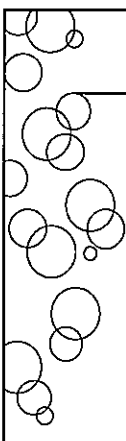
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The Changing World Output and World Trade Picture ○

- In the early 1960s, the U.S. was the world's dominant industrial power accounting for about 40.3% of world manufacturing output
- By 2007, the U.S. accounted for only 20.7%
- Other developed nations experienced a similar decline

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The Changing World Output and World Trade Picture ○

- Rapid economic growth is now being experienced by countries such as China, Thailand, and Malaysia
- Further relative decline in the U.S. share of world output and world exports seems likely
- Forecasts predict a rapid rise in the share of world output accounted for by developing nations such as China, India, Indonesia, Thailand, and South Korea, and a decline in the share by industrialized countries such as Britain, Japan, and the United States
- So companies may find both new markets and new competitors in the developing regions of the world

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The Changing World Output and World Trade Picture

The Changing Demographics of World GDP and Trade

Country	Share of World Output, 1963	Share of World GDP, 2007	Share of World Exports, 2006
United States	40.3%	20.7	9.8%
Germany	9.7	4.2	8.9
France	6.9	3.1	4.3
Italy	3.4	2.7	3.6
United Kingdom	6.5	3.2	4.6
Canada	3.0	1.9	3.1
Japan	5.5	6.5	5.0
China	NA	11.5	7.2

1-25

The Changing Foreign Direct Investment Picture

- The share of world output generated by developing countries has been steadily increasing since the 1960s
- The stock of foreign direct investment (total cumulative value of foreign investments) generated by rich industrial countries has been on a steady decline
- There has been a sustained growth in cross-border flows of foreign direct investment
- The largest recipient of FDI has been China

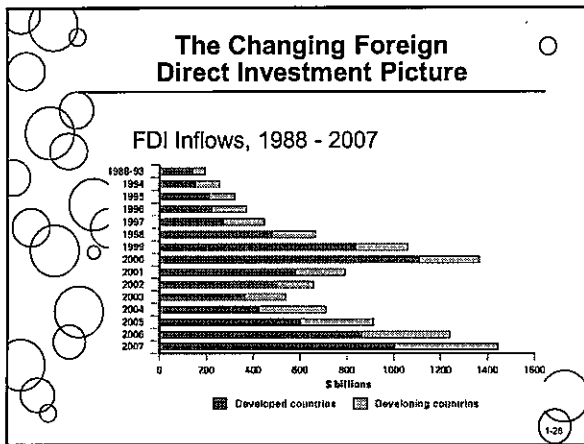
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The Changing Foreign Direct Investment Picture

Percentage Share of Total FDI Stock, 1980 - 2006

Country/Region	1980 (%)	1990 (%)	2006 (%)
United States	40	25	15
United Kingdom	15	10	5
Japan	10	5	2
Germany	10	5	2
France	10	5	2
Netherlands	10	5	2
Developing Economies	5	10	15

1-27




The Changing Nature of the Multinational Enterprise

- A multinational enterprise is any business that has productive activities in two or more countries
- Since the 1960s,
 - there has been a rise in non-U.S. multinationals
 - there has been a rise in mini-multinationals



The Changing Nature of the Multinational Enterprise


- The globalization of the world economy has resulted in a decline in the dominance of U.S. firms in the global marketplace
 - In 1973, 48.5 % of the world's 260 largest MNEs were U.S. firms
 - By 2006, just 24 of the world's 100 largest non-financial MNEs were from the U.S., 13 were from France, 12 from Germany, 12 were from Britain, and 9 were from Japan, and 7 of the world's largest 100 MNEs were from developing economies



The Changing Nature of the Multinational Enterprise



- While most international trade and investment is conducted by large MNEs, many small and medium-size firms are expanding internationally
- The Internet has made it easier for many smaller companies to build international sales

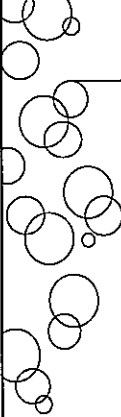





The Changing World Order



- Today, many markets that had been closed to Western firms are open
- The collapse of communism in Eastern Europe has created a host of export and investment opportunities
- Economic development in China has created huge opportunities despite continued Communist control
- Free market reforms and democracy in Latin America have created opportunities for new markets and new sources of materials and production



The Global Economy of the Twenty-First Century

- A more integrated global economy presents new opportunities for firms, but it can also result in political and economic disruptions that may throw plans into disarray

The Globalization Debate

Question: Is the shift toward a more integrated and interdependent global economy a good thing?

- Many experts believe that globalization is promoting greater prosperity in the global economy, more jobs, and lower prices for goods and services
- Others feel that globalization is not beneficial

1-34

Antiglobalization Protests

Question: What are the concerns of critics of globalization?

- Anti-globalization protesters now turn up at almost every major meeting of a global institution
- Protesters fear that globalization is forever changing the world in a negative way

1-35

Globalization, Jobs, and Income

- Critics of globalization worry that jobs in advanced economies are being lost to low-wage nations
- Supporters of globalization disagree, claiming that the benefits of free trade outweigh its costs
 - While some jobs may be lost, the economy as a whole is better off
- Supporters argue that free trade will result in countries specializing in the production of those goods and services that they can produce most efficiently, while importing goods and services that they cannot produce as efficiently, and that in doing so, all countries will gain

1-38

Globalization, Labor Policies, and the Environment

- Critics of globalization argue that that free trade encourages firms from advanced nations to move manufacturing facilities offshore to less developed countries with lax environmental and labor regulations
- Supporters of free trade point out that tougher environmental regulation and stricter labor standards go hand in hand with economic progress and that as countries get richer as a result of globalization, they raise their environmental and labor standards
- Free trade does not lead to more pollution and labor exploitation, it leads to less

Globalization and National Sovereignty

- Critics of globalization worry that economic power is shifting away from national governments and toward supranational organizations such as the WTO, the European Union (EU), and the UN
- Supporters of globalization argue that the power of these organizations is limited to what nation-states collectively agree to grant
 - The organizations must be able to persuade members states to follow certain actions
 - Without the support of members, the organizations have no power

Globalization and the World's Poor

- Critics of globalization argue that the gap between rich and poor has gotten wider and that the benefits of globalization have not been shared equally
- Supporters of free trade suggest that the actions of governments have made limited economic improvement in many countries
 - Many of the world's poorest nations are under totalitarian regimes, suffer from endemic corruption, have few property rights, are involved in war, and are burdened by high debt

Managing in the Global Marketplace

Question: What does the shift toward a global economy mean for managers within an international business?

- Managing an international business (any firm that engages in international trade or investment) differs from managing a domestic business in four key ways

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Managing in the Global Marketplace

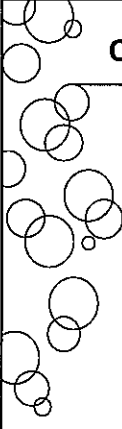
1. Countries differences require companies to vary their practices country by country
2. Managers face a greater and more complex range of problems
3. International companies must work within the limits imposed by governmental intervention and the global trading system
4. International transactions require converting funds and being susceptible to exchange rate changes

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Critical Discussion Question

1. Describe the shifts in the world economy over the last 30 years. What are the implications of these shifts for international businesses based in Great Britain? North America? Hong Kong?

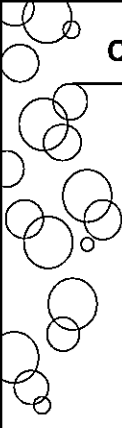
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Critical Discussion Question

2. "The study of international business is fine if you are going to work in a large multinational enterprise, but it has no relevance for individuals who are going to work in smaller firms." Evaluate this statement.

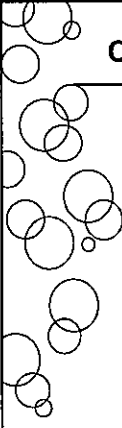
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Critical Discussion Question

3. How have changes in technology contributed to the globalization of markets and of production? Would the globalization of production and markets have been possible without these technological changes?

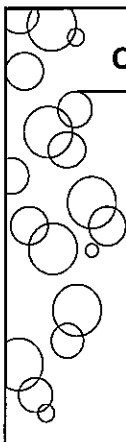
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Critical Discussion Question


4. "Ultimately, the study of international business is no different from the study of domestic business. Thus, there is no point in having a separate course on international business." Evaluate this statement.

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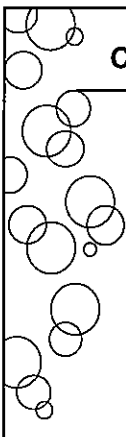


Critical Discussion Question

5. How might the Internet and the associated World Wide Web affect international business activity and the globalization of the world economy?




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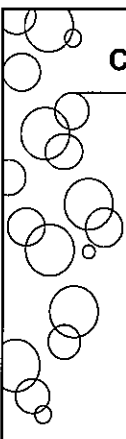
Critical Discussion Question

6. If current trends continue, China may emerge as the world's largest economy by 2020. Discuss the possible implications of such a development for:

- ☐ The world trading system.
- ☐ The world monetary system.
- ☐ The business strategy of today's European and U.S. based global corporations.
- ☐ Global commodity prices.




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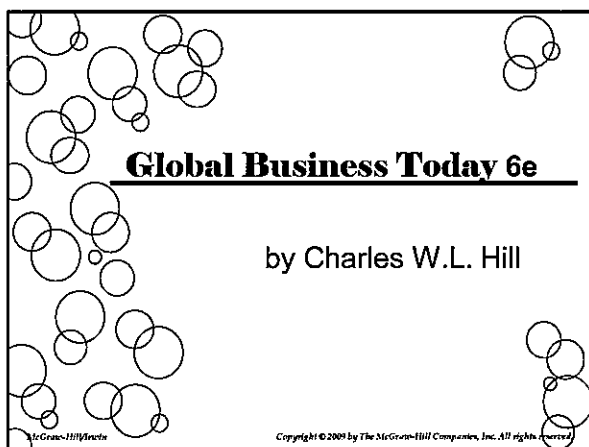
Critical Discussion Question

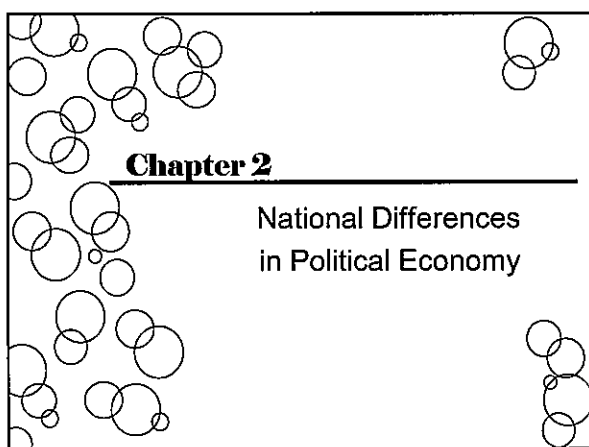
7. Read the Country Focus "Outsourcing American Healthcare," then answer the following questions:

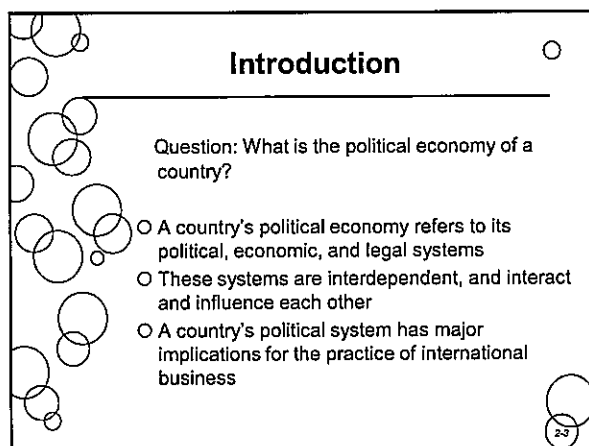
- a) A decade ago the idea that medical procedures might move offshore was unthinkable. Today it is a reality. What trends have facilitated this process?
- b) Is the globalization of health care good or bad for patients?
- c) Is the globalization of health care good or bad for the American economy?
- d) Who might benefit from the globalization of health care? Who might lose?
- e) Do you think that the U.S. government should restrict the outsourcing of medical work to developing nations? What if physicians in those countries are certified by U.S. medical institutions?



1-48







Political Systems

- A political system is the system of government in a nation
- Political systems can be assessed
 - In terms of the degree to which they emphasize collectivism as opposed to individualism
 - In terms of the degree to which they are democratic or totalitarian

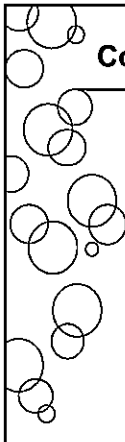
Collectivism and Individualism

- Collectivism refers to a system that stresses the primacy of collective goals over individual goals
 - Collectivism can be traced to the ancient Greek philosopher Plato
 - Today, socialists support collectivism
- When collectivism is emphasized, the needs of the society as whole are generally viewed as being more important than individual freedoms

Collectivism and Individualism


Socialism

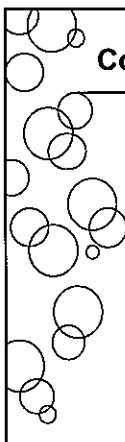
- Modern socialists trace their roots to Karl Marx who advocated state ownership of the basic means of production, distribution, and exchange
- The state then manages the enterprises for the benefit of society as whole



Collectivism and Individualism

- In the early 20th century, socialism split into communists and social democrats
 - Communists generally believed that collectivism could only be achieved through revolution and totalitarian dictatorship, while social democrats worked to achieve the same goals by democratic means
- Many state-owned enterprises failed to succeed, and today, many nations are implementing privatization programs whereby state-owned enterprises to private investors




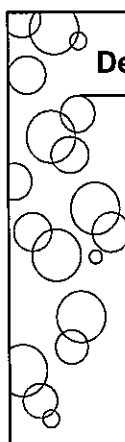


Collectivism and Individualism

Individualism

- Individualism is a political philosophy that suggests individuals should have freedom over their economic and political pursuits
 - It can be traced to Aristotle who argued that individual diversity and private ownership are desirable
- Individualism stresses
 - Individual freedom and self-expression
 - Letting people pursue their own self-interests to achieve the best overall good for society
 - Democratic systems and free markets







Democracy and Totalitarianism

Question: What is the difference between a democracy and totalitarianism?


- Democracy is a political system in which government is by the people, exercised either directly or through elected representatives
- Totalitarianism is a form of government in which one person or political party exercises absolute control over all spheres of human life, and opposing political parties are prohibited






Democracy and Totalitarianism


- Generally, democracy and individualism go hand in hand
- The most common form of democracy today is representative democracy, where elected representatives vote on behalf of constituents






Democracy and Totalitarianism

- Collectivism and totalitarianism generally go hand in hand
- In most totalitarian regimes
 - there is widespread political repression
 - there are no free and fair elections
 - media is censored
 - basic civil liberties are denied
 - challenges to the regime are prohibited




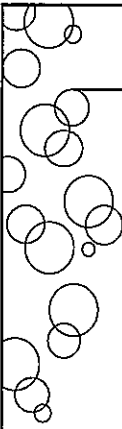


Democracy and Totalitarianism

There are four major forms of totalitarianism today:

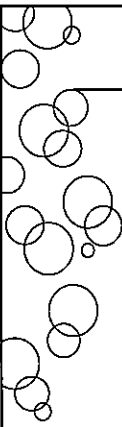
1. communist totalitarianism: advocates achieving socialism through totalitarian dictatorship
2. theocratic totalitarianism: political power is monopolized by a party, group, or individual that governs according to religious principles
3. tribal totalitarianism: a political party that represents the interests of a particular tribe monopolizes power
4. right wing totalitarianism: individual economic freedom is allowed but individual political freedom is restricted in the belief that it could lead to communism





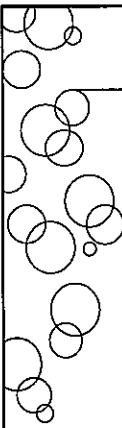
Economic Systems

- Political ideology and economic systems are connected
- There are three types of economic systems: the market economy, the command economy, and the mixed economy
- A free market system is likely in countries where individual goals are given primacy over collective goals
- State-owned enterprises and restricted markets are common in countries where collective goals are dominant



Market Economy

- In a pure market economy the goods and services that a country produces, and the quantity in which they are produced is determined by supply and demand
- Consumers, through their purchases, determine what is produced and in what quantity
- The role of government is to encourage free and fair competition between private producers



Command Economy

- In a pure command economy the goods and services that a country produces, the quantity in which they are produced, and the price at which they are sold are all planned by the government
- All businesses are state owned, and so have little incentive to control costs and be efficient
- Because there is no private ownership, there is little incentive to better serve consumer needs

Mixed Economy

- A mixed economy includes some elements of a market economy and some elements of a command economy
- Governments tend to take over troubled firms that are considered to be vital to national interests
- The number of mixed economies in the world today is falling

2-16

Legal Systems

- The legal system of a country refers to the rules, or laws, that regulate behavior, along with the processes by which the laws of a country are enforced and through which redress for grievances is obtained
- A country's legal system is important because
 - Laws regulate business practice
 - Laws define the manner in which business transactions are to be executed
 - Laws set down the rights and obligations of those involved in business transactions

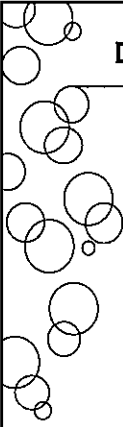
2-17

Different Legal Systems

There are three main types of legal systems:

1. Common law (based on tradition, precedent, and custom)
 - found in most of Great Britain's former colonies, including the United States
2. Civil law (based on a very detailed set of laws organized into codes)
 - found in over 80 countries, including Germany, France, Japan, and Russia
3. Theocratic law (based on religious teachings)
 - Islamic law is the most widely practiced

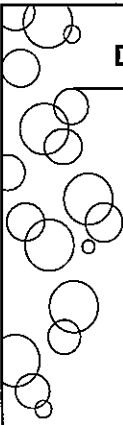
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Differences in Contract Law

Question: How do common law and civil differ?

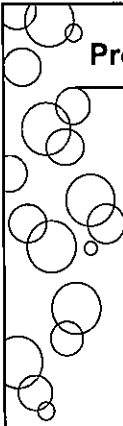
- The two systems approach contract law (the body of law that governs contract enforcement) in different ways
- A contract is a document that specifies the conditions under which an exchange is to occur and details the rights and obligations of the parties involved
- In a common law state, contracts are very detailed will all contingencies spelled out
- In a civil law state, contracts are shorter and much less specific



Differences in Contract Law

Question: In a contract dispute, which country's laws should apply?

- The United Nations Convention in Contracts for the International Sales of Goods (CIGS) establishes a uniform set of rules governing certain aspects of the making and performance of everyday commercial contracts between sellers and buyers who have their places of business in different nations
- Countries that adopt CIGS signal to other nations that they will treat the Convention's rules as part of their law



Property Rights and Corruption

- Property rights (the legal rights over the use to which a resource is put and over the use made of any income that may be derived from that resource) are very important for the functioning of business
- Property rights can be violated
 - by private action (theft, piracy, blackmail, and the like by private individuals or groups)
 - by public action (when public officials extort income or resources from property holders using various legal mechanisms including excessive taxation, requiring expensive licenses or permits from property holders, or taking assets into state ownership without compensating the owners)

Property Rights and Corruption

- Corruption is present in all countries to some degree, however when a country has a high level of corruption
 - Foreign direct investment falls
 - International trade falls
 - Economic growth falls

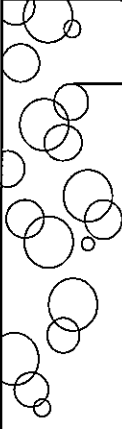
Property Rights and Corruption

Rankings of Corruption by Country 2007

Country	Corruption Index (0-10)
Finland	9.5
New Zealand	9.2
United Kingdom	8.8
Japan	8.5
France	8.2
United States	7.8
Italy	7.5
South Korea	7.2
Brazil	6.8
China	6.5
India	6.2
Vietnam	5.8
Russia	5.5
Indonesia	5.2
Nigeria	4.8
Iran	4.5
Somalia	4.2

Foreign Corrupt Practices Act


- To limit corruption in the U.S., the Foreign Corrupt Practices Act was passed
- The Act makes it a violation of the United States' law to bribe a foreign government official in order to obtain or maintain business over which the foreign official has authority, and requires all publicly traded countries to keep detailed records so that it is clear whether a violation of the act has occurred
- The Act does allow facilitating or expediting payments for secure the performance of routine government actions



The Protection of Intellectual Property

- Intellectual property is property, such as computer software, a screenplay, or the chemical formula for a new drug, that is the product of intellectual activity

2-25

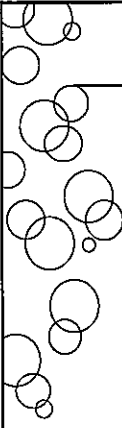


The Protection of Intellectual Property

Intellectual property rights include

- patents (documents giving the inventor of a new product or process exclusive rights to the manufacture, use, or sale of that invention)
- copyrights (exclusive legal rights of authors, composers, playwrights, artists, and publishers to publish and dispose of their work as they see fit)
- trademarks (designs and names, often officially registered, by which merchants or manufacturers designate and differentiate their products)

2-26



The Protection of Intellectual Property

- The protection of intellectual property rights differs greatly from country to country
- The Paris Convention for the Protection of Industrial Property is an agreement signed by 96 countries to protect intellectual property rights
- The Trade Related Aspects of Intellectual Property Rights (TRIPS) requires WTO members to grant and enforce patents lasting at least 20 years and copyrights lasting 50 years

2-27

Product Safety and Product Liability

- Product safety laws set certain safety standards to which a product must adhere
- Product liability involves holding a firm and its officers responsible when a product causes injury, death, or damage
 - Liability laws are usually least extensive in less developed countries
- Firms must decide whether to adhere to the standards of the home country or the standards of the host country

2-28

The Determinants of Economic Development

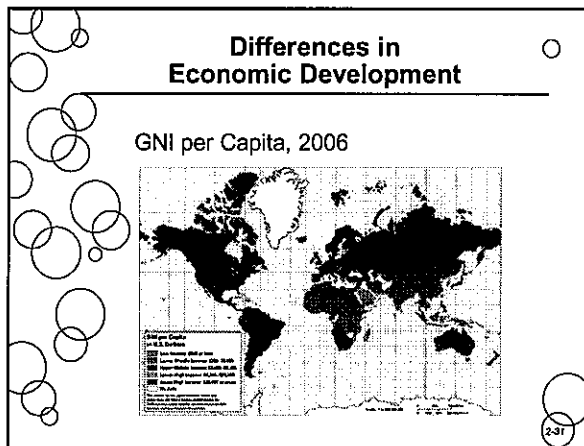
- A country's level of economic development affects its attractiveness as a possible market or production location for firms

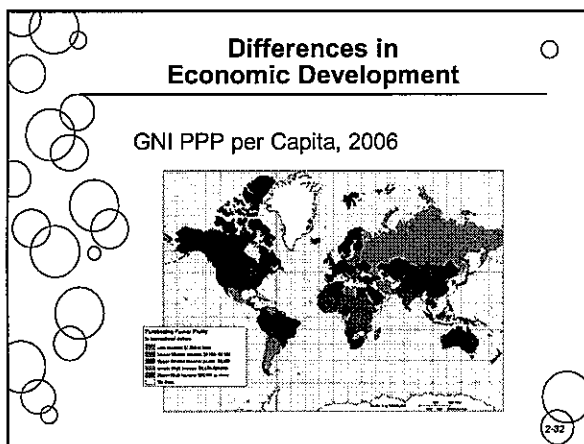
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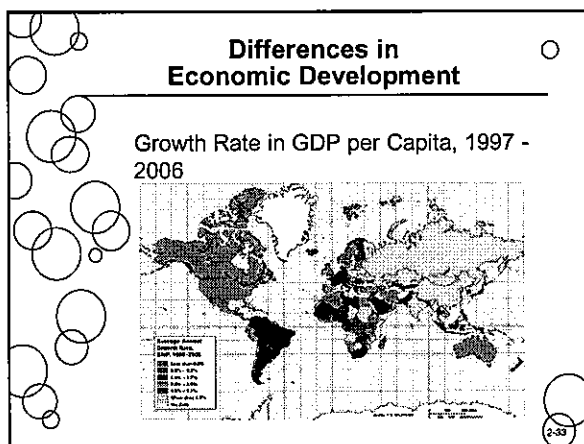
Differences in Economic Development

- One common measure of economic development is a country's gross national income (GNI) per head of population
- A purchasing power parity (PPP) adjustment allows for a more direct comparison of living standards in different countries
- Because both GNI and PPP data only provide a static picture of development, it is also important to consider growth rates

2-30







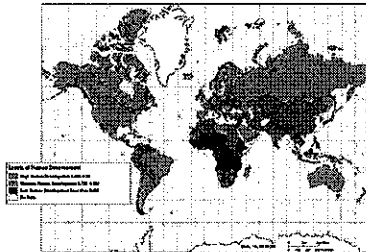
Broader Conceptions of Development: Amartya Sen

- Nobel Prize winning economist Amartya Sen argued that development should be assessed less by material output and more by the capabilities and opportunities that people enjoy
- To reflect Sen's ideas and gauge a country's economic development and likely future growth rate, the United Nations created the Human Development Index based on life expectancy, education attainment, and whether average incomes are sufficient to meet the basic needs of life in a country

2-34

Broader Conceptions of Development: Amartya Sen

Human Development Indicators, 2005



2-35

Political Economy and Economic Progress

- Question: What is the relationship between political economy and economic progress?
- There is broad agreement among experts that innovation (new products, new processes, new organizations, new management practices, and new strategies) and entrepreneurship are the engines of long-run economic growth
 - Entrepreneurs first commercialize innovative new products and processes
 - Some experts argue that economic freedom associated with a market economy creates greater incentives for innovation and entrepreneurship than either a planned or mixed economy

2-36

Political Economy and Economic Progress

- Strong legal protection of property rights is another requirement for a business environment conducive to innovation, entrepreneurship, and economic growth
- It seems likely that democratic regimes are more conducive to long-term economic growth than a dictatorship, even one of the benevolent kind
- It also seems evident that the subsequent economic growth leads to establishment of democratic regimes

2-37

Geography, Education, and Economic Development

- In addition to the political and economic systems, other factors can influence a country's rate of economic development
- Geography can influence economic policy, and thus economic development
 - Countries with favorable geography are more likely to engage in trade which can promote economic growth
- Education levels also influence economic development
 - Countries that invest more in the education of their young people develop faster economically

2-38

States in Transition

- Since the late 1980s, a wave of democratic revolutions has swept the world, and many of the previous totalitarian regimes collapsed
- There has been a move away from centrally planned and mixed economies towards free markets

2-39

The Spread of Democracy

Democracy has spread to new countries because

- many totalitarian regimes failed to deliver economic progress to the majority of their population
- new information and communication technologies have broken down the ability of the state to control access to uncensored information
- economic advances of the last quarter century have led to the emergence of increasingly prosperous middle and working classes who have pushed for democratic reforms

2-40

The New World Order and Global Terrorism

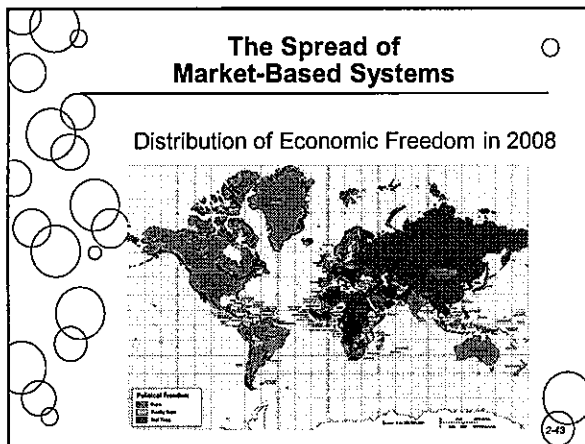
- The end of the Cold War and the "new world order" that followed the collapse of communism in Eastern Europe and the former Soviet Union, taken together with the collapse of many authoritarian regimes in Latin America, have given rise to intense speculation about the future shape of global geopolitics
- International businesses must be aware of geopolitical forces that could affect their ability to operate in certain countries

2-41

The Spread of Market-Based Systems

- Since the late 1980s there has been a transformation from centrally planned command economies to market-based economies
- In general, command and mixed economies failed to deliver the kind of sustained economic performance that was achieved by countries that had adopted market-based systems, prompting many countries to shift to a market-based system

2-42



Deregulation


1. Deregulation
 - Involves removing legal restrictions on the free play of markets, the establishment of private enterprises, and the manner in which private enterprises operate

2-44

Privatization


2. Privatization
 - Transfers the ownership of state property into the hands of private investors
 - Because private investors are motivated by potential profits to increase productivity, privatization should increase economic efficiency

2-45




Legal System

- A well-functioning market economy requires laws protecting private property rights and providing mechanisms for contract enforcement
- Without a legal system that protects property rights, and without the machinery to enforce that system, growth is hampered
- Many countries have made significant strides toward creating a strong legal system, but more work is necessary



Implications of a Changing Economy

- The changes in the political and economic systems have significant implications for international firms
- Markets that were formerly off-limits to Western business are now open
 - China (population of 1.2 billion) could be a bigger market than the U.S., the EU, and Japan combined
 - India (population 1.1 billion) is also a potentially huge market
- However, just as the potential gains are large, so are the risks



Implications for Managers

Question: What are the implications of the political economy for international businesses?

- There are two main implications
 1. the political, economic, and legal systems of a country raise important ethical issues that have implications for the practice of international business
 2. the political, economic, and legal environment of a country clearly influences the attractiveness of that country as a market and/or investment site

Benefits

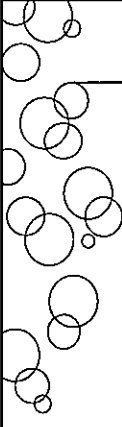
- The long-run benefits of doing business in a country are a function of market size, and current and future consumer purchasing power
- By identifying and investing early in a potential future economic stars, firms may be able to gain first mover advantages (advantages that accrue to early entrants into a market)

Costs

- Firms must be prepared to deal costs of doing business in foreign markets
 - Political costs include the cost of paying bribes or lobbying for favorable or fair treatment
 - Economic costs relate primarily to the sophistication of the economic system, including the infrastructure and supporting businesses
 - Legal costs can be higher in countries with dramatically different product, workplace, and pollution standards, or where there is poor legal protection for property rights


Risks

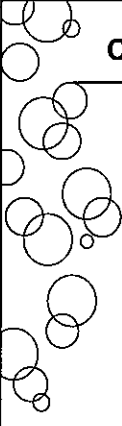
- Doing business in foreign markets involves risk
 - Political risk (the likelihood that political forces will cause drastic changes in a country's business environment that adversely affects the profit and other goals of a business enterprise)
 - Economic risk (the likelihood that economic mismanagement will cause drastic changes in a country's business environment that adversely affects the profit and other goals of a business enterprise)
 - Legal risk (the likelihood that a trading partner will opportunistically break a contract or expropriate property rights)



Overall Attractiveness


- The overall attractiveness of a country as a potential market and/or investment site for an international business depends on balancing the benefits, costs, and risks associated with doing business in that country
- Generally, the costs and risks are lower in economically developed and politically stable markets
- However, the potential for growth may be higher in less developed nations

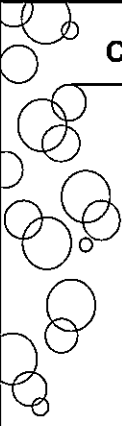




Critical Discussion Question


1. Free market economies stimulate greater economic growth, whereas state-directed economies stifle growth! Discuss.

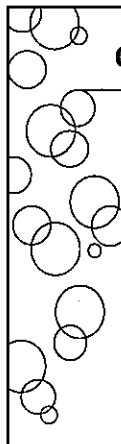




Critical Discussion Question

2. A democratic political system is an essential condition for sustained economic progress. Discuss.

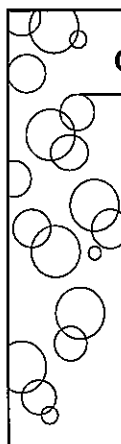




Critical Discussion Question

3. What is the relationship between corruption (i.e., bribe taking by government officials) in a country and economic growth? Is corruption always bad?


