

# Understanding the Global Context of Business

## chapter 4

Kumar Srikandan/Alamy



No matter where in the world a firm does  
business, management drives its success.

# International

businesses create unique management

challenges in

markets scattered

around the globe.

After reading this chapter,  
you should be able to:

- 4-1** **Discuss** the rise of international business and describe the major world marketplaces, trade agreements, and alliances.
- 4-2** **Explain** how differences in import–export balances, exchange rates, and foreign competition determine the ways in which countries and businesses respond to the international environment.
- 4-3** **Discuss** the factors involved in deciding to do business internationally and in selecting the appropriate levels of international involvement and international organizational structure.
- 4-4** **Explain** the role and importance of the cultural environment in international business.
- 4-5** **Describe** some of the ways in which economic, legal, and political differences among nations affect international business.



# The Door Opens

In December 2014, President Barack Obama made the historic announcement that he planned to normalize diplomatic relations with Cuba. While only Congress can put an end to the

U.S. embargo on trade with Cuba, this announcement creates a number of opportunities for U.S. businesses. One of the most significant impacts will be the ability of U.S. citizens to travel to Cuba. In the past, travel to Cuba was limited to certain educational or humanitarian efforts. However, travel to Cuba now can be authorized under 12 broad categories, including athletic competitions and people-to-people programs, and travelers will not have to apply for any special licenses before they travel.

In Cuba's socialist economy, most hotels are partially or completely government owned and often lack the amenities desired by American travelers. In addition, hotel capacity is limited and no new hotels are under construction. However, many private homes are available for short-term stays and San Francisco Airbnb is stepping in to fill the void. Within weeks of the announcement, more than 1,000 Cuban listings appeared on the Airbnb site. For as little as \$25 per night, travelers can arrange a stay in a private home in Cuba, soaking up the warm weather and Caribbean sunshine.<sup>1</sup>

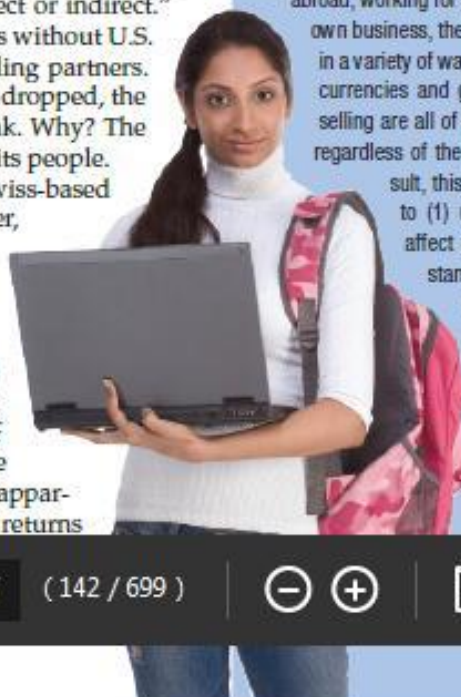
In spite of the restoration of diplomatic relations and easing of travel restrictions, the embargo on Cuban exports remains. The U.S. embargo, which was first imposed in 1960 in response to the revolutionary communist government's appropriation of U.S. land holdings in the country, prevents "U.S. persons" and entities "owned or controlled" by "U.S. persons" from engaging in any transactions in which Cuba has an "interest of any nature whatsoever, direct or indirect." Cuba, therefore, has no access to the U.S. market, does without U.S. imports, and amasses substantial debts to other trading partners. But observers also point out that if the embargo were dropped, the effects might not be as dramatic as some people think. Why? The embargo doesn't really have much effect on Cuba or its people.

Cubans now buy ice cream and soft drinks from Swiss-based Nestlé, soap and shampoo from Anglo-Dutch Unilever, and cigarettes from Brazil's Souza Cruz. The fact that the United States is the world's largest market for rum did not deter French-owned Pernod-Ricard from building a new distillery in Cuba, and Britain's Imperial Tobacco expects to double sales when Americans can once again purchase premium hand-rolled Cuban cigars. Most of the directors of Canada's Sherritt International are barred from the United States by provisions of the embargo, but they apparently regard the ban as a small price to pay for future returns on a \$1.5-billion investment in the mining and metal processing industries. Cuba



## what's in it for me?

As we will see in this chapter, global forces—business as well as political—affect each and every one of us on a daily basis. As you begin your business career, regardless of whether you see yourself living abroad, working for a big company, or starting your own business, the global economy will affect you in a variety of ways. Exchange rates for different currencies and global markets for buying and selling are all of major importance to everyone, regardless of their role or perspective. As a result, this chapter will better enable you to (1) understand how global forces affect you as a customer, (2) understand how globalization affects you as an employee, and (3) assess how global opportunities and challenges can affect you as a business owner and an investor. You will also gain insights into how wages and working conditions in different regions are linked to what we pay for the goods and services we use and the prices we pay.



107

(142 / 699)



This chapter explores the global context of business. We begin with an exploration of the major world marketplaces and trade agreements that affect international business. Next, we examine several factors that help determine how countries and businesses respond to international opportunities and challenges. We then direct our attention to some of the decisions managers must make if they intend to compete in international markets. Finally, we conclude with a discussion of some of the social, cultural, economic, legal, and political factors that affect international business.

once unavailable to Cuban consumers, such as computers, DVDs, and mobile phones, and sales of all these products will be a boon to Telecom Italia, which holds a 27 percent stake in the country's state-owned telecom operations.

Paul Katzeff, founder of Thanksgiving Coffee Company, a California producer of specialty coffees, regards the U.S. embargo as impractical (on the grounds that it hasn't achieved its goals) and immoral (on the grounds that it punishes Cuban people rather than their government). Katzeff is thinking the same thing that many U.S. businesspeople are undoubtedly thinking: When the embargo is dropped, there will be new business opportunities. As he sees it, Cuban coffee has a promising post-embargo future: Its potential is enormous because of the quality of the coffee beans. Although Katzeff's geopolitics may rankle some people, his business sense seems sound. At present, of course, he can't actually do business with Cuban coffee growers, but he has figured out a way to lay the groundwork. He has already established work-

ing relationships with coffee cooperatives, groups of individual growers who pool their crops to enter the export market and secure higher prices, in Latin America and Africa. His longer-term goal is to invest the same capital and acquired know-how in relationships with Cuban growers.

The director of Thanksgiving's Cuba project, Nick Hoskins, has already developed contacts in Cuba's coffee-growing regions, and Katzeff hopes to establish a *twinning agreement*, an exchange of people-to-people programs, with cooperatives in the coffee-growing province of Santiago de Cuba. In the meantime, though, Thanksgiving is willing to settle for a public relations program of transactions—monetary and otherwise—with U.S. coffee drinkers.<sup>2</sup> (After studying this chapter, you should be able to respond to the set of discussion questions found at the end of the chapter.)

#### OBJECTIVE 4-1 Discuss

the rise of international business and describe the major world marketplaces, trade agreements, and alliances.

*Globalization process by which the world economy is becoming a single interdependent system*

*Import product made or grown abroad but sold domestically*

*Export product made or grown domestically but shipped and sold abroad*

## The Contemporary Global Economy

The total volume of world trade is immense—more than \$19.3 trillion in merchandise is traded each year. Foreign investment in the United States exceeds \$236 billion, and U.S. investment abroad is more than \$300 billion.<sup>3</sup> As more firms engage in international business, the world economy is fast becoming an interdependent system through a process called **globalization**.

We often take for granted the diversity of products we can buy as a result of international trade. Your television, your shoes, and even your morning coffee or juice are probably **imports**, products made or grown abroad and sold domestically in the United States. At the same time, the success of many U.S. firms depends on **exports**, products made or grown here, such as machinery, electronic equipment, and grains, and shipped for sale abroad.

Firms such as McDonald's, Microsoft, Apple, and Starbucks have found international markets to be a fruitful area for growth. But firms sometime stumble when they try to expand abroad. Home Depot has closed most of the stores it opened in China, for example, because labor costs are so low there that few homeowners are interested in "do-it-yourself" projects. Similarly, Best Buy also closed its stores in China because consumers there tend to buy their electronics goods at lower prices from local or online merchants.<sup>4</sup>

The impact of globalization doesn't stop with firms looking to open locations abroad or having to close locations that fail. Small firms with no international operations (for example, an independent coffee shop) may still buy from international suppliers, and even individual contractors or self-employed people can be affected by fluctuations in exchange rates.





Some globalization protestors, like this man, fear that multinational companies will wipe out small domestic businesses like family farms.

to foreign businesses, offering incentives for domestic businesses to expand internationally, and making it easier for foreign firms to partner with local firms. Likewise, as more industries and markets become global, so, too, are the firms that compete in them.

Several forces have combined to spark and sustain globalization. For one thing, governments and businesses are more aware of the benefits of globalization to businesses and shareholders. These benefits include the potential for higher standards of living and improved business profitability. New technologies have made international travel, communication, and commerce faster and cheaper than ever before. Finally, there are competitive pressures: Sometimes a firm must expand into foreign markets simply to keep up with competitors.

Globalization is not without its detractors. Some critics charge that globalization allows businesses to exploit workers in less-developed countries and bypass domestic environmental and tax regulations. For example, businesses pay workers in Vietnam and Indonesia lower wages than their counterparts in the United States. Factories in China are not subject to the same environmental protection laws as are firms in Europe. And businesses that headquarter their corporate offices in the Cayman Islands pay lower taxes. Critics also charge that globalization leads to the loss of cultural heritages and often benefits the rich more than the poor. For instance, as the English language becomes increasingly widespread throughout the world, some local languages are simply disappearing. Similarly, local residents in Africa receive relatively little economic benefits when oil or precious minerals are discovered on their land; prosperous investors buy the rights from landowners, who often don't realize the value of these resources. As a result, many international gatherings of global economic leaders are marked by protests and demonstrations.

## The Major World Marketplaces

Managers involved with international businesses need a solid understanding of the global economy, including the major world marketplaces. This section examines some fundamental economic distinctions among countries based on wealth and then looks at some of the world's major international marketplaces.

**Distinctions Based on Wealth** The World Bank, an agency of the United Nations, uses per-capita income, average income per person, to make distinctions

among countries. Its current classification method consists of four different categories of countries:<sup>5</sup>

- 1 **High-income countries:** Those with annual per-capita income greater than \$12,746
- 2 **Upper-middle-income countries:** Those with annual per-capita income of \$12,746 or less but more than \$3,595
- 3 **Lower-middle-income countries:** Those with annual per-capita income of \$3,595 or lower but more than \$905
- 4 **Low-income countries** (often called **developing countries**): Those with annual per-capita income of \$905 or less

**Geographic Clusters** The world economy generally revolves around three major marketplaces: North America, Europe, and Pacific Asia. In general, these clusters include relatively more of the upper-middle- and high-income nations but relatively few low- and lower-middle-income countries.

**NORTH AMERICA** As the world's largest marketplace and most stable economy, the United States dominates the North American market. Canada also plays a major role in the international economy, and the United States and Canada are each other's largest trading partners.

