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CHAPTER 5

Globalization and Society

OBJECTIVES

After studying this chapter, you should be able to

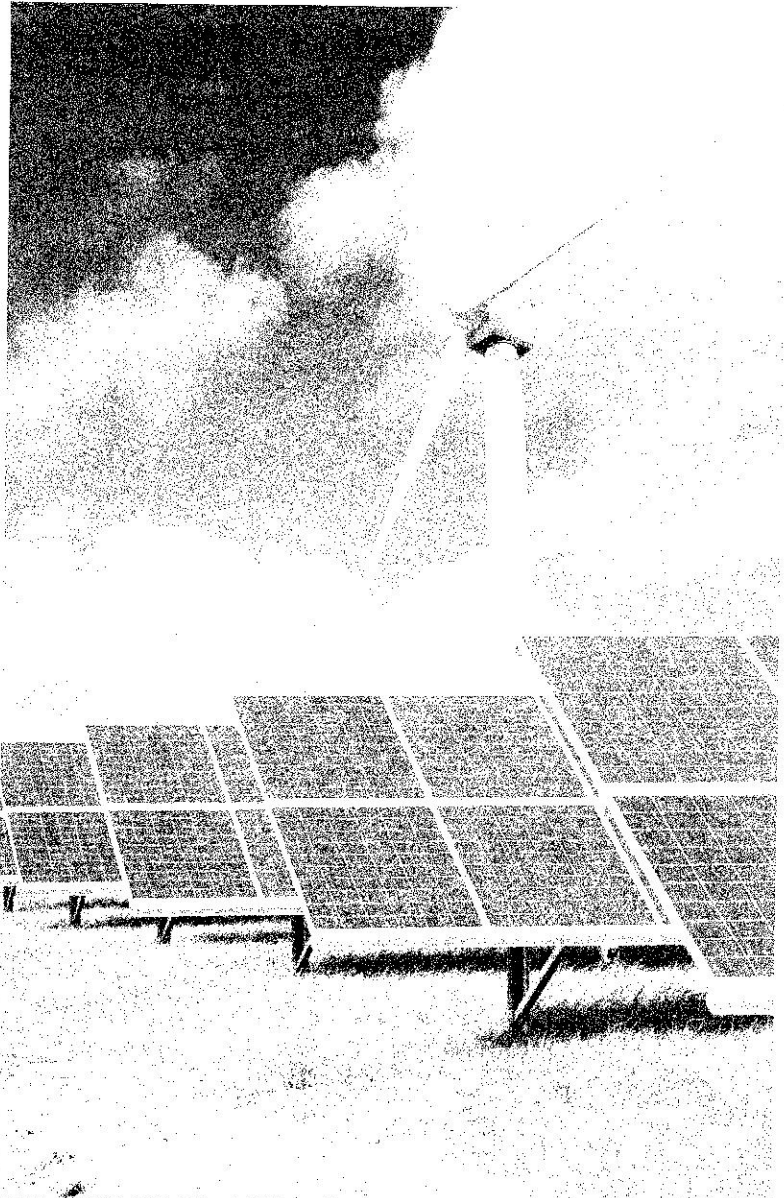
- 5-1 Describe the trade-offs among different stakeholders in MNE activities
- 5-2 Evaluate the major economic effects of MNEs on home and host countries
- 5-3 Explain the broad foundations of ethical behavior
- 5-4 Identify the cultural foundations of ethical behavior
- 5-5 Illustrate how ethical behavior is affected by different legal attitudes
- 5-6 Show how corruption and bribery affect and are affected by cultural, legal, and political forces
- 5-7 Summarize what the roles are of governments and companies in resolving environmental issues
- 5-8 Demonstrate how global labor issues need to be addressed by MNEs to their stakeholders
- 5-9 Restate how codes of conduct can help MNEs respond to concerns by stakeholders over responsible corporate behavior

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*When the last tree has been cut down, the
last river has been polluted and the last fish
has been caught—only then do you realize
that money can't buy everything.*

—Native American proverb

➤ Solar electricity plants like this one will help the transition to sustainable energy.