2-55



Critical Discussion Question

4. The Nobel prize-winning economist Amartya Sen argues that the concept of development should be broadened to include more than just economic development. What other factors does Sen think should be included in an assessment of development? How might adoption of Sen's views influence government policy? Do you think Sen is correct that development is about more than just economic development? Explain.

2-56



Critical Discussion Question

5. You are the CEO of a company that has to choose between making a \$100 million investment in either Russia or the Czech Republic. Both investments promise the same long-run return, so your choice of which investment to make is driven by considerations of risk. Assess the various risks of doing business in each of these nations. Which investment would you favor and why?

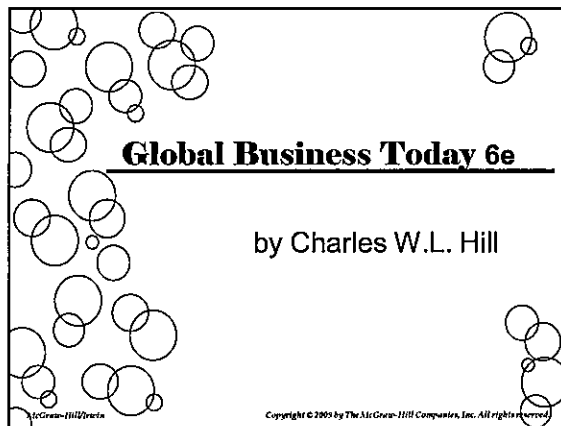
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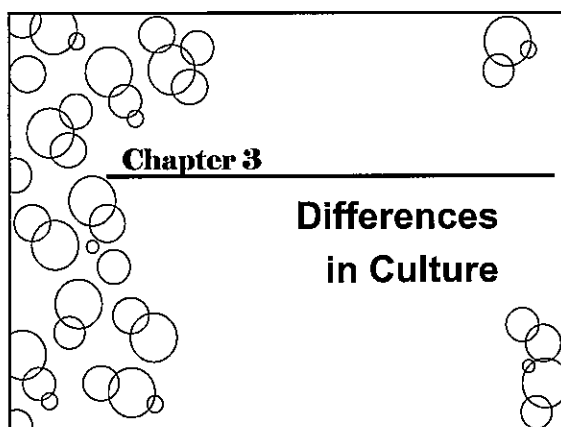
Critical Discussion Question

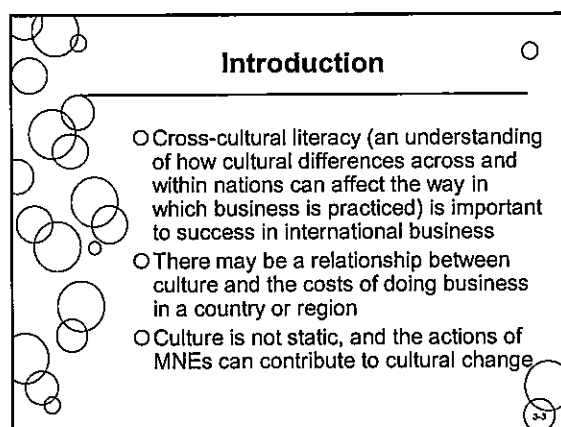
6. Read the Opening Case on India in this chapter and answer the following questions:

- a. What kind of economic system did India operate during 1947-1990? What kind of system is it moving towards today? What are the impediments to completing this transformation?
- b. How might widespread public ownership of businesses and extensive government regulations have impacted (i) the efficiency of state and private businesses, and (ii) the rate of new business formation in India during the 1947-1990 time frame? How do you think these factors affected the rate of economic growth in India during this time frame?
- c. How would privatization, deregulation, and the removal of barriers to foreign direct investment affect the efficiency of business, new business formation, and the rate of economic growth in India during the post-1990 time period?
- d. India now has pockets of strengths in key high technology industries such as software and pharmaceuticals. Why do you think India is developing strength in these areas? How might success in these industries help to generate growth in other sectors of the Indian economy?
- e. Given what is now occurring in the Indian economy, do you think that the country represents an attractive target for inward investment by foreign multinationals selling consumer products? Why?

2-58







What is Culture?

Question: What is culture?

- Culture is a system of values (abstract ideas about what a group believes to be good, right, and desirable) and norms (the social rules and guidelines that prescribe appropriate behavior in particular situations) that are shared among a group of people and that when taken together constitute a design for living
- A society is a group of people who share a common set of values and norms

Values and Norms

- Values provide the context within which a society's norms are established and justified
- Norms are the social rules that govern the actions of people toward one another and can be further subdivided into
 - Folkways (the routine conventions of everyday life)
 - Mores (norms that are seen as central to the functioning of a society and to its social life)

Culture, Society, and the Nation-State

- A society can be defined as a group of people that share a common set of values and norms
- There is not a strict one-to-one correspondence between a society and a nation-state
 - Nation- states are political creations that can contain a single culture or several cultures
 - Some cultures embrace several nations

The Determinants of Culture

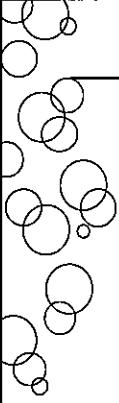
- The values and norms of a culture are the evolutionary product of a number of factors at work in a society including
 - prevailing political and economic philosophies
 - a society's social structure
 - the dominant religion, language, and education

The Determinants of Culture

The Determinants of Culture



Social Structure


- A society's social structure is its basic social organization
- Two dimensions to consider:
 - the degree to which the basic unit of social organization is the individual, as opposed to the group
 - the degree to which a society is stratified into classes or castes



Individuals and Groups



- A group is an association of two or more individuals who have a shared sense of identity and who interact with each other in structured ways on the basis of a common set of expectations about each other's behavior
- Groups are common in many Asian societies
- Many Western countries emphasize the individual







Individuals and Groups



- In societies where the individual is emphasized
 - Individual achievement and entrepreneurship are promoted
 - but, this can encourage job switching, competition between individuals in a company rather than team building, and a lack of loyalty to the firm
- In societies with a strong identification with the group
 - cooperation and team work are encouraged and life time employment is common
 - but, individual initiative and creativity may be suppressed







Social Stratification


- All societies are stratified on a hierarchical basis into social categories, or social strata (usually defined by characteristics such as family background, occupation, and income)
- Societies differ in terms of
 - the degree of mobility between social strata
 - the significance attached to social strata in a business context



Social Stratification


- Social mobility refers to the extent to which individuals can move out of the strata into which they are born
- The most rigid system is the caste system (a closed system of stratification in which social position is determined by the family into which a person is born, and change in that position are unlikely)
- A less rigid system is the class system (a form of open social stratification in which the position a person has by birth can be changed through achievement or luck)



Social Stratification

Question: What is the significance of social stratification for business?

- In cultures where there is a great deal of class consciousness (a condition where people tend to perceive themselves in terms of their class background, and this shapes their relationships with others), the way individuals from different classes work together (i.e. management and labor) may be prescribed
 - Antagonism between labor and management can raise the costs of doing business



Religious and Ethical Systems

- Religion is a system of shared beliefs and rituals that are concerned with the realm of the sacred
- Religions with the greatest following are
 - Christianity (1.7 billion adherents)
 - Islam (1 billion adherents)
 - Hinduism (750 million adherents)
 - Buddhism (350 million adherents)
 - Confucianism also influences behavior and shapes culture in many parts of Asia

Religious and Ethical Systems

Dominant Religions

Legend:

- Christianity (blue)
- Islam (orange)
- Hinduism (green)
- Buddhism (yellow)
- Judaism (dark blue)
- Sikhism (purple)
- Others (grey)

Approximate percentages of the world population:

- Christianity: 31.2%
- Islam: 23.7%
- Hinduism: 15.2%
- Buddhism: 6.8%
- Judaism: 0.2%
- Sikhism: 0.1%
- Others: 22.8%

2-18

Religious and Ethical Systems

- Ethical systems are a set of moral principles, or values, that are used to guide and shape behavior
- The ethical practices of individuals within a culture are often closely intertwined with their religion

2-17

Christianity

- Christianity is the most widely practiced religion and is common throughout Europe, the Americas, and other countries settled by Europeans

Question: What are the economic implications of Christianity?

- In 1904, Max Weber suggested that it was the Protestant work ethic (focus on hard work, wealth creation, and frugality) that was the driving force of capitalism

2-18

Islam

- Adherents of Islam, called Muslims, believe that there is one true omnipotent God
- Islam is an all-embracing way of life that governs one's being

Question: What is Islamic fundamentalism?

- In the West, Islamic fundamentalism is associated in the media with militants, terrorists, and violent upheavals, however, the vast majority of Muslims point out that Islam teaches peace, justice, and tolerance
- Perhaps in response to the influence of Western ideas, some Muslims feel threatened, and are promoting a commitment to traditional beliefs and practices
- Fundamentalists have gained political power in many Muslim countries, and have tried to make Islamic law the law of the land

Islam

Question: What are the economic implications of Islam?


- Under Islam, people do not own property, but only act as stewards for God and thus must take care of that which they have been entrusted with
- While Islam is supportive of business, the way business is practiced is prescribed
- Businesses that are perceived to be making a profit through the exploitation of others, by deception, or by breaking contractual obligations are unwelcome

Hinduism

- Hinduism, practiced primarily on the Indian sub-continent, focuses on the importance of achieving spiritual growth and development, which may require material and physical self-denial

Question: What are the economic implications of Hinduism?

- Hindus are valued by their spiritual rather than material achievements
- Promotion and adding new responsibilities may not be the goal of an employee, or may be infeasible due to the employee's caste




Buddhism

- Buddhists, found mainly in Central and Southeast Asia, China, Korea, and Japan, stress spiritual growth and the afterlife, rather than achievement while in this world

Question: What are the economic implications of Buddhism?

- Buddhism does not support the caste system, so individuals do have some mobility and can work with individuals from different classes
- Entrepreneurial activity is acceptable in Buddhist societies




Confucianism

- Confucianism, practiced mainly in China, teaches the importance of attaining personal salvation through right action
- The need for high moral and ethical conduct and loyalty to others is central in Confucianism


Question: What are the economic implications of Confucianism?

- Three key teachings of Confucianism - loyalty, reciprocal obligations, and honesty - may all lead to a lowering of the cost of doing business in Confucian societies




Language

- Countries differ in terms of language or means of communication
- There are two forms language
 - Spoken
 - Unspoken
- Language is one of the defining characteristics of culture




Spoken Language

- Countries with more than one spoken language often have more than one culture
- Chinese is the mother tongue of the largest number of people in the world
- English is the most widely spoken language in the world, and is becoming the language of international business
- However, knowledge of the local language is beneficial, and in some cases, critical for business success



Unspoken Language

- Unspoken language refers to nonverbal cues
- Unspoken language such as facial expressions and hand gestures can be important for communication
- Many nonverbal cues are culturally bound and because they may be interpreted differently, can result in misunderstandings



Education

- Formal education is the medium through which individuals learn many of the language, conceptual, and mathematical skills that are indispensable in a modern society
- The knowledge base, training, and educational opportunities available to a country's citizens can also give it a competitive advantage in the market and make it a more or less attractive place for expanding business
- The general education level of a country is a good indicator of the types of products that might sell in that location or the type of promotional materials that might be successful

Culture and the Workplace

Question: How does a society's culture impact on the values found in the workplace?

- The most famous study undertaken to answer this question was done by Geert Hofstede who isolated four dimensions that he believed summarized different cultures
- 1. Power distance
- 2. Individualism versus collectivism
- 3. Uncertainty avoidance
- 4. Masculinity versus femininity

3-28

Culture and the Workplace

- 1. Power distance is focused on how a society deals with the fact that people are unequal in physical and intellectual capabilities
- 2. Individualism versus collectivism is focused on the relationship between the individual and his or her fellows
- 3. Uncertainty avoidance measures the extent to which different cultures socialize their members into accepting ambiguous situations and tolerating ambiguity
- 4. Masculinity versus femininity looks at the relationship between gender and work roles
- Hofstede later added a fifth dimension, Confucian dynamism, to capture attitudes towards time, persistence, ordering by status, protection of face, respect for tradition, and reciprocation of gifts and favors


3-29

Culture and the Workplace

Hofstede's Four Dimensions

	Power Distance	Uncertainty Avoidance	Individualism	Masculinity
Argentina	48	38	41	36
Australia	38	31	92	61
Brunei	69	76	26	48
Canada	39	48	92	32
Denmark	16	23	74	16
France	68	86	71	45
Germany (F.R.G.)	37	65	67	66
Greek Britain	35	35	88	66
Indonesia	78	90	14	46
India	77	46	18	59
Ireland	13	61	74	43
Japan	54	93	46	95
Norway	31	42	80	69
Sweden	31	53	86	14
Switzerland	30	88	71	54
Taiwan	92	88	13	42
Thailand	51	79	13	6
Thailand	64	64	20	34
Turkey	58	97	17	75
United States	40	40	91	42


3-30




Implications for Managers

Differences in culture imply that


1. there is a need for managers to develop cross-cultural literacy
2. there is a connection between culture and national competitive advantage
3. there is a connection between culture and ethics in decision making (discussed in the next chapter)






Cross-Cultural Literacy


- Individuals and firms must develop cross-cultural literacy
- International businesses that are ill informed about the practices of another culture are unlikely to succeed in that culture
- Individuals must also beware of ethnocentric behavior (a belief in the superiority of one's own culture)

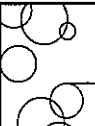




Culture and Competitive Advantage



- For international companies, the connection between culture and competitive advantage is important because
 - the connection suggests which countries are likely to produce the most viable competitors
 - the connection has implications for the choice of countries in which to locate production facilities and do business



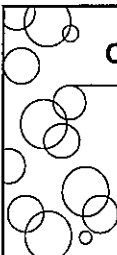


Critical Discussion Question

1. Outline why the culture of a country might influence the costs of doing business in that country. Illustrate your answer with examples.




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Critical Discussion Question

2. Do you think business practices in an Islamic country are likely to differ from business practices in the United States? If so, how?




-
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Critical Discussion Question

3. What are the implications for international business of differences in the dominant religion or ethical system of a country?


-
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Critical Discussion Question

4. Choose two countries that appear to be culturally diverse. Compare the culture of those countries and then indicate how cultural differences influence (a) the costs of doing business in each country, (b) the likely future economic development of that country, (c) business practices, and (d) business ethics.

5-27

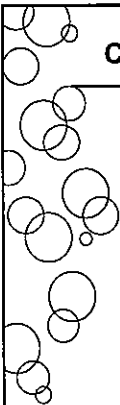


Critical Discussion Question

5. Reread the Country Focus on Islamic Capitalism in Turkey. Then answer the following questions:

- a) Can you see anything in the value of Islam that is hostile to business?
- b) What does the experience of the region around Kayseri teach us about the relationship between Islam and business?
- c) What are the implications of Islamic values towards business for the participation of a country like Turkey in the global economy?

5-28

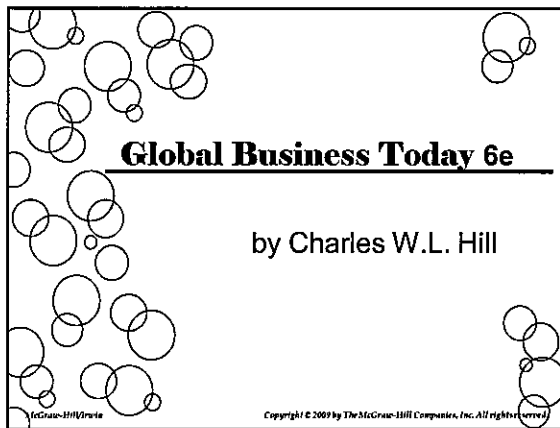


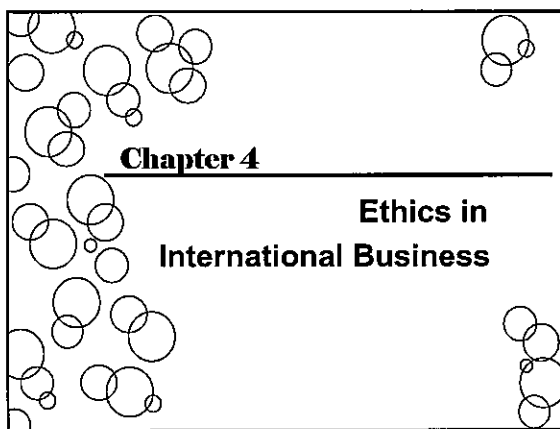
Critical Discussion Question

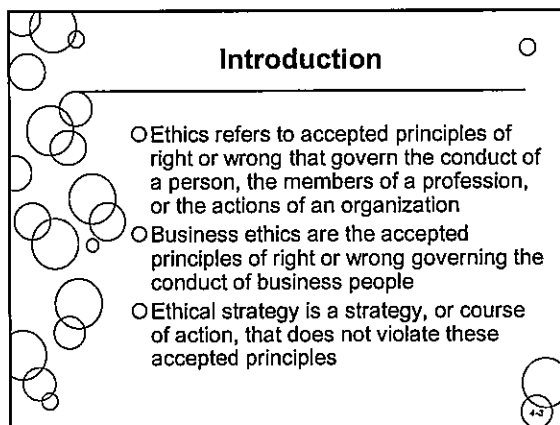
6. Reread the Management Focus on DMG-Shanghai and answer the following questions:

- a) Why do you think it is so important to cultivate guanxi and guanxiwang in China?
- b) What does the experience of DMG tell us about the way things work in China? What would likely happen to a business that obeyed all of the rules and regulations rather than trying to find a way round them as Dan Mintz apparently does?
- c) What are the ethical issues that might arise when drawing upon guanxiwang to get things done in China? What does this suggest about the limits of using guanxiwang for a Western business committed to high ethical standards?

5-29







Ethical Issues in International Business

- The most common ethical issues in business involve
 - employment practices
 - human rights
 - environmental regulations
 - corruption
 - the moral obligation of multinational companies

Employment Practices

Question: When work conditions in a host nations are clearly inferior to those in a multinational's home nation, what standards should be applied?

- The standards of the home nation?
- The standards of the host nation?
- Something in between?

Human Rights

Question: What is the responsibility of a foreign multinational when operating in a country where basic human rights are not respected?

- Basic human rights taken for granted in the developed world such as freedom of association, freedom of speech, freedom of assembly, freedom of movement, and so on, are by no means universally accepted

Environmental Pollution

Question: Should a multinational feel free to pollute in a developing nation if doing so does not violate laws?

- When environmental regulations in host nations are far inferior to those in the home nation, ethical issues arise
- The tragedy of the commons occurs when a resource held in common by all, but owned by no one, is overused by individuals resulting in its degradation

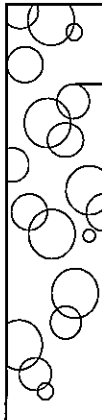
Corruption

Question: Is it ethical to make payments to government officials to secure business?

- In the United States, the Foreign Corrupt Practices Act outlawed the practice of paying bribes to foreign government officials in order to gain business
- The Convention on Combating Bribery of Foreign Public Officials in International Business Transactions adopted by the Organization for Economic Cooperation and Development (OECD) obliges member states to make the bribery of foreign public officials a criminal offense

Corruption

- Some economists suggest that the practice of giving bribes might be the price that must be paid to do a greater good
 - In countries where preexisting political structures distort or limit the workings of the market mechanism, corruption in the form of black-marketeering, smuggling, and side payments to government bureaucrats to "speed up" approval for business investments may actually enhance welfare
- However, other economists have argued that corruption reduces the returns on business investment and leads to low economic growth

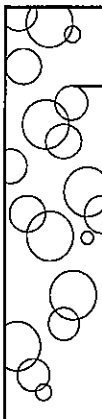


Moral Obligations

Question: Do multinationals have a responsibility to give back to the societies that enable them to grow and prosper?

- The concept of social responsibility refers to the idea that business people should take the social consequences of economic actions into account when making business decisions, and that there should be a presumption in favor of decisions that have both good economic and good social consequences

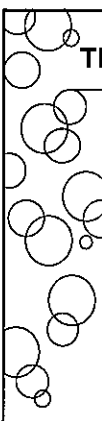
4-10



Ethical Dilemmas

- Managers often face situations where the appropriate course of action is not clear
- Ethical dilemmas are situations in which none of the available alternatives seems ethically acceptable
- They exist because real world decisions are complex, difficult to frame, and involve various consequences that are difficult to quantify

4-11

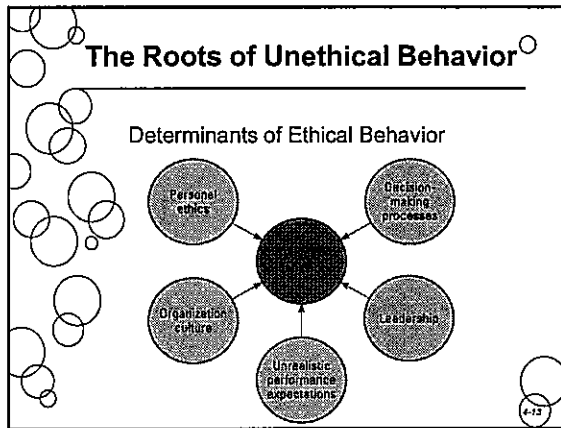


The Roots of Unethical Behavior

Question: Why do managers behave in an unethical manner?

- Managerial behavior is influenced by
 - Personal ethics
 - Decision making processes
 - Organizational culture
 - Unrealistic performance expectations
 - Leadership

4-12



Personal Ethics


- Business ethics reflect personal ethics (the generally accepted principles of right and wrong governing the conduct of individuals)
- Expatriates may face pressure to violate their personal ethics because they are away from their ordinary social context and supporting culture, and they are psychologically and geographically distant from the parent company

4-14

Decision Making Processes


- Studies show that business people may behave unethically because they fail to ask the relevant question—is this decision or action ethical?
- Decisions are made based on economic logic, without consideration for ethics


4-15



Organizational Culture


- Unethical behavior may exist in firms with an organization culture (the values and norms that are shared among employees of an organization) that does not emphasize business ethics
- Values and norms shape the culture of a firm, and that culture influences decision making






Unrealistic Performance Expectations


- Pressure from the parent company to meet performance goals that are unrealistic, and can only be attained by cutting corners or acting in an unethical manner can cause unethical behavior

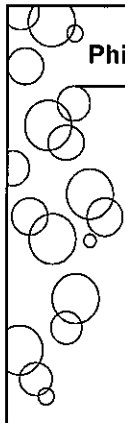




Leadership



- If a firm's leaders fail to act in an ethical manner, other employees may not act ethically
- Actions speak louder than words

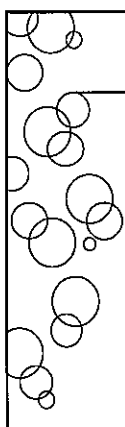




Philosophical Approaches to Ethics



- There are several approaches to business ethics including
 - Straw men
 - The Friedman doctrine
 - Cultural relativism
 - The righteous moralist
 - The naïve immoralist
 - Utilitarian and Kantian
 - Rights theories
 - Justice Theories

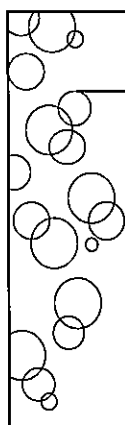





Straw Men

- Straw men approaches to business ethics are raised by business ethics scholars primarily for the purpose of demonstrating that they offer inappropriate guidelines for ethical decision making in a multinational enterprise
- Four such approaches are
 - the Friedman doctrine
 - cultural relativism
 - the righteous moralist
 - the naïve immoralist








Straw Men

The Friedman Doctrine

- Economist's Milton Friedman's suggests that the only social responsibility of business is to increase profits, so long as the company stays within the rules of law
- Friedman does not believe that companies should undertake expenditures beyond those mandated by law and those required for the efficient running of a business

Straw Men

Cultural Relativism

- Cultural relativism is the belief that ethics are culturally determined and that firms should adopt the ethics of the cultures in which they operate
 - "when in Rome, do as the Romans do"

Straw Men

The Righteous Moralist

- The righteous moralist claims that a multinational's home country standards of ethics are the appropriate ones for companies to follow in foreign countries
 - This approach is common among managers from developed countries

Straw Men

The Naïve Immoralist

- The naïve immoralist asserts that if a manager of a multinational sees that firms from other nations are not following ethical norms in a host nation, that manager should not either
 - Actions are ethically justified if everyone else is doing the same thing

Utilitarian and Kantian Ethics

- Utilitarian approaches to ethics hold that the moral worth of actions or practices is determined by their consequences
 - Actions have multiple consequences, some good, some not
 - Actions are desirable if they leads to the best possible balance of good consequences over bad consequences
- Problems with this approach include measuring the benefits, costs, and risks of a course of action, and the fact that the philosophy fails to consider justice

4-26

Utilitarian and Kantian Ethics

- Kantian ethics are based on the philosophy of Immanuel Kant who argued that people should be treated as ends and never purely as means to the ends of others
 - People have dignity and need to be respected, they are not machines

4-26

Rights Theories

- Rights theories recognize that human beings have fundamental rights and privileges that transcend national boundaries and culture
- Moral theorists argue that fundamental human rights form the basis for the moral compass that managers should navigate by when making decisions that have an ethical component
- The idea that some fundamental rights transcend national borders and cultures was the underlying motivation for the UN's Universal Declaration of Human Rights (specifies the basic principles that should always be adhered to irrespective of the culture in which one is doing business)

4-27

Justice Theories

- Justice theories focus on the attainment of a just distribution (one that is considered fair and equitable) of economic goods and services
- John Rawls argued that all economic goods and services should be distributed equally except when an unequal distribution would work to everyone's advantage
 - Impartiality is guaranteed by the veil of ignorance (everyone is imagined to be ignorant of all his or her particular characteristics)

Implications for Managers

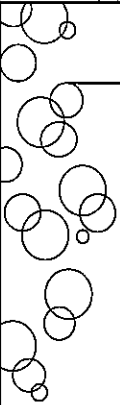
Question: How can managers ensure that ethical issues are considered in business decisions?

Managers should

- favor hiring and promoting people with a well grounded sense of personal ethics
- build an organizational culture that places a high value on ethical behavior
- makes sure that leaders within the business not only articulate the rhetoric of ethical behavior, but also act in manner that is consistent with that rhetoric
- put decision making processes in place that require people to consider the ethical dimension of business decisions
- develop moral courage



Hiring and Promotion

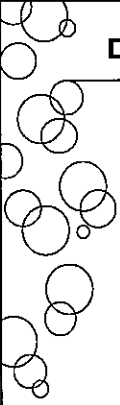
- Businesses should strive to identify and hire people with a strong sense of personal ethics
- Prospective employees should find out as much as they can about the ethical climate in an organization



Organization Culture and Leadership



- Businesses need to build an organization culture that places a high value on ethical behavior
 - the business must explicitly articulate values that place a strong emphasis on ethical behavior, perhaps using a code of ethics (a formal statement of the ethical priorities a business adheres to)
 - leaders in the business should give life and meaning to the code of ethics by repeatedly emphasizing their importance, and then acting on them
 - the business should put in place a system of incentives and rewards that recognize people who engage in ethical behavior and sanction those who do not

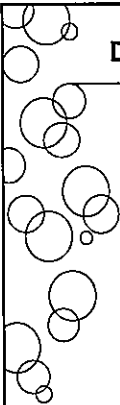





Decision-Making Processes



- A moral compass can help determine whether a decision is ethical. If a manager can answer "yes" to the following questions, the decision is ethically acceptable.
 - does my decision fall within the accepted values of standards that typically apply in the organizational environment?
 - am I willing to see the decision communicated to all stakeholders affected by it?
 - would the people with whom I have significant personal relationships approve of the decision?







Decision-Making Processes


- A five-step process can also help managers think through ethical issues
 1. How would a decision affect stakeholders (the individuals or groups who have an interest, stake, or claim in the actions and overall performance of a company)
 - Internal stakeholders are people who work for or who own the business such as employees, the board of directors, and stockholders.
 - External stakeholders are the individuals or groups who have some claim on a firm such as customers, suppliers, and unions




Decision-Making Processes

- Managers need to determine whether a proposed decision would violate the fundamental rights of any stakeholders
- Managers need to establish moral intent (the business must resolve to place moral concerns ahead of other concerns in cases where either the fundamental rights of stakeholders or key moral principles have been violated)
- The company should then engage in ethical behavior
- The business must audit its decisions, reviewing them to make sure that they were consistent with ethical principles



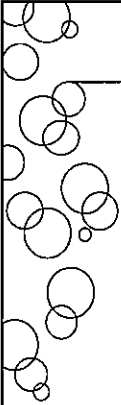
Ethics Officers

- To encourage ethical behavior in a business, a number of firms now have ethics officers
- Ethics officers ensure that
 - Employees are trained to be ethically aware
 - Ethical considerations enter decision-making
 - The company's code of ethics is followed




Moral Courage

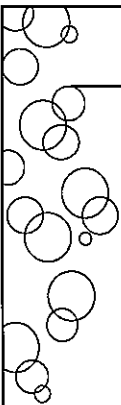
- Employees in an international business may need significant moral courage
- Managers need to be able to walk away from decisions that are profitable, but unethical
- Employees need to be able to say no to actions that are unethical



Summary of Decision-Making Steps


- International businesses should
 - strive to hire and promote people based on ethical considerations as well as other metrics of performance
 - establish an ethical culture within the organization
 - appoint ethics officers
 - create an environment that facilitates moral courage
- Even so, it is important to recognize that not all ethical dilemmas have a clear and obvious solution

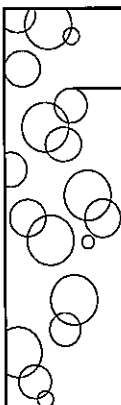




Critical Discussion Question


. A visiting American executive finds that a foreign subsidiary in a poor nation has hired a 12-year old girl to work on a factory floor, in violation of the company's prohibition on child labor. He tells the local manager to replace the child and tell her to go back to school. The local manager tells the American executive that the child is an orphan with no other means of support, and she will probably become a street child if she is denied work. What should the American executive do?





Critical Discussion Question

A manager from a developing country is overseeing a multinational's operations in a country where drug trafficking and lawlessness are rife. One day, a representative of a local "big man" approaches the manager and asks for a "donation" to help the "big man" provide housing for the poor. The representative tells the manager that in return for the donation, the "big man" will make sure that the manager has a productive stay in his country. No threats are made, but the manager is well aware that the "big man" heads a criminal organization that is engaged in drug trafficking. He also knows that the big man does indeed help the poor in the run down neighborhood of the city where he was born. What should the manager do?

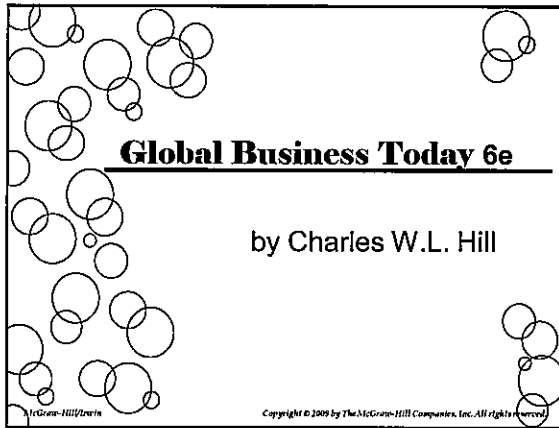


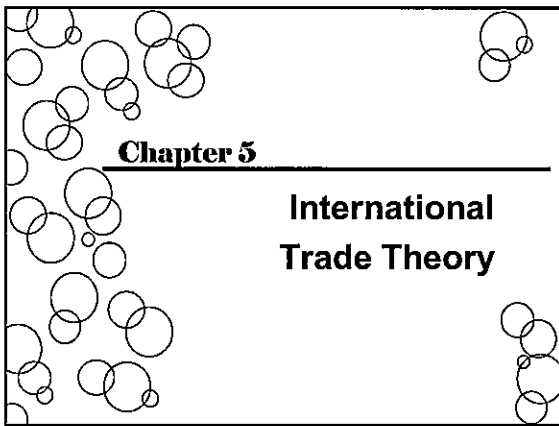
Critical Discussion Question

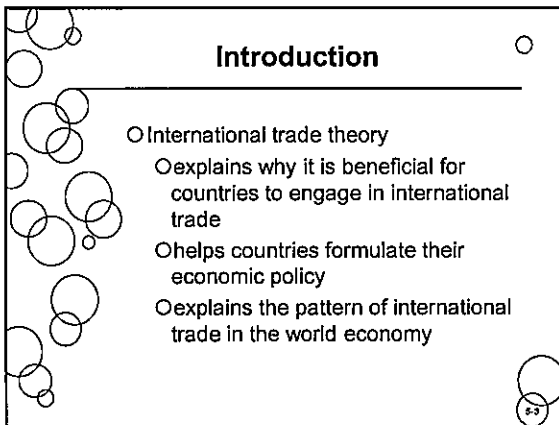
Reread the Management focus feature on Unocal and answer the following questions:


- Was it ethical for Unocal to enter into a partnership with a brutal military dictatorship for financial gain?
- What actions could Unocal have taken, short of not investing at all, to safeguard the human rights of people impacted by the gas pipeline project?

b) What actions could Unocal have taken, short of not investing at all, to safeguard the human rights of people impacted by the gas pipeline project?