Mexico has been a major manufacturing center, especially along the U.S. border, where cheap labor and low transportation costs have encouraged many firms from the United States and other countries to build factories. However, Mexico's role as a low-cost manufacturing center is in flux. Just a few years ago, many experts believed that the emergence of China as a low-cost manufacturing center would lead companies to begin to shift their production from Mexico to China.<sup>6</sup> (The escalating drug-related violence along the northern Mexican border also contributed to this shift.) But a recent reversal of this trend is discussed in the boxed feature *Finding a Better Way*.

**EUROPE** Europe is often regarded as two regions—Western and Eastern. Western Europe, dominated by Germany, the United Kingdom, and France, has long been a mature but fragmented marketplace. The transformation of this region via the European Union (discussed later in this chapter) into an integrated economic system has further increased its importance. E-commerce and technology have also become increasingly important in this region. There has been a surge in Internet start-ups in southeastern England, the Netherlands, and the Scandinavian countries; Ireland is now one of the world's largest exporters of software; Strasbourg, France, is a major center for biotech start-ups; Barcelona, Spain, has many flourishing software and Internet companies; and the Frankfurt region of Germany is dotted with software and biotech start-ups.

Eastern Europe, once primarily communist, has also gained in importance, both as a marketplace and as a producer. Such multinational corporations as Daewoo, Nestlé, General Motors, and ABB Asea Brown Boveri have all set up operations in Poland. Ford, General Motors, Suzuki, and Volkswagen have built new factories in Hungary. On the other hand, governmental instability, corruption, and uncertainty have hampered development in parts of Russia, Bulgaria, Albania, Romania, and other countries.

**PACIFIC ASIA** Pacific Asia is generally agreed to consist of Japan, China, Thailand, Malaysia, Singapore, Indonesia, South Korea, Taiwan, the Philippines, and Australia. Fueled by strong entries in the automobile, electronics, and banking industries, the economies of these countries grew rapidly in the 1970s and 1980s. After a currency crisis in the late 1990s that slowed growth in virtually every country of the region, Pacific Asia showed clear signs of revitalization until the global recession in 2009.

As the global economy begins to regain its momentum, Pacific Asia is expected to experience the fastest. This is especially true of Japan, which is led by firms such as Toyota, Honda, and Nissan. The area (home to the world's largest oil reserves) is also a major source of oil. Saudi Arabia (home to the world's largest oil reserves) is also a major source of oil.



# finding a better way

## Too Much of a Good Thing? China's Success Creates More Jobs in Mexico

In today's competitive global economy, businesses strive for every possible advantage. Many manufacturers, for example, locate their factories in countries that have an ample supply of low-cost skilled labor. During the 1980s and 1990s, the place to be was Mexico. Hundreds of factories were built just across the U.S.–Mexican border, and workers streamed to the region from other parts of Mexico for stable and well-paying jobs. But in the late 1990s, the world started to shift.

Mexican prosperity, fueled in part by its role as a center of manufacturing, led to increases in the cost-of-living, followed quickly by wage increases so workers could keep up. At about that same time, China began to emerge as an attractive manufacturing alternative. For instance, in 2003, wages in China were only one-third of the wages in Mexico. And there was certainly no shortage of workers eager to take steady jobs in factories making products for other countries. China's boom was Mexico's bust, as one company after another reduced or eliminated manufacturing there and moved to Asia.

In recent years, things have started to tilt back in Mexico's favor. Why? As China's economy has flourished, its labor costs have crept higher and higher, so it's less of a bargain than it used to be. Whereas Mexican wages were once three times higher than wages in China, Mexican wages today are approximately 20 percent less than those in China, according to research by Merrill Lynch.<sup>7</sup> When manufacturers factor in shipping costs (which have increased because of fuel prices), producing in Mexico may cost the same or less than in China.



vario Images GmbH & Co.KG/Alamy

Time differences between the United States and China also can make it difficult to schedule videoconferences and telephone calls. Several companies have also been burned by China's lack of protection for industrial and intellectual property.

Mexico is making enormous gains in the automobile sector. Companies such as Nissan, Honda, Volkswagen, and Mazda have invested billions of dollars in Mexican production vehicles, with over 3 million vehicles produced in 2014. Eighty percent of these cars are exported to other countries, with the bulk being sent to the United States. Because of NAFTA, as well as other trade agreements, Mexico can export cars without tariffs to North and South America as well as Europe and Japan. According to Volkswagen's Vice President of Corporate Affairs in Mexico, "There's not another country in the world where you can do that."<sup>8</sup>

and the manufacturing home of many foreign firms), and Hong Kong (a major financial center) are also successful players in the international economy.

China, one of the world's most densely populated countries, has emerged as an important market and now boasts one of the world's largest economies. Although its per-capita income remains low, the sheer number of potential consumers makes it an important market. India, though not part of Pacific Asia, is also rapidly emerging as one of the globe's most important economies. As in North America and Europe, technology promises to play an increasingly important role in the future of this region. In some parts of Asia, however, poorly developed electronic infrastructures, slower adoption of computers and information technology, and a higher percentage of lower-income consumers hamper the emergence of technology firms.

## Trade Agreements and Alliances

Various legal agreements have sparked international trade and shaped the global business environment. Virtually every nation has formal trade treaties with other nations. A *treaty* is a legal agreement that specifies areas in which nations will cooperate with one another. Among the most significant treaties is the *North American Free Trade Agreement*. The *European Union*, the *Association of Southeast Asian Nations*, and

the *World Trade Organization*, all governed by treaties, are also instrumental in promoting international business activity.

**North American Free Trade Agreement (NAFTA)** agreement to gradually eliminate tariffs and other trade barriers among the United States, Canada, and Mexico

**North American Free Trade Agreement (NAFTA)** The **North American Free Trade Agreement (NAFTA)** removes most tariffs and other trade barriers among the United States, Canada, and Mexico and includes agreements on environmental issues and labor abuses.

Most observers agree that NAFTA is achieving its basic purpose—to create a more active and unified North American market. It has created several hundred thousand new jobs, although this number is smaller than NAFTA proponents had hoped. One thing is clear, though; the flood of U.S. jobs lost to Mexico predicted by NAFTA critics, especially labor unions, has not occurred.

**European Union (EU)** agreement among major European nations to eliminate or make uniform most trade barriers affecting group members

**The European Union** The **European Union (EU)** includes most European nations, as shown in Figure 4.1. These nations have eliminated most quotas and set uniform tariff levels on products imported and exported within their group. In 1992, virtually all internal trade barriers went down, making the EU the largest free marketplace in the world. The adoption of a common currency, the *euro*, by most member nations further solidified the EU's position in the world economy.



**FIGURE 4.1** The Nations of the European Union  
 Source: [http://europa.eu/abc/maps/index\\_en.htm](http://europa.eu/abc/maps/index_en.htm), accessed April 5, 2013.

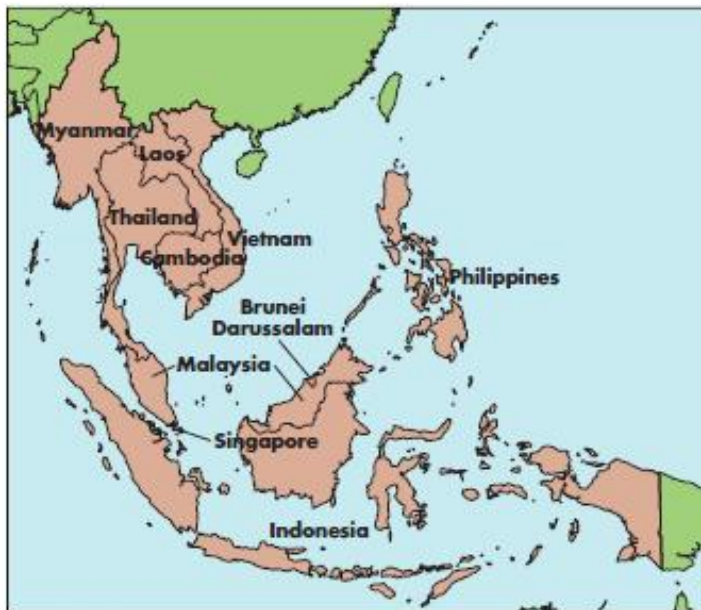


FIGURE 4.2 The Nations of the Association of Southeast Asian Nations (ASEAN)

**The Association of Southeast Asian Nations** The **Association of Southeast Asian Nations (ASEAN)** was founded in 1967 as an organization for economic, political, social, and cultural cooperation. In 1995, Vietnam became the group's first communist member. Figure 4.2 shows a map of the ASEAN countries. Because of its relative size, the ASEAN does not have the same global economic significance as NAFTA and the EU.

*Association of Southeast Asian Nations (ASEAN) organization for economic, political, social, and cultural cooperation among Southeast Asian nations*

**The World Trade Organization** The **General Agreement on Tariffs and Trade (GATT)** was signed in 1947. Its purpose was to reduce or eliminate trade barriers, such as tariffs and quotas. It did so by encouraging nations to protect domestic industries within agreed-on limits and to engage in multilateral negotiations. The GATT proved to be relatively successful. So, to further promote globalization, most of the world's countries joined to create the **World Trade Organization (WTO)**, which began on January 1, 1995. (The GATT is the actual treaty that governs the WTO.) The 160-member countries are required to open markets to international trade, and the WTO is empowered to pursue three goals.<sup>9</sup>

*General Agreement on Tariffs and Trade (GATT) international trade agreement to encourage the multilateral reduction or elimination of trade barriers*

*World Trade Organization (WTO) organization through which member nations negotiate trading agreements and resolve disputes about trade policies and practices*

- 1 Promote trade by encouraging members to adopt fair-trade practices.
- 2 Reduce trade barriers by promoting multilateral negotiations.
- 3 Establish fair procedures for resolving disputes among members.

## International Trade

The global economy is essentially defined by international trade. International trade occurs when an exchange involving goods, services, and/or currency takes place across national boundaries. Although international trade has many advantages, it can also pose problems if a country's imports and exports don't maintain an acceptable balance. Table 4.1 lists the United States' 15 largest trading partners. However, the United States also does business with many more countries. For instance, in 2013, the United States exported \$5.1 billion to Egypt, \$2.4 billion to Kuwait, \$3.0 billion to Poland, and \$132.9 million to Zambia; imports from those same countries were \$2.8

### OBJECTIVE 4-2 Explain

how differences in import-export balances, exchange rates, and foreign competition determine the ways in which countries and businesses respond to the international environment.