Source: Sergey Sedukhin/Fotolia

CASE

Ecomagination and the Global Greening of GE

As noted on Map 5.1, a recent TV ad invites viewers to “accompany” a small green frog as it does a little globe hopping from one exotic location to another.¹ The frog, however, doesn’t seem intent on hitting the usual tourist spots, instead preferring stopovers at such places as a solar farm in South Korea, a water-purification plant in Kuwait, and a wind farm in Germany. To begin the second leg of his tour, he hops on a GE90 aircraft engine flying over China and takes viewers to a “clean” coal-powered facility somewhere in Florida. Then he boards a GE Evolution locomotive in the Canadian Rockies as a voiceover explains the point of all this seemingly ordinary sightseeing: “At GE, we’re combining imagination with advanced technology around the world to make it a better place to live for everyone.” The journey’s end finds our frog in the midst of a lush, green tropical rain forest.

“GREEN IS GREEN”

The ad is part of a major promotional campaign by General Electric Company (GE) for its Ecomagination Initiative. Announced in 2005 by CEO Jeffrey Immelt, Ecomagination is an ambitious strategy designed to demonstrate that an ecologically conscious conglomerate can cultivate the bottom line while doing its duty toward the global environment—hence, the campaign motto “Green Is Green.”

The world’s eighth-largest corporation (in terms of market capitalization), U.S.-based GE sells products in more than 175 countries through its industry business and GE capital. Industry is further divided into oil and gas, energy management, health care, transportation, and appliances and lighting. It sells, among other things, appliances, aircraft engines, consumer electronics, energy-related products such as solar panels and wind generators, and locomotive engines. It also operates research centers in the United States, Brazil, India, China, Germany, and Israel. In early 2016, GE announced that it was selling its appliance business to Chinese company, Haier.

When the company announced its plan to launch an internal green revolution, GE surprised both investors and industrial customers who had long seen the firm as an ally in the struggle against environmental activists and lobbyists. But as more and more evidence piles up to support the claim that carbon dioxide emitted from human-made sources is heating up average global temperatures, GE has decided to take a more conciliatory stance, allying itself with a growing number of companies that regard investor and environmental interests as intrinsically interlocked, rather than diametrically opposed.

COMMITMENTS AND GOALS

GE’s new initiative represents five basic commitments on its part: (1) to reduce greenhouse emissions and improve the energy efficiency of operations; (2) to double investment in the research and development of “clean” technologies; (3) to increase revenues from those same

technologies; (4) to reduce its global water use by 20 percent; and (5) to keep the public informed. It now evaluates business unit managers not only on profitability and return on capital but also on success in reducing carbon dioxide emissions, the chief greenhouse gas (GHG) attributed to global warming. Energy-intensive divisions, such as those catering to the power and industrial sectors, are responsible for the largest cuts.

The company’s overall target was a 1 percent reduction from 2004 levels by 2012. At first glance, the goal doesn’t seem to have been overly ambitious, but that number represents a significant improvement if you account for the fact that, given GE’s projected growth, levels would otherwise soar to 40 percent above 2004 levels. Immelt also committed the company to reducing the intensity of GHG emissions—its level of emissions in relation to the company’s economic activity—30 percent by 2008 and to improving energy efficiency 30 percent by 2012. To ensure that these goals were met, Immelt assembled a cross-business, cross-functional team to oversee planning and monitor progress. By 2014, the company had reduced GHG emissions by 31 percent from its 2004 baseline, more than the 25 percent it had forecast. It also had improved energy intensity by 32 percent from 2004 levels.