An Overview of Trade Theory

Question: What is free trade?

- Free trade refers to a situation where a government does not attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country







An Overview of Trade Theory

Question: How has international trade theory evolved?

- Mercantilism (16th and 17th centuries) promoted the idea of encouraging exports and discouraging imports
- In 1776, Adam Smith promoted the idea of unrestricted free trade
- In the 19th century, David Ricardo built on Smith ideas, and in the 20th century, Eli Heckscher and Bertil Ohlin refined Ricardo's work






The Benefits of Trade

Question: Why is it beneficial for countries to engage in free trade?

- The theories of Smith, Ricardo and Heckscher-Ohlin show why it is beneficial for a country to engage in international trade even for products it is able to produce for itself
- International trade allows a country to specialize in the manufacture and export of products that can be produced most efficiently in that country, and import products that can be produced more efficiently in other countries



The Pattern of International Trade


- International trade theory helps explain trade patterns
 - Some patterns of trade are fairly easy to explain - it is obvious why Saudi Arabia exports oil, Ghana exports cocoa, and Brazil exports coffee
 - But, why does Switzerland export chemicals, pharmaceuticals, watches, and jewelry? Why does Japan export automobiles, consumer electronics, and machine tools?

The Pattern of International Trade

- Ricardo's theory of comparative advantage suggests that existing trade patterns are related to differences in labor productivity
- Heckscher and Ohlin's theory explains trade through the interplay between the proportions in which the factors of production are available in different countries and the proportions in which they are need for producing particular goods
- Ray Vernon suggested that trade patterns could be explained by looking at a product's life cycle


The Pattern of International Trade

- Paul Krugman developed new trade theory which suggests that the world market can only support a limited number of firms in some industries, and so trade will skew toward those countries that have firms that were able to capture first mover advantages
- Michael Porter focused on the importance of country factors to explain a nation's dominance in the production and export of certain products




Trade Theory and Government Policy

- While the theories all suggest that trade is beneficial, they lack agreement in their recommendations for government policy
 - Mercantilism makes a case for government involvement in promoting exports and limiting imports
 - Smith, Ricardo, and Heckscher-Ohlin promote unrestricted free trade
 - New trade theory and Porter justify limited and selective government intervention to support the development of certain export-oriented industries



Mercantilism

- Mercantilism (mid-16th century) asserted that it is in a country's best interest to maintain a trade surplus, to export more than it imports
 - it advocated government intervention to achieve a surplus in the balance of trade
 - it viewed trade as a zero-sum game (one in which a gain by one country results in a loss by another)
- Mercantilism is problematic and not economically valid, yet many political views today have the goal of boosting exports while limiting imports by seeking only selective liberalization of trade



Absolute Advantage

- In 1776, Adam Smith attacked the mercantilist assumption that trade is a zero-sum game and argued that countries differ in their ability to produce goods efficiently, and that a country has an absolute advantage in the production of a product when it is more efficient than any other country in producing it
- According to Smith, countries should specialize in the production of goods for which they have an absolute advantage and then trade these goods for the goods produced by other countries

Absolute Advantage

- Assume that two countries, Ghana and South Korea, both have 200 units of resources that could either be used to produce rice or cocoa
- In Ghana, it takes 10 units of resources to produce one ton of cocoa and 20 units of resources to produce one ton of rice
- So, Ghana could produce 20 tons of cocoa and no rice, 10 tons of rice and no cocoa, or some combination of rice and cocoa between the two extremes

8-13

Absolute Advantage

- In South Korea it takes 40 units of resources to produce one ton of cocoa and 10 resources to produce one ton of rice
- So, South Korea could produce 5 tons of cocoa and no rice, 20 tons of rice and no cocoa, or some combination in between
- Ghana has an absolute advantage in the production of cocoa
- South Korea has an absolute advantage in the production of rice

8-14

Absolute Advantage

- Without trade
 - Ghana would produce 10 tons of cocoa and 5 tons of rice
 - South Korea would produce 10 tons of rice and 2.5 tons of cocoa
- If each country specializes in the product in which it has an absolute advantage and trades for the other product
 - Ghana would produce 20 tons of cocoa
 - South Korea would produce 20 tons of rice

8-15

Absolute Advantage

- Suppose
 - Ghana could trade 6 tons of cocoa to South Korea for 6 tons of rice
- After trade
 - Ghana would have 14 tons of cocoa left, and 6 tons of rice
 - South Korea would have 14 tons of rice left and 6 tons of cocoa
- Both countries gained from trade

5-16

Absolute Advantage

Absolute Advantage and the Gains from Trade


Absolute Advantage in Cocoa & Rice Production			
	Cocoa	Rice	
Ghana	14	0	
South Korea	0	14	
Production after specialization (total)	14	14	
Distribution of the total production			
	Cocoa	Rice	
Ghana	14	0	
South Korea	0	14	
Total production	14	14	
Consumption after specialization			
	Cocoa	Rice	
Ghana	14	0	
South Korea	0	14	
Total production	14	14	
Consumption after trade (Ghana exports 6 tons of cocoa to South Korea for 6 tons of rice)			
	Cocoa	Rice	
Ghana	8	6	
South Korea	6	8	
Total production	14	14	

5-17

Comparative Advantage



- In 1817, David Ricardo explored what might happen when one country has an absolute advantage in the production of *all* goods
- According to Ricardo's theory of comparative advantage, it makes sense for a country to specialize in the production of those goods that it produces most efficiently and to buy the goods that it produces less efficiently from other countries, even if this means buying goods from other countries that it could produce more efficiently itself


5-18



Comparative Advantage



- Assume
 - Ghana is more efficient in the production of both cocoa and rice
 - In Ghana, it takes 10 resources to produce one ton of cocoa, and 13 1/3 resources to produce one ton of rice
 - So, Ghana could produce 20 tons of cocoa and no rice, 15 tons of rice and no cocoa, or some combination of the two







Comparative Advantage



- In South Korea, it takes 40 resources to produce one ton of cocoa and 20 resources to produce one ton of rice
- So, South Korea could produce 5 tons of cocoa and no rice, 10 tons of rice and no cocoa, or some combination of the two
- If each country specializes in the production of the good in which it has a comparative advantage and trades for the other, both countries will gain



Comparative Advantage

- With trade
 - Ghana could export 4 tons of cocoa to South Korea in exchange for 4 tons of rice
 - Ghana will still have 11 tons of cocoa, and 4 additional tons of rice
 - South Korea still has 6 tons of rice and 4 tons of cocoa

The Gains from Trade

- The theory of comparative advantage argues that trade is a positive sum gain in which all gain
- Potential world production is greater with unrestricted free trade than it is with restricted trade
- The theory of comparative advantage provides a strong rationale for encouraging free trade

Qualifications and Assumptions

- The simple example of comparative advantage assumes
 - Only two countries and two goods
 - Zero transportation costs
 - Similar prices and values
 - Resources are mobile between goods within countries, but not across countries
 - Constant returns to scale
 - Fixed stocks of resources
 - No effects on income distribution within countries

Extensions of the Ricardian Model

- Suppose the following assumptions are relaxed
 1. Resources move freely from the production of one good to another within a country
 2. There are constant returns to scale
 3. Trade does not change a country's stock of resources or the efficiency with which those resources are utilized

Extensions of the Ricardian Model

- 1. Immobile Resources
 - Resources do not always move freely from one economic activity to another
 - Governments may help retrain displaced workers
- 2. Diminishing Returns
 - The simple model assumes constant returns to specialization (the units of resources required to produce a good are assumed to remain constant), but an assumption of diminishing returns is more realistic since not all resources are of the same quality and different goods use resources in different proportions

Extensions of the Ricardian Model

- 3. Dynamic Effects and Economic Growth
 - Trade might increase a country's stock of resources as increased supplies become available from abroad
 - Free trade might increase the efficiency of resource utilization, and free up resources for other uses

Extensions of the Ricardian Model

- The Samuelson Critique
 - Paul Samuelson argued that in some cases, dynamic gains can lead to less beneficial outcomes
 - He is concerned that the ability to offshore services jobs that were traditionally not internationally mobile may have the effect of a mass inward migration into the United States, where wages would then fall

Extensions of the Ricardian Model

The Link between Trade and Growth

- Studies exploring the relationship between trade and economic growth suggest that countries that adopt a more open stance toward international trade enjoy higher growth rates than those that close their economies to trade
 - Higher growth rates raise income levels and living standards

○

Heckscher-Ohlin Theory

- Heckscher and Ohlin argued that comparative advantage arises from differences in national factor endowments (the extent to which a country is endowed with resources such as land, labor, and capital)
 - The more abundant a factor, the lower its cost
- Countries will export goods that make intensive use of those factors that are locally abundant, and import goods that make intensive use of factors that are locally scarce

○

The Leontief Paradox

- Wassily Leontief (1953) argued that since the U.S. was relatively abundant in capital, it would be an exporter of capital intensive goods and an importer of labor-intensive goods.
 - Leontief found however, that U.S. exports were less capital intensive than U.S. imports
- Possible explanations for these findings include
 - that the U.S. has a special advantage in producing products made with innovative technologies that are less capital intensive
 - differences in technology lead to differences in productivity which then drives trade patterns

○

The Product Life Cycle Theory ○

- Raymond Vernon (mid-1960s) proposed the product life-cycle theory suggesting that as products mature both the location of sales and the optimal production location will change affecting the flow and direction of trade
- In the mid-1960s, the wealth and size of the U.S. market gave a strong incentive to U.S. firms to develop new products

S-21

The Product Life Cycle Theory ○

- According to Vernon, in the early stages of a product's life cycle demand may grow in the U.S., but demand in other advanced countries is limited to high-income groups
- Therefore, it is not worthwhile for firms in those countries to start producing the new product, but it does necessitate some exports from the U.S. to those countries

S-22

The Product Life Cycle Theory ○

- Over time, demand for the new product starts to grow in other advanced countries making it worthwhile for foreign producers to begin producing for their home markets
- U.S. firms might also set up production facilities in those advanced countries where demand is growing limiting the exports from the U.S.
- As the market in the U.S. and other advanced nations matures, the product becomes more standardized, and price becomes the main competitive weapon

S-23

The Product Life Cycle Theory


- Producers based in advanced countries where labor costs are lower than the United States might now be able to export to the U.S.
- If cost pressures become intense, developing countries begin to acquire a production advantage over advanced countries
- The United States switches from being an exporter of the product to an importer of the product as production becomes more concentrated in lower-cost foreign locations

The Product Life Cycle Theory

The Product Life Cycle

Evaluating The Product Life Cycle Theory

- While the product life cycle theory accurately explains what has happened for products like photocopiers and a number of other high technology products developed in the US in the 1960s and 1970s, the increasing globalization and integration of the world economy has made this theory less valid in today's world
 - Today, many new products are initially introduced in Japan or Europe, or are introduced simultaneously in the U.S., Japan, and Europe
 - Production may also be dispersed to those locations where it is most favorable




New Trade Theory

New trade theory (1970s) suggests

1. Because of economies of scale (unit cost reductions associated with a large scale of output), trade can increase the variety of goods available to consumers and decrease the average cost of those goods
2. In those industries when the output required to attain economies of scale represents a significant proportion of total world demand, the global market may only be able to support a small number of firms


5-37



Increasing Product Variety and Reducing Costs

- Without trade
 - A small nation may not be able to support the demand necessary for producers to realize required economies of scale, and so certain products may not be produced
- With trade
 - A nation may be able to specialize in producing a narrower range of products and then buy the goods that it does not make from other countries
 - Each nation then simultaneously increases the variety of goods available to its consumers and lowers the costs of those goods

5-38



Economies of Scale, First Mover Advantages and the Pattern of Trade

- Firms with first mover advantages (the economic and strategic advantages that accrue to many entrants into an industry) will develop economies of scale and create barriers to entry for other firms
- The pattern of trade we observe in the world economy may be the result of first mover advantages and economies of scale

5-39

Implications of New Trade Theory

- New trade theory suggests
 - Nations may benefit from trade even when they do not differ in resource endowments or technology
 - A country may predominate in the export of a good simply because it was lucky enough to have one or more firms among the first to produce that good
- Thus, new trade theory provides an economic rationale for a proactive trade policy that is at variance with other free trade theories

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National Competitive Advantage: Porter's Diamond

- Porter (1990) tried to explain why a nation achieves international success in a particular industry
- Porter identified four attributes he calls the diamond that promote or impede the creation of competitive advantage
 1. Factor endowments
 2. Demand conditions
 3. Related and supporting industries
 4. Firm strategy, structure, and rivalry
- In addition, Porter identified two additional variables (chance and government) that can influence the diamond in important ways

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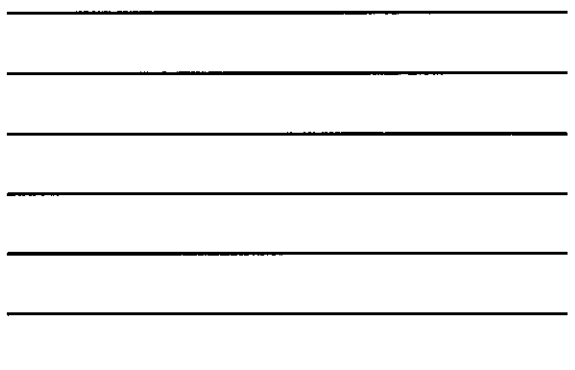
National Competitive Advantage: Porter's Diamond