**table 4.1** Major Trading Partners of the United States  
(In Millions)

Rank	Country	Exports	Imports	Total Trade	Percent of Total Trade
---	Total, All Countries	1,489.6	2,149.0	3,638.6	100.0%
---	Total, Top 15 Countries	1,034.2	1,632.7	2,666.9	73.3%
1	Canada	287.8	317.4	605.2	16.6%
2	China	111.8	426.1	537.9	14.8%
3	Mexico	221.4	270.3	491.7	13.5%
4	Japan	61.2	122.5	183.6	5.0%
5	Germany	45.7	113.1	158.7	4.4%
6	Korea, South	40.7	63.6	104.3	2.9%
7	United Kingdom	49.2	49.2	98.4	2.7%
8	France	28.7	43.1	71.7	2.0%
9	Brazil	39.3	27.5	66.8	1.8%
10	Taiwan	24.5	37.4	61.8	1.7%
11	India	19.7	41.8	61.4	1.7%
12	Saudi Arabia	16.4	44.1	60.5	1.7%
13	Netherlands	40.0	19.2	59.2	1.6%
14	Italy	15.6	38.5	54.0	1.5%
15	Belgium	32.2	19.2	51.5	1.4%

Source: [www.census.gov/foreign-trade/statistics/highlights/top1411yr.html](http://www.census.gov/foreign-trade/statistics/highlights/top1411yr.html)

billion, \$12.2 billion, \$4.2 billion, and \$62 million, respectively. In deciding whether an overall balance exists between imports and exports, economists use two measures: *balance of trade* and *balance of payments*.

## Balance of Trade

A country's **balance of trade** is the total economic value of all the products that it exports minus the economic value of all the products that it imports. A *positive balance of trade* results when a country exports (sells to other countries) more than it imports (buys from other countries). A *negative balance of trade* results when a country imports more than it exports.

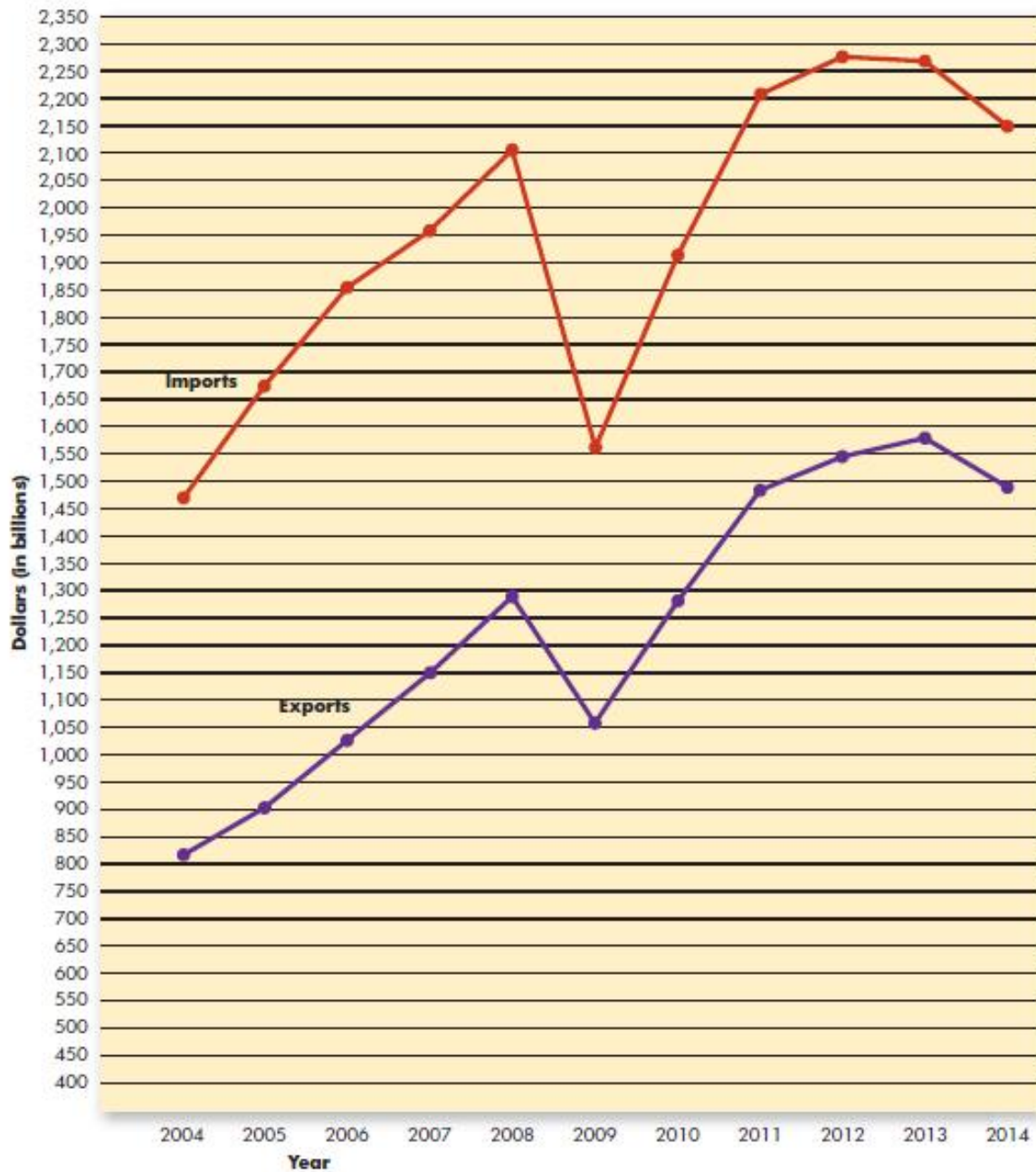
Relatively small trade imbalances are common and are unimportant. Large imbalances, however, are another matter. The biggest concern about trade balances involves the flow of currency. When U.S. consumers and businesses buy foreign products, dollars flow from the United States to other countries; when U.S. businesses are selling to foreign consumers and businesses, dollars flow back into the United States. A large negative balance of trade means that many dollars are controlled by interests outside the United States.

A **trade deficit** occurs when a country's imports exceed its exports, when it has a negative balance of trade. When exports exceed imports, the nation enjoys a **trade surplus**. Several factors, such as general economic conditions and the effect of trade agreements, influence trade deficits and surpluses. For example, higher domestic costs, greater international competition, and continuing economic problems among some of its regional trading partners have slowed the tremendous growth in exports

**Balance of Trade** economic value of all products a country exports minus the economic value of all products it imports

**Trade Deficit** situation in which a country's imports exceed its exports, creating a negative balance of trade

**Trade Surplus** situation in which a country's exports exceed its imports, creating a positive balance of trade



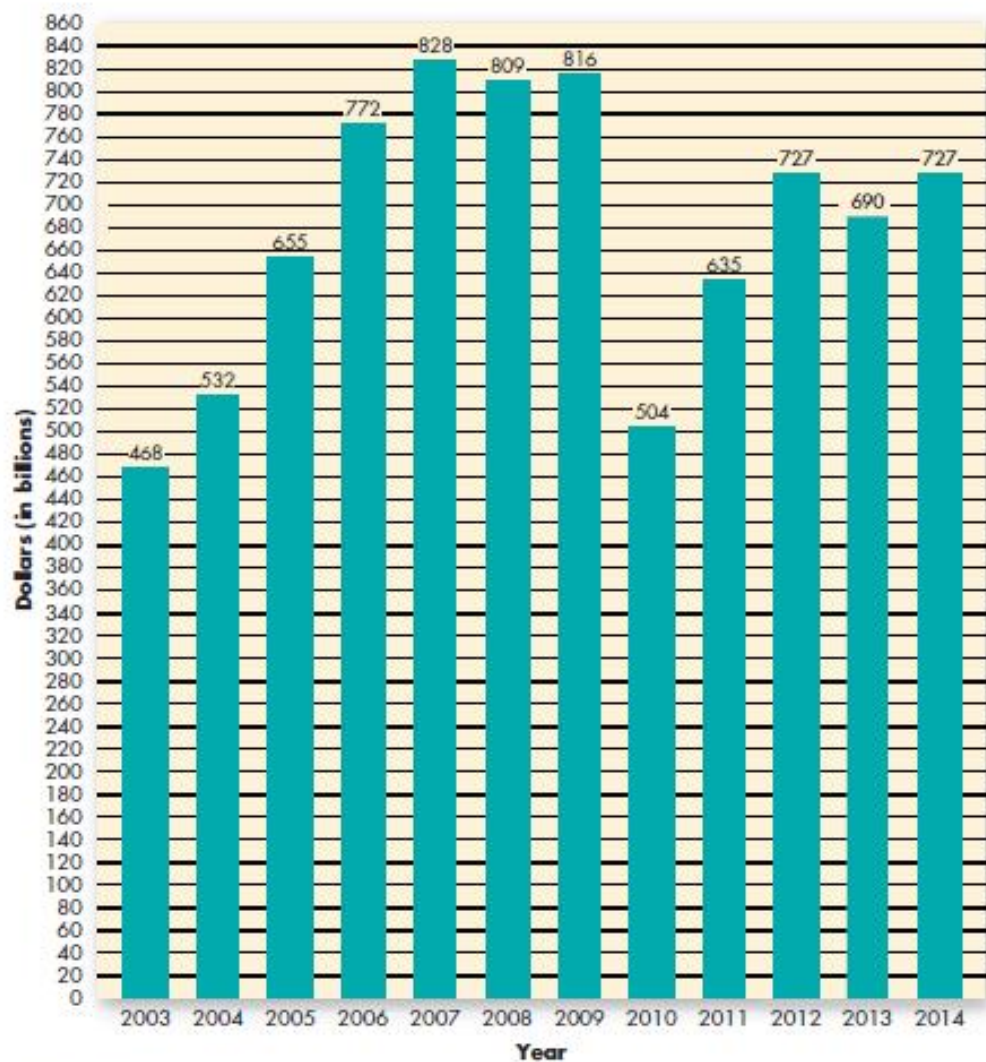
**FIGURE 4.3** U.S. Imports and Exports

Source: <http://www.census.gov/foreign-trade/balance/c0015.html#2014>

that Japan once enjoyed. But rising prosperity in China and India has led to strong increases in both exports from and imports to those countries.

Figures 4.3 and 4.4 highlight two series of events: (1) recent trends in U.S. exports and imports and (2) the resulting trade deficit. As Figure 4.3 shows, both U.S. imports and U.S. exports, with minor variations, have been generally increasing—a trend that's projected to continue.

Trade deficits between 2001 and 2014 are shown in Figure 4.4. There was a deficit in each of these years because more money flowed out to pay for foreign imports than flowed in to pay for U.S. exports. For example, in 2008, the United States exported \$1,287.4 billion in goods and services and imported \$2,103.6 billion in goods



**FIGURE 4.4** U.S. Trade Deficit

Source: U.S. Census Bureau: Foreign Trade Statistics, at <http://www.census.gov/foreign-trade/statistics/highlights/annual.html>, accessed 2015

and services. Because imports exceeded exports, the United States had a *trade deficit* of \$816 billion (the difference between exports and imports). Note also that both exports and imports declined in 2008 and 2009 from the previous year. This was a result of the global economic slowdown.

## Balance of Payments

The **balance of payments** refers to the flow of *money* into or out of a country. The money that a country pays for imports and receives for exports, its balance of trade, accounts for much of its balance of payments. Other financial exchanges are also factors. Money spent by tourists in a country, money spent by a country on foreign-aid programs, and money exchanged by buying and selling currency on international money markets affect the balance of payments.