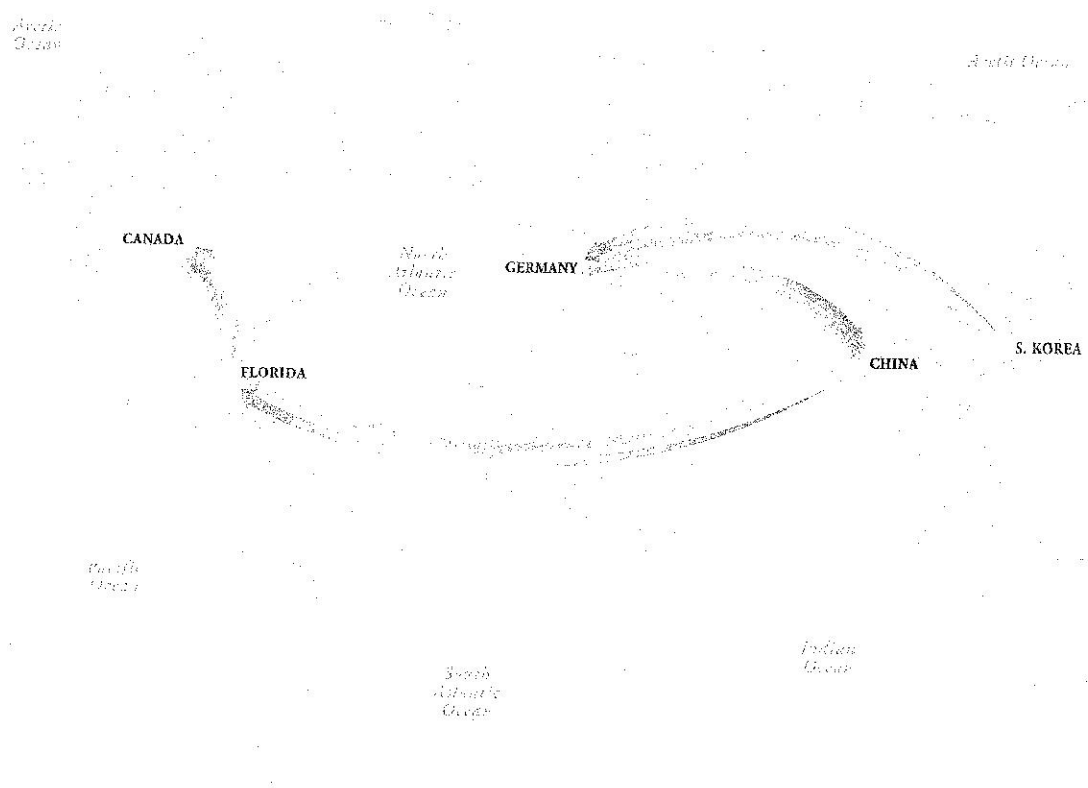
A LITTLE CONSENSUS SEEKING

In addition to instituting the internal changes necessary to curb GHG emissions, Immelt considered GE’s global political environment. He enlisted the Belgian and Japanese governments in the global ecological discussion and allied GE with other green-minded corporations to lobby American lawmakers on such matters as mandatory GHG reductions. Working with the Environmental and Natural Resources Defense Council and the Pew Center on Global Climate Change, GE also joined other companies to form the U.S. Climate Action Partnership to help shape the international political debate over global warming.

GE and its allies want to be known for developing forward-looking strategies and making long-term investments in an increasingly fragmented regulatory environment. With half of its markets located outside the United States, GE is already under the jurisdiction of foreign governments that are more active than the United States in addressing environmental issues.

TECHNOLOGICAL TACTICS AND ECO-FRIENDLY PRODUCTS

Under Immelt’s direction, GE has also been gearing up to double R&D investment in clean technologies, including renewable-energy, water-purification processes, and fuel-efficient products from which it expects significant revenue growth. GE had already spent \$10 billion on R&D investment between 2010 and 2014.

MAP 5.1 Global Travels of GE's "Green Frog," Its Symbol of Commitment to the Environment

In 2006, GE announced that it would reduce water usage by 25 percent from its 2006 baseline, and it achieved a 42 percent reduction by 2014.

When the Ecomagination initiative was first launched, GE marketed only 17 products that met its own Ecomagination criteria; by 2009, there were 90 such products, and by 2011, there were 140 products and solutions generating \$105 billion in revenues. By 2014, revenues over the 2010–2014 period had increased to \$200 billion. GE wind was generating \$30 billion in revenues, and there were over 30,000 wind turbines in operation. In 2016, GE purchased the energy business of French-based Alstom, giving GE access to Alstom's giant offshore wind turbine technology.