Determinants of National Competitive Advantage: Porter's Diamond

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graph TD; A[Government] <--> B[Private Enterprise]; B <--> C[Academia]; C <--> D[Government]; A <--> C; B <--> D
```

The diagram illustrates Porter's Diamond model, showing four determinants of national competitive advantage arranged in a diamond shape, interconnected by arrows. The determinants are: Government (top), Private Enterprise (left), Academia (right), and Government (bottom). The arrows indicate a complex, interdependent relationship between these factors.

5-42



Factor Endowments

- A nation's position in factor endowments (factors of production) can lead to competitive advantage
- These factors can be either basic (natural resources, climate, location) or advanced (skilled labor, infrastructure, technological know-how)
- Basic factors can provide an initial advantage that is then reinforced and extended by investment in advanced factors

Demand Conditions

- Demand conditions refers to the nature of home demand for an industry's product or service
- Demand conditions influence the development of capabilities
- Sophisticated and demanding customers pressure firms to be more competitive and to produce high quality, innovative products

Related and Supporting Industries

- Related and supporting industries refers to the presence supplier industries and related industries that are internationally competitive
- Investing in these industries can spill over and contribute to success in other industries
- Successful industries tend to be grouped in clusters in countries which then prompts knowledge flows between firms
 - Having world class manufacturers of semi-conductor processing equipment can lead to (and be a result of having) a competitive semi-conductor industry

Firm Strategy, Structure, and Rivalry

- Firm strategy, structure, and rivalry refers to the conditions in the nation governing how companies are created, organized, and managed, and the nature of domestic rivalry
- Different nations are characterized by different management ideologies which influence the ability of firms to build national competitive advantage
- There is a strong association between vigorous domestic rivalry and the creation and persistence of competitive advantage in an industry

5-46

Evaluating Porter's Theory

- Porter suggests that the four attributes of the diamond together with government policy, and chance work as a reinforcing system, complementing each other and in combination creating the conditions appropriate for competitive advantage
- Porter believes that government policy can affect demand through product standards, influence rivalry through regulation and antitrust laws, and impact the availability of highly educated workers and advanced transportation infrastructure

5-47

Evaluating Porter's Theory

Question: Is Porter right?

- If Porter is correct, his model should predict the pattern of international trade in the real world
 - Countries should export products from industries where the diamond is favorable
 - Countries should import products from areas where the diamond is not favorable
- So, far there has been little empirical testing of the theory

5-48

Location

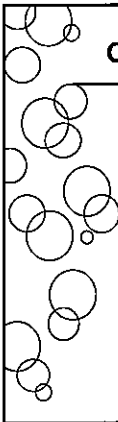
- Different countries have advantages in different productive activities
- These differences influence a firm's decision about where to locate productive activities
- It makes sense for a firm to disperse its various productive activities to those countries where they can be performed most efficiently

First-Mover Advantages

- Firms that establish a first-mover advantage in the production of a new product may later dominate global trade in that product
- It can be worthwhile for a firm to invest resources in trying to build first-mover advantages, even if it means losses for a few years before a venture becomes profitable



Government Policy

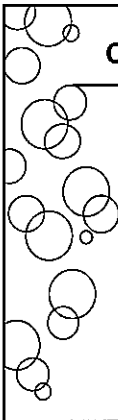
- Government policies with respect to free trade or protecting domestic industries can significantly impact global competitiveness
- Businesses should work to encourage governmental policies that support free trade



Critical Discussion Question



Is free trade fair? Discuss!

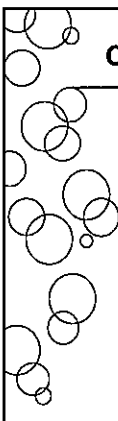




Critical Discussion Question



Unions in developed nations often oppose imports from low-wage countries and advocate trade barriers to protect jobs from what they often characterize as "unfair" import competition. Is such competition "unfair?" Do you think that this argument is in the best interests of (a) the unions, (b) the people they represent, and/or (c) the country as a whole?






Critical Discussion Question

What are the potential costs of adopting a free trade regime? Do you think governments should do anything to reduce these costs? What?







Critical Discussion Question

. Reread the Country Focus on "Is China a Neo-Mercantilist Nation?"


- Do you think China is pursuing an economic policy that can be characterized as neo-Mercantilist?
- What should the United States, and other countries, do about this?






Critical Discussion Question


Drawing upon the new trade theory and Porter's theory of national competitive advantage, outline the case for government policies that would build national competitive advantage in biotechnology. What kind of policies would you recommend that the government adopt? Are these policies at variance with the basic free trade philosophy?

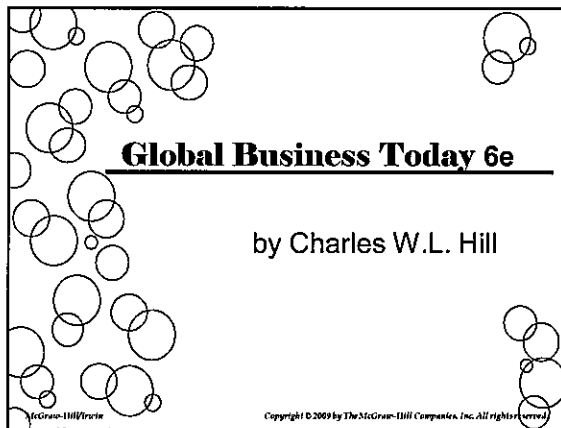


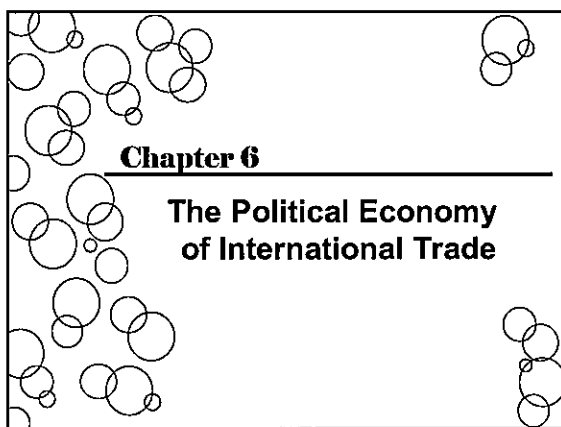


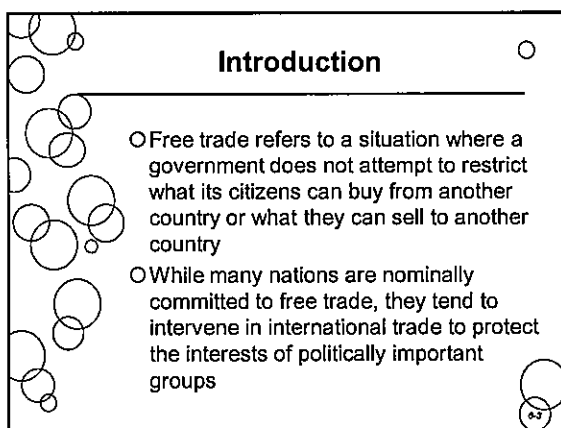
Critical Discussion Question


The world's poorest countries are at a competitive disadvantage in every sector of their economies. They have little to export. They have no capital; their land is of poor quality; they often have too many people given available work opportunities; and they are poorly educated. Free trade cannot possibly be in the interests of such nations! Discuss.













Instruments of Trade Policy

Question: How do governments intervene in international trade?


- There are seven main instruments of trade policy
 1. Tariffs
 2. Subsidies
 3. Import quotas
 4. Voluntary export restraints
 5. Local content requirements
 6. Antidumping policies
 7. Administrative policies






Tariffs

- A tariff is a tax levied on imports that effectively raises the cost of imported products relative to domestic products
- Specific tariffs are levied as a fixed charge for each unit of a good imported
- Ad valorem tariffs are levied as a proportion of the value of the imported good






Tariffs

Question: Why do governments impose tariffs?

- Tariffs
 - Increase government revenues
 - Provide protection to domestic producers against foreign competitors by increasing the cost of imported foreign goods
 - Force consumers to pay more for certain imports
- So, tariffs are unambiguously pro-producer and anti-consumer, and tariffs reduce the overall efficiency of the world economy



Subsidies

- A subsidy is a government payment to a domestic producer
- Subsidies help domestic producers
 - compete against low-cost foreign imports
 - gain export markets
- Consumers typically absorb the costs of subsidies

Import Quotas and Voluntary Export Restraints

- An import quota is a direct restriction on the quantity of some good that may be imported into a country
- Tariff rate quotas are a hybrid of a quota and a tariff where a lower tariff is applied to imports within the quota than to those over the quota
- Voluntary export restraints are quotas on trade imposed by the exporting country, typically at the request of the importing country's government
- A quota rent is the extra profit that producers make when supply is artificially limited by an import quota

Import Quotas and Voluntary Export Restraints

Question: Who benefits from import quotas and voluntary export restraints?

- Import quotas and voluntary export restraints benefit domestic producers by limiting import competition, but they raise the prices of imported goods for consumers

Local Content Requirements

- A local content requirement demands that some specific fraction of a good be produced domestically
 - The requirement can be in physical terms or in value terms
- Local content requirements benefit domestic producers and jobs, but consumers face higher prices

Administrative Policies

- Administrative trade policies are bureaucratic rules that are designed to make it difficult for imports to enter a country
- These policies hurt consumers by denying access to possibly superior foreign products

Administrative Policies

- Dumping is selling goods in a foreign market below their cost of production, or selling goods in a foreign market at below their "fair" market value
 - It can be a way for firms to unload excess production in foreign markets
 - Some dumping may be predatory behavior, with producers using substantial profits from their home markets to subsidize prices in a foreign market with a view to driving indigenous competitors out of that market, and later raising prices and earning substantial profits

Administrative Policies

- Antidumping policies are designed to punish foreign firms that engage in dumping
- The goal is to protect domestic producers from "unfair" foreign competition
- U.S. firms that believe a foreign firm is dumping can file a complaint with the government
- If the complaint has merit, antidumping duties, also known as countervailing duties may be imposed

6-13

The Case for Government Intervention

Question: Why do governments intervene in trade?

- There are two types of arguments
 1. Political arguments are concerned with protecting the interests of certain groups within a nation (normally producers), often at the expense of other groups (normally consumers)
 2. Economic arguments are typically concerned with boosting the overall wealth of a nation (to the benefit of all, both producers and consumers)

6-14

Political Arguments for Intervention

- Political arguments for government intervention include
 1. protecting jobs
 2. protecting industries deemed important for national security
 3. retaliating to unfair foreign competition
 4. protecting consumers from "dangerous" products
 5. furthering the goals of foreign policy
 6. protecting the human rights of individuals in exporting countries

6-15

Political Arguments for Intervention

- Protecting jobs and industries
 - This is the most common political reason for trade restrictions
 - This is typically the result of political pressures by unions or industries that are "threatened" by more efficient foreign producers, and have more political clout than the consumers who will eventually pay the costs

6-16

Political Arguments for Intervention

- National Security
 - Governments sometimes protect certain industries such as aerospace or advanced electronics because they are important for national security
 - This argument is less common today than in the past

6-17

Political Arguments for Intervention

- Retaliation
 - When governments take, or threaten to take, specific actions, other countries may remove trade barriers
 - This can be a risky strategy
 - If threatened governments don't back down, tensions can escalate and new trade barriers may be enacted

6-18

Political Arguments for Intervention

4. Protecting Consumers

- Protecting consumers from unsafe products is also be an argument for restricting imports
- This often involves limiting or banning the import of certain products

5-10

Political Arguments for Intervention

5. Furthering Foreign Policy Objectives

- Trade policy can be used to support foreign policy objectives
 - Preferential trade terms can be granted to countries that a government wants to build strong relations with
 - Rogue states that do not abide by international laws or norms can be punished
- However, it might cause other countries to undermine unilateral trade sanctions
- Two acts, the Helms-Burton Act and the D'Amato Act, have been passed to protect American companies from such actions

6-20

Political Arguments for Intervention

6. Protecting Human Rights

- Governments can use trade policy to improve the human rights policies of trading partners
 - Unless a large number of countries choose to take such action, however, it is unlikely to prove successful
- Some critics have argued that the best way to change the internal human rights of a country is to engage it in international trade
 - The decision to grant China MFN status in 1999 was based on this philosophy

6-21

Economic Arguments for Intervention


- Economic arguments for government intervention in international trade include
 1. The infant industry argument
 2. Strategic trade policy

Economic Arguments for Intervention

1. The infant industry argument
 - The infant industry argument suggests that an industry should be protected until it can develop and be viable and competitive internationally
 - This has been accepted as a justification for temporary trade restrictions under the WTO
 - However, this argument has been criticized because
 - it is useless unless it makes the industry more efficient
 - if a country has the potential to develop a viable competitive position, its firms should be capable of raising necessary funds
- Critics argue that


Economic Arguments for Intervention


2. Strategic Trade Policy
 - Strategic trade policy suggests that in cases where there may be important first mover advantages, governments can help firms from their countries attain these advantages
 - Strategic trade policy also suggests that governments can help firms overcome barriers to entry into industries where foreign firms have an initial advantage



The Revised Case for Free Trade


- New trade theorists believe government intervention in international trade is justified
- Classic trade theorists disagree
- Some new trade theorists believe that while strategic trade theory is appealing in theory, it may not be workable in practice – they suggest a revised case for free trade
- Two situations where restrictions on trade may be inappropriate
 - Retaliation
 - Domestic Policies






Retaliation and War


- Krugman argues that strategic trade policies aimed at establishing domestic firms in a dominant position in a global industry are beggar-thy-neighbor policies that boost national income at the expense of other countries
- A country that attempts to use such policies will probably provoke retaliation
 - A trade war could leave both countries worse off






Domestic Policies



- Governments can be influenced by special interest
- Consequently, a government's decision to intervene in a market may appease a certain group, but not necessarily the support the interests of the country as a whole






Development of the World Trading System



- Since World War II, an international trading framework has evolved to govern world trade
- In its first fifty years, the framework was known as the General Agreement on Tariffs and Trade (GATT)
- Since 1995, the framework has been known as the World Trade Organization (WTO)







From Smith to the Great Depression



- Up until the Great Depression of the 1930s, most countries had some degree of protectionism
- In 1930, the U.S. enacted the Smoot-Hawley Act, which created significant import tariffs on foreign goods
- Other nations took similar steps and as the depression deepened, world trade fell further



1947-1979: GATT, Trade Liberalization, and Economic Growth

- After WWII, the U.S. and other nations realized the value of freer trade, and established the General Agreement on Tariffs and Trade in 1947
- The approach of GATT (a multilateral agreement to liberalize trade) was to gradually eliminate barriers to trade
 - GATT's membership grew from 19 to more than 120 nations
 - Tariff reduction was spread over eight rounds of negotiation
 - GATT regulations were enforced by a mutual monitoring system

1980-1993: Protectionist Trends

- The world trading system came under strain during the 1980s and early 1990s because
 - Japan's economic success strained what had been more equal trading patterns
 - Persistent trade deficits by the U.S caused significant problems in some industries and political problems for the government
 - Many countries found that although GATT limited the use of tariffs, there were many other forms of intervention that had the same effect that did not technically violate GATT

6-31

The Uruguay Round and the World Trade Organization


- The Uruguay Round (1986) focused on
 1. Services and Intellectual Property
 - Trade issues related to services and intellectual property and agriculture were emphasized
 2. The World Trade Organization
 - The WTO was established as a more effective policeman of the global trade rules
 - The WTO encompassed GATT and the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS)

6-32

WTO Experience to Date

- Since its establishment, the WTO has emerged as an effective advocate and facilitator of future trade deals, particularly in such areas as services
 - So far, most countries have adopted WTO recommendations for trade disputes
 - The WTO has brokered negotiations to reform the global telecommunications and financial services industries
 - The 1999 meeting of the WTO in Seattle demonstrated that issues surrounding free trade have become mainstream, and dependent on popular opinion

6-33




The Future of the WTO: Unresolved Issues and the Doha Round ○

The WTO is currently focusing on

1. Anti-dumping policies
 - The WTO is encouraging members to strengthen the regulations governing the imposition of antidumping duties
2. Protectionism in agriculture
 - The WTO is concerned with the high level of tariffs and subsidies in the agricultural sector of many economies
3. Protecting intellectual property
 - Members believe that the protection of intellectual property rights is essential to the international trading system
 - TRIPS obliges WTO members to grant and enforce patents lasting at least 20 years and copyrights lasting 50 years


6-24



The Future of the WTO: Unresolved Issues and the Doha Round ○

4. Market access for nonagricultural goods and services
 - The WTO would like to bring down tariff rates on nonagricultural goods and services, and reduce the scope for the selective use of high tariff rates
5. A new round of talks: Doha
 - The WTO launched a new round of talks in 2001 to focus on
 - cutting tariffs on industrial goods and services
 - phasing out subsidies to agricultural producers
 - reducing barriers to cross-border investment
 - limiting the use of anti-dumping laws

6-25



Implications for Managers ○

Question: Why should international managers care about the political economy of free trade or about the relative merits of arguments for free trade and protectionism?

- Trade barriers impact firm strategy
- Firms can play a role in promoting free trade or trade barriers

6-26

Trade Barriers and Firm Strategy

- Trade theory suggests why dispersing production activities globally can be beneficial
- However, trade barriers may limit a firm's ability to do so
 - Trade barriers raise the cost of exporting
 - Quotas limit exports
 - Firms may have to locate production activities within a country to meet local content regulations
 - The threat of future trade barriers can influence firm strategy
- All of these can raise costs above what they may have been in a world of free trade

6-37

Policy Implications


- International firms have an incentive to lobby for free trade, and keep protectionist pressures from causing them to have to change strategies
- While there may be short run benefits to having government protection in some situations, in the long run these can backfire and other governments can retaliate making it more difficult to construct a globally dispersed production system

6-38

Critical Discussion Question


1. Do you think the U.S. government should consider human rights when granting preferential trading rights to countries? What are the arguments for and against taking such a position?


6-39



Critical Discussion Question


Whose interests should be the paramount concern of government trade policy - the interests of producers (businesses and their employees) or those of consumers?






Critical Discussion Question


Given the arguments relating to the new trade theory and strategic trade policy, what kind of trade policy should business be pressuring government to adopt?





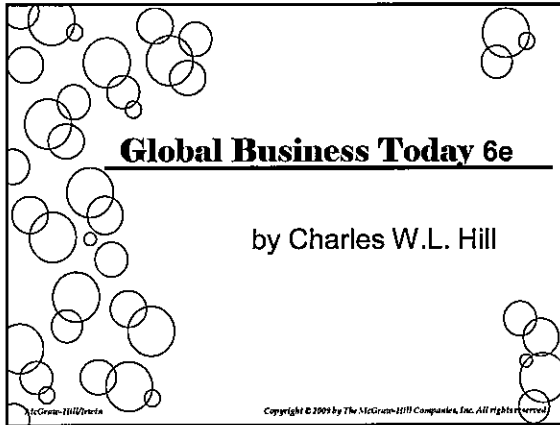
Critical Discussion Question

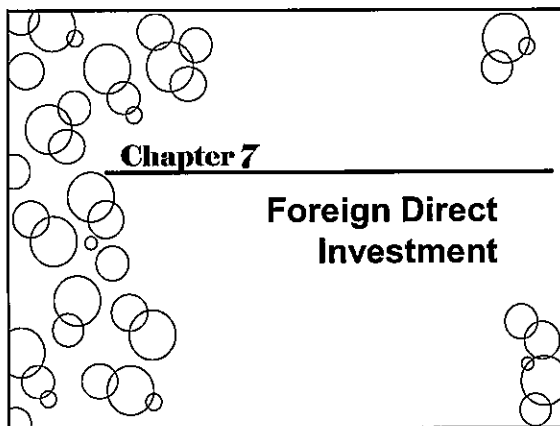
You are an employee of an U.S. firm that produces personal computers in Thailand and then exports them to the U.S. and other countries for sale. The personal computers were originally produced in Thailand to take advantage of relatively low labor costs and a skilled workforce. Other possible locations considered at that time were Malaysia and Hong Kong. The U.S. government decides to impose punitive 100 percent ad valorem tariffs on imports of computers from Thailand to punish the country for administrative trade barriers that restrict U.S. exports to Thailand. How should your firm respond? What does this tell you about the use of targeted trade barriers?

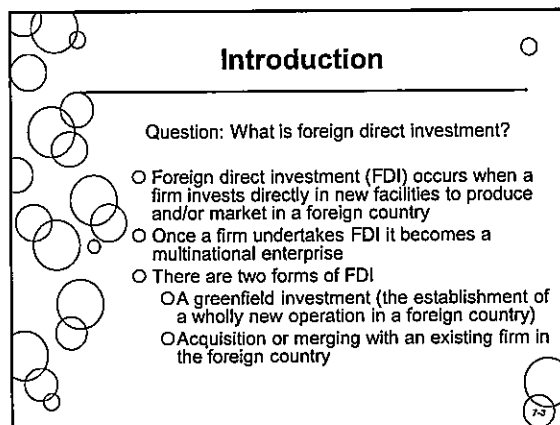


Critical Discussion Question

Reread the Management Focus feature on U.S. Magnesium Seeks Protection. Who gains most from the anti-dumping duties levied by the United States on imports of magnesium from China and Russia? Who are the losers? Are these duties in the best national interests of the United States?







Foreign Direct Investment in the World Economy

- There are two ways to look at FDI
 - The flow of FDI refers to the amount of FDI undertaken over a given time period
 - The stock of FDI refers to the total accumulated value of foreign-owned assets at a given time
- Outflows of FDI are the flows of FDI out of a country
- Inflows of FDI are the flows of FDI into a country

Trends in FDI

- Both the flow and stock of FDI in the world economy has increased over the last 20 years
- FDI has grown more rapidly than world trade and world output because
 - firms still fear the threat of protectionism
 - the general shift toward democratic political institutions and free market economies has encouraged FDI
 - the globalization of the world economy is prompting firms to undertake FDI to ensure they have a significant presence in many regions of the world

Trends in FDI

FDI Outflows 1982-2007

Year	Outflows (Billions)
1982	50
1983	100
1984	150
1985	200
1986	250
1987	300
1988	350
1989	400
1990	450
1991	500
1992	550
1993	600
1994	650
1995	700
1996	750
1997	800
1998	850
1999	900
2000	950
2001	1000
2002	1050
2003	1100
2004	1150
2005	1200
2006	1250
2007	1300

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The Source of FDI

- Since World War II, the U.S. has been the largest source country for FDI
- Other important source countries include the United Kingdom, the Netherlands, France, Germany, and Japan
- These countries also predominate in rankings of the world's largest multinationals

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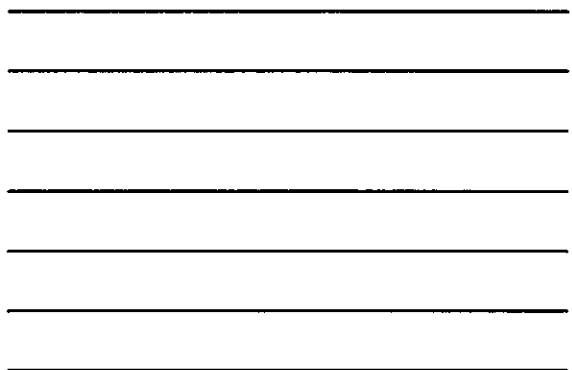
The Source of FDI

Cumulative FDI Outflows 1998 - 2006

Country	Cumulative FDI Outflows (U.S. Dollars in billions)
France	~800
Japan	~350
Germany	~400
Netherlands	~450
United Kingdom	~1000
United States	~1350

A horizontal bar chart comparing the values of six countries in U.S. Dollars (billions). The x-axis is labeled 'U.S. Dollars (billions)' and ranges from 0 to 1400 in increments of 200. The y-axis lists the countries: France, Japan, Germany, Netherlands, United Kingdom, and United States. The bars are black with a white grid pattern. The United States has the highest value at approximately 1350 billion, followed by the United Kingdom at 1000 billion, France at 850 billion, Japan at 500 billion, Germany at 450 billion, and the Netherlands at 400 billion.


Country	U.S. Dollars (billions)
France	850
Japan	500
Germany	450
Netherlands	400
United Kingdom	1000
United States	1350



The Form of FDI: Acquisitions versus Greenfield Investments



- The majority of cross-border investment involves mergers and acquisitions rather than greenfield investments
- Firms prefer to acquire existing assets because
 - mergers and acquisitions are quicker to execute than greenfield investments
 - it is easier and perhaps less risky for a firm to acquire desired assets than build them from the ground up
 - firms believe they can increase the efficiency of an acquired unit by transferring capital, technology, or management skills

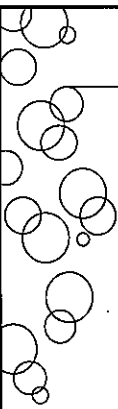
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The Shift to Services

- In the last two decades, there has been a shift towards FDI in services
- The shift to services is being driven by
 - the general move in many developed countries toward services
 - the fact that many services cannot be exported
 - a liberalization of policies governing FDI in services
 - the rise of Internet-based global telecommunications networks that have allowed some service enterprises to relocate some of their value creation activities to different nations to take advantage of favorable factor costs






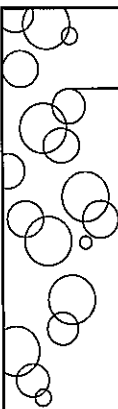


Theories of Foreign Direct Investment

Question: Why do firms prefer FDI to either exporting (producing goods at home and then shipping them to the receiving country for sale) or licensing (granting a foreign entity the right to produce and sell the firm's product in return for a royalty fee on every unit that the foreign entity sells)?

- To answer this question, we need to look at the limitations of exporting and licensing, and the advantages of FDI








Theories of Foreign Direct Investment

1. Limitations of Exporting

- The viability of an exporting strategy can be constrained by transportation costs and trade barriers
 - When transportation costs are high, exporting can be unprofitable
 - Foreign direct investment may be a response to actual or threatened trade barriers such as import tariffs or quotas

Theories of Foreign Direct Investment

- 2. Limitations of Licensing
 - Internalization theory (also known as market imperfections) suggests that licensing has three major drawbacks
 - it may result in a firm's giving away valuable technological know-how to a potential foreign competitor
 - it does not give a firm the tight control over manufacturing, marketing, and strategy in a foreign country that may be required to maximize its profitability
 - It may be difficult if the firm's competitive advantage is not amenable to licensing

7-16

The Pattern of Foreign Direct Investment


- 3. Advantages of Foreign Direct Investment
 - A firm will favor FDI over exporting as an entry strategy when
 - transportation costs are high
 - trade barriers are high
 - A firm will favor FDI over licensing when
 - it wants control over its technological know-how
 - it wants over its operations and business strategy
 - the firm's capabilities are not amenable to licensing

7-17

The Pattern of Foreign Direct Investment


- It is common for firms in the same industry to
 - have similar strategic behavior and undertake foreign direct investment around the same time
 - direct their investment activities towards certain locations at certain stages in the product life cycle

7-18




The Pattern of Foreign Direct Investment

- 1. Strategic Behavior
 - Knickerbocker explored the relationship between FDI and rivalry in oligopolistic industries (industries composed of a limited number of large firms)
 - Knickerbocker suggested that FDI flows are a reflection of strategic rivalry between firms in the global marketplace
 - This theory can be extended to embrace the concept of multipoint competition (when two or more enterprises encounter each other in different regional markets, national markets, or industries)



The Pattern of Foreign Direct Investment

- 2. The Product Life Cycle
 - Vernon argues that firms undertake FDI at particular stages in the life cycle of a product they have pioneered
 - Firms invest in other advanced countries when local demand in those countries grows large enough to support local production
 - Firms then shift production to low-cost developing countries when product standardization and market saturation give rise to price competition and cost pressures



The Eclectic Paradigm

- John Dunning's eclectic paradigm argues that in addition to the various factors discussed earlier, two additional factors must be considered when explaining both the rationale for and the direction of foreign direct investment
 - Location-specific advantages (that arise from using resource endowments or assets that are tied to a particular location and that a firm finds valuable to combine with its own unique assets)
 - Externalities (knowledge spillovers that occur when companies in the same industry locate in the same area)

Political Ideology and Foreign Direct Investment

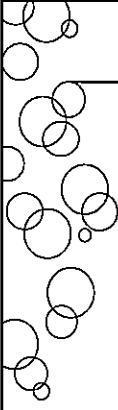
- Ideology toward FDI has ranged from a radical stance that is hostile to all FDI to the non-interventionist principle of free market economies
- Between these two extremes is an approach that might be called pragmatic nationalism

The Radical View

- The radical view argues that the MNE is an instrument of imperialist domination and a tool for exploiting host countries to the exclusive benefit of their capitalist-imperialist home countries
- The radical view has been in retreat because of
 - the collapse of communism in Eastern Europe
 - the poor economic performance of those countries that had embraced the policy
 - the strong economic performance of developing countries that had embraced capitalism

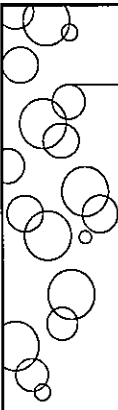
The Free Market View

- The free market view argues that international production should be distributed among countries according to the theory of comparative advantage
 - So, the MNE increases the overall efficiency of the world economy
- The free market view has been embraced by advanced and developing nations, including the United States, Britain, Chile, and Hong Kong



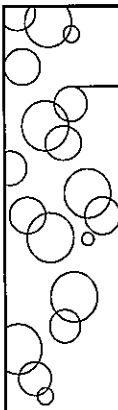
Pragmatic Nationalism

- The pragmatic nationalist view is that FDI has both benefits, such as inflows of capital, technology, skills and jobs, and costs, such as repatriation of profits to the home country and a negative balance of payments effect
- According to this view, FDI should be allowed only if the benefits outweigh the costs



Shifting Ideology

- In recent years, there has been a strong shift toward the free market stance creating
 - a surge in the volume of FDI worldwide
 - an increase in the volume of FDI directed at countries that have recently liberalized their regimes



Benefits and Costs of FDI

Question: What are the benefits and costs of FDI?

- The benefits and costs of FDI must be explored from the perspective of both the host (receiving) country and the home (source) country

Host Country Benefits

- Resource Transfer Effects
 - FDI can make a positive contribution to a host economy by supplying capital, technology, and management resources that would otherwise not be available
- Employment Effects
 - FDI can bring jobs to a host country that would otherwise not be created there

7-28

Host Country Benefits

- Balance-of-Payments Effects
 - A country's balance-of-payments account is a record of a country's payments to and receipts from other countries
 - The current account is a record of a country's export and import of goods and services
 - A current account surplus is usually favored over a deficit
 - FDI can help achieve a current account surplus
 - If the FDI is a substitute for imports of goods and services
 - If the MNE uses a foreign subsidiary to export goods and services to other countries

7-29

Host Country Benefits

- Effect on Competition and Economic Growth
 - FDI in the form of greenfield investment
 - Increases the level of competition in a market
 - Drives down prices
 - Improves the welfare of consumers
 - Increased competition can lead to
 - Increased productivity growth
 - Product and process innovation
 - Greater economic growth

7-30

Host Country Costs

- There are three main costs of inward FDI
 1. the possible adverse effects of FDI on competition within the host nation
 2. adverse effects on the balance of payments
 3. the perceived loss of national sovereignty and autonomy

7-31

Host Country Costs

1. Adverse Effects on Competition
 - Host governments worry that the subsidiaries of foreign MNEs operating in their country may have greater economic power than indigenous competitors because they may be part of a larger international organization
 - As part of larger organization, the MNE could draw on funds generated elsewhere to subsidize costs in the local market
 - Doing so could allow the MNE to drive indigenous competitors out of the market and create a monopoly position

7-32

Host Country Costs

2. Adverse Effects on the Balance of Payments
 - There are two possible adverse effects of FDI on a host country's balance-of-payments
 - With the initial capital inflows that come with FDI must be the subsequent outflow of capital as the foreign subsidiary repatriates earnings to its parent country
 - When a foreign subsidiary imports a substantial number of its inputs from abroad, there is a debit on the current account of the host country's balance of payments

7-33

Host Country Costs

- 3. National Sovereignty and Autonomy
 - Many host governments worry that FDI is accompanied by some loss of economic independence
 - Key decisions that can affect the host country's economy will be made by a foreign parent that has no real commitment to the host country, and over which the host country's government has no real control

7-34

Home Country Benefits

- The benefits of FDI to the home country include
 - the effect on the capital account of the home country's balance of payments from the inward flow of foreign earnings
 - the employment effects that arise from outward FDI
 - the gains from learning valuable skills from foreign markets that can subsequently be transferred back to the home country

7-35

Home Country Costs

- The most important concerns for the home country center around
 - The balance-of-payments
 - The balance of payments suffers from the initial capital outflow required to finance the FDI
 - The current account is negatively affected if the purpose of the FDI is to serve the home market from a low-cost production location
 - The current account suffers if the FDI is a substitute for direct exports

7-36

Home Country Costs

- 2. Employment effects of outward FDI
 - If the home country is suffering from unemployment, there may be concern about the export of jobs

7-37

International Trade Theory and FDI


- International trade theory suggests that home country concerns about the negative economic effects of offshore production (FDI undertaken to serve the home market) may not be valid
 - FDI may actually stimulate economic growth by freeing home country resources to concentrate on activities where the home country has a comparative advantage
 - Consumers may also benefit in the form of lower prices

7-38

Government Policy Instruments and FDI


- FDI can be regulated by both home and host countries
- Governments can implement policies to
 1. encourage FDI
 2. discourage FDI

7-39




Home Country Policies

- Encouraging Outward FDI
 - Many nations now have government-backed insurance programs to cover major types of foreign investment risk
 - This type of policy can encourage firms to undertake FDI in politically unstable nations
 - Many countries have eliminated also double taxation of foreign income
 - Many host nations have relaxed restrictions on inbound FDI



Home Country Policies

- Restricting Outward FDI
 - Virtually all investor countries, including the United States, have exercised some control over outward FDI from time to time
 - Some countries manipulate tax rules to make it more favorable for firms to invest at home
 - Countries may restrict firms from investing in certain nations for political reasons



Host Country Policies

- Encouraging Inward FDI
 - Governments offer incentives to foreign firms to invest in their countries
 - Incentives are motivated by a desire to gain from the resource-transfer and employment effects of FDI, and to capture FDI away from other potential host countries

Host Country Policies

- 2. Restricting Inward FDI
 - Ownership restraints and performance requirements (controls over the behavior of the MNE's local subsidiary) are used to restrict FDI