For instance, suppose that the United States has a negative balance of trade of \$1 million. Now, suppose that this year, U.S. citizens travel abroad as tourists and spend a total of \$200,000 in other countries. This amount gets added to the balance of trade to form the balance of payments, which is now a negative \$1.2 million dollars. Now, further suppose that tourists from other countries come to the United States and spend the equivalent of \$300,000 while they are here. This has the effect of reducing

Balance of Payments flow of all money into or out of a country

the negative balance of payments to \$900,000. Then, further suppose that the United States then sends \$600,000 in aid to help the victims of a tsunami-ravaged country in Asia. Because this represents additional dollars leaving the United States, the balance of payments is now a negative \$1.5 million. For many years, the United States enjoyed a positive balance of payments. Recently, however, the overall balance has become negative.

## Exchange Rates

The balance of imports and exports between two countries is affected by the rate of exchange between their currencies. An **exchange rate** is the rate at which the currency of one nation can be exchanged for that of another. Suppose, for example, that the exchange rate between the U.S. dollar and the British pound was \$2 to £1. This means that it costs £1 to “buy” \$2 or \$1 to “buy” £0.5. Stated differently, £1 and \$2 have the same purchasing power, or  $£1 = \$2$ .

At the end of World War II, the major nations of the world agreed to set *fixed exchange rates*. The value of any country’s currency relative to that of another would remain constant. The goal was to allow the global economy to stabilize. Today, however, *floating exchange rates* are the norm, and the value of one country’s currency relative to that of another varies with market conditions. For example, when many British citizens want to spend pounds to buy U.S. dollars (or goods), the value of the dollar relative to the pound increases. Demand for the dollar is high, and a currency is strong when demand for it is high. It’s also strong when there’s high demand for the goods manufactured with that currency. On a daily basis, exchange rates fluctuate very little. Significant variations usually occur over longer time spans. Highly regulated economic systems such as in China are among the few that still use fixed exchange rates. The Chinese government regulates the flow of currency—its own as well as all others—into and out of China and determines the precise rate of exchange within its borders.

Exchange-rate fluctuation can have an important impact on balance of trade. Suppose you want to buy some English tea for £10 per box. At an exchange rate of \$2 to £1, a box will cost you \$20 ( $£10 \times 2 = 20$ ). But what if the pound is weaker? At an exchange rate of, say, \$1.25 to £1, the same box would cost you only \$12.50 ( $£10 \times 1.25 = 12.50$ ). If the dollar is strong in relation to the pound, the prices of all U.S.-made products will rise in England, and the prices of all English-made products will fall in the United States. The English would buy fewer U.S. products, and Americans would be prompted to spend more on English-made products. The result would probably be a U.S. trade deficit with England.

One of the most significant developments in foreign exchange has been the introduction of the **euro**, the common currency of the EU. The euro was officially introduced in 2002 and has replaced other currencies, such as the German Deutsche Mark, the Italian lira, and the French franc. In the years since its debut, the euro has become one of the world’s most important currencies. When it was first introduced, the euro’s value was pegged as being equivalent to the dollar:  $€1 = \$1$ . But because the dollar was relatively weak in the years that followed, its value eroded relative to that of the euro. At one point in the late 1990s, \$1 was worth only about half a euro. In the aftermath of the Great Recession, though, the dollar has strengthened relative to the euro and the exchange in early 2015 was  $\$1 = €0.90$ .

Companies with international operations must watch exchange-rate fluctuations closely because changes affect overseas demand for their products and can be a major factor in competition. In general, when the value of a country’s currency rises—becomes stronger—companies based there find it harder to export products to foreign markets and easier for foreign companies to enter local markets. It also makes it more cost-efficient for domestic companies to move operations to lower-cost foreign sites. When the value of a currency declines—becomes weaker—the opposite occurs. As the value of a country’s currency falls, its balance of trade usually improves because domestic companies should experience a boost in exports. There should also be less reason for foreign companies to ship products into the domestic market and less reason to establish operations in other countries.

*Exchange Rate rate at which the currency of one nation can be exchanged for the currency of another nation*

*Euro a common currency shared among most of the members of the EU (excluding Denmark, Sweden, and the United Kingdom)*

## Forms of Competitive Advantage

Before we discuss the fundamental issues involved in international business management, we must consider one last factor: forms of *competitive advantage*. Because no country can produce everything that it needs, countries tend to export what they can produce better or less expensively than other countries and use the proceeds to import what they can't produce as effectively. This principle doesn't fully explain why nations export and import what they do. Such decisions hinge partly on the advantages that a particular country enjoys regarding its abilities to create or sell certain products and resources.<sup>10</sup> Economists traditionally focused on absolute and comparative advantage to explain international trade. But because this approach focuses narrowly on such factors as natural resources and labor costs, a more contemporary view of national competitive advantage has emerged.

**Absolute Advantage** the ability to produce something more efficiently than any other country can

**Absolute Advantage** An **absolute advantage** exists when a country can produce something that is cheaper or of higher quality than any other country. Saudi oil, Brazilian coffee beans, and Canadian timber come close (because these countries have such abundant supplies of these resources), but examples of true absolute advantage are rare. For example, many experts say that the vineyards of France produce the world's finest wines. But the burgeoning wine business in California demonstrates that producers there can also make good wines—wines that rival those from France but come in more varieties and at lower prices.

**Comparative Advantage** the ability to produce some products more efficiently than others

**Comparative Advantage** A country has a **comparative advantage** in goods that it can produce more efficiently or better than other nations. If businesses in a given country can make computers more efficiently than they can make automobiles, then that nation has a comparative advantage in computer manufacturing.

# managing in turbulent times

## The Ups and Downs of Globalization

In 2010, Toyota and other Japanese automakers found themselves in a very tough position. Several high-profile recalls had cut into Toyota's sales, and the exchange rate of yen for dollars made a bad situation worse. The yen was at a 15-year high against the dollar and a nine-year high versus the euro. Toyota made more than half of their cars in Japan, where costs were high, yet sold many overseas. Sales made in the United States and Europe converted to fewer yen, sharply cutting into Toyota's profit margins. As a result, Toyota began to expand production of both cars and their components to lower-cost countries as well as major markets.<sup>11</sup> Although Toyota's stock was selling above \$130 per share in late 2006, five years later, Toyota's stock price had plummeted by half to less than \$65 per share.

In the fiscal year that ended in March 2015, Toyota had its most profitable year ever and exchange rates, somewhat surprisingly, were a big part of their success. Their stock price soared to prices higher than the 2006 peak, selling at more than \$140 per share. What changed in such a short time? After several years of record-breaking deflation, Japan's central bank began pumping money into the economy. While the additional capital has stimulated the Japanese economy, the value of the



DAIJI TAKASHI/Photo Agency/Alamy

yen compared to the dollar and euro sharply declined. By early 2015, a dollar bought 50 percent more yen than it did just four years earlier. Even more concerning to U.S. automakers, the yen is now cheaper than it has been since the 1970s. Masahiro Akita, an industry analyst at Credit Suisse, explains, "For automakers, the key factors are volume, exchange rates, and fixed costs. If you can get all those things to go your way, you're in good shape. And Toyota has."<sup>12</sup>

In general, both absolute and comparative advantages translate into competitive advantage. Brazil, for instance, can produce and market coffee beans knowing full well that few other countries have the right mix of climate, terrain, and altitude to enter the coffee bean market. The United States has comparative advantages in the computer industry (because of technological sophistication) and in farming (because of large amounts of fertile land and a temperate climate). South Korea has a comparative advantage in electronics manufacturing because of efficient operations and cheap labor. As a result of each country's comparative advantage, U.S. firms export computers and grain to South Korea and import DVD players from South Korea. South Korea can produce food, and the United States can build DVD players, but each nation imports certain products because the other holds a comparative advantage in the relevant industry.

**National Competitive Advantage** In recent years, a theory of national competitive advantage has become a widely accepted model of why nations engage in international trade.<sup>13</sup> **National competitive advantage** derives from four conditions:

- 1 **Factor conditions** are the factors of production we discussed in Chapter 1—*labor, capital, entrepreneurs, physical resources, and information resources.*
- 2 **Demand conditions** reflect a large domestic consumer base that promotes strong demand for innovative products.
- 3 **Related and supporting industries** include strong local or regional suppliers or industrial customers.
- 4 **Strategies, structures, and rivalries** refer to firms and industries that stress cost reduction, product quality, higher productivity, and innovative products.

When all attributes of national competitive advantage exist, a nation is likely to be heavily involved in international business. Japan, for instance, has an abundance of natural resources and strong domestic demand for automobiles. Its carmakers have well-oiled supplier networks, and domestic firms have competed intensely with one another for decades. These circumstances explain why Japanese car companies such as Toyota and Honda are successful in foreign markets.

*National Competitive Advantage international competitive advantage stemming from a combination of factor conditions, demand conditions, related and supporting industries, and firm strategies, structures, and rivalries*

## International Business Management

Regardless of where a firm is located, its success depends largely on how well it's managed. International business is so challenging because basic management tasks—planning, organizing, directing, and controlling—are much more difficult when a firm operates in markets scattered around the globe.

Managing means making decisions. In this section, we examine the three basic decisions that a company must make when considering globalization. The first decision is whether to go international. Once that decision has been made, managers must decide on the level of international involvement and on the organizational structure that will best meet the firm's global needs.

### Going International

As the world economy becomes increasingly globalized, more and more firms are expanding their international operations. U.S. firms are aggressively expanding abroad, and foreign companies such as BP and Nestlé continue to expand into foreign markets as well, including the U.S. market. This route, however, isn't appropriate for every company. If you buy and sell fresh fish, you'll probably find it more profitable to confine your activities to limited geographic areas because storage and transport costs may be too high to make international operations worthwhile. As Figure 4.5 shows, several factors affect the decision to go international.

#### OBJECTIVE 4-3 Discuss

the factors involved in deciding to do business internationally and in selecting the appropriate levels of international involvement and international organizational structure.

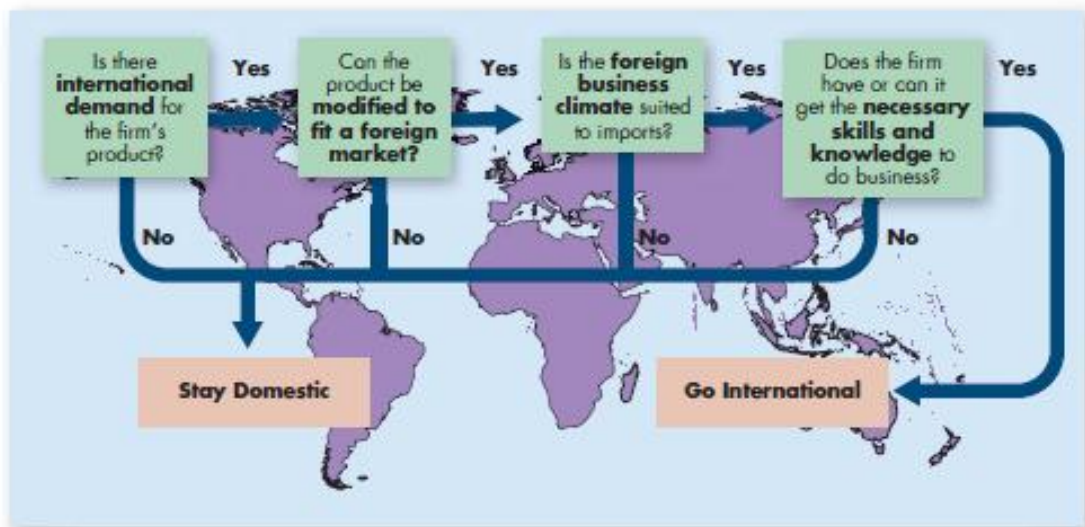


FIGURE 4.5 Going International

**Gauging International Demand** In considering international expansion, a company must determine whether there is a demand for its products abroad. Products that are successful in one country may be useless in another. Even when there is demand, advertising may still need to be adjusted. For example, bicycles are largely used for recreation in the United States but are seen as basic transportation in China. Hence, a bicycle maker would need to use different marketing strategies in each of these countries. Market research or the prior market entry of competitors may indicate whether there's an international demand for a firm's products.