 - Ownership restraints
 - exclude foreign firms from certain sectors on the grounds of national security or competition
 - are often based on a belief that local owners can help to maximize the resource transfer and employment benefits of FDI
 - Performance requirements are used to maximize the benefits and minimize the costs of FDI for the host country

International Institutions and the Liberalization of FDI

- Until recently there has been no consistent involvement by multinational institutions in the governing of FDI
- The formation of the World Trade Organization in 1995 is changing this
 - The WTO has had some success in establishing a universal set of rules to promote the liberalization of FDI

Implications for Managers

Question: What does FDI mean for international businesses?

- The theory of FDI has implications for strategic behavior of firms
- Government policy on FDI can also be important for international businesses

The Theory of FDI

- The location-specific advantages argument associated with John Dunning help explain the direction of FDI
- However, internalization theory is needed to explain why firms prefer FDI to licensing or exporting
 - Exporting is preferable to licensing and FDI as long as transportation costs and trade barriers are low

The Theory of FDI

- Licensing is unattractive when
 - the firm's proprietary property cannot be properly protected by a licensing agreement
 - the firm needs tight control over a foreign entity in order to maximize its market share and earnings in that country
 - the firm's skills and capabilities are not amenable to licensing

The Theory of FDI

A Decision Framework

Government Policy

- A host government's attitude toward FDI is an important in decisions about where to locate foreign production facilities and where to make a foreign direct investment
- A firm's bargaining power with the host government is highest when
 - the host government places a high value on what the firm has to offer
 - when there are few comparable alternatives available
 - when the firm has a long time to negotiate

Critical Discussion Question

1. In 2004, inward FDI accounted for some 24 percent of gross capital formation in Ireland, but only 0.6 percent in Japan. What do you think explains this difference in FDI inflows into the two countries?

Critical Discussion Question

2. Compare and contrast these explanations of FDI: internalization theory, Vernon's product life cycle theory, and Knickerbocker's theory of FDI. Which theory do you think offers the best explanation of the historical pattern of horizontal FDI? Why?

Critical Discussion Question

Reread the Management Focus on Cemex and then answer the following questions:

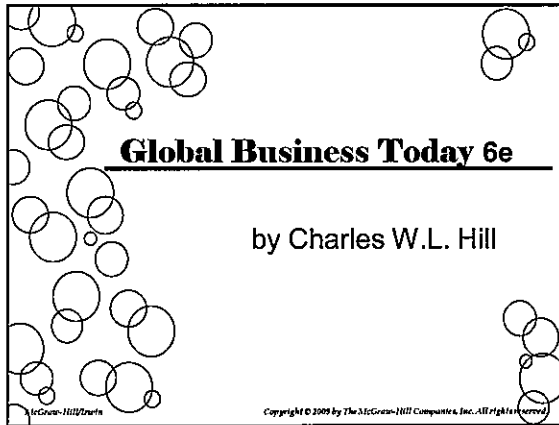
- a) Which theoretical explanation, or explanations, of FDI best explains Cemex's FDI?
- b) What is the value that Cemex brings to the host economy? Can you see any potential drawbacks of inward investment by Cemex in an economy?
- c) Cemex has a strong preference for acquisitions over greenfield ventures as an entry mode. Why?
- d) Why do you think Cemex decided to exit Indonesia after failing to gain majority control of Semen Gresik? Why is majority control so important to Cemex?
- e) Why do you think politicians in Indonesia tried to block Cemex's attempt to gain majority control over Semen Gresik? Do you think Indonesia's best interests were served by limiting Cemex's FDI in the country?

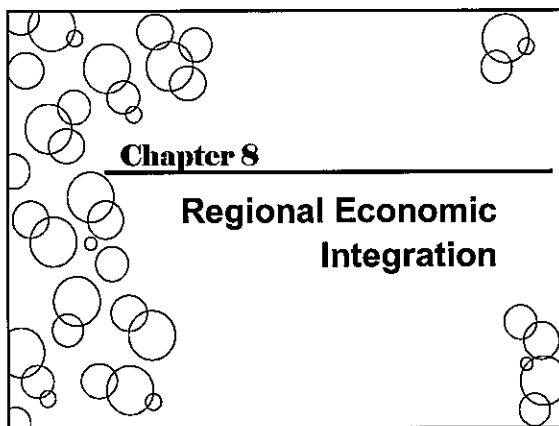
7-32

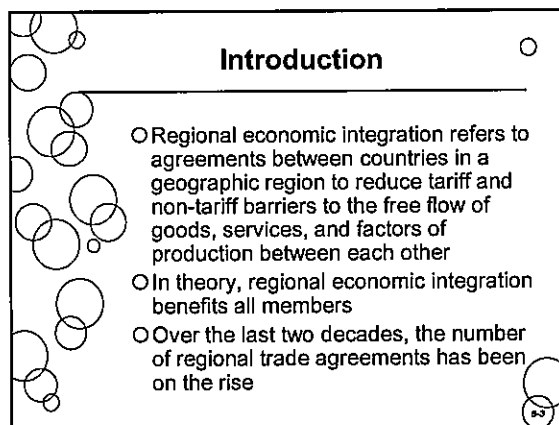
Critical Discussion Question

You are the international manager of a US business that has just invented a revolutionary new personal computer that can perform the same functions as PCs, but costs only half as much to manufacture. Your CEO has asked you to decide how to expand into the European Union market. Your options are (i) to export from the United States, (ii) to license a European firm to manufacture and market the computer in Europe, and (iii) to set up a wholly owned subsidiary in Europe. Evaluate the pros and cons of each alternative and suggest a course of action to your CEO.

7-33







Introduction

Question: Is regional economic integration a good thing?


- While regional trade agreements are designed to promote free trade, there is some concern that the world is moving toward a situation in which a number of regional trade blocks compete against each other
- If this scenario materializes, the gains from free trade within blocs could be offset by a decline in trade between blocs

Levels of Economic Integration

- There are five levels of economic integration
 - Free trade area - all barriers to the trade of goods and services among member countries are removed, but members determine their own trade policies with regard to nonmembers
- This is the most popular form of integration
- Examples include
 - the European Free Trade Association (between Norway, Iceland, Liechtenstein, and Switzerland)
 - the North American Free Trade Agreement (between the U.S., Canada, and Mexico)


Levels of Economic Integration


Levels of Economic Integration



Levels of Economic Integration


- 2. Customs union - eliminates trade barriers between member countries and adopts a common external trade policy
 - Most countries that enter a customs union desire further integration in the future
 - Examples include
 - Othe Andean Pact (between Bolivia, Columbia, Ecuador, Venezuela, and Peru)






Levels of Economic Integration


- 3. Common market - no barriers to trade between member countries, a common external trade policy, and the free movement of the factors of production
 - This type of integration can be difficult to achieve and requires significant harmony among members in fiscal, monetary, and employment policies
 - Examples include
 - OMERCOSUR (between Brazil, Argentina, Paraguay, and Uruguay) hope to achieve this status





Levels of Economic Integration

- 4. Economic union - involves the free flow of products and factors of production between members, the adoption of a common external trade policy, and in addition, a common currency, harmonization of the member countries' tax rates, and a common monetary and fiscal policy
 - This level of integration involves sacrificing a significant amount of national sovereignty
 - Examples include
 - Othe European Union (EU)



Levels of Economic Integration ○

- 5. Political union - independent states are combined into a single union
 - This requires that a central political apparatus coordinate economic, social, and foreign policy for member states
 - The EU is headed toward at least partial political union, and the United States is an example of even closer political union

8-10

The Case for Regional Integration ○


- There are both economic and political arguments supporting regional economic integration
- Generally, many groups within a country oppose the notion of economic integration

8-11

The Economic Case for Integration ○


- Regional economic integration is an attempt to achieve additional gains from the free flow of trade and investment between countries beyond those attainable under international agreements such as the WTO
- Since it is easier to form an agreement with a few countries than across all nations, there has been a push toward regional economic integration

8-12



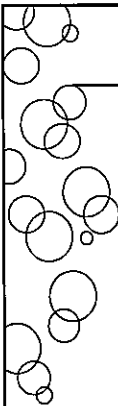
The Political Case for Integration

- Politically, integration is attractive because
 - by linking countries together, making them more dependent on each other, and forming a structure where they regularly have to interact, the likelihood of violent conflict and war will decrease
 - by linking countries together, they have greater clout and are politically much stronger in dealing with other nations



Impediments to Integration

- Integration is not easy to achieve or maintain
- There are two main impediments to integration
 - it can be costly - while a nation as a whole may benefit from a regional free trade agreement, certain groups may lose
 - it can result in a loss of national sovereignty



The Case Against Regional Integration

- Regional economic integration only makes sense when the amount of trade it creates exceeds the amount it diverts
- Trade creation occurs when low cost producers within the free trade area replace high cost domestic producers
- Trade diversion occurs when higher cost suppliers within the free trade area replace lower cost external suppliers

Regional Economic Integration in Europe

- Europe has two trade blocs
 - the European Union with 27 members
 - the European Free Trade Association with 4 members
- The European Union is expected to become a superpower of the same order as the United States

6-16

Evolution of the European Union

- The European Union (EU) is the result of
 - the devastation of two world wars on Western Europe and the desire for a lasting peace
 - the desire by the European nations to hold their own on the world's political and economic stage
- The forerunner of the EU was the European Coal and Steel Community (formed in 1951)
- The Treaty of Rome established the European Economic Community in 1957
 - The name was changed to the EU in 1994

6-17

Evolution of the European Union

Member States of the European Union in 2008

6-18

Political Structure of the European Union

- The four main institutions of the EU are
 - the European Commission - proposes EU legislation, implements it, and monitors compliance
 - the European Council - the ultimate controlling authority within the EU
 - the European Parliament - debates legislation proposed by the commission and forwarded to it by the council
 - the Court of Justice - the supreme appeals court for EU law

6-10

The Single European Act

- The Single European Act (1987) committed EC countries to work toward establishment of a single market by 1992
- The Act was born out of frustration among EC members that the community was not living up to its promise
- The Act proposed to
 - remove all frontier controls between EC countries
 - apply the principle of mutual recognition to product standards
 - open procurement to non-national suppliers
 - lift barriers to competition in retail banking and insurance
 - remove all restrictions on foreign exchange transactions between member countries
 - abolish restrictions on cabotage
- The Act prompted the restructuring of substantial sectors of European industry

6-20

The Establishment of the Euro

- The Maastricht Treaty (1991) committed EU members to adopt a single currency, the euro
 - The euro is used by 15 of the 27 member states
 - This has created the euro zone, the second largest currency zone in the world after that of the U.S. dollar
 - Countries that participate have agreed to give up control of their monetary policy
 - So far, Britain, Denmark and Sweden have opted out of the euro zone

6-21

The Establishment of the Euro

Question: What are the benefits of the euro?

- Firms and individuals should save by handling one currency, rather than many
- Consumers should find it easier to compare prices across Europe
- Producers should become more efficient as they reduce their production costs in order to maintain their profit margins
- The highly liquid pan-European capital market should get a strong boost
- The range of investment options open both to individuals and institutions should increase

8-22

The Establishment of the Euro

Question: What are the costs of the euro?

- Membership in the euro zone implies that nations lose control over the monetary policy
 - The European Central Bank (ECB) was established to manage monetary policy, but some question its ability to act independently
- The EU is not an optimal currency area (an area where similarities in the underlying structure of economic activities make it feasible to adopt a single currency and use a single exchange rate as an instrument of macro-economic policy)
 - So, countries may react very differently to changes in the euro

8-23

The Establishment of the Euro

- Since its establishment the euro has had a volatile trading history with the U.S. dollar
- Initially, the euro was valued at \$1.17, then fell in value relative to the dollar, but strengthened to an all-time high of \$1.54 in March 2008

8-24

Enlargement of the European Union

- Many countries, particularly from Eastern Europe, have applied for membership in the EU
- Ten countries joined in 2004 expanding the EU to 25 states, with population of 450 million people, and a single continental economy with a GDP of €11 trillion
- In 2007, Bulgaria and Romania joined bringing membership to 27 countries
- Turkey has also applied for membership

Regional Economic Integration in the Americas

- Regional economic integration is on the rise in the Americas
- The most significant attempt is the North American Free Trade Agreement
- Other agreements include
 - the Andean Community
 - MERCOSUR
- There are also attempts to form a Free Trade Area of the Americas

Regional Economic Integration in the Americas

Regional Integration in the Americas

The North American Free Trade Agreement

- The North American Free Trade Agreement (NAFTA) between the U.S., Canada, and Mexico became law in 1994
- NAFTA
 - abolished tariffs on 99 percent of goods traded
 - removed barriers on the cross-border flow of services
 - protects intellectual property rights
 - allows each country to apply its own environmental standards
 - establishes two commissions to impose fines and remove trade privileges when environmental standards or legislation involving health and safety, minimum wages, or child labor are ignored

The North American Free Trade Agreement

Question: What are the benefits of NAFTA?

- Mexico will benefit from increased jobs as low cost production moves south, and will attain more rapid economic growth as a result
- The U.S. and Canada will benefit from the access to a large and increasingly prosperous market and from the lower prices for consumers from goods produced in Mexico
- U.S. and Canadian firms with production sites in Mexico will be more competitive on world markets

The North American Free Trade Agreement

Question: What are the drawbacks of NAFTA?

- Jobs could be lost and wage levels could decline in the U.S. and Canada
- Mexican workers could emigrate north
- Pollution could increase due to Mexico's more lax standards
- Mexico would lose its sovereignty

The North American Free Trade Agreement

Question: How successful has NAFTA been?

- Studies of NAFTA's early impact suggest that both advocates and detractors may have been guilty of exaggeration
 - Trade between the three countries has increased by 250 percent
 - The members have become more integrated
 - Productivity has increased in member nations
 - Employment effects have been small
 - Mexico has become more politically stable

The North American Free Trade Agreement

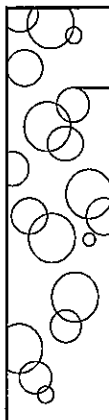
Question: Should NAFTA accept new members?

- Several other Latin American countries have indicated their desire to eventually join NAFTA
- Currently both Canada and the U.S. are adopting a wait and see attitude with regard to most countries

Classroom Performance System


Studies show that after its first decade

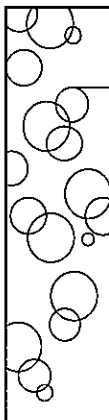
- There was a small net gain of jobs in the U.S.
- Exports from the U.S. failed to grow
- NAFTA's overall impact has been significant
- The U.S., Canada, and Mexico all experienced a decrease in productivity



The Andean Community


- The Andean Pact (formed in 1969) was based on the EU model
- The agreement had more or less failed by the mid-1980s
- In the late 1980s, Latin American governments began to adopt free market economic policies
- In 1990, the Andean Pact was re-launched, and now operates as a customs union
- In 2003, it signed an agreement with MERCOSUR to restart negotiations towards the creation of a free trade area
- Current members include Bolivia, Ecuador, Peru, and Columbia






MERCOSUR


- MERCOSUR originated in 1988 as a free trade pact between Brazil and Argentina
- In 1990, it was expanded to include Paraguay and Uruguay
- MERCOSUR has been successful at reducing trade barriers between member states
- However, critics worry that MERCOSUR is diverting trade rather than creating trade, and local firms are investing in industries that are not competitive on a worldwide basis
- Current members include Brazil, Argentina, Paraguay, Uruguay, and Venezuela





Central American Common Market, CAFTA and CARICOM

- Two other trade pacts in the Americas are
 1. the Central American Trade Market
 - Current members are Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic
 2. CARICOM (1973), a customs union between English-speaking Caribbean countries
- These countries were joined by the U.S. in 2003 to create a free trade agreement, the Central American Free Trade Agreement (2003)
- Six members formed the Caribbean Single Market and Economy (CSME) in 2006 to lower trade barriers and harmonize macro-economic and monetary policy



Free Trade of the Americas

- Talks began in 1998 to establish a Free Trade of The Americas (FTAA) by 2005
- The FTAA was not established as planned
- Current support for the agreement by the U.S. and Brazil is limited
- If the FTAA is established, it would create a free trade area of nearly 800 million people

Regional Economic Integration Elsewhere

- There have been various attempts at regional economic integration throughout Asia and Africa
- The success of these attempts have been limited
- The most significant efforts are the Association of Southeast Asian Nations and the Asia-Pacific Economic Cooperation

Association of Southeast Asian Nations

- The Association of Southeast Asian Nations (ASEAN) was formed in 1967
- ASEAN currently includes Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand, Vietnam, Myanmar, Laos, and Cambodia
- The goal of ASEAN is to foster freer trade between member countries and to achieve some cooperation in their industrial policies
- In 2003, an ASEAN Free Trade Area (AFTA) between the six original members of ASEAN came into full effect with a goal of reducing import tariffs among the older members
- Vietnam, Laos, and Myanmar have all joined AFTA more recently

Asia-Pacific Economic Cooperation

- Asian Pacific Economic Cooperation (APEC) was founded in 1990
- APEC currently has 21 members including the United States, Japan, and China
- APEC wants to increase multilateral cooperation in view of the economic rise of the Pacific nations and the growing interdependence within the region

8-40

Regional Trade Blocs in Africa

- There are nine trade blocs on the African continent
- However progress toward the establishment of meaningful trade blocs has been slow
- Many countries believe that they need to protect their industries from unfair foreign competition making it difficult to create free trade areas or customs unions

8-41

Implications for Managers

Question: Why is regional economic integration important to international companies?

- Thanks to regional economic integration, markets that had been protected from foreign competition are increasingly open
- These developments are particularly significant in the European Union and NAFTA
- However, regional economic integration is likely to increase competition

8-42

Opportunities

- Formerly protected markets are now open to exports and direct investment
- Because of the free movement of goods across borders, the harmonization of product standards, and the simplification of tax regimes, firms can realize potentially enormous cost economies by centralizing production in those locations where the mix of factor costs and skills is optimal

Threats

- Lower trade and investment barriers could lead to increased price competition within the EU and NAFTA
- Increased competition within the EU is forcing EU firms to become more efficient, and stronger global competitors
- Firms outside the blocs risk being shut out of the single market by the creation of a "trade fortress"
- Firms may be limited in their ability to pursue the strategy of their choice in the EU intervenes and imposes conditions on companies proposing mergers and acquisitions

Critical Discussion Question

1. NAFTA has produced significant net benefits for the Canadian, Mexican, and U.S. economy. Discuss.

Critical Discussion Question

2. What are the economic and political arguments for regional economic integration? Given these arguments, why don't we see more substantial examples of integration in the world economy?

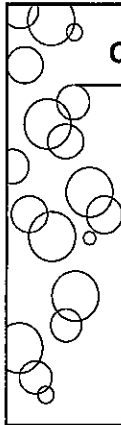
Critical Discussion Question

3. What effect is creation of a single market and a single currency within the EU likely to have on competition within the EU? Why?

Critical Discussion Question

4. Do you think it is correct for the European Commission to restrict mergers between American companies that do business in Europe? (For example, the European Commission vetoed the proposed merger between WorldCom and Sprint, both U.S. companies, and it carefully reviewed the merger between AOL and TimeWarner, again both U.S. companies.)

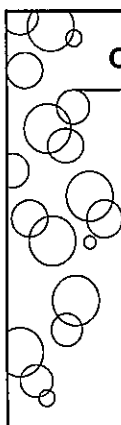
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Critical Discussion Question

5. How should a U.S. firm that currently only exports to ASEAN countries respond to the creation of a single market in this regional grouping?

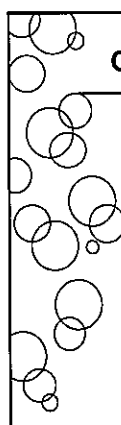
6-10



Critical Discussion Question

6. How should a firm that has self-sufficient production facilities in several ASEAN countries respond to the creation of a single market? What are the constraints on its ability to respond in a manner that minimizes production costs?

6-11



Critical Discussion Question

Would the establishment of a Free Trade Area of the Americas (FTAA) be good for the two most advanced economies of the hemisphere, the United States and Canada? How might the establishment of the FTAA impact the strategy of North American firms?

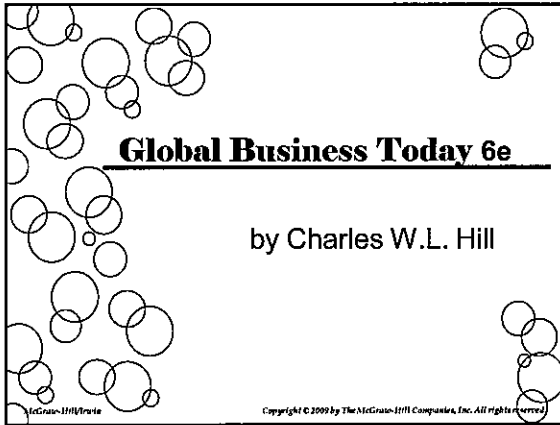
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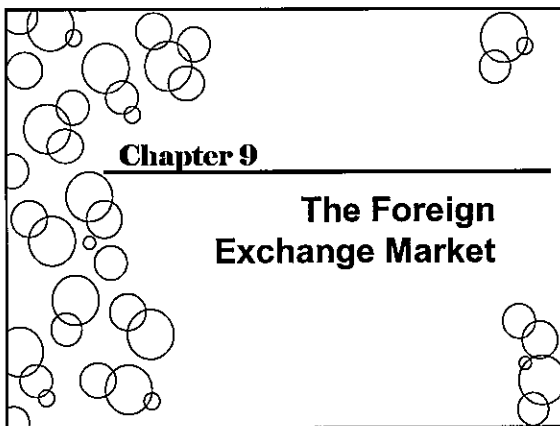
Critical Discussion Question

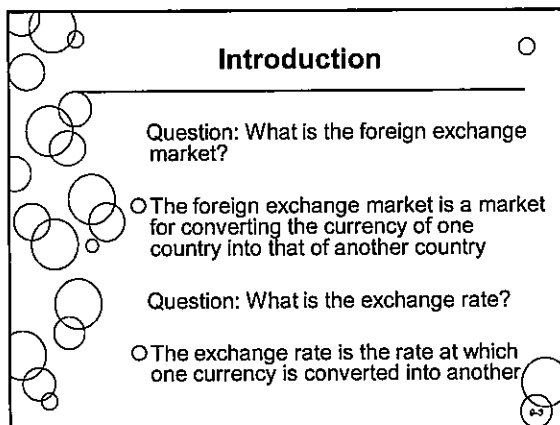
Reread the Management Focus case on the European Commission and Media Industry Mergers, then answer the following questions:

- a) Given that both AOL and Time Warner were U.S. based companies, do you think the European Commission had a right to review and regulate their planned merger?
- b) Were the concessions extracted by the European Commission from AOL and Time Warner reasonable? Whose interests was the Commission trying to protect?
- c) What precedent do the actions of the European Commission in this case set? What are the implications for managers of foreign enterprises with substantial operations in Europe?

6-52







The Functions of the Foreign Exchange Market

Question: What is the purpose of the foreign exchange market?

- The foreign exchange market
 - enables the conversion of the currency of one country into the currency of another
 - provides some insurance against foreign exchange risk (the adverse consequences of unpredictable changes in exchange rates)

Currency Conversion

International firms use foreign exchange markets

- to convert export receipts, income received from foreign investments, or income received from licensing agreements
- to pay a foreign company for products or services
- to invest spare cash for short terms in money markets
- for currency speculation (the short-term movement of funds from one currency to another in the hopes of profiting from shifts in exchange rates)

Insuring Against Foreign Exchange Risk

- The foreign exchange market can be used to provide insurance to protect against foreign exchange risk (the possibility that unpredicted changes in future exchange rates will have adverse consequences for the firm)
- A firm that protects itself against foreign exchange risk is hedging
- The market performs this function using
 - spot exchange rates
 - forward exchange rates
 - currency swaps

Insuring Against Foreign Exchange Risk

1. Spot Exchange Rates

- The spot exchange rate is the rate at which a foreign exchange dealer converts one currency into another currency on a particular day
- Spot rates are determined by the interaction between supply and demand, and so change continually

Insuring Against Foreign Exchange Risk


2. Forward Exchange Rates

- A forward exchange occurs when two parties agree to exchange currency and execute the deal at some specific date in the future
- A forward exchange rate is the exchange rate governing such a future transaction
- Forward rates are typically quoted for 30, 90, or 180 days into the future

Insuring Against Foreign Exchange Risk



3. Currency Swaps


- A currency swap is the simultaneous purchase and sale of a given amount of foreign exchange for two different value dates
- Swaps are used when it is desirable to move out of one currency into another for a limited period without incurring foreign exchange rate risk



The Nature of the Foreign Exchange Market

- The foreign exchange market is a global network of banks, brokers, and foreign exchange dealers connected by electronic communications systems
- The market is always open somewhere in the world
 - If exchange rates quoted in different markets were not essentially the same, there would be an opportunity for arbitrage (the process of buying a currency low and selling it high)
- Most transactions involve U.S. dollars on one side
 - The U.S. dollar is a vehicle currency









Economic Theories of Exchange Rate Determination

Question: What factors are important to future exchange rates?

- Three factors that have an important impact on future exchange rate movements are
 1. a country's price inflation
 2. a country's interest rate
 3. market psychology









Prices and Exchange Rates

Question: How are prices related to exchange rate movements?


- To understand how prices and exchange rates are linked, we need to understand the law of one price, and the theory of purchasing power parity



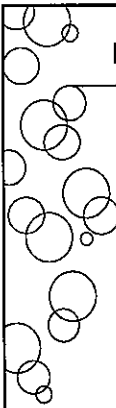
Prices and Exchange Rates

- The law of one price states that in competitive markets free of transportation costs and barriers to trade, identical products sold in different countries must sell for the same price when their price is expressed in terms of the same currency
- Purchasing power parity theory argues that given relatively efficient markets (markets in which few impediments to international trade and investment exist) the price of a "basket of goods" should be roughly equivalent in each country



Prices and Exchange Rates

- PPP predicts that changes in relative prices will result in changes in exchange rates
 - When inflation is relatively high, a currency should depreciate
- So, if we can predict inflation rates, we can predict how a currency's value might change
 - The growth of a country's money supply determines its likely future inflation rate
 - When the growth in the money supply is greater than the growth in output, inflation will occur



Prices and Exchange Rates

Question: How well does PPP theory work?

- Empirical testing of the PPP theory indicates that it is not completely accurate in estimating exchange rate changes in the short run, but is relatively accurate in the long run

Interest Rates and Exchange Rates

Question: How do interest rates affect exchange rates?

- The Fisher Effect states that a country's nominal interest rate (i) is the sum of the required real rate of interest (r) and the expected rate of inflation over the period for which the funds are to be lent (π)
 - In other words, $i = r + \pi$
- So, if the real interest rate is the same everywhere, any difference in interest rates between countries reflects differing expectations about inflation rates

9-16

Investor Psychology and Bandwagon Effects

Question: How are exchange rates influenced by investor psychology?

- The bandwagon effect occurs when expectations on the part of traders turn into self-fulfilling prophecies, and traders join the bandwagon and move exchange rates based on group expectations
- Governmental intervention can prevent the bandwagon from starting, but is not always effective

9-17

Summary

- Relative monetary growth, relative inflation rates, and nominal interest rate differentials are all moderately good predictors of long-run changes in exchange rates, but poor predictors of short term changes
- So, international businesses should pay attention to countries' differing monetary growth, inflation, and interest rates

9-18

Exchange Rate Forecasting

Question: Should companies invest in exchange rate forecasting services to help with decision-making?

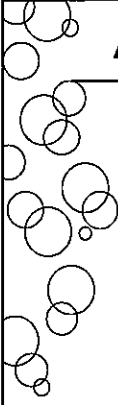
- The efficient market school argues that forward exchange rates are the best predictors of future spot exchange rates
 - Therefore, investing in forecasting services would be a waste of money
- The inefficient market school argues that companies should invest in forecasting services
 - This school of thought does not believe that forward rates are the best predictor of future spot rates

The Efficient Market School

- An efficient market is one in which prices reflect all available information
- If the foreign exchange market is efficient, forward exchange rates should be unbiased predictors of future spot rates
- Most empirical tests confirm the efficient market hypothesis suggesting that companies should not waste their money on forecasting services, but some recent studies have challenged the theory


The Inefficient Market School

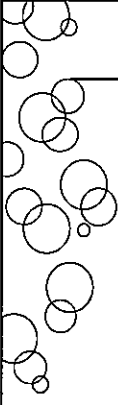
- An inefficient market is one in which prices do not reflect all available information
- In an inefficient market, forward exchange rates are not the best predictors of future spot exchange rates and it may be worthwhile for international businesses to invest in forecasting services
- However, the track record of forecasting services is questionable



Approaches to Forecasting

1. Fundamental Analysis
 - Fundamental analysis draws upon economic factors like interest rates, monetary policy, inflation rates, or balance of payments information to predict exchange rates
2. Technical Analysis
 - Technical analysis focuses on trends and believes that past trends and waves are reasonable predictors of future trends and waves




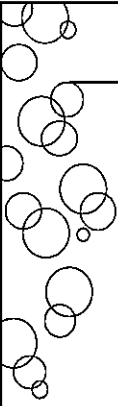


Currency Convertibility

Question: Are all currencies freely convertible?

- A currency is freely convertible when both residents and non-residents can purchase unlimited amounts of foreign currency with the domestic currency
- A currency is externally convertible when only non-residents can convert their holdings of domestic currency into a foreign currency
- A currency is nonconvertible when both residents and non-residents are prohibited from converting their holdings of domestic currency into a foreign currency




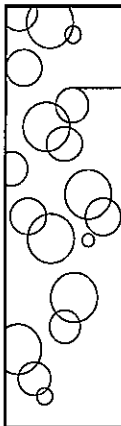


Currency Convertibility

Question: Why do countries limit currency convertibility?

- The main reason to limit convertibility is to preserve foreign exchange reserves and prevent capital flight (when residents and nonresidents rush to convert their holdings of domestic currency into a foreign currency).
- In the case of a nonconvertible currency, firms may turn to countertrade (barter like agreements by which goods and services can be traded for other goods and services) to facilitate international trade



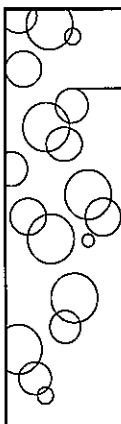


Implications for Managers

Question: What does the foreign exchange market mean for international firms?

- Firms must understand the influence of exchange rates on the profitability of trade and investment deals
- This exchange rate risk can be divided into
 1. Transaction exposure
 2. Translation exposure
 3. Economic exposure

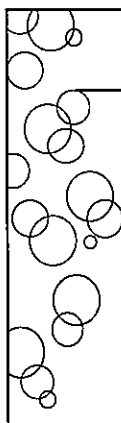
p-25



Transaction Exposure

- Transaction exposure is the extent to which the income from individual transactions is affected by fluctuations in foreign exchange values
- It can lead to a real monetary loss

p-26



Translation Exposure

- Translation exposure is the impact of currency exchange rate changes on the reported financial statements of a company
- It deals with the present measurement of past events
- Gains and losses from translation exposure are reflected only on paper

p-27

Economic Exposure

- Economic exposure is the extent to which a firm's future international earning power is affected by changes in exchange rates
- It is concerned with the long-term effect of changes in exchange rates on future prices, sales, and costs

Reducing Translation and Transaction Exposure

Question: How can firms minimize translation and transaction exposure?

- Firms can
 - buying forward
 - using swaps
 - leading and lagging payables and receivables (paying suppliers and collecting payment from customers early or late depending on expected exchange rate movements)

Reducing Translation and Transaction Exposure

- A lead strategy involves attempting to collect foreign currency receivables early when a foreign currency is expected to depreciate and paying foreign currency payables before they are due when a currency is expected to appreciate
- A lag strategy involves delaying collection of foreign currency receivables if that currency is expected to appreciate and delaying payables if the currency is expected to depreciate
- Lead and lag strategies can be difficult to implement

Reducing Economic Exposure

Question: How can a firm reduce economic exposure?

- To reduce economic exposure firms need to distribute productive assets to various locations so the firm's long-term financial well-being is not severely affected by changes in exchange rates
- This requires that the firm's assets are not overly concentrated in countries where likely rises in currency values will lead to damaging increases in the foreign prices of the goods and services they produce

Other Steps for Managing Foreign Exchange Risk

Question: Are there other strategies to manage foreign exchange risk?

- To further manage foreign exchange risk, firms should
 - establish central control to protect resources efficiently and ensure that each subunit adopts the correct mix of tactics and strategies

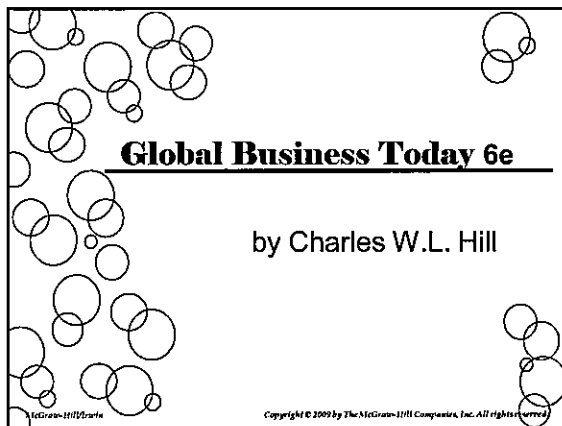
Other Steps for Managing Foreign Exchange Risk

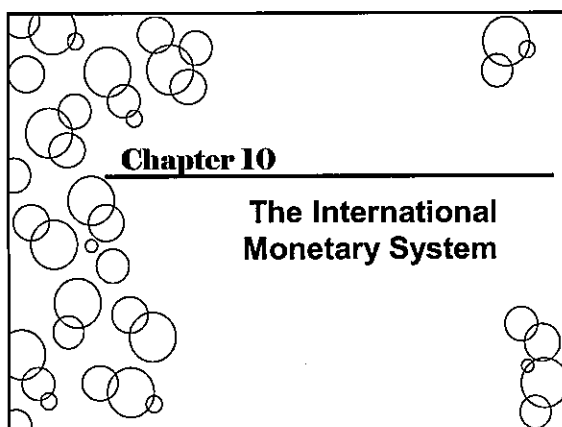
- distinguish between transaction and translation exposure on the one hand, and economic exposure on the other hand
- attempt to forecast future exchange rates
- establish good reporting systems so the central finance function can regularly monitor the firm's exposure position
- produce monthly foreign exchange exposure reports

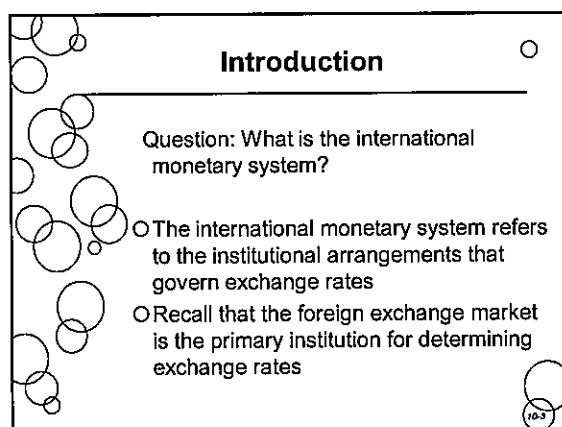
Critical Discussion Question

Reread the Management Focus feature on Volkswagen in this chapter, then answer the following questions:

- a) Why do you think management at Volkswagen decided to hedge only 30 percent of their foreign currency exposure in 2003? What would have happened if they had hedged 70 percent of their exposure?
- b) Why do you think the value of the U.S. dollar declined against that of the Euro in 2003?
- c) Apart from hedging through the foreign exchange market, what else can Volkswagen do to reduce its exposure to future declines in the value of the U.S. dollar against the euro?







Introduction

- A floating exchange rate system exists in countries where the foreign exchange market determines the relative value of a currency
 - Examples include the U.S. dollar, the European Union's euro, the Japanese yen, and the British pound
- A pegged exchange rate system exists when the value of a currency is fixed to a reference country and then the exchange rate between that currency and other currencies is determined by the reference currency exchange rate
 - Many developing countries have pegged exchange rates

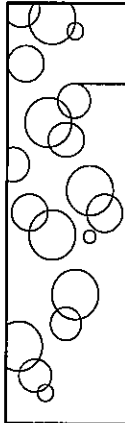
Introduction

- A dirty float exists when the value of a currency is determined by market forces, but with central bank intervention if it depreciates too rapidly against an important reference currency
 - China adopted this policy in 2005
- With a fixed exchange rate system countries fix their currencies against each other at a mutually agreed upon value
 - Prior to the introduction of the euro, some European Union countries operated with fixed exchange rates within the context of the European Monetary System (EMS)

Introduction

Question: What role does the international monetary system play in determining exchange rates?


- To answer this question, we have to look at the evolution of the international monetary system
 - The Gold Standard
 - The Bretton Woods system
 - The International Monetary Fund
 - The World Bank

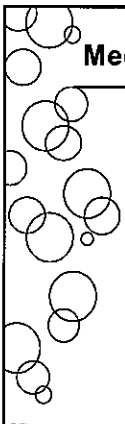


The Gold Standard

Question: What is the Gold Standard?


- The origin of the gold standard dates back to ancient times when gold coins were a medium of exchange, unit of account, and store of value
- To facilitate trade, a system was developed so that payment could be made in paper currency that could then be converted to gold at a fixed rate of exchange

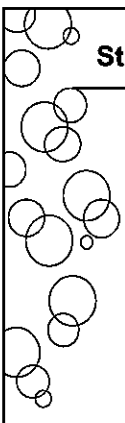




Mechanics of the Gold Standard


- The gold standard refers to the practice of pegging currencies to gold and guaranteeing convertibility
 - Under the gold standard one U.S. dollar was defined as equivalent to 23.22 grains of "fine (pure) gold"
- The exchange rate between currencies was based on the gold par value (the amount of a currency needed to purchase one ounce of gold)





Strength of the Gold Standard

- The key strength of the gold standard was its powerful mechanism for simultaneously achieving balance-of-trade equilibrium (when the income a country's residents earn from its exports is equal to the money its residents pay for imports) by all countries
- Many people today believe the world should return to the gold standard



The Period Between the Wars: 1918 - 1939

- The gold standard worked fairly well from the 1870s until the start of World War I
- After the war, in an effort to encourage exports and domestic employment, countries started regularly devaluing their currencies
- Confidence in the system fell, and people began to demand gold for their currency putting pressure on countries' gold reserves, and forcing them to suspend gold convertibility
- The Gold Standard ended in 1939

10-10

The Bretton Woods System

- A new international monetary system was designed in 1944 in Bretton Woods, New Hampshire
- The goal was to build an enduring economic order that would facilitate postwar economic growth
- The Bretton Woods Agreement established two multinational institutions
 1. The International Monetary Fund (IMF) to maintain order in the international monetary system
 2. The World Bank to promote general economic development

10-11

The Bretton Woods System

- Under the Bretton Woods Agreement
 - the US dollar was the only currency to be convertible to gold, and other currencies would set their exchange rates relative to the dollar
- devaluations were not to be used for competitive purposes
- a country could not devalue its currency by more than 10% without IMF approval

10-12

The Role of the IMF

- The IMF was responsible for avoiding a repetition of the chaos that occurred between the wars through a combination of
 1. Discipline
 - a fixed exchange rate puts a brake on competitive devaluations and brings stability to the world trade environment
 - a fixed exchange rate regime imposes monetary discipline on countries, thereby curtailing price inflation

The Role of the IMF

2. Flexibility
 - A rigid policy of fixed exchange rates would be too inflexible
 - So, the IMF was ready to lend foreign currencies to members to tide them over during short periods of balance-of-payments deficits
 - A country could devalue its currency by more than 10 percent with IMF approval

The Role of the World Bank

- The official name of the World Bank is the International Bank for Reconstruction and Development (IBRD)
- The World Bank lends money in two ways
 - Under the IBRD scheme, money is raised through bond sales in the international capital market and borrowers pay what the bank calls a market rate of interest - the bank's cost of funds plus a margin for expenses.
 - Under the International Development Agency scheme, loans go only to the poorest countries

The Collapse of the Fixed Exchange Rate System

Question: What caused the collapse of the Bretton Woods system?

- The collapse of the Bretton Woods system can be traced to U.S. macroeconomic policy decisions (1965 to 1968)
- During this time, the U.S. financed huge increases in welfare programs and the Vietnam War by increasing its money supply which then caused significant inflation
- Speculation that the dollar would have to be devalued relative to most other currencies forced other countries to increase the value of their currencies relative to the dollar

10-18

The Collapse of the Fixed Exchange Rate System

- The Bretton Woods system relied on an economically well managed U.S.
- So, when the U.S. began to print money, run high trade deficits, and experience high inflation, the system was strained to the breaking point
- The Bretton Woods Agreement collapsed in 1973

10-17

The Floating Exchange Rate Regime

Question: What followed the collapse of the Bretton Woods exchange rate system?

- Following the collapse of the Bretton Woods agreement, a floating exchange rate regime was formalized in 1976 in Jamaica
- The rules for the international monetary system that were agreed upon at the meeting are still in place today

10-18

The Jamaica Agreement

- At the Jamaica meeting, the IMF's Articles of Agreement were revised to reflect the new reality of floating exchange rates
- Under the Jamaican agreement
 - floating rates were declared acceptable
 - gold was abandoned as a reserve asset
 - total annual IMF quotas - the amount member countries contribute to the IMF - were increased to \$41 billion (today, this number is \$311 billion)

Exchange Rates Since 1973

- Since 1973, exchange rates have become more volatile and less predictable because of
 - the oil crisis in 1971
 - the loss of confidence in the dollar after U.S. inflation jumped between 1977 and 1978
 - the oil crisis of 1979
 - the rise in the dollar between 1980 and 1985
 - the partial collapse of the European Monetary System in 1992
 - the 1997 Asian currency crisis
 - the decline in the dollar in the mid to late 2000s

Fixed versus Floating Exchange Rates

Question: Which is better – a fixed exchange rate system or a floating exchange rate system?

- Disappointment with floating rates in recent years has led to renewed debate about the merits of a fixed exchange rate system

The Case for Floating Exchange Rates

- A floating exchange rate system provides two attractive features
 1. monetary policy autonomy
 2. automatic trade balance adjustments

The Case for Floating Exchange Rates

1. Monetary Policy Autonomy
 - The removal of the obligation to maintain exchange rate parity restores monetary control to a government
 - In contrast, with a fixed system, a country's ability to expand or contract its money supply is limited by the need to maintain exchange rate parity

The Case for Floating Exchange Rates

2. Trade Balance Adjustments
 - The balance of payments adjustment mechanism works more smoothly under a floating exchange rate regime
 - Under the Bretton Woods system (fixed system), IMF approval was need to correct a permanent deficit in a country's balance of trade that could not be corrected by domestic policy alone

The Case for Fixed Exchange Rates

- A fixed exchange rate system is attractive because
 1. of the monetary discipline it imposes
 2. it limits speculation
 3. it limits uncertainty
 4. of the lack of connection between the trade balance and exchange rates

The Case for Fixed Exchange Rates

1. Monetary Discipline
 - Because a fixed exchange rate system requires maintaining exchange rate parity, it also ensures that governments do not expand their money supplies at inflationary rates
2. Speculation
 - A fixed exchange rate regime prevents destabilizing speculation

The Case for Fixed Exchange Rates

3. Uncertainty
 - The uncertainty associated with floating exchange rates makes business transactions more risky
4. Trade Balance Adjustments
 - Floating rates help adjust trade imbalances

Who is Right?

- There is no real agreement as to which system is better
- History shows that fixed exchange rate regime modeled along the lines of the Bretton Woods system will not work
- A different kind of fixed exchange rate system might be more enduring and might foster the kind of stability that would facilitate more rapid growth in international trade and investment

○-28

Exchange Rate Regimes in Practice

- Currently, there are several different exchange rate regimes in practice
- In 2006
 - 14% of IMF members allow their currencies to float freely
 - 26% of IMF members follow a managed float system
 - 28% of IMF members have no legal tender of their own
 - the remaining countries use less flexible systems such as pegged arrangements, or adjustable pegs

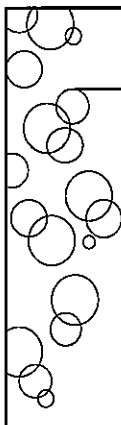
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Exchange Rate Regimes in Practice

Exchange Rate Policies, IMF Members, 2006

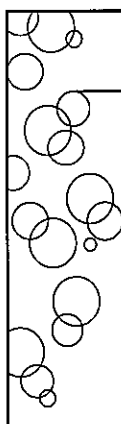
Policy	Percentage
Free Float	14%
Managed Float	26%
Fixed Peg	20%
No Separate Tender	22%
Adjustable Peg	6%
Currency Board	4%

○-30



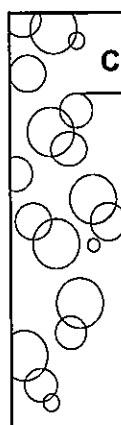
Pegged Exchange Rates

- Under a pegged exchange rate regime countries peg the value of their currency to that of other major currencies
- Pegged exchange rates are popular among the world's smaller nations
- There is some evidence that adopting a pegged exchange rate regime moderates inflationary pressures in a country



Currency Boards

- A country with a currency board commits to converting its domestic currency on demand into another currency at a fixed exchange rate
- The currency board holds reserves of foreign currency equal at the fixed exchange rate to at least 100% of the domestic currency issued
 - Additional domestic notes and coins can be introduced only if there are foreign exchange reserves to back it



Crisis Management by the IMF

Question: What has been the role of the IMF in the international monetary systems since the collapse of Bretton Woods?

- The IMF has redefined its mission, and now focuses on lending money to countries experiencing financial crises in exchange for enacting certain macroeconomic policies
- Membership in the IMF has grown to 185 countries in 2007, 68 of which has some type of IMF program in place

Financial Crises in the Post-Bretton Woods Era

- Three types of financial crises that have required involvement by the IMF are
 1. A currency crisis - occurs when a speculative attack on the exchange value of a currency results in a sharp depreciation in the value of the currency, or forces authorities to expend large volumes of international currency reserves and sharply increase interest rates in order to defend prevailing exchange rates

○

Financial Crises in the Post-Bretton Woods Era

- 2. A banking crisis - refers to a situation in which a loss of confidence in the banking system leads to a run on the banks, as individuals and companies withdraw their deposits
- 3. A foreign debt crisis - a situation in which a country cannot service its foreign debt obligations, whether private sector or government debt
- Two crises that are particularly significant are
 1. the 1995 Mexican currency crisis
 2. the 1997 Asian currency crisis

○

The Mexican Currency Crisis of 1995

- The Mexican currency crisis of 1995 was a result of high Mexican debts, and a pegged exchange rate that did not allow for a natural adjustment of prices
- In order to keep Mexico from defaulting on its debt, a \$50 billion aid package was created by the IMF
- By 1997, Mexico was well on the way to recovery

○

The Asian Crisis

Question: What were the causes of the 1997 Asian financial crisis?

- The causes of the crisis can be traced to the previous decade when the region was experiencing unprecedented growth

- The Investment Boom
 - Fueled by export-led growth
 - Large investments were often based on projections about future demand conditions that were unrealistic

0-37

The Asian Crisis

- Excess Capacity
 - Investments made on the basis of unrealistic projections about future demand conditions created significant excess capacity
- The Debt Bomb
 - Investments were often supported by dollar-based debts
 - When inflation and increasing imports put pressure on the currencies, the resulting devaluations led to default on dollar-denominated debts
- Expanding Imports
 - By the mid-1990s, imports were expanding across the region causing balance of payments deficits
 - The balance of payments deficits made it difficult for countries to maintain their currencies against the U.S. dollar

0-38

The Asian Crisis

- By mid-1997, it became clear that several key Thai financial institutions were on the verge of default
- Foreign exchange dealers and hedge funds started to speculate against the Thai baht, selling it short
- After struggling to defend the peg, the Thai government abandoned its defense and announced that the baht would float freely against the dollar

0-39

The Asian Crisis

- Thailand turned to the IMF for help
- Speculation continued to affect other Asian countries including Malaysia, Indonesia, Singapore which all saw their currencies drop
- These devaluations were mainly a result of excess investment, high borrowings, much of it in dollar denominated debt, and a deteriorating balance of payments position
- South Korea was the final country in the region to fall

Evaluating the IMF's Policy Prescriptions

- Question: How successful is the IMF at getting countries back on track?
- In 2006, 59 countries were working IMF programs
- All IMF loan packages come with conditions attached, generally a combination of tight macroeconomic policy and tight monetary policy
- Many experts have criticized these policy prescriptions for three reasons

Evaluating the IMF's Policy Prescriptions

1. Inappropriate Policies
 - The IMF has been criticized for having a "one-size-fits-all" approach to macroeconomic policy that is inappropriate for many countries
2. Moral Hazard
 - The IMF has also been criticized for exacerbating moral hazard (when people behave recklessly because they know they will be saved if things go wrong)

Evaluating the IMF's Policy Prescriptions

- 3. Lack of Accountability
 - The final criticism of the IMF is that it has become too powerful for an institution that lacks any real mechanism for accountability

Question: Who is right?

- As with many debates about international economics, it is not clear who is right

Implications for Managers

Question: What are the implications of the international monetary system for managers?

- The international monetary system affects international managers in three ways
 - Currency management
 - Business strategy
 - Corporate-government relations

Currency Management

- Currency Management
 - The current exchange rate system is a managed float
 - So, government intervention and speculative activity influence currency values
 - Firms can protect themselves from exchange rate volatility through forward markets and swaps

Business Strategy

2. Business Strategy

- Exchange rate movements can have a major impact on the competitive position of businesses
- The forward market can offer some protection from volatile exchange rates in the shorter term
- Firms can protect themselves from the uncertainty of exchange rate movements over the longer term by building strategic flexibility into their operations that minimizes economic exposure
 - Firms can disperse production to different locations
 - Firms can outsource manufacturing

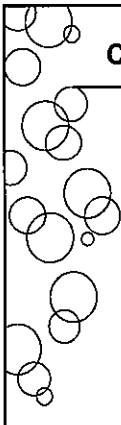
Corporate-Government Relations

3. Corporate-Government Relations

- Firms can influence government policy towards the international monetary system
- Firms should focus their efforts on encouraging the government to
 - Promote the growth of international trade and investment
 - Adopt an international monetary system that minimizes volatile exchange rates

Critical Discussion Question

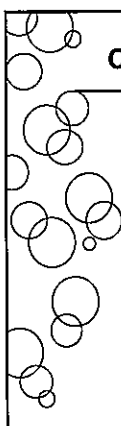
What opportunities might current IMF lending policies to developing nations create for international businesses?
What threats might they create?



Critical Discussion Question

Do you think the standard IMF policy prescriptions of tight monetary policy and reduced government spending are always appropriate for developing nations experiencing a currency crisis? How might the IMF change its approach? What would the implications be for international businesses?

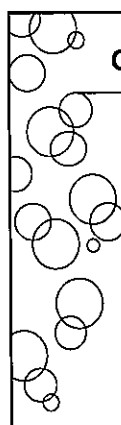
Q-19



Critical Discussion Question

Debate the relative merits of fixed and floating exchange rate regimes. From the perspective of an international business, what are the most important criteria in a choice between the systems? Which system is the more desirable for an international business?

Q-20



Critical Discussion Question

Imagine that Canada, the United States, and Mexico decide to adopt a fixed exchange rate system. What would be the likely consequences of such a system for (a) international businesses and (b) the flow of trade and investment among the three countries?

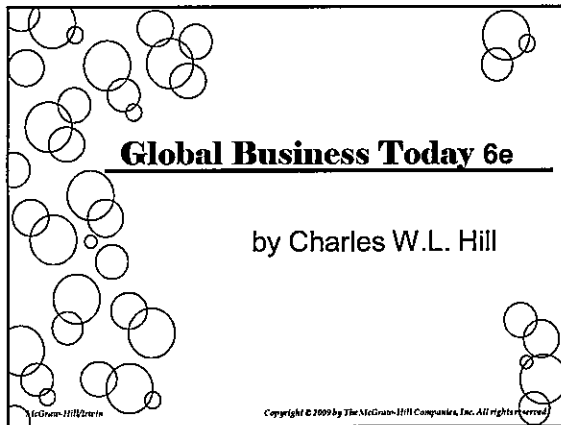
Q-21

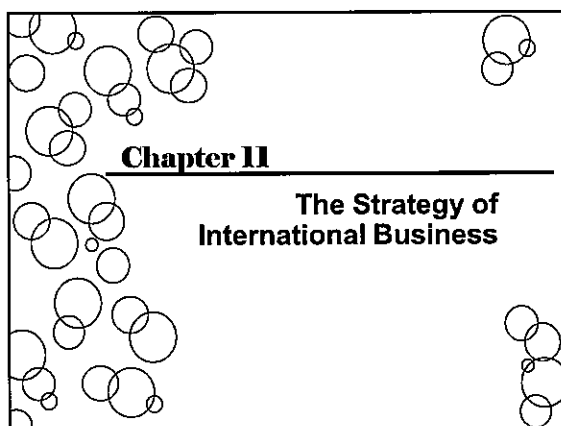
Critical Discussion Question

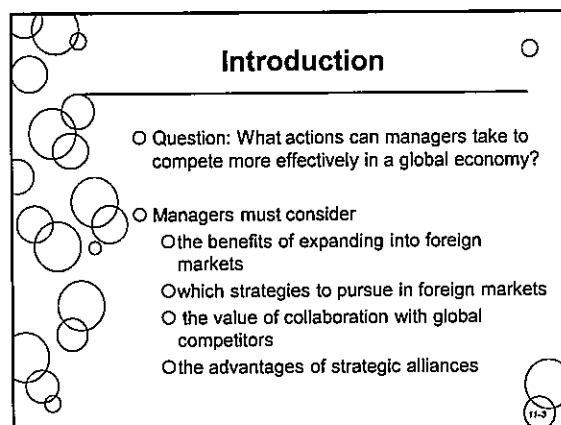
Reread the Country Focus on the U.S. dollar, oil prices, and recycling petrodollars, then answer the following questions:

- a) What will happen to the value of the U.S. dollar if oil producers decide to invest most of their earnings from oil sales in domestic infrastructure projects?
- b) What factors determine the relative attractiveness of dollar, euro, and yen denominated assets to oil producers flush with petrodollars? What might lead them to direct more funds towards non-dollar denominated assets?
- c) What will happen to the value of the dollar if OPEC members decide to invest more of their petrodollars towards non-dollar assets, such as euro denominated stocks and bonds?
- d) In addition to oil producers, China is also accumulating a large stock of dollars, currently estimated to total \$1.4 trillion. What would happen to the value of the dollar if China and oil producing nations all shifted out of dollar denominated assets at the same time? What would be the consequence for the United States economy?

9-52







Strategy and the Firm

Question: What is strategy?

- A firm's strategy can be defined as the actions that managers take to attain the goals of the firm
- Typically, strategies focus on profitability and profit growth
- Profitability refers to the rate of return the firm makes on its invested capital
- Profit growth is the percentage increase in net profits over time

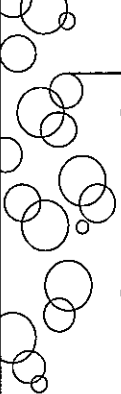
Strategy and the Firm

Determinants of Enterprise Value

Value Creation



Question: How do you increase the profitability of a firm?


- To increase profitability, value must be created for the consumer
- Value creation is measured by the difference between V (the price that the firm can charge for that product given competitive pressures) and C (the costs of producing that product)
- The two basic strategies for creating value are
 1. differentiation
 2. low cost



Strategic Positioning



- To maximize profitability, a firm must
 - pick a position on the efficiency frontier that is viable in the sense that there is enough demand to support that choice
 - configure its internal operations so that they support that position
 - make sure that the firm has the right organization structure in place to execute its strategy
- So, a firm's strategy, operations, and organization must all be consistent with each other in order to achieve a competitive advantage and superior profitability

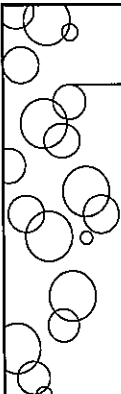





Operations: The Firm as a Value Chain



- Firms are essentially value chains composed of a series of distinct value creation activities, including production, marketing, materials management, R&D, human resources, information systems, and the firm infrastructure
- Value creation activities can be categorized as
 - primary activities
 - support activities

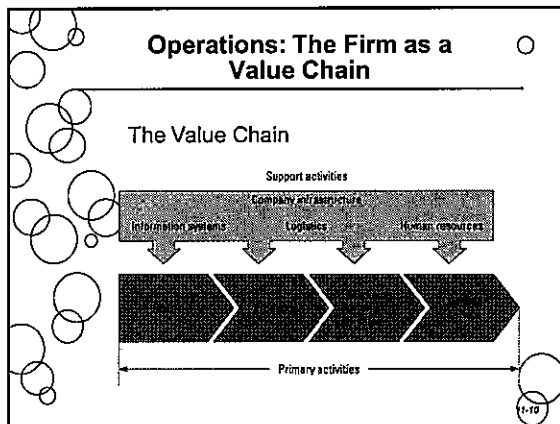



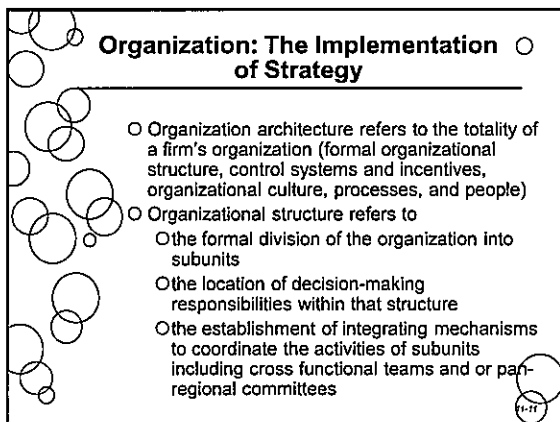


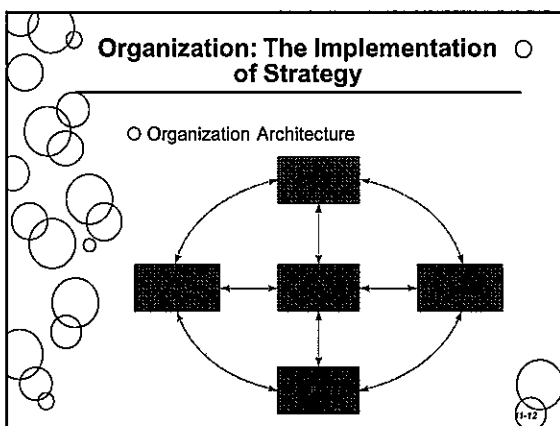
Operations: The Firm as a Value Chain

- Primary Activities
 - involves creating the product, marketing and delivering the product to buyers, and providing support and after-sale service to the buyers of the product
- Support Activities
 - provides the inputs that allow the primary activities of production and marketing to occur







Organization: The Implementation of Strategy

- Controls are the metrics used to measure the performance of subunits and make judgments about how well the subunits are run
- Incentives are the devices used to reward appropriate managerial behavior
- Processes are the manner in which decisions are made and work is performed
- Organizational culture is the norms and value systems that are shared among the employees
- People refers to employees and the strategy used to recruit, compensate, and retain those individuals

In Sum: Strategic Fit

- So, to attain superior performance and earn a high return on capital, a firm's strategy must make sense given market conditions
- The operations of the firm must support the firm's strategy
- The organizational architecture of the firm must match the firm's operations and strategy
- If market conditions shift, so must the firm's strategy, operations, and organization

In Sum: Strategic Fit

The diagram, titled "Strategic Fit", illustrates the relationship between three key components. On the left, a circle labeled "Strategy" is connected by a double-headed arrow labeled "Supports" to a circle below it labeled "Organizational Architecture". From "Organizational Architecture", a single-headed arrow labeled "Supports" points to a third circle on the right labeled "Environment". A single-headed arrow labeled "Fits" points from "Environment" back to "Strategy", completing a cycle.

Global Expansion, Profitability and Profit Growth

- Firms that operate internationally can
 - Expand the market for their domestic product offerings by selling those products in international markets
 - Realize location economies by dispersing individual value creation activities to locations around the globe where they can be performed most efficiently and effectively
 - Realize greater cost economies from experience effects by serving an expanded global market from a central location, thereby reducing the costs of value creation
 - Earn a greater return by leveraging any valuable skills developed in foreign operations and transferring them to other entities within the firm's global network of operations

Expanding the Market: Leveraging Products and Competencies

- To increase growth, a firm can sell products or services developed at home in foreign markets
- Success depends on the type of goods and services, and the firm's core competencies (skills within the firm that competitors cannot easily match or imitate)
- Core competencies
 - Enable the firm to reduce the costs of value creation
 - Create perceived value so that premium pricing is possible

Location Economies

- Firms should locate value creation activities where economic, political, and cultural conditions are most conducive to the performance of that activity
- Firms that successfully do this can realize location economies (the economies that arise from performing a value creation activity in the optimal location for that activity, wherever in the world that might be)
- Locating value creation activities in optimal locations
 - Can lower the costs of value creation
 - Can enable a firm to differentiate its product offering from those of competitors

Location Economies

- Multinationals that take advantage of location economies create a global web of value creation activities
- Under this strategy, different stages of the value chain are dispersed to those locations around the globe where perceived value is maximized or where the costs of value creation are minimized
 - However, introducing transportation costs and trade barriers complicates this picture
 - Political risks must be assessed when making location decisions

Experience Effects

- The experience curve refers to the systematic reductions in production costs that have been observed to occur over the life of a product
 - Studies show that a product's production costs decline by some quantity about each time cumulative output doubles
- Learning effects are cost savings that come from learning by doing
 - Labor productivity increases when individuals learn the most efficient ways to perform particular tasks and management learns how to manage the new operation more efficiently

Experience Effects

- Economies of scale refer to the reductions in unit cost achieved by producing a large volume of a product
- Sources include
 - the ability to spread fixed costs over a large volume
 - the ability of large firms to employ increasingly specialized equipment or personnel
- Serving a global market from a single location is consistent with moving down the experience curve and establishing a low-cost position

Leveraging Subsidiary Skills

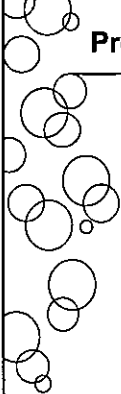
- To help increase firm value, managers should
 - recognize that valuable skills can be developed anywhere within the firm's global network (not just at the corporate center)
 - incentive systems can encourage local employees to acquire new skills
 - develop a process to identify when new skills have been created
 - act as facilitators to transfer valuable skills within the firm

Summary

- Firms that expand internationally can increase their profitability and profit growth by
 - Entering markets where competitors lack similar competencies
 - Realizing location economies
 - Exploiting experience curve effects
 - Transferring valuable skills within the organization

Cost Pressures and Pressures for Local Responsiveness

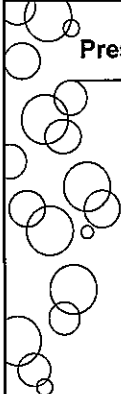
- Firms that compete in the global marketplace typically face two types of competitive pressures
 1. pressures for cost reductions
 2. pressures to be locally responsive
- These pressures place conflicting demands on the firm



Pressures for Cost Reductions

- Pressures for cost reductions are greatest
 - in industries producing commodity type products that fill universal needs (needs that exist when the tastes and preferences of consumers in different nations are similar if not identical)
 - when major competitors are based in low cost locations
 - where there is persistent excess capacity
 - where consumers are powerful and face low switching costs
- To respond to these pressures, firms need to lower the costs of value creation

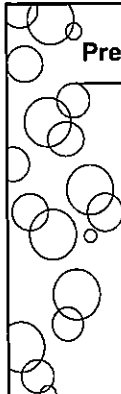
1-28



Pressures for Local Responsiveness

- Pressures for local responsiveness arise from
 1. differences in consumer tastes and preferences
 2. differences in traditional practices and infrastructure
 3. differences in distribution channels
 4. host government demands
- Firms facing these pressures need to differentiate their products and marketing strategy in each country


1-29



Pressures for Local Responsiveness

1. Differences in Consumer Tastes and Preferences
 - When consumer tastes and preferences differ significantly between countries, firms face strong pressures for local responsiveness
2. Differences in Infrastructure and Traditional Practices
 - When there are differences in infrastructure and/or traditional practices between countries, pressures for local responsiveness emerge


1-30



Pressures for Local Responsiveness

- 3. Differences in Distribution Channels
 - A firm's marketing strategies may be influenced by differences in distribution channels between countries
- 4. Host Government Demands
 - Economic and political demands imposed by host country governments may necessitate a degree of local responsiveness

1-29




Choosing a Strategy

Question: How do the pressures for cost reductions and local responsiveness influence a firm's choice of strategy?

- There are four basic strategies to compete in the international environment
 1. global standardization
 2. localization
 3. transnational
 4. international

1-28




Global Standardization Strategy

Question: When does a global standardization strategy make sense?

- A global standardization strategy focuses on increasing profitability and profit growth by reaping the cost reductions that come from economies of scale, learning effects, and location economies
 - The strategic goal is to pursue a low-cost strategy on a global scale
- This strategy makes sense when there are strong pressures for cost reductions and demands for local responsiveness are minimal

1-30

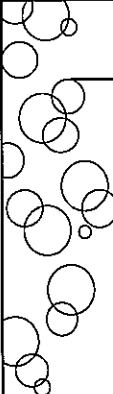


Localization Strategy

Question: When does a localization strategy make sense?

- A localization strategy focuses on increasing profitability by customizing the firm's goods or services so that they provide a good match to tastes and preferences in different national markets
- This strategy makes sense when there are substantial differences across nations with regard to consumer tastes and preferences, and where cost pressures are not too intense

11-31

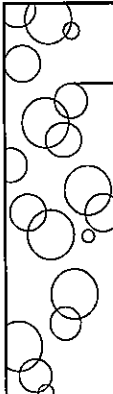


Transnational Strategy

Question: When does a transnational strategy make sense?

- A transnational strategy tries to simultaneously
 - achieve low costs through location economies, economies of scale, and learning effects
 - differentiate the product offering across geographic markets to account for local differences
 - foster a multidirectional flow of skills between different subsidiaries
- This strategy makes sense when there are both high cost pressures and high pressures for local responsiveness

11-32

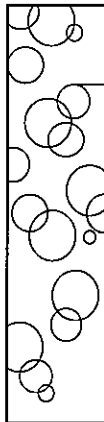


International Strategy

Question: When does an international strategy make sense?

- An international strategy involves taking products first produced for the domestic market and then selling them internationally with only minimal local customization
- This strategy makes sense when there are low cost pressures and low pressures for local responsiveness


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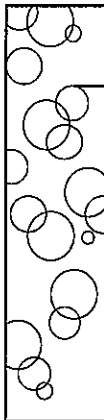


The Evolution of Strategy

Question: Is the choice of strategy static?

- As competition increases, international and localization strategies become less viable
- To survive, firms may need to shift to a global standardization strategy or a transnational strategy in advance of competitors




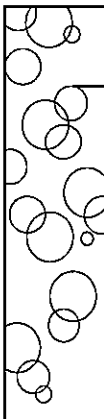


Strategic Alliances

Question: What is a strategic alliance?

- Strategic alliances refer to cooperative agreements between potential or actual competitors
- Examples include
 - formal joint ventures
 - short term contractual arrangements
- The number of international strategic alliances has risen significantly in recent decades




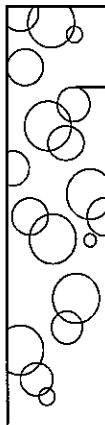


The Advantages of Strategic Alliances

Question: Why form a strategic alliance?

- Strategic alliances are attractive because they
 - facilitate entry into a foreign market
 - allow firms to share the fixed costs (and associated risks) of developing new products or processes
 - bring together complementary skills and assets that neither partner could easily develop on its own
 - can help establish technological standards for the industry that will benefit the firm






The Disadvantages of Strategic Alliances

Question: What are the drawbacks of strategic alliances?

- Strategic alliances can give competitors low-cost routes to new technology and markets
- Unless a firm is careful, it can give away more in a strategic alliance than it receives

1-37




Making Alliances Work

Question: How can firms increase the success of their alliances?

- Many international strategic alliances run into problems
- The success of an alliance seems to be a function of three main factors
 1. partner selection
 2. alliance structure
 3. the manner in which the alliance is managed

1-38




Making Alliances Work

1. Partner Selection

- A good partner
 - helps the firm achieve its strategic goals and has the capabilities the firm lacks and that it values
 - shares the firm's vision for the purpose of the alliance
 - does not expropriate the firm's technological know-how while giving away little in return

1-39




Making Alliances Work


2. Alliance Structure

OA good alliance should

- be designed to make it difficult to transfer technology not meant to be transferred
- have contractual safeguards to guard against the risk of opportunism by a partner
- involve an agreement in advance to swap skills and technologies to ensure a chance for equitable gain
- extract a significant credible commitment from the partner in advance



11-40




Making Alliances Work


3. Managing the Alliance

OA good alliance

- requires managers from both companies to build interpersonal relationships
- should promote learning from alliance partners
- should promote the diffusion of learned knowledge throughout the organization




11-41



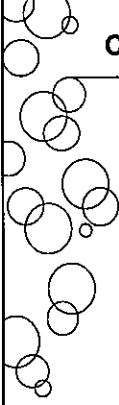
Critical Discussion Question

Re-Read the Management Focus box on Procter & Gamble and then answer the following questions:

- a) What strategy was Procter & Gamble pursuing when it first entered foreign markets in the period up until the 1980s?
- b) Why do you think this strategy became less viable in the 1990s?
- c) What strategy does Procter & Gamble appear to be moving toward? What are the benefits of this strategy? What are the potential risks associated with it?



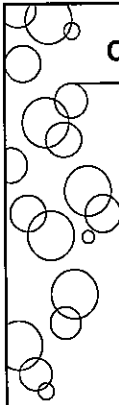
11-42



Critical Discussion Question

4. What do you see as the main organizational problems that are likely to be associated with the implementation of a transnational strategy?

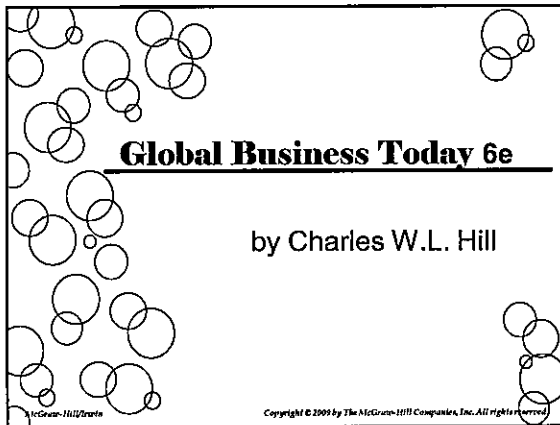
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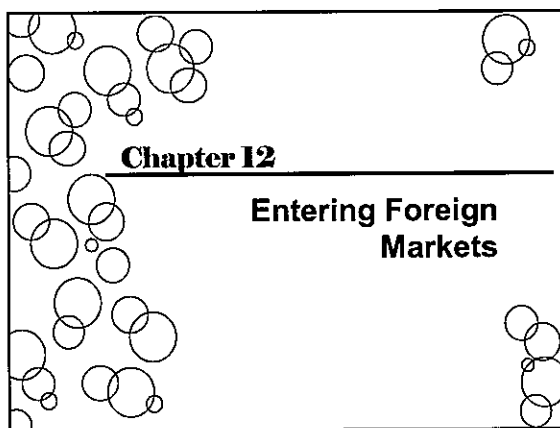


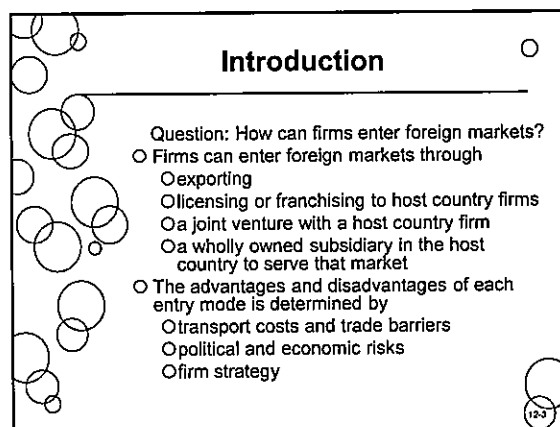
Critical Discussion Question


5. Reread the Management Focus box on the alliance between Cisco and Fujitsu. What are the benefits to Cisco and Fujitsu respectively of the alliance? What are the risks to Cisco? How can Cisco mitigate those risks?

11-44










Basic Entry Decisions


Question: What are the basic entry decisions for firms expanding internationally?

- A firm expanding internationally must decide
 - which markets to enter
 - when to enter them and on what scale
 - how to enter them (the choice of entry mode)



Which Foreign Markets?

- Firms need to assess the long run profit potential of each market
- The most favorable markets are politically stable developed and developing nations with free market systems, low inflation, and low private sector debt
- The less desirable markets are politically unstable developing nations with mixed or command economies, or developing nations where speculative financial bubbles have led to excess borrowing
- Success firms usually offer products that have not been widely available in the market and that satisfy an unmet need



Timing of Entry

- After a firm identifies which market to enter, it must determine the timing of entry
- Entry is early when an international business enters a foreign market before other foreign firms
- Entry is late when a firm enters after other international businesses have already established themselves in the market

Timing of Entry

- Firms entering a market early can gain first mover advantages including
 - the ability to pre-empt rivals and capture demand by establishing a strong brand name
 - the ability to build up sales volume in that country and ride down the experience curve ahead of rivals and gain a cost advantage over later entrants
 - the ability to create switching costs that tie customers into their products or services making it difficult for later entrants to win business

12-7

Timing of Entry

- First mover disadvantages are the disadvantages associated with entering a foreign market before other international businesses
- These may result in pioneering costs (costs that an early entrant has to bear that a later entrant can avoid) such as
 - the costs of business failure if the firm, due to its ignorance of the foreign environment, makes some major mistakes
 - the costs of promoting and establishing a product offering, including the cost of educating the customers

12-8

Scale of Entry and Strategic Commitments

- Firms that enter foreign markets on a significant scale make a major strategic commitment that changes the competitive playing field
 - This involves decisions that have a long term impact and are difficult to reverse
- Small-scale entry can be attractive because it allows the firm to learn about a foreign market, but at the same time it limits the firm's exposure to that market

12-9