**Adapting to Customer Needs** If its product is in demand, a firm must decide whether and how to adapt it to meet the special demands of foreign customers. For example, to satisfy local tastes, McDonald's sells wine in France, beer in Germany, gazpacho in Spain, and provides some vegetarian sandwiches in India. Likewise, consumer electronics companies have to be aware that different countries use different kinds of electric sockets and different levels of electric power. Therefore, regardless of demand, customer needs must still be considered.

**Outsourcing** the practice of paying suppliers and distributors to perform certain business processes or to provide needed materials or services

**Outsourcing and Offshoring** **Outsourcing**, the practice of paying suppliers and distributors to perform certain business processes or to provide needed materials or services, has become a popular option for going international. It has become so popular because (1) it helps firms focus on their core activities and avoid getting sidetracked on secondary activities, and (2) it reduces costs by locating certain business functions in areas where relevant costs are low.<sup>14</sup>

**Offshoring** the practice of outsourcing to foreign countries

The practice of outsourcing to foreign countries is more specifically referred to as **offshoring**. Many companies today contract their manufacturing to low-cost factories in Asia. Similarly, many service call centers today are outsourced to businesses located in India. The Oscar-winning movie *Slumdog Millionaire* featured a young Indian man who worked for an international call center in Mumbai. In real life, DirecTV, Chase Bank Credit Card Services, and several home mortgage support businesses have established call centers in India and have enjoyed considerable success. On the other hand, though, the network of FTD florists opened a call center in India but subsequently closed it. As it turns out, many people who call to order flowers need more personal assistance—advice on type of flowers, colors of arrangements, and so forth—than can be provided by someone from a different culture on the other side of the world.

# entrepreneurship and new ventures

## A Better Coconut Water

Founded in 2009, Harmless Harvest is the manufacturer and distributor of a popular line of organic coconut water that is available in stores across the United States. Douglas Riboud and Justin Guilbert saw an opportunity with the sudden popularity of coconut water, but they were troubled by environmental and economic concerns. After extensive research, Riboud and Guilbert concluded that the best-tasting coconut water could be produced from a single species of coconut from Thailand, in spite of lower yields and more complex cultivation. Unlike other producers, their coconut water is pasteurized through high-pressure treatment rather than heat, creating a raw, better-tasting product. According to Riboud, "The most important thing for us is taste. And the best we can do, the hardest job you can do as a manufacturer who works in food, is not screw up the ingredient you had in the first place."<sup>15</sup>

Harmless Harvest has addressed environmental concerns by making sure that their product is organic. They made an early commitment to working with farmers to make sure that no harmful pesticides or synthetic fertilizers were used and worked to obtain organic certification. Although this process was time-consuming and costly, it assured Riboud and Guilbert that their entire supply chain was built upon their vision of sustainability.

Finally, Harmless Harvest has contributed to economic change in a number of ways. In 2013, they built a manufacturing facility in Thailand rather than importing coconuts to the



Hilun Wanthong/V123RF

United States or outsourcing production. According to their website, "This location allows us to oversee vital steps in our production cycle and adds value to the area by developing employment opportunities for the surrounding communities." The company has also worked to obtain Fair for Life Social & Fair Trade Certification, further testament to their commitment to their cause. This certification attests to their commitment to paying fair prices for the coconuts that they purchase from local farmers and making sure that they work with companies that pay a living wage.<sup>16</sup>

## Levels of International Involvement

After deciding to go international, a firm must determine the level of its involvement. Several levels are possible: a firm may act as an exporter or importer, organize as an international firm, or (like most of the world's largest industrial firms) operate as a multinational firm.

**Exporters and Importers** An **exporter** makes products in one country to distribute and sell in others. An **importer** buys products in foreign markets and brings them home for resale. Both conduct most of their business in their home nations. Both entail the lowest level of involvement in international operations, and both are good ways to learn the fine points of global business. Many large firms entered international business as exporters. General Electric and Coca Cola, among others, exported to Europe for several years before setting up production sites there. It is also useful to remember that most import/export transactions involve both activities. A bottle of French wine sold in New York, for instance, was exported by the French winery and imported by the U.S. wine distributor.

**International Firms** As exporters and importers gain experience and grow, many move to the next level of involvement. **International firms** conduct a meaningful amount of their business abroad and may even maintain overseas manufacturing facilities. An international firm may be large, but it's still basically a domestic company with international operations. Hershey, for instance, buys ingredients for its chocolates from several foreign suppliers and makes all of its

*Exporter firm that distributes and sells products to one or more foreign countries*

*Importer firm that buys products in foreign markets and then imports them for resale in its home country*

*International Firm firm that conducts a significant portion of its business in foreign countries*

products in the United States but has one plant in Mexico. Moreover, although it sells its products in approximately 70 other countries, it generates most of its revenues from its domestic market.<sup>17</sup>

**Multinational Firm** firm that designs, produces, and markets products in many nations

**Multinational Firms** Most **multinational firms**, firms that design, produce, and market products in many nations, such as ExxonMobil, Nestlé, Honda, and Ford, don't think of themselves as having domestic and international divisions. Headquarters locations are almost irrelevant, and planning and decision making are geared to international markets. The world's largest multinationals in 2014, based on sales, profits, and employees, are shown in Table 4.2.

We can't underestimate the economic impact of multinational firms. Consider just the impact of the 500 largest multinationals: In 2013, these 500 firms generated \$31.1 trillion in revenues and nearly \$2 trillion in owner profits.<sup>18</sup> They employed tens of millions of people, bought materials and equipment from literally thousands of other firms, and paid billions in taxes. Moreover, their products affected the lives of hundreds of millions of consumers, competitors, investors, and even protestors.

### International Organization Structures

Different levels of international involvement entail different kinds of organizational structures. A structure that would help coordinate an exporter's activities would be inadequate for those of a multinational. In this section, we consider the spectrum of organizational strategies, including *independent agents*, *licensing arrangements*, *branch offices*, *strategic alliances*, and *foreign direct investment*.

**Independent Agent** foreign individual or organization that agrees to represent an exporter's interests

**Independent Agents** An **independent agent** is a foreign individual or organization that represents an exporter in foreign markets. Independent agents often act as sales representatives: They sell the exporter's products, collect payment, and make sure that customers are satisfied. They often represent several firms at once and usually don't specialize in a particular product or market. Peter So operates an

**table 4.2 The World's Largest Non-U.S. Companies by Sales, Profits, and Number of Employees (2014)**

Company	Sales (\$millions)	Profits (\$billions)	Employees
Royal Dutch Shell	459,599		
Sinopec	457,201		
China Nat'l Petro.	432,007		
BP	396,217		
State Grid	333,386		
Samsung			
Industrial and Commercial Bank of China		42.7	
Gazprom		35.7	
China Construction Bank		34.9	
Samsung		27.2	
Agricultural Bank of China		27.1	
G4S plc			618,000
Randstad Holding NV			595,730
Volkswagen			555,097
PetroChina Co. Ltd.			544,083

Source: <http://www.usatoday.com/story/money/business/2014/10/25/24-7-wall-st-most-profitable-companies/17707869/> and <http://www.usatoday.com/story/money/business/2014/08/24/24-7-wall-st-biggest-employers/14443001/>

import–export office in Hong Kong. He and his staff of three handle imports from about 15 foreign companies into Hong Kong and about 10 Hong Kong firms that export products abroad.

**Licensing Arrangements** Companies seeking more involvement may opt for licensing arrangements. A **licensing arrangement** is a contract under which one firm allows another to use its brand name, operating procedures, or proprietary technology. Firms give foreign individuals or companies exclusive rights (called *licensing agreements*) to manufacture or market their products in that market. In return, the exporter receives a fee plus ongoing payments (royalties) that are calculated as a percentage of the license holder's sales. Franchising is a popular form of licensing. For example, McDonald's, Pizza Hut, and Hertz Car Rental have franchises around the world.

**Branch Offices** Instead of developing relationships with foreign agents or licensing companies, a firm may send its own managers to overseas branch offices, where the firm has more direct control than it does over agents or license holders. **Branch offices** also furnish a more visible public presence in foreign countries, and foreign customers tend to feel more secure when there's a local branch office. Halliburton, a Houston-based oil field supply and services company, opened a branch office in Dubai to more effectively establish relationships with customers in the Middle East.

**Strategic Alliances** In a **strategic alliance**, a company finds a partner in the country in which it wants to do business. Each party agrees to invest resources and capital into a new business or to cooperate in some mutually beneficial way. This new business, the alliance, is owned by the partners, who divide its profits. Such alliances are sometimes called *joint ventures*, but the term *strategic alliance* has arisen because such partnerships are playing increasingly important roles in the strategies of major companies. Ford and Russian automaker Sollers have a joint venture in Russia. Sollers manufactures Ford products in Russia and the two partners work together on marketing them.<sup>19</sup> In many countries, such as Mexico, India, and China, laws make alliances virtually the only way to do international business. Mexico, for example, requires that all foreign firms investing there have local partners. Likewise, local interests own the majority of both Disney theme parks in China; Disney is the minority owner but also collects management and licensing fees.

In addition to easing the way into new markets, alliances give firms greater control over foreign activities than agents and licensees. Alliances also allow firms to benefit from the knowledge and expertise of foreign partners. Microsoft, for example, relies heavily on alliances when it expands into new international markets. This approach has helped the firm learn the intricacies of doing business in China and India, two of the hardest emerging markets to crack.

**Foreign Direct Investment** **Foreign direct investment (FDI)** involves buying or establishing tangible assets in another country. Dell Computer, for example, has built assembly plants in Europe and China. Volkswagen has built a factory in Brazil, and Coca-Cola has built bottling plants in dozens of different countries. FedEx has a major distribution center in Paris. Each of these activities represents FDI by a firm in another country.