Summary

- There are no "right" decisions with foreign market entry, just decisions that are associated with different levels of risk and reward
- Firms in developing countries can learn from the experiences of firms in developed countries

2-10

Classroom Performance System

The time and effort in learning the rules of a new market, failure due to ignorance, and the liability of being a foreigner are all examples of

- a) First mover advantages
- b) Strategic commitments
- c) Pioneering costs
- d) Market entry costs

2-11

Entry Modes

Question: What is the best way to enter a foreign market?

- Firms can enter foreign market through
 1. Exporting
 2. Turnkey projects
 3. Licensing
 4. Franchising
 5. Joint ventures
 6. Wholly owned subsidiaries
- Each mode has advantages and disadvantages

2-12

Exporting

- Exporting is often the first method firms use to enter foreign market
 - Exporting is attractive because
 - It is relatively low cost
 - firms may achieve experience curve economies
 - Exporting is not attractive when
 - lower-cost manufacturing locations exist
 - transport costs are high
 - tariff barriers are high
 - foreign agents fail to in the exporter's best interest

2-13

Turnkey Projects

- Turnkey projects involve a contractor that agrees to handle every detail of the project for a foreign client, including the training of operating personnel
 - At completion of the contract, the foreign client is handed the "key" to a plant that is ready for full operation

2-14

Turnkey Projects

Turnkey projects are attractive because

- They allow firms to earn great economic returns from the know-how required to assemble and run a technologically complex process
- They are less risky in countries where the political and economic environment is such that a longer-term investment might expose the firm to unacceptable political and/or economic risk
- Turnkey projects are not attractive when
 - The firm's process technology is a source of competitive advantage

2-15

Licensing

3. Licensing is an arrangement whereby a licensor grants the rights to intangible property to another entity (the licensee) for a specified time period, and in return, the licensor receives a royalty fee from the licensee

- Intangible property includes patents, inventions, formulas, processes, designs, copyrights, and trademarks
- Licensing is attractive when
 - The firm does not have to bear the development costs and risks associated with opening a foreign market
 - The firm avoids barriers to investment
 - It allows a firm with intangible property that might have business applications, but which doesn't want to develop those applications itself, to capitalize on market opportunities

Licensing

- Licensing is unattractive when
 - The firm doesn't have the tight control over manufacturing, marketing, and strategy necessary to realize experience curve and location economies
 - The firm's ability to coordinate strategic moves across countries by using profits earned in one country to support competitive attacks in another is compromised
- There is the potential for loss of proprietary (or intangible) technology or property
 - To reduce this risk, firms can use cross-licensing agreements or link the agreement with the decision to form a joint venture

Franchising

4. Franchising is a form of licensing in which the franchisor sells intangible property to the franchisee, and requires the franchisee agree to abide by strict rules as to how it does business

- Franchising is attractive because
 - Firms avoid many costs and risks of opening up a foreign market
- Franchising is unattractive because
 - It may inhibit the firm's ability to take profits out of one country to support competitive attacks in another
 - The geographic distance of the firm from its foreign franchisees can make poor quality difficult for the franchisor to detect

Joint Ventures

- 5. Joint ventures involve the establishment of a firm that is jointly owned by two or more otherwise independent firms
- Joint ventures are attractive because
 - A firm can benefit from a local partner's knowledge of the host country's competitive conditions, culture, language, political systems, and business systems
 - The costs and risks of opening a foreign market are shared with the partner
 - They can help firms avoid the risk of nationalization or other adverse government interference

Joint Ventures

- Joint ventures can be unattractive because
 - The firm risks giving control of its technology to its partner
 - The firm may not have the tight control over subsidiaries that it might need to realize experience curve or location economies
 - Shared ownership can lead to conflicts and battles for control if goals and objectives differ or change over time

Wholly Owned Subsidiaries

- 6. Wholly owned subsidiaries involve 100 percent ownership of the stock of the subsidiary
- Firms establishing a wholly owned subsidiary can
 - Set up a new operation in that country
 - Acquire an established firm

Wholly Owned Subsidiaries

- Wholly owned subsidiaries are attractive because
 - they reduce the risk of losing control over core competencies
 - they give the firm the tight control over operations in different countries that is necessary for engaging in global strategic coordination
 - they may be required if a firm is trying to realize location and experience curve economies
- Wholly owned subsidiaries are unattractive because firms bear the full costs and risks of setting up overseas operations

Selecting an Entry Mode

Question: How should a firm choose a specific entry mode?

- All entry modes have advantages and disadvantages
- The optimal choice of entry mode involves trade-offs

Selecting an Entry Mode

Advantages and Disadvantages of Entry Modes

Entry Mode	Advantages	Disadvantages
Exporting	Ability to reduce location and experience curve advantages	High transportation costs Trade barriers Firmness of the local supply system
Licensing	Ability to use international sales and distribution networks; ability to use local sales and distribution networks; ability to use local sales and distribution networks	Overhead costs; competitors Loss of experience curve advantages
Joint Venture	Local knowledge and contacts Local financial resources and contacts	Loss of control over the firm Loss of experience curve advantages Loss of control over the firm
Acquisition	Local knowledge and contacts Local financial resources and contacts	Loss of control over the firm Loss of experience curve advantages Loss of control over the firm
Wholly Owned Subsidiary	Full control over the firm Full control over the firm Full control over the firm	High costs and risks High costs and risks High costs and risks

Core Competencies and Entry Mode

- The optimal entry mode depends to some degree on the nature of a firm's core competencies
- Core competencies can involve
 - technological know-how
 - management know-how

2-25

Core Competencies and Entry Mode

1. Technological Know-How

- When competitive advantage is based on proprietary technological know-how, firms should avoid licensing and joint venture arrangements in order to minimize the risk of losing control over the technology
- However, if a technological advantage is only transitory, or the firm can establish its technology as the dominant design in the industry, then licensing may be attractive

2-26

Core Competencies and Entry Mode

2. Management Know-How

- The competitive advantage of many service firms is based upon management know-how
- International trademark laws are generally effective for protecting trademarks
- Since the risk of losing control over management skills to franchisees or joint venture partners is not high, the benefits from getting greater use of brand names is significant

2-27

Pressures for Cost Reductions and Entry Mode

- Firms facing strong pressures for cost reductions are likely to pursue some combination of exporting and wholly owned subsidiaries
- This will allow the firms to achieve location and scale economies as well as retain some degree of control over worldwide product manufacturing and distribution

2-28

Classroom Performance System

A firm that wants the ability to engage in global strategic coordination should choose

- a) Franchising
- b) Joint ventures
- c) Licensing
- d) Wholly owned subsidiaries

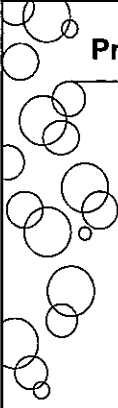
2-29

Greenfield or Acquisition?

Question: Should a firm establish a wholly owned subsidiary in a country by building a subsidiary from the ground up (greenfield strategy), or by acquiring an established enterprise in the target market (acquisition strategy)?


- The number of cross border acquisitions are increasing
- Over the last decade, 50-80 percent of all FDI inflows have been mergers and acquisitions

2-30

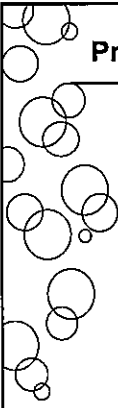


Pros and Cons of Acquisitions

- Acquisitions
 - are quick to execute
 - enable firms to preempt their competitors
 - can be less risky than green-field ventures
- However, many acquisitions are not successful




2-31



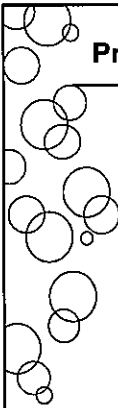
Pros and Cons of Acquisitions

Question: Why do acquisitions fail?

- Acquisitions fail when
 - the firm overpays for the assets of the acquired firm
 - there is a clash between the cultures of the acquiring and acquired firm
 - attempts to realize synergies by integrating the operations of the acquired and acquiring entities run into roadblocks and take much longer than forecast
 - there is inadequate pre-acquisition screening




2-32



Pros and Cons of Acquisitions

Question: How can firms reduce the problems associated with acquisitions?

- Firms can reduce the problems associated with acquisitions
 - through careful screening of the firm to be acquired
 - by moving rapidly once the firm is acquired to implement an integration plan



2-33

Pros and Cons of Greenfield Ventures

- Question: Why are greenfield ventures attractive?
- Greenfield ventures are attractive because they allow the firm to build the kind of subsidiary company that it wants
- However, greenfield ventures
 - are slower to establish
 - are risky because they have no proven track record
 - can be problematic if a competitor enters via acquisition and quickly builds market share

Classroom Performance System

Which of the following is not an advantage of acquisitions as compared to greenfield investments?

- a) They are quicker to execute
- b) Attempts to realize synergies by integrating the operations of the acquired entities can be challenging and take time
- c) They enable firms to preempt their competitors
- d) They may be less risky

Critical Discussion Question

Review the Management Focus on Tesco. Then answer the following questions:

- a) Why did Tesco's initial international expansion strategy focus on developing nations?
- b) How does Tesco create value in its international operations?
- c) In Asia, Tesco has a long history of entering into joint venture agreements with local partners. What are the benefits of doing this for Tesco? What are the risks? How are those risks mitigated?
- d) In March 2006, Tesco announced that it would enter the United States. This represents a departure from its historic strategy of focusing on developing nations. Why do you think Tesco made this decision? How is the U.S. market different from others Tesco has entered? What are the risks here? How do you think Tesco will do?

Critical Discussion Question

2. Licensing propriety technology to foreign competitors is the best way to give up a firm's competitive advantage. Discuss.

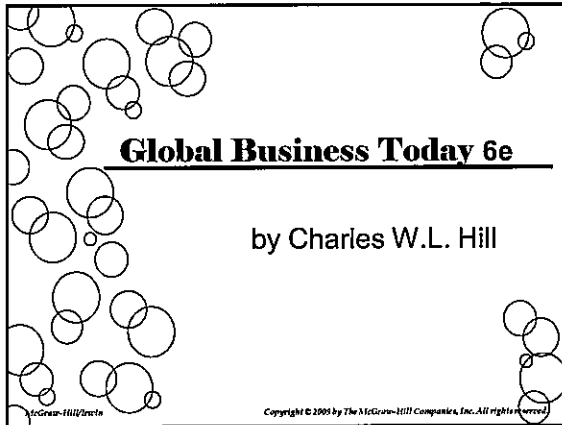
Critical Discussion Question

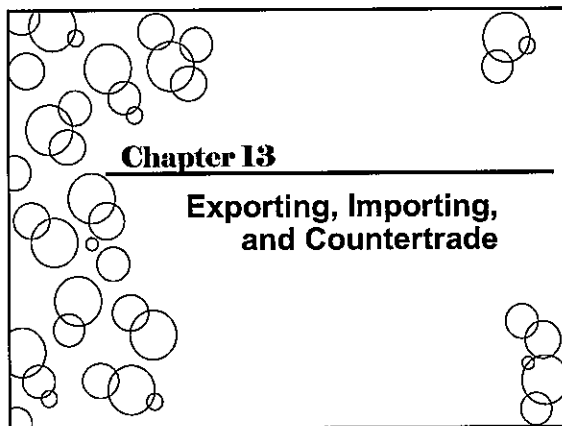
3. Discuss how the need for control over foreign operations varies with firms' strategies and core competencies. What are the implications for the choice of entry mode?

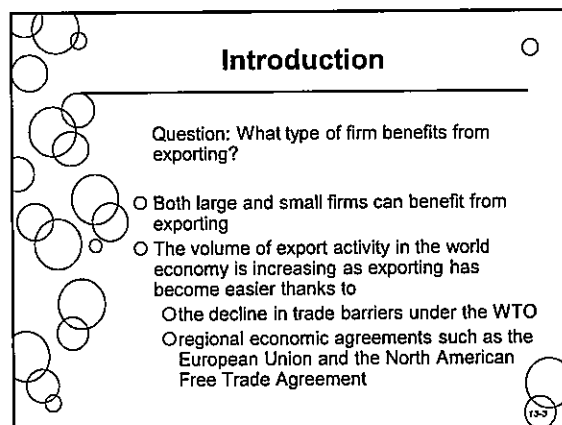
Critical Discussion Question

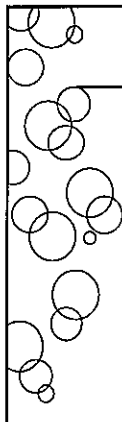
A small Canadian firm that has developed some valuable new medical products using its unique biotechnology know-how is trying to decide how best to serve the European Community market. Its choices are given below. The cost of investment in manufacturing facilities will be a major one for the Canadian firm, but it is not outside its reach. If these are the firm's only options, which one would you advise it to choose? Why?

- Manufacture the product at home and let foreign sales agents handle marketing.
- Manufacture the products at home but set up a wholly owned subsidiary in Europe to handle marketing.
- Enter into a strategic alliance with a large European pharmaceutical firm. The product would be manufactured in Europe by a 50/50 joint venture, and marketed by the European firm.





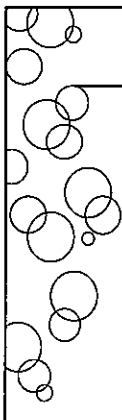




Introduction

Question: What do firms that want to export need to do?

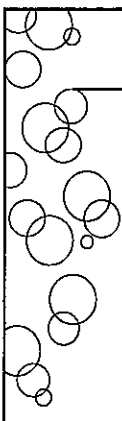
- Firms wishing to export must
 - Identify export opportunities
 - avoid a host of unanticipated problems associated with doing business in a foreign market
 - become familiar with the mechanics of export and import financing
 - learn where to get financing and export credit insurance
 - learn how to deal with foreign exchange risk



The Promise and Pitfalls of Exporting

Question: What are the benefits of exporting?

- The benefits from exporting can be great—the rest of the world is a much larger market than the domestic market
- Larger firms may be proactive in seeking out new export opportunities, but many smaller firms take a reactive approach to exporting
- Many novice exporters have run into significant problems when first trying to do business abroad, souring them on following up on subsequent opportunities

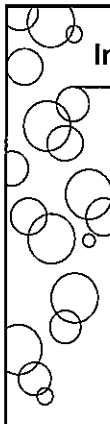


The Promise and Pitfalls of Exporting

Question: What are the pitfalls facing exporters?





Common pitfalls for exporters include


- poor market analysis
- poor understanding of competitive conditions
- a lack of customization for local markets, poor distribution arrangements, bad promotional campaigns
- a general underestimation of the differences and expertise required for foreign market penetration
- difficulty dealing with the tremendous paperwork and formalities involved



Improving Export Performance



Question: How can exporters improve their performance?

-  To improve their success, exporters should
 -  Acquire more knowledge of foreign market opportunities
 -  Consider using an export management company
 -  Adopt a successful export strategy

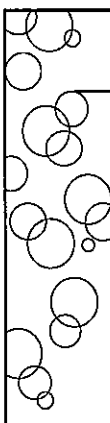




An International Comparison





-  Many firms fail to consider export opportunities simply because they lack knowledge of the opportunities available
-  Both Germany and Japan have developed extensive institutional structures or promoting exports
-  Japanese exporters can also take advantage of the knowledge and contacts of sogo shosha, the country's great trading houses






Utilizing Export Management Companies

Question: What assistance can exporters get from export management companies?

-  Export management companies are export specialists that act as the export marketing department or international department for client firms
-  EMCs
 -  1. start exporting operations for a firm with the understanding that the firm will take over operations after they are well established
 -  2. start services with the understanding that the EMC will have continuing responsibility for selling the firm's products



Export Strategy

Question: What steps should exporters take to increase their chances of success?

- Exporters
 - can hire an EMC to help identify opportunities and navigate paperwork and regulations
 - start by focusing initially on just one or a few markets
 - enter a foreign market on a fairly small scale in order to reduce the costs of any subsequent failures

3-10

Export Strategy

- Exporters should also
 - recognize the time and managerial commitment involved in building export sales
 - devote attention to building strong and enduring relationships with local distributors and customers
 - hire local personnel to help the firm establish itself in a foreign market
 - keep the option of local production

3-11

Export and Import Financing

Question: How can firms deal with the lack of trust that exists in export transactions?

- Various mechanisms for financing exports and imports have evolved over the centuries in response to lack of trust that exists in export transactions

3-12

Lack of Trust

- Exporters and importers have to trust someone who may be very difficult to track down if they default on an obligation
- Each party has a different set of preferences regarding the configuration of the transaction
 - Exporters prefer to be paid in advance, while importers prefer to pay after shipment arrives
- Problems arising from the lack of trust can be solved by using a third party who is trusted by both - normally a reputable bank

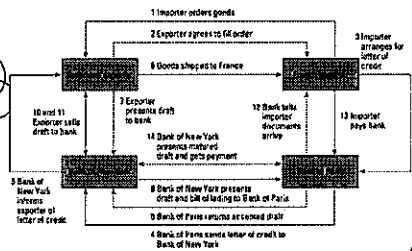
Letter of Credit

- A letter of credit is issued by a bank at the request of an importer and states the bank will pay a specified sum of money to a beneficiary, normally the exporter, on presentation of particular, specified documents
- This system is attractive because both parties are likely to trust a reputable bank even if they do not trust each other

Draft

Question: How is payment actually made in an export transaction?

- Most export transactions involve a draft, also called a bill of exchange
- A draft is an order written by an exporter instructing an importer, or an importer's agent, to pay a specified amount of money at a specified time
- A sight draft is payable on presentation to the drawee while a time draft allows for a delay in payment - normally 30, 60, 90, or 120 days

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Export Assistance

Question: Where can exporters get financing help?

- U.S. exporters can draw on two forms of government-backed assistance to help their export programs
 1. they can get financing aid from the Export-Import Bank
 2. they can get export credit insurance from the Foreign Credit Insurance Association

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Export-Import Bank

1. The Export Import Bank
 - The Export-Import Bank (Eximbank) is an independent agency of the U.S. government
 - Its mission is to provide financing aid that will facilitate exports, imports, and the exchange of commodities between the U.S. and other countries

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Export Credit Insurance

2. Export Credit Insurance

- In the U.S., export credit insurance is provided by the Foreign Credit Insurance Association (FICA)
- FICA provides coverage against commercial risks and political risks

5-19

Countertrade

Question: What alternatives do exporters have when conventional methods of payment are not an option?

- Exporters can use countertrade when conventional means of payment are difficult, costly, or nonexistent
- Countertrade refers to a range of barter-like agreements that facilitate the trade of goods and services for other goods and services when they cannot be traded for money

5-20

The Incidence of Countertrade

- In the 1960s the Soviet Union and the Communist states of Eastern Europe, whose currencies were generally nonconvertible, turned to countertrade to purchase imports
- Many developing nations that lacked the foreign exchange reserves required to purchase necessary imports turned to countertrade during the 1980s
- There was a notable increase in the volume of countertrade after the Asian financial crisis of 1997

5-21

Types of Countertrade

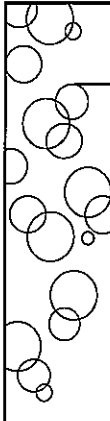
- There are five types of countertrade
 1. barter
 2. counterpurchase
 3. offset
 4. switch trading
 5. compensation or buyback

Types of Countertrade

1. Barter
 - Barter, the most restrictive countertrade arrangement, is a direct exchange of goods and/or services between two parties without a cash transaction
 - It is used primarily for one-time-only deals in transactions with trading partners who are not creditworthy or trustworthy
2. Counterpurchase
 - Counterpurchase is a reciprocal buying agreement
 - It occurs when a firm agrees to purchase a certain amount of materials back from a country to which a sale is made

Types of Countertrade

3. Offset
 - Offset is similar to counterpurchase insofar as one party agrees to purchase goods and services with a specified percentage of the proceeds from the original sale
 - The difference is that this party can fulfill the obligation with any firm in the country to which the sale is being made

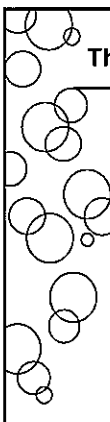


Types of Countertrade

4. Compensation or Buybacks

- A buyback occurs when a firm builds a plant in a country—or supplies technology, equipment, training, or other services to the country—and agrees to take a certain percentage of the plant's output as a partial payment for the contract

13-25

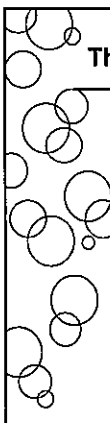


The Pros and Cons of Countertrade

Question: What are the advantages and disadvantages of countertrade?

- Countertrade is a way for firms to finance an export deal when other means are not available
- Firms that are unwilling to enter a countertrade agreement may lose an export opportunity to a competitor that is willing to make a countertrade agreement
- A countertrade arrangement may be required by the government of a country to which a firm is exporting goods or services

13-26



The Pros and Cons of Countertrade

- Countertrade is unattractive because
 - most firms prefer to be paid in hard currency
 - it may involve the exchange of unusable or poor-quality goods that the firm cannot dispose of profitably
- Countertrade is most attractive to large, diverse multinational enterprises that can use their worldwide network of contacts to dispose of goods acquired in countertrading

13-27

Classroom Performance System

Which of the following is not an advantage of countertrade?

- a) It may involve the exchange of unusable or poor-quality goods that the firm cannot dispose of profitably
- b) It can give a firm a way to finance an export deal when other means are not available
- c) It can be a strategic marketing weapon
- d) It can give a firm an advantage over firms that are unwilling to engage in countertrade arrangements

3-28

Critical Discussion Question

You are the assistant to the CEO of a small textile firm that manufactures high-quality, premium-priced, stylish clothing. The CEO has decided to see what the opportunities are for exporting and has asked you for advice as to the steps the company should take. What advice would you give the CEO?

3-29

Critical Discussion Question

How do you explain the popularity of countertrade? Under what scenarios might its popularity increase still further by the year 2010? Under what scenarios might its popularity decline?

3-30

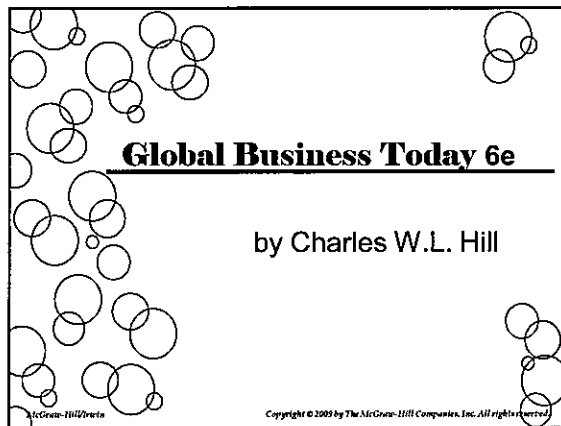
Critical Discussion Question

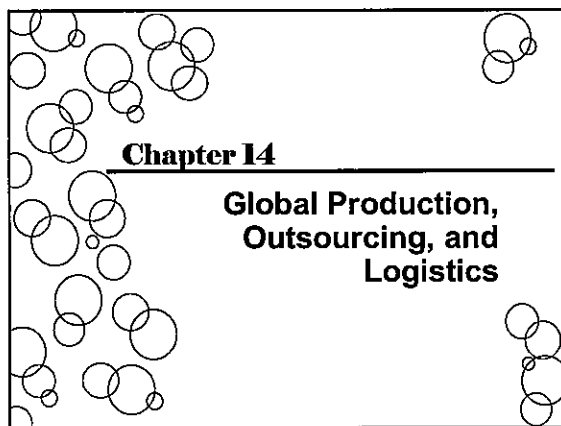
5. How might a company make strategic use of countertrade schemes as a marketing weapon to generate export sales revenues? What are the risks associated with pursuing such a strategy?

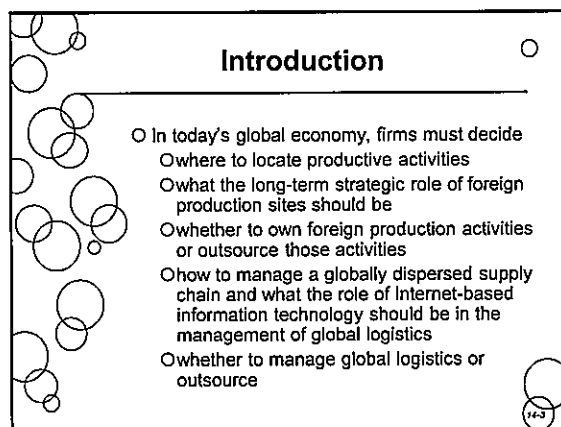
Critical Discussion Question

5. How might a company make strategic use of countertrade schemes as a marketing weapon to generate export sales revenues? What are the risks associated with pursuing such a strategy?

1







Strategy, Production, and Logistics

Question: How can production and logistics be conducted internationally to

- lower the costs of value creation
- add value by better serving customer needs?

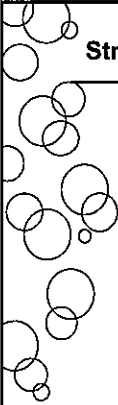
- Production refers to activities involved in creating a product
- Logistics refers to the procurement and physical transmission of material through the supply chain, from suppliers to customers

Strategy, Production, and Logistics

- The strategic objectives of the production and logistics function are
 - to lower costs
 - to increase product quality by eliminating defective products from both the supply chain and the manufacturing process
- These two objectives are interrelated

Strategy, Production, and Logistics


- Better quality control helps firms reduce costs because
 - time is not wasted manufacturing poor quality products that cannot be sold
 - re-work and scrap costs are lower
 - warranty costs and the time used to fix defective products are lower

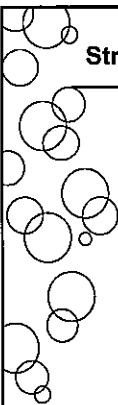


Strategy, Production, and Logistics

Question: What management tool is used to increase the reliability of product offerings?


- The Six Sigma quality improvement program aims to reduce defects, boost productivity, eliminate waste, and cut costs throughout a company
- Six Sigma is a direct descendant of total quality management (TQM)
- In addition, some countries have also promoted specific quality guidelines like the European Union's ISO 9000 standards

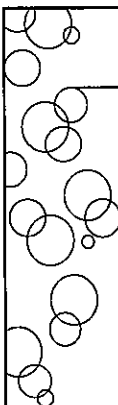




Strategy, Production, and Logistics

- Two other objectives are important for international companies
 1. production and logistics functions must be able to accommodate demands for local responsiveness
 2. production and logistics must be able to respond quickly to shifts in customer demand






Where to Produce

Question: Where should production activities be located?

- When deciding where to locate production facilities, firms must consider
 - country factors
 - technological factors
 - product factors



Country Factors

- Firms should locate manufacturing activities where economic, political, and cultural conditions, including relative factor costs, are most conducive to the performance of that activity
- Regulations affecting FDI and trade can significantly affect the appropriateness of specific countries, as can expectations about future exchange rate changes


Technological Factors

- The type of technology a firm uses in its manufacturing can affect location decisions
- Firms should consider
 1. The level of fixed costs involved
- If the fixed costs of setting up a manufacturing plant are very high, it could make sense for the firm to serve the world market from a single location or from a very few locations
- 2. The minimum efficient scale of the technology
- The larger the minimum efficient scale (the level of output at which most plant-level scale economies are exhausted) of a plant, the more likely centralized production makes sense

Technological Factors


3. The flexibility of the technology

- The term flexible manufacturing technology or lean production covers a range of manufacturing technologies that are designed to:
 - reduce set up times for complex equipment
 - increase the utilization of individual machines through better scheduling
 - improve quality control at all stages of the manufacturing process




Technological Factors

- So, flexible manufacturing technologies enable firms to produce a wide variety of end products at a unit cost that traditionally would require mass production of a standardized output
- Mass customization implies that a firm may be able to customize its product range to suit the needs of different customer groups without bearing a cost penalty



Technological Factors

- Flexible machine cells (grouping of various types of machinery, a common materials handler, and a centralized cell controller) are another common flexible manufacturing technology
- Adopting flexible manufacturing technologies can help improve the competitive position of firms by allowing the firm to customize products to meet the demands of small customer groups in different national markets
- So, firms can act like a local firm without bearing the costs of establishing local manufacturing facilities



Technological Factors

Question: When does it make sense to concentrate production at a few choice locations?

- Concentrated production makes sense when
 - fixed costs are substantial
 - the minimum efficient scale of production is high
 - flexible manufacturing technologies are available
- Concentrated production does not make sense when
 - both fixed costs and the minimum efficient scale of production are relatively low
 - appropriate flexible manufacturing technologies are not available

Product Factors

- Two product factors impact location decisions
 - The product's value-to-weight ratio
 - If the value-to-weight ratio is high, it is practical to produce the product in a single location and export it
 - If the value-to-weight ratio is low, there is greater pressure to manufacture the product in multiple locations across the world
 - Whether the product serves universal needs
 - The need for local responsiveness is reduced for products that do, which increases the attractiveness of concentrated manufacturing

4-16

Locating Production Facilities

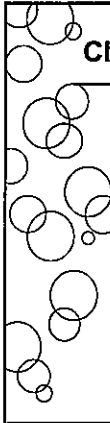
- There are two basic strategies for locating manufacturing facilities
 - Concentrating them in the optimal location and serving the world market from there
 - Decentralizing them in various regional or national locations that are close to major markets

4-17

Locating Production Facilities

	Concentrated Production Favored	Decentralized Production Favored
Country factors		
Difference in political economy	Substantial	Few
Difference in culture	Substantial	Few
Difference in factor costs	Substantial	Few
Trade barriers	Substantial	Few
Location externalities	Important in industry	Not important in industry
Exchange rates	Stable	Volatile
Technological factors		
Fixed costs	High	Low
Minimum efficient scale	High	Low
Flexible manufacturing technology	Available	Not Available
Product factors		
Value-to-weight ratio	High	Low
Serves universal needs	Yes	No


4-18

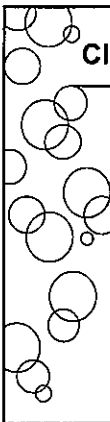


Classroom Performance System

Decentralized production will be favored when

- a) There are substantial differences in political economy
- b) Fixed costs are high
- c) The product's value-to-weight ratio is high
- d) Exchange rates are volatile




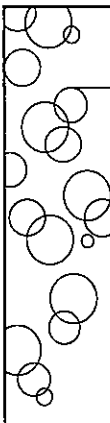


Classroom Performance System

Firms will prefer concentrated production when

- a) Minimum efficient scale is high
- b) Location externalities are not important
- c) The product does not serve universal needs
- d) There are few trade barriers






The Strategic Role of Foreign Factories

Question: Does the rationale for establishing a foreign production facility change?

- ☐ The strategic role of foreign factories and the strategic advantage of a particular location can change over time
- ☐ A factory initially established to make a standard product to serve a local market, or to take advantage of low cost inputs, can evolve into a facility with advanced design capabilities
- ☐ As governmental regulations change and/or countries upgrade their factors of production the strategic advantage of a particular location can change



The Strategic Role of Foreign Factories

- As the strategic role of a factory is upgraded and a firm develops centers of excellence in different locations worldwide, it supports the development of a transnational strategy
- A focus of a transnational strategy is global learning (the idea that valuable knowledge does not reside just in a firm's domestic operations, it may also be found in its foreign subsidiaries)
- So, managers should promote the idea that factories are potential centers of excellence with strategic importance to the firm

4-22

Outsourcing Production: Make-or-Buy Decisions

Question: Should an international business make the component parts to go into their final product or outsource them?

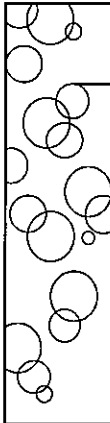
- Make-or-buy decisions (decisions about whether to perform a certain value creation activity in-house or outsource it to another firm) are important to a firm's manufacturing strategy

4-23

The Advantages of Make

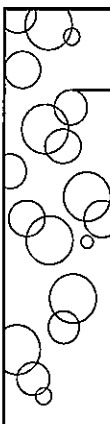
- Making component parts in-house (vertical integration) is attractive because it
 1. is associated with lower costs
 2. facilitates investments in highly specialized assets
 3. protects proprietary technology
 4. facilitates the scheduling of adjacent processes

4-24



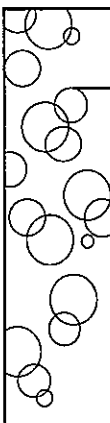
The Advantages of Make

- Lowering Costs
 - A firm should consider manufacturing a part in-house if the firm is more efficient at that a production activity than any other enterprise
- Facilitating Specialized Investments
 - In-house production makes sense when substantial investments in specialized assets (assets whose value is contingent upon a particular relationship persisting) are required to manufacture a component



The Advantages of Make

- Protecting Proprietary Technology
 - When proprietary technology is involved, in-house production can make sense to maintain control over the technology
- Improving Scheduling
 - In some cases, in-house production can make planning, coordination, and scheduling of adjacent processes easier



The Advantages of Buy

- Buying component parts from independent suppliers (outsourcing) is attractive because it
 - gives the firm greater flexibility
 - helps drive down the firm's cost structure
 - helps the firm to capture orders from international customers

The Advantages of Buy

1. Strategic Flexibility
 - Outsourcing provides the firm with the flexibility to switching orders between suppliers as circumstances dictate
 - This ability is particularly important when changes in exchange rates and trade barriers the attractiveness of supply sources

4-28

The Advantages of Buy

2. Lower Costs
 - Firms that outsource can avoid
 - the challenges involved with coordinating and controlling additional subunits
 - the lack of incentive associated with internal suppliers
 - the difficulties with setting appropriate transfer prices
3. Offsets
 - Outsourcing can help firms capture more orders from suppliers' countries

4-29

Trade-Offs

- The benefits of manufacturing components in-house are greatest when
 - highly specialized assets are involved
 - when vertical integration is necessary for protecting proprietary technology
 - when the firm is more efficient than external suppliers at performing a particular activity

4-30

Strategic Alliances with Suppliers

Question: Can strategic alliances with suppliers give firms the benefits of vertical integration?

- Some firms have tried to use strategic alliances to capture some of the benefits of vertical integration, without having the associated organizational problems
- However, in some cases, this backfires as firms find their strategic flexibility limited by commitments to alliance partners

6-21

Classroom Performance System

Buying from independent suppliers offers all of the following advantages except

- a) It gives the firm greater flexibility
- b) It helps drive down the firm's cost structure
- c) It protects proprietary property
- d) It helps the firm to capture orders from international customers

6-32

Managing a Global Supply Chain

Question: Why is logistics important to the international firm?

- Logistics encompasses the activities necessary to get materials to a manufacturing facility, through the manufacturing process, and out through a distribution system to the end user
- In international business, this is complicated by distance, time, exchange rates, and customs barriers, etc.
- Efficient logistics can have a major impact upon a firm's bottom line

6-33

The Role of Just-in-Time Inventory

Question: How can a just-in-time inventory process help a firm?

- A just-in-time (JIT) economizes on inventory holding costs by having materials arrive at a manufacturing plant just in time to enter the production process, and not before
- It can result in major cost savings from reduced warehousing and inventory holding costs
- It can help firms spot defective parts, take them out of the manufacturing process, and boost product quality

4-34

The Role of Information Technology and the Internet

Question: What is the role of information technology in materials management?

- Electronic data interchange (EDI)
 - facilitates the tracking of inputs
 - allows the firm to optimize its production schedule
 - allows the firm and its suppliers to communicate in real time
 - eliminates the flow of paperwork between a firm and its suppliers

4-35

Critical Discussion Question

1. An electronics firm is considering how best to supply the world market for microprocessors used in consumer and industrial electronic products. A manufacturing plant costs approximately \$500 million to construct and requires a highly skilled work force. The total value of the world market for this product over the next 10 years is estimated to be between \$10 and \$15 billion. The tariffs prevailing in this industry are currently low. Should the firm adopt a concentrated or decentralized manufacturing strategy? What kind of location(s) should the firm favor for its plant(s)?