*Licensing Arrangement arrangement in which firms choose foreign individuals or organizations to manufacture or market their products in another country*

*Branch Office foreign office set up by an international or multinational firm*

*Strategic Alliance arrangement (also called joint venture) in which a company finds a foreign partner to contribute approximately half of the resources needed to establish and operate a new business in the partner's country*

*Foreign Direct Investment (FDI) arrangement in which a firm buys or establishes tangible assets in another country*

## Understanding the Cultural Environment

A major factor in the success—or failure—of international business activity is having a deep understanding of the cultural environment and how it affects business. Disney's Hong Kong theme park struggled after it first opened, in large part because Disney made the mistake of minimizing all elements of Chinese culture in the park—essentially making it a generic miniature reproduction of the original

### OBJECTIVE 4-4 Explain

the role and importance of the cultural environment in international business.

Disneyland in California. Disney also confused potential visitors with ads showing a father, mother, and two children walking hand-in-hand toward the theme park, overlooking China's laws that restrict many families to a single child. Only after a refurbishment to make the park more Chinese and a revised ad campaign did attendance begin to improve.<sup>20</sup> A country's culture includes all the values, symbols, beliefs, and language that guide behavior.

## Values, Symbols, Beliefs, and Language

Cultural values and beliefs are often unspoken; they may even be taken for granted by those who live in a particular country. Cultural factors do not necessarily cause problems for managers when the cultures of two countries are similar. Difficulties can arise, however, when there is little overlap between the home culture of a manager and the culture of the country in which business is to be conducted. For example, most U.S. managers find the culture and traditions of England relatively familiar. The people of both countries speak the same language and share strong historical roots, and there is a history of strong commerce between the two countries. When U.S. managers begin operations in Japan or the Middle East, however, most of those commonalities disappear.

In Japanese, the word *hai* (pronounced "hi") means "yes." In conversation, however, this word is used much like people in the United States use "uh-huh"; it moves a conversation along or shows the person with whom you are talking that you are paying attention. So when does *hai* mean "yes" and when does it mean "uh-huh"? This turns out to be a relatively difficult question to answer. If a U.S. manager asks a Japanese manager if he agrees to some trade arrangement, the Japanese manager is likely to say, "Hai"—but this may mean "Yes, I agree," "Yes, I understand," or "Yes, I am listening." Some U.S. managers become frustrated in negotiations with the Japanese because they believe that the Japanese continue to raise issues that have already been settled (because the Japanese managers said "Yes"). What many of these managers fail to recognize is that "yes" does not always mean "yes" in Japan.

Cultural differences between countries can have a direct impact on business practice. For example, the religion of Islam teaches that people should not make a living by exploiting the misfortune of others; as a result, charging interest payments is seen as immoral. This also means that in Saudi Arabia there are few businesses that provide auto-towing services to take stalled cars to a garage for repair (because that would be capitalizing on misfortune), and in the Sudan, banks cannot pay or charge interest. Given these cultural and religious constraints, those two businesses—automobile towing and banking—do not seem to hold great promise for international managers in those particular countries!

Some cultural differences between countries can be even subtler and yet have a major impact on business activities. For example, in the United States, most managers clearly agree about the value of time. Most U.S. managers schedule their activities tightly and then try to adhere to their schedules. Other cultures do not put such a premium on time. In the Middle East, managers do not like to set appointments, and they rarely keep appointments set too far into the future. U.S. managers interacting with managers from the Middle East might misinterpret the late arrival of a potential business partner as a negotiation ploy or an insult, when it is rather a simple reflection of different views of time and its value.<sup>21</sup>

Language itself can be an important factor. Beyond the obvious and clear barriers posed by people who speak different languages, subtle differences in meaning can also play a major role. For example, Imperial Oil of Canada markets gasoline under the brand name Esso. When the firm tried to sell its gasoline in Japan, it learned that *esso* means "stalled car" in Japanese. Likewise, when Chevrolet first introduced a U.S. model called the Nova in Latin America, General Motors executives could not understand why the car sold poorly. They eventually learned, though, that, in Spanish, *no va* means "It doesn't go." The color green is used extensively in Muslim countries, but it signifies death in some other countries. The color associated with femininity in the United States is pink, but in many other countries, yellow is the most feminine color.

## Employee Behavior Across Cultures

Managers in international business also have to understand that there are differences in what motivates people in different cultures. Although it's impossible to predict exactly how people from different cultures will react in the workplace, some insights have been developed from research on individual behaviors and attitudes across different cultures. This research, conducted by Geert Hofstede, identifies five important dimensions along which people seem to differ across cultures. These dimensions are illustrated in Figure 4.6.

The first dimension is **social orientation**. Social orientation is a person's beliefs about the relative importance of the individual versus groups to which that person belongs. The two extremes of social orientation are individualism and collectivism. *Individualism* is the cultural belief that the person comes first. Research suggests that people in the United States, the United Kingdom, Australia, Canada, New Zealand, and the Netherlands tend to be relatively individualistic. *Collectivism* is the belief that the group comes first. Research has found that people from Mexico, Greece, Hong Kong, Taiwan, Peru, Singapore, Colombia, and Pakistan tend to be relatively collectivistic in their values. In countries with higher levels of individualism, many workers may prefer reward systems that link pay with the performance of individual employees. In a more collectivistic culture, such a reward system may in fact be counterproductive.

A second important dimension is **power orientation**, the beliefs that people in a culture hold about the appropriateness of power and authority differences in

*Social Orientation* a person's beliefs about the relative importance of the individual versus groups to which that person belongs

*Power Orientation* the beliefs that people in a culture hold about the appropriateness of power and authority differences in hierarchies such as business organizations

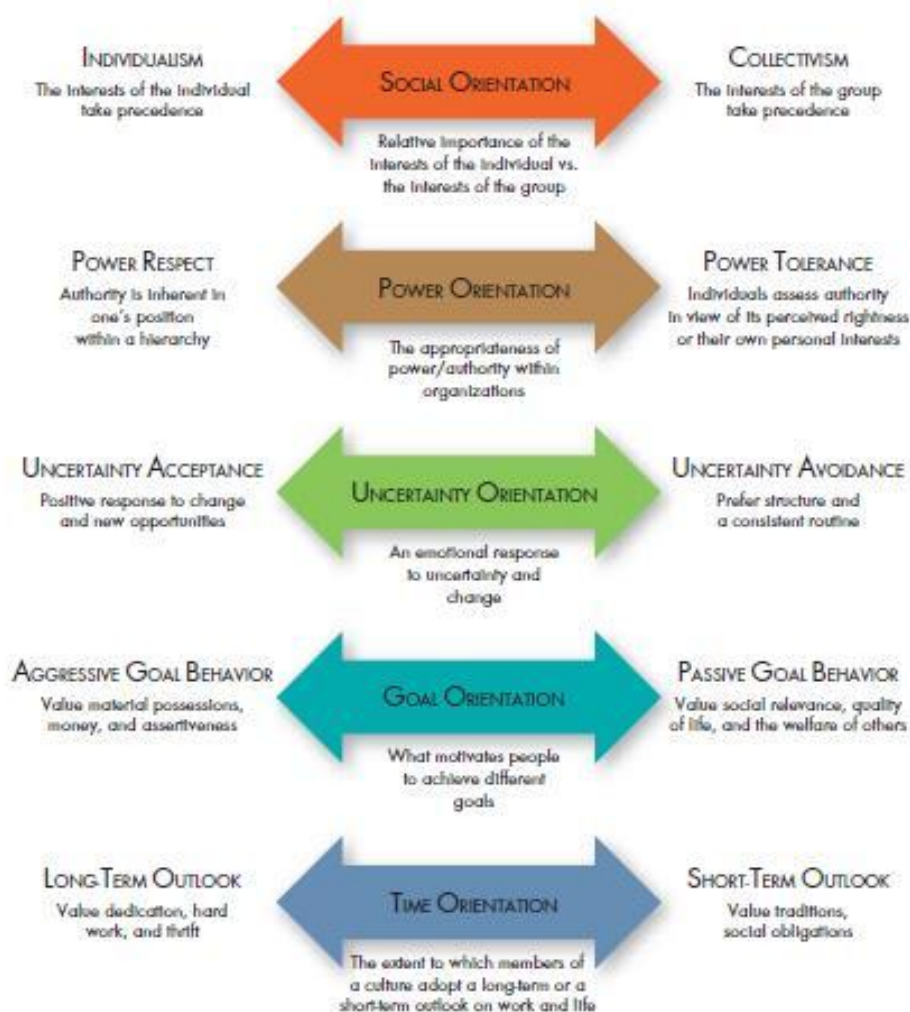


FIGURE 4.6 Hofstede's Five Dimensions of National Culture

## Employee Behavior Across Cultures

Managers in international business also have to understand that there are differences in what motivates people in different cultures. Although it's impossible to predict exactly how people from different cultures will react in the workplace, some insights have been developed from research on individual behaviors and attitudes across different cultures. This research, conducted by Geert Hofstede, identifies five important dimensions along which people seem to differ across cultures. These dimensions are illustrated in Figure 4.6.

The first dimension is **social orientation**. Social orientation is a person's beliefs about the relative importance of the individual versus groups to which that person belongs. The two extremes of social orientation are individualism and collectivism. *Individualism* is the cultural belief that the person comes first. Research suggests that people in the United States, the United Kingdom, Australia, Canada, New Zealand, and the Netherlands tend to be relatively individualistic. *Collectivism* is the belief that the group comes first. Research has found that people from Mexico, Greece, Hong Kong, Taiwan, Peru, Singapore, Colombia, and Pakistan tend to be relatively collectivistic in their values. In countries with higher levels of individualism, many workers may prefer reward systems that link pay with the performance of individual employees. In a more collectivistic culture, such a reward system may in fact be counterproductive.

A second important dimension is **power orientation**, the beliefs that people in a culture hold about the appropriateness of power and authority differences in

*Social Orientation* a person's beliefs about the relative importance of the individual versus groups to which that person belongs

*Power Orientation* the beliefs that people in a culture hold about the appropriateness of power and authority differences in hierarchies such as business organizations

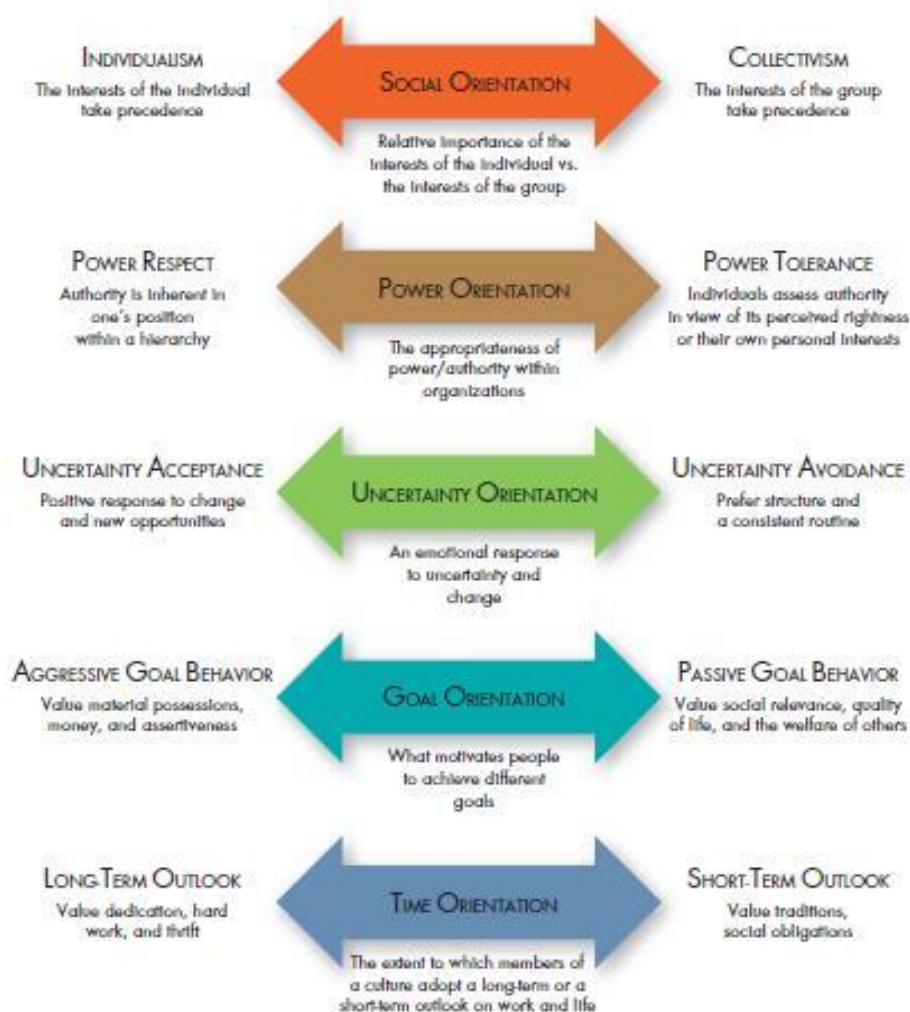


FIGURE 4.6 Hofstede's Five Dimensions of National Culture

hierarchies such as business organizations. Some cultures are characterized by *power respect*. This means that people tend to accept the power and authority of their superiors simply on the basis of their position in the hierarchy and to respect their right to hold that power. Research has found that people in France, Spain, Mexico, Japan, Brazil, Indonesia, and Singapore are relatively power accepting. In contrast, people in cultures with a *power tolerance* orientation attach much less significance to a person's position in the hierarchy. These individuals are more willing to question a decision or mandate from someone at a higher level or perhaps even refuse to accept it. Research suggests that people in the United States, Israel, Austria, Denmark, Ireland, Norway, Germany, and New Zealand tend to be more power tolerant.

**Uncertainty Orientation** the feeling individuals have regarding uncertain and ambiguous situations

The third basic dimension of individual differences is *uncertainty orientation*. **Uncertainty orientation** is the feeling individuals have regarding uncertain and ambiguous situations. People in cultures with *uncertainty acceptance* are stimulated by change and thrive on new opportunities. The research suggests that many people in the United States, Denmark, Sweden, Canada, Singapore, Hong Kong, and Australia are among those in this category. In contrast, people with *uncertainty avoidance* tendencies dislike and will avoid ambiguity whenever possible. The research found that many people in Israel, Austria, Japan, Italy, Columbia, France, Peru, and Germany tend to avoid uncertainty whenever possible.

**Goal Orientation** the manner in which people are motivated to work toward different kinds of goals

The fourth dimension of cultural values is goal orientation. In this context, **goal orientation** is the manner in which people are motivated to work toward different kinds of goals. One extreme on the goal orientation continuum is *aggressive goal behavior*. People who exhibit aggressive goal behaviors tend to place a high premium on material possessions, money, and assertiveness. On the other hand, people who adopt *passive goal behavior* place a higher value on social relationships, quality of life, and concern for others. According to the research, many people in Japan tend to exhibit relatively aggressive goal behaviors, whereas many people in Germany, Mexico, Italy, and the United States reflect moderately aggressive goal behaviors. People from the Netherlands and the Scandinavian countries of Norway, Sweden, Denmark, and Finland all tend to exhibit relatively passive goal behaviors.

**Time Orientation** the extent to which members of a culture adopt a long-term versus a short-term outlook on work, life, and other elements of society

A fifth dimension is called time orientation. **Time orientation** is the extent to which members of a culture adopt a long-term versus a short-term outlook on work, life, and other elements of society. Some cultures, such as Japan, Hong Kong, Taiwan, and South Korea, have a longer-term orientation. One implication of this orientation is that people from these cultures are willing to accept that they may have to work hard for many years before achieving their goals. Other cultures, such as Pakistan and West Africa, are more likely to have a short-term orientation. As a result, people from these cultures may prefer jobs that provide more immediate rewards. Research suggests that people in the United States and Germany tend to have an intermediate time orientation.<sup>22</sup>

#### OBJECTIVE 4-5 Describe

some of the ways in which economic, legal, and political differences among nations affect international business.

## Barriers to International Trade

Whether a business is truly multinational or sells to only a few foreign markets, several factors will affect its international operations. Success in foreign markets will largely depend on the ways a business responds to *social and cultural forces* (as described previously) and *economic, legal, and political barriers* to international trade.

### Economic Differences

Although cultural differences are often subtle, economic differences can be fairly pronounced. As we discussed in Chapter 1, in dealing with mixed-market economies like those of France and Sweden, firms must know when—and to what extent—the government is involved in a given industry. The French government, for instance, is heavily involved in all aspects of airplane design and manufacturing. The impact of economic differences can be even greater in planned economies such as those of China and Vietnam, where the government owns and operates many factors of production.

## Legal and Political Differences

Governments can affect international business in many ways. They can set conditions for doing business within their borders and even prohibit doing business altogether. They can control the flow of capital and use tax legislation to discourage or encourage activity in a given industry. They can even confiscate the property of foreign-owned companies. In this section, we discuss some of the more common legal and political issues in international business: *quotas, tariffs, and subsidies; local content laws; and business practice laws.*

**Quotas, Tariffs, and Subsidies** Even free market economies, such as the United States, have some quotas or tariffs, both of which affect prices and quantities of foreign-made products. A **quota** restricts the number of products of a certain type that can be imported and, by reducing supply, raises the prices of those imports. The United States has imposed quotas on ice cream and timber: Belgian ice-cream makers can't ship more than 922,315 kilograms to the United States each year, and Canada can ship no more than 14.7 billion board feet of softwood timber per year. Quotas are often determined by treaties. Better terms are often given to friendly trading partners, and quotas are typically adjusted to protect domestic producers.

The ultimate quota is an **embargo**, a government order forbidding exportation or importation of a particular product—or even all products—from a specific country. Many nations control bacteria and disease by banning certain agricultural products. Since the days of the Cold War, the United States had an embargo against Cuba, and it wasn't until 2015 that this embargo started to be lifted. The United States also has embargoes against trade with Libya, Iran, and North Korea. When the United States imposes an embargo, it means that U.S. firms can't invest in these countries, and their products can't legally be sold in U.S. markets.

**Tariffs** are taxes on imported products. They raise the prices of imports by making consumers pay not only for the products but also for tariff fees. Tariffs take two forms: revenue and protectionist. Revenue tariffs are imposed to raise money for governments, but most tariffs, called protectionist tariffs, are meant to discourage particular imports. Did you know that firms that import ironing-board covers into the United States pay a 7 percent tariff on the price of the product? Firms that import women's athletic shoes pay a flat rate of \$0.90 per pair plus 20 percent of the product price. Such figures are determined through a complicated process designed to put foreign and domestic firms on competitive footing (that is, to make the foreign goods cost about the same as the domestic goods).

Quotas and tariffs are imposed for numerous reasons. The U.S. government aids domestic automakers by restricting the number of Japanese cars imported into this country. Because of national security concerns, we limit the export of technology (for example, computer and nuclear technology to China). The United States isn't the only country that uses tariffs and quotas. To protect domestic firms, Italy imposes high tariffs on electronic goods. As a result, Asian-made DVD players are very expensive in Italy.

A **subsidy** is a government payment to help a domestic business compete with foreign firms. They're actually indirect tariffs that lower the prices of domestic goods rather than raise the prices of foreign goods. For example, many European governments subsidize farmers to help them compete against U.S. grain imports.

**The Protectionism Debate** In the United States, **protectionism**, the practice of protecting domestic business at the expense of free market competition, is controversial. Supporters argue that tariffs and quotas protect domestic firms and jobs as well as shelter new industries until they're able to compete internationally. They contend that we need such measures to counter steps taken by other nations. During the 2012 London Olympics, critics were outraged when it was discovered that Ralph Lauren, provider of official U.S. team uniforms, had outsourced the production of those uniforms to firms in China. These critics charged that the jobs of making the uniforms should have gone to U.S. workers. On the other hand, Ralph Lauren pointed out that the uniforms would have cost a lot more if they had been made in the United States. Other advocates justify protectionism in the name of

*Quota restriction on the number of products of a certain type that can be imported into a country*

*Embargo government order banning exportation or importation of a particular product or all products from a particular country*

*Tariff tax levied on imported products*

*Subsidy government payment to help a domestic business compete with foreign firms*

*Protectionism practice of protecting domestic business against foreign competition*

national security. A nation, they argue, must be able to produce efficiently the goods needed for survival in case of war.

Critics cite protectionism as a source of friction between nations. They also charge that it drives up prices by reducing competition. They maintain that although jobs in some industries would be lost as a result of free trade, jobs in other industries (for example, electronics and automobiles) would be created if all nations abandoned protectionist tactics.

Protectionism sometimes takes on almost comic proportions. Neither Europe nor the United States grows bananas, but both European and U.S. firms buy and sell bananas in foreign markets. Problems arose a few years ago when the EU put a quota on bananas imported from Latin America, a market dominated by two U.S. firms, Chiquita and Dole, to help firms based in current and former European colonies in the Caribbean. To retaliate, the United States imposed a 100 percent tariff on certain luxury products imported from Europe, including Louis Vuitton handbags, Scottish cashmere sweaters, and Parma ham.

**Local Content Laws** Many countries, including the United States, have **local content laws**, requirements that products sold in a country be at least partly made there. Firms seeking to do business in a country must either invest there directly or take on a domestic partner. In this way, some of the profits from doing business in a foreign country stay there rather than flow out to another nation. In some cases, the partnership arrangement is optional but wise. In Mexico, for instance, Radio Shack de México is a joint venture owned by Tandy Corporation (49 percent) and Mexico's Grupo Gigante (51 percent). This allows the retailer to promote a strong Mexican identity; it also makes it easier to address certain import regulations that are easier for Mexican than for U.S. firms. Both China and India currently require that when a foreign firm enters into a joint venture with a local firm, the local partner must have the controlling ownership stake.