4-36

Critical Discussion Question

2. A chemical firm is considering how best to supply the world market for sulfuric acid. A manufacturing plant costs approximately \$20 million to construct and requires a moderately skilled work force. The total value of the world market for this product over the next 10 years is estimated to be between \$20 and \$30 billion. The tariffs prevailing in this industry are moderate. Should the firm favor concentrated manufacturing or decentralized manufacturing? What kind of location(s) should the firm seek for its plant(s)?

4-37

Critical Discussion Question

3. A firm must decide whether to make a component part in-house or to contract it out to an independent supplier. Manufacturing the part requires a non-recoverable investment in specialized assets. The most efficient suppliers are located in countries with currencies that many foreign exchange analysts expect to appreciate substantially over the next decade. What are the pros and cons of (a) manufacturing the component in-house and (b) outsourcing manufacture to an independent supplier? Which option would you recommend? Why?

4-38

Critical Discussion Question

4. Reread the Management Focus on Philips in China then answer the following questions:

- What are the benefits to Philips of shifting so much of its global production to China?
- What are the risks associated with a heavy concentration of manufacturing assets in China?
- What strategies might Philips adopt to maximize the benefits and mitigate the risks associated with moving so much product?

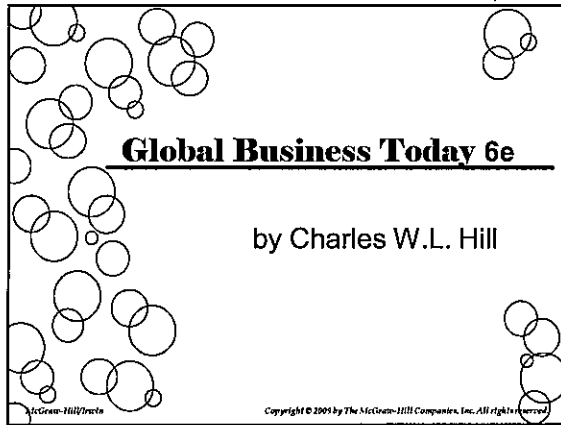
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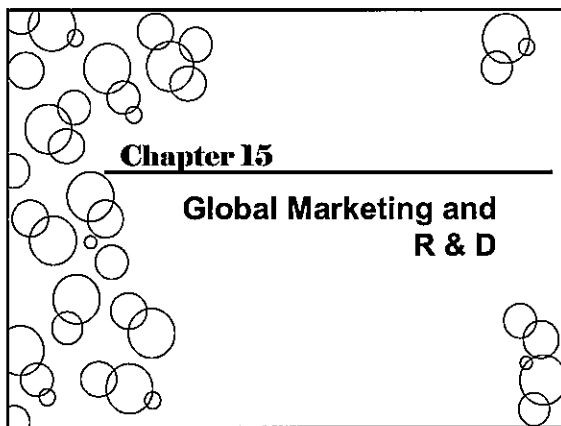
Critical Discussion Question

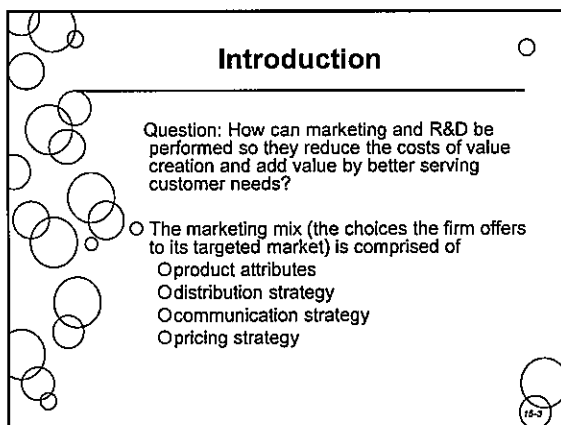
5. Explain how an efficient materials management function can help an international business compete more effectively in the global marketplace.

Critical Discussion Question

5. Explain how an efficient materials management function can help an international business compete more effectively in the global marketplace.







The Globalization of Markets and Brands

- Theodore Levitt argued that world markets were becoming increasingly similar making it unnecessary to localize the marketing mix
- Levitt's theory has become a lightning rod in the debate about globalization
- Most experts believe that while there is a trend towards global markets, cultural and economic differences among nations act as a major brake on any trend toward global consumer tastes and preferences
- In addition, trade barriers and differences in product and technical standards also limit the ability of firms to sell a standardized product to a global market

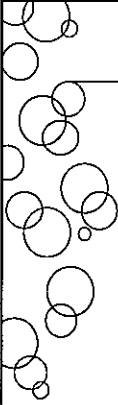
Market Segmentation

Question: What is market segmentation?

- Market segmentation involves identifying distinct groups of consumers whose purchasing behavior differs from others in important ways
- Global market segments are more likely to exist in industrial products than in consumer products


Market Segmentation

- Firms must
 - adjust their marketing mix from segment to segment
 - consider the existence of segments that transcend national borders and understand differences across countries in the structure of segments
 - must customize the product, the packaging, or the way in which the product is marketed in order to maximize performance in market where there are no cross-national segments



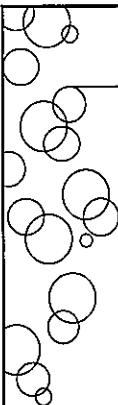
Product Attributes

- Products can be thought of as a bundle of attributes
- Products sell well when their attributes match consumer needs
- Consumer needs vary from country to country depending on
 1. culture
 2. the level of economic development
- So, the ability of firms to sell the same product worldwide is limited



Cultural Differences

- Countries differ along a range of cultural dimensions including
 - tradition
 - social structure
 - language
 - religion
 - education
- While, there is some evidence that tastes and preferences are becoming more cosmopolitan, the global culture that Levitt proposed is still a long way off



Economic Development

Question: How does a country's level of economic development influence marketing?

- Consumers in highly developed countries tend to demand a lot of extra performance attributes into their products
- Consumers in less developed nations tend to prefer more basic products

Product and Technical Standards

Question: How do differences in product and technical standards impact marketing decisions?

- National differences in product and technological standards force firms to customize the marketing mix
 - Government mandated product standards can make mass production difficult
 - Idiosyncratic decisions made in the past on technical standards can influence future marketing strategies

5-10

Distribution Strategy


- A firm's distribution strategy (the means it chooses for delivering the product to the consumer) is a critical element of the marketing mix
- If the firm manufactures its product in the particular country, it can sell directly to the consumer, to the retailer, or to the wholesaler
- The same options are available to a firm that manufactures outside the country, or the firm could sell to an import agent

5-11

Distribution Strategy

A Typical Distribution System


5-12



Differences between Countries

Question: How do distribution systems differ between countries?

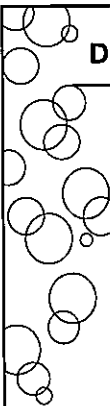
- The main differences between distribution systems are
 - retail concentration
 - channel length
 - channel exclusivity
 - channel quality



Differences between Countries

1. Retail Concentration


- In some countries the retail system is very concentrated, while in other countries it is fragmented
- In a concentrated system, a few retailers supply most of the market
- In a fragmented system there are many retailers, no one of which has a major share of the market



Differences between Countries

2. Channel Length

- Channel length refers to the number of intermediaries between the producer and the consumer
- When the producer sells directly to the consumer, the channel is very short
- When the producer sells through an import agent, a wholesaler, and a retailer, a long channel exists
- Fragmented retail systems tend to have longer channels




Differences between Countries

3. Channel Exclusivity

- An exclusive distribution channel is one that is difficult for outsiders to access
- Japan's system is an example of a very exclusive system

5-16




Differences between Countries

4. Channel Quality

- Channel quality refers to the expertise, competencies, and skills of established retailers in a nation, and their ability to sell and support the products of international businesses
- The quality of retailers is good in most developed countries, but is variable at best in emerging markets and less developed countries
- A poor quality channel can impede market entry

5-17



Choosing a Distribution Strategy

Question: Which distribution strategy should a firm choose?

- The choice of distribution strategy depends on the relative costs and benefits of each alternative
- Since each intermediary in a channel adds its own markup to the products, there is a link between channel length and profit margin
 - If price is important, a shorter channel is better
 - If a retail sector is very fragmented, a long channel is better

5-18

Communication Strategy

Question: How should a firm communicate the attributes of its product to prospective customers?

- Communication channels available to a firm include
 - direct selling
 - sales promotion
 - direct marketing
 - advertising

6-18

Barriers to International Communication

Question: What factors affect the success of a firm's international communications?

- International communication occurs whenever a firm uses a marketing message to sell its products in another country
- The effectiveness of a firm's international communication can be jeopardized by
 1. cultural barriers
 2. source and country of origin effects
 3. noise levels

6-20

Push versus Pull Strategies

- Firms must choose between a push strategy (emphasizes personnel selling) and a pull strategy (emphasizes mass media advertising)
- The choice between the strategies depends upon
 1. product type and consumer sophistication
 2. channel length
 3. media availability

6-21

Push versus Pull Strategies

1. Product Type and Consumer Sophistication

- Consumer goods firms trying to sell to a large segment of the market tend to prefer a pull strategy
- Industrial products firms or makers of other complex products favor a push strategy

5-22

Push versus Pull Strategies

2. Channel Length

- The longer the channel, the more intermediaries involved
- It can be expensive to using direct selling to push a product through many layers of a distribution channel
- A firm may try to pull its product through the channels by using mass advertising to create consumer demand

5-23

Push versus Pull Strategies

3. Media Availability

- A pull strategy relies on access to advertising media
- A push strategy is more attractive when there is limited access to mass media

5-24

Push versus Pull Strategies

- Push strategies tend to be emphasized
 - for industrial products and/or complex new products
 - when distribution channels are short
 - when few print or electronic media are available
- Pull strategies tend to be emphasized
 - for consumer goods products
 - when distribution channels are long
 - when sufficient print and electronic media are available to carry the marketing message

Global Advertising

Question: Should a firm standardize its advertising worldwide?

- Standardized advertising makes sense when
 - it has significant economic advantages
 - creative talent is scarce and one large effort to develop a campaign will be more successful than numerous smaller efforts
 - brand names are global
- Standardized advertising is not appropriate when
 - cultural differences among nations are significant
 - country differences in advertising regulations may block the implementation of standardized advertising

Classroom Performance System

A push strategy works best in all of the following situations except

- For industrial products
- When distribution channels are short
- When sufficient print and electronic media are available to carry the marketing message
- For complex new products

Global Advertising

- Some firms try to capture the benefits of global standardization while responding to individual cultural and legal environments
- Firms can use some features to use in advertising campaigns worldwide, and then localize other features

5-28

Pricing Strategy

Question: How should a firm price its product or service in foreign markets?

- Firms must consider
 - price discrimination
 - strategic pricing
 - government-mandated price controls

5-29

Price Discrimination

Question: Should a firm charge the same price everywhere, or price its product on a market-by-market basis?

- Firms can maximize profits through price discrimination (charging consumers in different countries different prices for the same product)
- For price discrimination to work
 - the firm must be able to keep national markets separate
 - different price elasticities of demand must exist in different countries

5-30

Price Discrimination

- Price elasticity of demand is a measure of the responsiveness of demand for a product to changes in price
- Demand is elastic when a small change in price produces a large change in demand
- Demand is inelastic when a large change in price produces only a small change in demand
- Elasticity of demand is determined by
 - Income level
 - Competitive conditions
- In general price elasticities tend to be greater in countries with lower income levels and greater numbers of competitors

Strategic Pricing

- Strategic pricing has three aspects
 1. Predatory pricing - the profit gained in one market is used to support aggressive pricing designed to drive competitors out, in another market
 2. Multi-point pricing - a firm's pricing strategy in one market may have an impact on a rival's pricing strategy in another market
 - Aggressive pricing in one market can prompt a competitive response from a rival in another market
 - So, central monitoring of pricing decisions around the world is important

Strategic Pricing

- 3. Experience curve pricing - involves pricing low worldwide in an attempt to build global sales volume as rapidly as possible, even if this means taking large losses initially
 - Firms believe that several years in the future, when it has moved down the experience curve, they will be making substantial profits and have a cost advantage over less aggressive competitors

Regulatory Influences on Prices

- The use of either price discrimination or strategic pricing may be limited by national or international regulations
- Dumping occurs whenever a firm sells a product for a price that is less than the cost of producing it
 - Antidumping rules set a floor under export prices and limit firms' ability to pursue strategic pricing
- Many developed nations have regulations promoting competition and restricting monopoly practices

5-24

Classroom Performance System

When a firm uses a pricing strategy aimed at giving a company a competitive advantage over its rivals, the firm is engaging in

- Predatory pricing
- Multipoint pricing
- Experience curve pricing
- Strategic pricing


5-25

Configuring the Marketing Mix

Question: How should a firm configure its marketing mix?

- Standardization versus customization is not an all or nothing concept
- Most firms standardize some things and customize others
- Decisions about what to standardize and what to customize should be made after exploring the costs and benefits of each option


5-26



New Product Development

- Firms need to develop and market new products
 - Technological innovation is important in new product development
 - Product life cycles are shorter than in the past because technological innovation generates creative destruction
- Firms need to invest in R&D and apply the technology to developing products that meet consumer needs, and that can be manufactured in a cost-effective way

5-37




The Location of R&D

Question: Where should a firm locate R&D?

- New product ideas come from the interactions of scientific research, demand conditions, and competitive conditions
- New-product development is greater when
 - more money is spent on basic and applied research and development
 - demand is strong
 - consumers are affluent
 - competition is intense

5-38



Integrating R&D, Marketing, and Production

Question: How can a firm ensure that its new product development is successful?

- Commercialization of new technologies in international firms may require different versions of a new product to be produced for different countries
- New product development efforts should be closely coordinated with the marketing, production, and materials management functions
- This integration will ensure that customer needs are met and that the company performs all its value creation activities efficiently

5-39

Cross-Functional Teams

Question: How can a firm achieve cross-functional integration?

- Cross-functional integration is facilitated by cross-functional product development teams
- Effective cross functional teams should
 - Be led by a heavyweight project manager with status in the organization
 - Have members from all the critical functional areas
 - Have members located together
 - Have clear goals
 - Have an effective conflict resolution process

6-40

Building Global R&D Capabilities

Question: How should a firm build global R&D capabilities?

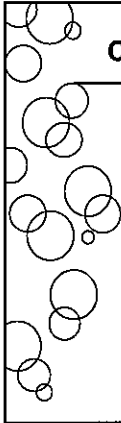
- R&D and marketing need to be integrated to adequately commercialize new technologies
- Many firms establish a global network of R&D centers to develop the basic technologies that will become new products
- These technologies are then applied by local R&D groups in regional or country units

6-41

Critical Discussion Question



1. Imagine you are the marketing manager for a US manufacturer of disposable diapers. Your firm is considering entering the Brazilian market. Your CEO believes the advertising message that has been effective in the United States will suffice in Brazil. Outline some possible objections to this. Your CEO also believes that the pricing decisions in Brazil can be delegated to local managers. Why might she be wrong?

6-42

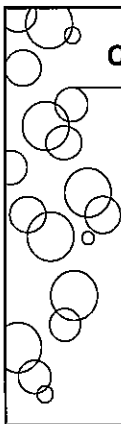


Critical Discussion Question

2. Within 20 years we will have seen the emergence of enormous global markets for standardized consumer products. Do you agree with this statement? Justify your answer.





5-43

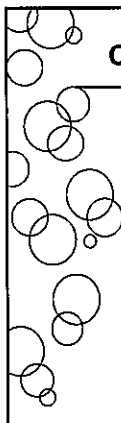


Critical Discussion Question

3. You are the marketing manager of a food products company that is considering entering the Indian market. The retail system in India tends to be very fragmented. Also, retailers and wholesalers tend to have long-term ties with Indian food companies, which makes access to distribution channels difficult. What distribution strategy would you advise the company to pursue? Why?





5-44



Critical Discussion Question

4. Price discrimination is indistinguishable from dumping. Discuss the accuracy of this statement?

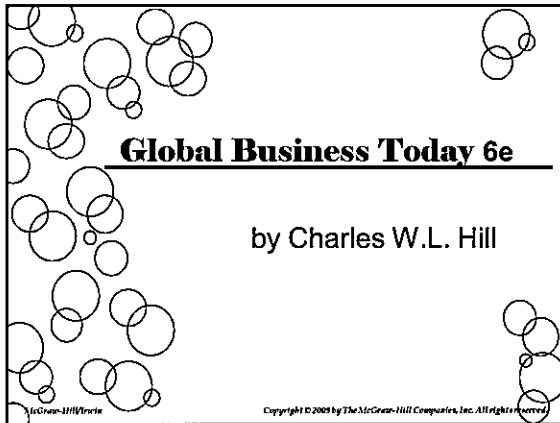


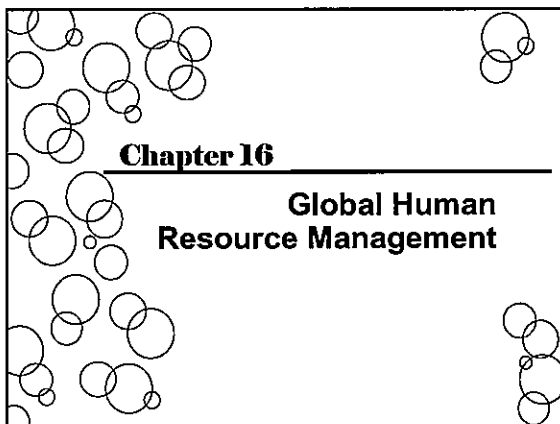
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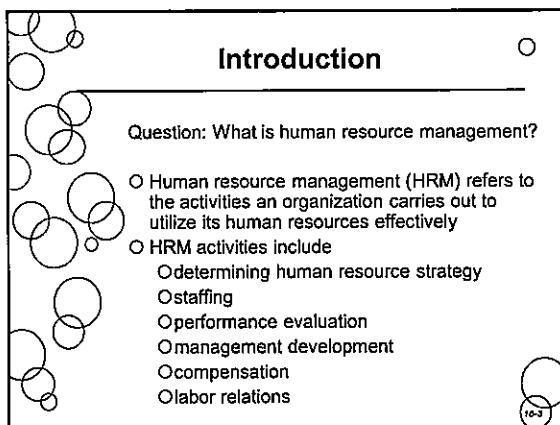
Critical Discussion Question

5. You work for a company that designs and manufactures personal computers. Your company's R&D center is in North Dakota. The computers are manufactured under contract in Taiwan. Marketing strategy is delegated to the heads of three regional groups: a North American group (based in Chicago), a European group (based in Paris), and an Asian group (based in Singapore). Each regional group develops the marketing approach within its region. In order of importance, the largest markets for your products are North America, Germany, Britain, China, and Australia. Your company is experiencing problems in its product development and commercialization process. Products are late to market, the manufacturing quality is poor, and costs are higher than projected, and market acceptance of new products is less than hoped for. What might be the source of these problems? How would you fix them?

5. You work for a company that designs and manufactures personal computers. Your company's R&D center is in North Dakota. The computers are manufactured under contract in Taiwan. Marketing strategy is delegated to the heads of three regional groups: a North American group (based in Chicago), a European group (based in Paris), and an Asian group (based in Singapore). Each regional group develops the marketing approach within its region. In order of importance, the largest markets for your products are North America, Germany, Britain, China, and Australia. Your company is experiencing problems in its product development and commercialization process. Products are late to market, the manufacturing quality is poor, and costs are higher than projected, and market acceptance of new products is less than hoped for. What might be the source of these problems? How would you fix them?







Introduction

- HRM is more complex in an international business because of differences between countries in labor markets, culture, legal systems, economic systems, and so on
- International HRM also deals with issues related to expatriate managers (citizens of one country working abroad) including
 - when to use expatriates
 - who to send on expatriate posting
 - how expatriates should be compensated
 - how to handle the repatriation of expatriates

The Strategic Role of International HRM

Question: Why is international HRM important to the success of the firm?

- Strategy is implemented through organization
- People are the linchpin to the firm's organization architecture
- So, success in international business requires that HRM policies be congruent with the firm's strategy

The Strategic Role of International HRM

The Role of Human Resources in Shaping Organization Architecture

Staffing Policy

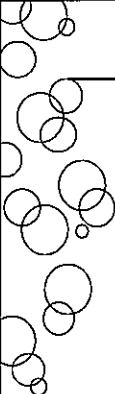
- Staffing policy is concerned with the selection of employees for a particular job
 - It involves selecting people who have the right skills for a particular job
 - It also involves developing and promoting the corporate culture of the firm (the organization's norms and value systems)

Types of Staffing Policy

- There are three types of staffing policies
 1. the ethnocentric approach
 2. the polycentric approach
 3. the geocentric approach
- The most attractive policy is the geocentric approach, however it is not always easy to implement

Types of Staffing Policy

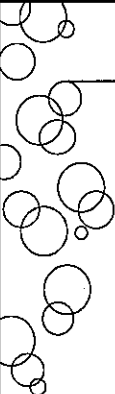
1. The Ethnocentric Approach
 - An ethnocentric approach to staffing policy is one in which key management positions in an international business are filled by parent-country nationals
 - The policy makes most sense for firms pursuing an international strategy



Types of Staffing Policy

- An ethnocentric staffing policy is attractive when
 - the firm believes there is a lack of qualified individuals in the host country to fill senior management positions
 - the firm sees an ethnocentric staffing policy as the best way to maintain a unified corporate culture
 - the firm wants to transfer knowledge of core competencies to the foreign operation
- This policy is falling out of favor because
 - it limits the advancement of host country nationals
 - it can lead to cultural myopia


9-10



Types of Staffing Policy

- The ethnocentric approach to staffing is falling out of favor because
 - it limits the advancement of host country nationals
 - This can lead to resentment, lower productivity, and increased turnover
 - it can lead to cultural myopia (the firm's failure to understand host-country cultural differences that require different approaches to marketing and management)

9-11




Types of Staffing Policy

2. The Polycentric Approach


- A polycentric staffing policy is one in which host country nationals are recruited to manage subsidiaries in their own country, while parent country nationals occupy the key positions at corporate headquarters
- This approach minimizes the dangers of cultural myopia, but it also helps create a gap between home and host country operations
- The polycentric policy is best suited to firms pursuing a localization strategy


9-12



Types of Staffing Policy

- The advantages of the polycentric policy are that
 - the firm is less likely to suffer from cultural myopia
 - it may be less expensive to implement
- The disadvantages of the polycentric policy are that
 - host country nationals have few opportunities to gain foreign experience and so cannot progress beyond senior positions in their own subsidiaries
 - a gap can form between host country managers and parent country managers




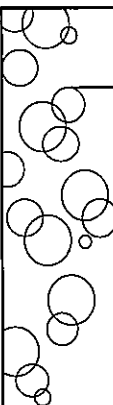


Types of Staffing Policy

3. The Geocentric Approach


- A geocentric staffing policy is one in which the best people are sought for key jobs throughout the organization, regardless of their nationality
- This approach is consistent with building a strong unifying culture and informal management network
- It makes sense for firms pursuing either a global or transnational strategy
- Immigration policies of national governments may limit the ability of a firm to pursue this policy





Types of Staffing Policy

- The advantages of a geocentric approach to staffing are that it
 - enables the firm to make the best use of its human resources
 - builds a cadre of international executives who feel at home working in a number of different cultures
- The disadvantages of geocentric approach include
 - difficulties with immigration laws
 - costs associated with implementing the strategy



Types of Staffing Policy

Comparison of Staffing Approaches

Staffing Approach	Staffing Appropriateness	Advantages	Disadvantages
Ethnocentric	International	Overcomes lack of qualified managers in host country Unifies culture Helps transfer core competencies	Produce resentment in host country Can lead to cultural misview
Polycentric	Localisation	Adaptates culture Example: Responsive to customers	Low career mobility Inexperienced managers from foreign subsidiaries
Geocentric	Global standardisation and cross-national	Uses human resources efficiently Helps build strong culture and internal management systems	Expensive National integration policies may limit implementation

6-16

Expatriate Managers

- Firms that use expatriates must consider the problem of expatriate failure (the premature return of an expatriate manager to his home country)
- U.S. firms have higher expatriate failure rates than either European or Japanese firms
 - Studies show that 76 percent of U.S. MNEs had expatriate failure rates of 10 percent or more – 7 percent had failure rates as high as 20 percent
 - Estimates of the cost of expatriate failure range from \$250,000 million to \$1 million

6-17

Expatriate Managers

- The main reasons for expatriate failure for U.S. MNEs are
 - The inability of an expatriate's spouse to adapt to a foreign culture
 - The inability of the employee to adjust
 - Other family-related reasons
 - The manager's personal or emotional maturity
 - The inability to cope with larger overseas responsibilities

6-18

Expatriate Managers

- For European firms, only one reason was found to consistently explain expatriate failure
 - the inability of the manager's spouse to adjust to a new environment
- For Japanese firms, the reasons for failure were
 - the inability to cope with larger overseas responsibility
 - difficulties with the new environment
 - personal or emotional problems
 - a lack of technical competence
 - the inability of spouse to adjust

Classroom Performance System

Studies show the most common reason for expatriate failure is

- a) The manager's inability to adjust
- b) The manager's emotional or personal maturity
- c) The inability of the spouse to adjust
- d) The manager's lack of technical competence

Expatriate Managers

Question: How can firms reduce the rate of expatriate failure?

- Expatriate failure rates can be reduced through better selection procedures
- Mendenhall and Oddou identified four dimensions that predict expatriate success
 1. self-orientation
 2. others-orientation
 3. perceptual ability
 4. cultural toughness

Expatriate Managers

1. Self-orientation attributes strengthen the expatriate's self-esteem, self-confidence, and mental well-being
2. Others orientation refers to how the attributes of this dimension enhance the expatriate's ability to interact effectively with host-country nationals
3. Perceptual ability refers to the ability to understand why people of other countries behave the way they do
4. Cultural toughness refers to the fact that how well an expatriate adjusts to a particular posting tends to be related to the country of assignment

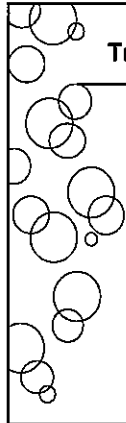
The Global Mindset

- Some experts believe that a global mindset (one that is characterized by cognitive complexity and a cosmopolitan outlook) is essential to the success of global managers
- Yet, studies show that few firms consider this when selecting expatriate managers, and instead focus on technical expertise

Training and Management Development

Question: How should firms prepare expatriate for their foreign postings?


- Training focuses upon preparing the manager for a specific job
- Management development focuses on developing the skills of the manager over her career with the firm
- Traditionally, training has been considered more important than management development, however this mindset is beginning to shift

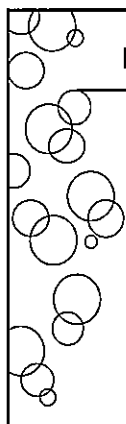


Training for Expatriate Managers

Question: How can firms reduce expatriate failure?

- To reduce expatriate failure, firms should provide
 1. Cultural training - seeks to foster an appreciation for the host country's culture
 2. Language training - improves the effectiveness of managers and helps them better relate to the foreign country
 3. Practical training - helps the expatriate manager and family ease into day-to-day life of the host country




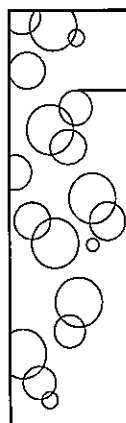


Repatriation of Expatriates

Question: How should firms prepare expatriates for their return?

- Managers need to be prepared for reentry into their home country organization
- This involves HRM planning to determine
 - the role of the employee in the home country at the end of the assignment
 - how to utilize the knowledge the employee acquired while abroad




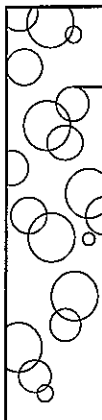


Management Development and Strategy

Question: How can firms use management development as a strategic tool?

- Management development programs increase the skill levels of managers through
 - management education
 - the rotation of managers through jobs
- Management development is often used as a strategic tool to build a strong unifying culture and informal management network, both of which are supportive of a transnational and global strategy





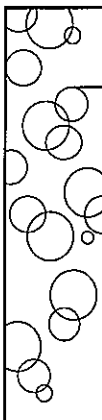


Performance Appraisal

Question: How should employees be evaluated?

- Performance appraisal systems are used to evaluate employees
- These systems are important components in the firm's control system






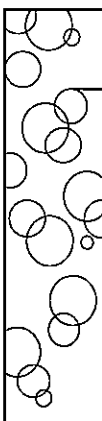


Performance Appraisal Problems

Question: Why is it difficult to evaluate the performance of expatriates?

- When evaluating employees,
 - home country managers tend to rely on hard data
 - host country managers can be biased towards their own frame of reference
- So, many firms rely on both groups to evaluate the performance of expatriate managers








Guidelines for Performance Appraisal

Question: How can firms reduce the bias in performance evaluations?

- To reduce bias
 - most expatriates believe more weight should be given to an on-site manager's appraisal than to an off-site manager's appraisal
 - a former expatriate who has served in the same location should be involved in the appraisal process
 - home office managers should probably be consulted before an on-site manager completes a formal termination evaluation

Compensation

Question: What are the key compensation issues for international firms?

- There are two key issues
 1. how compensation should be adjusted to reflect national differences in economic circumstances and compensation practices
 2. how expatriate managers should be paid

National Differences in Compensation

Question: Should firms pay executives in different countries according to the prevailing standards in each country, or should it equalize pay on a global basis?

- Firms using a geocentric policy that want to develop an international cadre of managers must pay executives the same salary regardless of their country of origin
 - If a firm does not equalize pay, it could create resentment among foreign nationals

Expatriate Pay

- The most common approach to expatriate pay is the balance sheet approach
- This approach equalizes purchasing power across countries so employees can have the same standard of living in the foreign country as they do at home
- The components of the typical compensation package are
 1. base salary
 2. a foreign service premium
 3. allowances of various types
 4. benefits
 5. tax differentials

Expatriate Pay

- Base Salary
 - An expatriate's base salary is normally in the same range as the base salary for a similar position in the home country
- Foreign Service Premium
 - A foreign service premium is extra pay the expatriate receives for working outside his country of origin
 - It is offered as an inducement to accept foreign postings

Expatriate Pay

- Allowances
 - Four types of allowances are often included in a package
 - hardship allowances
 - housing allowances
 - cost-of-living allowances
 - education allowances
- Benefits
 - Many firms also ensure that their expatriates receive the same level of medical and pension benefits abroad that they received at home

Expatriate Pay

- Taxation
 - Unless a host country has a reciprocal tax treaty with the expatriate's home country, the expatriate may have to pay income tax to both the home country and the host-country governments
 - When a reciprocal tax treaty is not in force, the firm typically pays the expatriate's income tax in the host country

International Labor Relations

Question: How can organized labor be able to limit the choices available to an international business?

- A firm's ability to pursue a transnational or global strategy can be significantly constrained by the actions of labor unions
- So, the HRM function must foster harmony and minimize conflict between management and labor

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The Concerns of Organized Labor

Question: What are the concerns of organized labor?

- Organized labor has three main concerns
 1. that the multinational can counter union bargaining power by threatening to move production to another country
 2. that multinationals will keep highly skilled tasks in the home country and farm out only low skilled tasks
 3. that imported employment practices and contractual agreements will reduce its influence and power

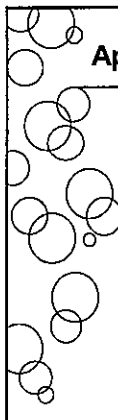
6-38

The Strategy of Organized Labor

Question: How can organized labor respond to the power of multinationals?

- Organized labor has responded to the increased bargaining power of multinationals by
 - trying to set-up their own international organizations
 - lobbying for national legislation to restrict multinationals
 - trying to achieve regulations of multinationals through international organization such as the United Nations
- So far, these efforts have had only limited success


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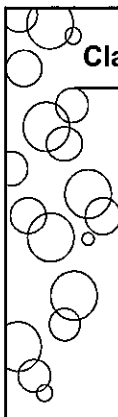


Approaches to Labor Relations

Question: How do firms approach labor relations?

- Traditionally, most labor relations have been decentralized to individual subsidiaries
- However, because many firms are realizing that the way in which work is organized within a plant can be a major source of competitive advantage, there is a shift towards greater centralization to enhance the bargaining power of the multinational vis-à-vis organized labor
- In addition, many firms are realizing how work is organized within a plant can be a source of competitive advantage




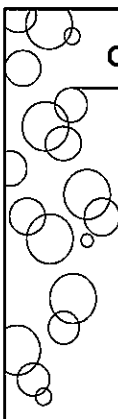


Classroom Performance System

Labor has responded to the increased bargaining power of multinationals by doing all of the following except


- a) Establishing global unions
- b) Trying to set-up their own international organizations
- c) Lobbying for national legislation to restrict multinationals
- d) Trying to achieve regulations of multinationals through international organization such as the United Nations

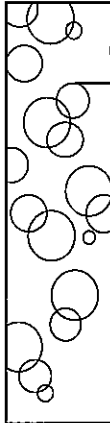




Critical Discussion Question


1. What are the main advantages and disadvantages of the ethnocentric, polycentric, and geocentric approaches to staffing policy? When is each approach appropriate?

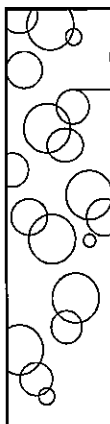




Critical Discussion Question


2. Research suggests that many expatriate employees encounter problems that limit both their effectiveness in a foreign posting and their contribution to the company when they return home. What are the main causes and consequences of these problems, and how might a firm reduce the occurrence of such problems?

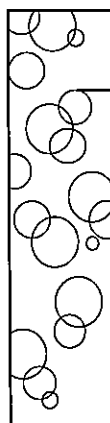




Critical Discussion Question


3. What is the link between an international business's strategy and its human resource management policies, particularly with regard to the use of expatriate employees and their pay scale?





Critical Discussion Question

4. In what ways can organized labor constrain the strategic choices of an international business? How can an international business limit these constraints?



Critical Discussion Question

5. Reread the Management Focus on McDonald's global compensation practices. How does McDonald's approach help the company to take local differences into account when reviewing the performance of different country managers and awarding bonus pay?