**Business Practice Laws** Many businesses entering new markets encounter problems in complying with stringent regulations and bureaucratic obstacles. Such practices are affected by the **business practice laws** by which host countries govern business practices within their jurisdictions. As part of its entry strategy in Germany several years ago, Walmart had to buy existing retailers rather than open brand-new stores because, at the time, the German government was not issuing new licenses to sell food products. Walmart also was not allowed to follow its normal practice of refunding price differences on items sold for less by other stores because the practice is illegal in Germany. In addition, Walmart had to comply with business-hour restrictions: Stores can't open before 7:00 A.M., must close by 8:00 P.M. on weeknights and 4:00 P.M. on Saturday, and must remain closed on Sunday. After a few years, Walmart eventually decided its meager profits in Germany didn't warrant the effort it required to generate them and closed all of its stores there.

Sometimes, a legal—even an accepted—practice in one country is illegal in another. In some South American countries, for example, it is sometimes legal to bribe business and government officials. These bribe are generally called “expediting fees” or something similar. The existence of **cartels**, associations of producers that control supply and prices, also gives tremendous power to some nations, such as those belonging to the Organization of Petroleum Exporting Countries (OPEC). U.S. law forbids both bribery and cartels.

Finally, many (but not all) countries forbid **dumping**, selling a product abroad for less than the cost of production at home. U.S. antidumping legislation sets two conditions for determining whether dumping is being practiced:

- 1 Products are being priced at “less than fair value.”
- 2 The result unfairly harms domestic industry.

Just a few years ago, the United States charged Japan and Brazil with dumping steel at prices 70 percent below normal value. To protect local manufacturers, the U.S. government imposed a significant tariff on steel imported from those countries.

**Local Content Law** law requiring that products sold in a particular country be at least partly made there

**Business Practice Law** law or regulation governing business practices in given countries

**Cartel association of producers** whose purpose is to control supply and prices

**Dumping practice** of selling a product abroad for less than the cost of production

# summary of learning objectives

## OBJECTIVE 4-1

**Discuss** the rise of international business and describe the major world marketplaces, trade agreements, and alliances. (pp. 108–113)

Importing and exporting products from one country to another greatly increases the variety of products available to consumers and businesses. Several forces have combined to spark and sustain globalization. Governments and businesses have become aware of the potential for higher standards of living and increased profits. New technologies make international travel, communication, and commerce faster and less expensive. In addition, some companies expand into foreign markets just to keep up with their competitors.

North America, Europe, and Pacific Asia represent three geographic clusters that are the major marketplaces for international business activity. These major marketplaces include relatively more of the upper-middle-income and high-income nations but relatively few low-income and low-middle-income countries.

Trade treaties are legal agreements that specify how countries will work together to support international trade. The most significant treaties are (1) the *North American Free Trade Agreement (NAFTA)*, (2) the *European Union (EU)*, (3) the *Association of Southeast Asian Nations (ASEAN)*, and (4) the *General Agreement on Tariffs and Trade (GATT)*.

## OBJECTIVE 4-2

**Explain** how differences in import–export balances, exchange rates, and foreign competition determine the ways in which countries and businesses respond to the international environment. (pp. 113–119)

Economists use two measures to assess the balance between imports and exports. A nation's *balance of trade* is the total economic value of all products that it exports minus the total economic value of all products that it imports. When a country's imports exceed its exports, it has a *negative balance of trade* and it suffers a *trade deficit*. A *positive balance of trade* occurs when exports exceed imports, resulting in a *trade surplus*.

The *balance of payments* refers to the flow of money into or out of a country. Payments for imports and exports, money spent by tourists, funding from foreign-aid programs, and proceeds from currency transactions all contribute to the balance of payments.

*Exchange rates*, the rates at which one nation's currency can be exchanged for that of another, are a major influence on international trade. Most countries use *floating exchange rates*, in which the value of one currency relative to that of another varies with market conditions.

Countries *export* what they can produce better or less expensively than other countries and use the proceeds to *import* what they can't produce as effectively. Economists once focused on two forms of advantage to explain international trade: *absolute advantage* and *comparative advantage*. Today, the theory of *national competitive advantage* is a widely accepted model of why nations engage in international trade. According to this theory, comparative advantage derives from four conditions: (1) factor of production conditions, (2) demand conditions, (3) related and supporting industries, and (4) strategies, structures, and rivalries.

## OBJECTIVE 4-3

**Discuss** the factors involved in deciding to do business internationally and in selecting the appropriate levels of international involvement and international organizational structure. (pp. 119–123)

Several factors enter into the decision to go international. A company wishing to sell products in foreign markets should consider the following questions: (1) Is there a *demand* for its products abroad? (2) If so, must it *adapt* those products for international consumption? Companies may also go international through outsourcing and offshoring.

After deciding to go international, a firm must decide on its level of involvement. Several levels are possible: (1) *exporters and importers*, (2) *international firms*, and (3) *multinational firms*.

Different levels of involvement require different kinds of organizational structure. The spectrum of international organizational strategies includes the following: (1) *independent agents*, (2) *licensing arrangements*, (3) *branch offices*, (4) *strategic alliances (or joint ventures)*, and (5) *foreign direct investment (FDI)*. Independent agents are foreign individuals or organizations that represent an exporter in foreign markets. Another option, licensing arrangements, represents a contract under which one firm allows another to use its brand name, operating procedures, or proprietary technology. Companies may also consider establishing a branch office by sending managers overseas to set up a physical presence. A strategic alliance occurs when a company seeking international expansion finds a partner in the country in which it wishes to do business. Finally, FDI is the practice of buying or establishing tangible assets in another country.

#### OBJECTIVE 4-4

**Explain** the role and importance of the cultural environment in international business. (pp. 123–126)

A country's culture includes all the values, symbols, beliefs, and language that guide behavior. Cultural values and beliefs are often unspoken; they may even be taken for granted by those who live in a particular country. Cultural factors do not necessarily cause problems for managers when the cultures of two countries are similar. Difficulties can arise, however, when there is little overlap between the home culture of a manager and the culture of the country in which business is to be conducted. Cultural differences between countries can have a direct impact on business practice. Some cultural differences between countries, such as the meaning of time, can be even subtler and yet have a major impact on business activities. Language itself can be an important factor. Beyond the obvious and clear barriers posed by people who speak different languages, subtle differences in meaning can also play a major role.

Managers in international business also have to understand that there are differences in what motivates people in different cultures. Social orientation is a person's beliefs about the relative importance of the individual versus groups to which that person belongs. A second important dimension is power orientation, the beliefs that people in a culture hold about the appropriateness of power and authority differences in hierarchies, such as business organizations. Uncertainty orientation is the feeling individuals have regarding uncertain and ambiguous situations. Goal orientation is the manner in which people are motivated to work toward different kinds of goals. Time orientation is the extent to which members of a culture adopt a long-term versus a short-term outlook on work, life, and other elements of society.

#### OBJECTIVE 4-5

**Describe** some of the ways in which economic, legal, and political differences among nations affect international business. (pp. 126–129)

Economic differences among nations can be fairly pronounced and can affect businesses in a variety of ways. Common legal and political issues in international business include *quotas*, *tariffs*, *subsidies*, *local content laws*, and *business practice laws*. Quotas restrict the number of certain products that can be imported into a country, and a tariff is a tax that a country imposes on imported products. Subsidies are government payments to domestic companies to help them better compete with international companies. Another legal strategy to support a nation's businesses is implementing local content laws that require that products sold in a country be at least partially made there. Business practice laws control business activities within their jurisdiction and create obstacles for businesses trying to enter new markets.


The term *protectionism* describes the practice of protecting domestic businesses at the expense of free market competition. Although some economists argue that legal strategies such as quotas, tariffs, and subsidies are necessary to protect domestic firms, others argue that protectionism ultimately hurts consumers because of the resulting higher prices.

A final obstacle to international business is that business practices that are legal in one country may not be legal in another. Bribery, the formation of cartels, and dumping are forbidden in the United States, but legal in other countries, which is challenging for U.S. companies trying to enter some foreign markets.

## key terms

- absolute advantage (p. 118)  
 Association of Southeast Asian Nations (ASEAN) (p. 113)  
 balance of payments (p. 116)  
 balance of trade (p. 114)  
 branch office (p. 123)  
 business practice law (p. 128)  
 cartel (p. 128)  
 comparative advantage (p. 118)  
 dumping (p. 128)  
 embargo (p. 127)  
 euro (p. 117)  
 European Union (EU) (p. 112)  
 exchange rate (p. 117)  
 export (p. 108)  
 exporter (p. 121)  
 foreign direct investment (FDI) (p. 123)  
 General Agreement on Tariffs and Trade (GATT) (p. 113)  
 globalization (p. 108)  
 goal orientation (p. 126)  
 import (p. 108)  
 importer (p. 121)  
 independent agent (p. 122)  
 international firm (p. 121)  
 licensing arrangement (p. 123)  
 local content law (p. 128)  
 multinational firm (p. 122)  
 national competitive advantage (p. 119)  
 North American Free Trade Agreement (NAFTA) (p. 112)  
 offshoring (p. 120)  
 outsourcing (p. 120)  
 power orientation (p. 125)  
 protectionism (p. 127)  
 quota (p. 127)  
 social orientation (p. 125)  
 strategic alliance (p. 123)  
 subsidy (p. 127)  
 tariff (p. 127)  
 time orientation (p. 126)  
 trade deficit (p. 114)  
 trade surplus (p. 114)  
 uncertainty orientation (p. 126)  
 World Trade Organization (WTO) (p. 113)

## MyBizLab

To complete the problems with the , go to EOC Discussion Questions in the MyLab.

## questions & exercises

### QUESTIONS FOR REVIEW

- ★ 4-1. What are the advantages and disadvantages of globalization?
- 4-2. What are the three possible levels of involvement in international business? Give examples of each.
- 4-3. What are the elements of national competitive advantage?
- 4-4. Describe the five international organizational structures.

### QUESTIONS FOR ANALYSIS

- 4-5. List all the major items in your bedroom, including furnishings, and identify the country in which each item was made. Develop a hypothesis about why each product was made in the United States or abroad.
- 4-6. Describe the United States in terms of the five cultural orientations.
- ★ 4-7. Do you support protectionist tariffs for the United States? If so, in what instances and for what reasons? If not, why?

- ★ 4-8. Do you think that a firm operating internationally is better advised to adopt a single standard of ethical conduct or to adapt to local conditions? Under what kinds of conditions might each approach be preferable?

### APPLICATION EXERCISES

- 4-9. The World Bank uses per-capita income to make distinctions among countries. Use Web or database research to identify at least three countries in the following categories for last year: high-income countries, upper-middle-income countries, lower-middle-income countries, and lower-income countries. In addition, identify the source of the data that you used to draw these conclusions.
- 4-10. China is one of the fastest-growing markets in the world. Use Web or database research to uncover how to best describe China according to the five cultural dimensions. Cite the sources for your information.

## building a business: continuing team exercise

### Assignment

Meet with your team members and discuss your new business venture within the context of this chapter. Develop specific responses to the following:

- 4-11. Are you likely to acquire any of your materials, products, or services from abroad? Why or why not?
- 4-12. Are there likely to be any export opportunities for your products or services? Why or why not? If you are able to export your product, will it need to be adapted to sell in foreign markets?
- 4-13. To what extent, if any, will your new venture be affected by social and cultural differences, economic differences, and/or legal and political differences across cultures?