In addition to making other products, such as appliances and light bulbs, energy efficient, GE intends to establish itself as an “energy-services” consultant and to bid on contracts for maintaining water-purification plants and wind farms, a venture that could be five times as lucrative as simply manufacturing the products needed for such projects. The use of its website to communicate information about its green products and the efforts to improve its own GHG emissions reduction is an example of commitment #5, listed above:

to keep the public informed. In addition, it communicates information through social media such as Twitter and Facebook.

“SOLVING ENVIRONMENTAL PROBLEMS IS GOOD BUSINESS”

GE insists that the markets for such products and services are both growing and profitable, and Immelt is convinced that taking advantage of them not only helps the environment but also strengthens the company's strategic position with major profit opportunities.

GE also regards its Ecomagination strategy as a necessary response to customer demand. Before embarking on this initiative, GE spent 18 months working with industrial customers, inviting managers to two-day “dreaming sessions” to imagine life in 2015 and to discuss the kinds of products they'd need in such an environment. The result? Management came out of the talks with the indelible impression that both GE's customers and the social and political environments in which it conducted business would be demanding more environmentally “clean” products.

Many of GE's Asian and European competitors had already begun investing in cleaner technologies, and GE knew it couldn't risk falling behind. GE is also focusing on emerging markets such as China and India, where rapid economic growth has spurred the need for expanded infrastructures, such as water and sewage systems, and for means of curbing appallingly high levels of pollution.

MIXED REACTIONS

Not surprisingly, GE has been praised for its efforts to go green. It reached the ninth spot on *Fortune* magazine's list of the "Most Admired Companies" for 2015, and it earned a place on the Dow Jones Sustainability Index, which identifies the 300 firms that perform best according to combined environmental, social, and financial criteria.

At the same time, however, the company has generated a certain amount of skepticism. What happens, for example, if the markets it's betting on don't materialize fast enough (or at all)?

Another potential risk revolves around the participation of developing nations in the clean-technology push. In particular, will they be willing to pay prices that developed countries pay for the technology that reaches the market? GE also faces the challenge of implementing the internal changes entailed by its fledgling green strategy.

Traditionally, the firm's culture has been accustomed to strategies of incremental change in time-tested products and services. In fact, its highly touted Six Sigma program, championed by ex-CEO Jack Welch, inherently discourages radical deviation and unnecessary risk taking. Management may have its work cut out when it comes to persuading marketing, sales, and production teams that untested, early stage Ecomagination products are worth the risk.

Then, of course, there are clients and shareholders. Many of GE's customers work out of the utility sector, which has assumed a leadership role in disregarding warnings of climatic change and opposing ecofriendly regulation. Some investors seemed particularly concerned about the company's newfound activism and the potential of newly instituted greening initiatives to alienate industrial customers. ■

QUESTIONS

- 5-1. What are the major challenges GE faces in adopting a green strategy while keeping all of its stakeholders happy?
- 5-2. From the standpoint of environmental impact, do you think it's more important for GE to reduce its carbon footprint or to develop products that fit their Ecomagination strategy of being energy efficient?

WORLD GLOBALIZATION

In this chapter, we'll examine how globalization affects society and managers' judgments as they interact with different laws and cultures and try to be socially responsible. Doing business abroad is not easy. The greater the "distance" from one's home country, the more complicated it is to do business. Distance can be described in many different ways, but one way to identify it is the acronym CAGE: cultural (also known as psychic distance), administrative (such as political and institutional policies), geographic, and economic.² Given the criticisms of globalization and the challenge of companies and individuals doing business in areas of the world that are quite distant, as defined above, how can companies and individuals be successful, or at least not create serious mistakes?

STAKEHOLDER TRIANGLE

Companies must satisfy the demands of

- shareholders,
- employees,
- customers,
- suppliers
- society.

To prosper—indeed, to survive—a company must satisfy different groups of **stakeholders**, including shareholders, employees, customers, suppliers, and society at large. Obviously, this juggling act can be quite tricky. The shareholder (or stockholder)-versus-stakeholder dilemma pits the demands of one stakeholder against all the others. There is a debate on the idea of shared value, which implies that companies can increase profits while at the same time addressing critical social problems. It is tricky to do both successfully, but many MNEs feel it is worth the effort.³ The basic idea of focusing on stakeholders more broadly is that companies can consider various socially important groups when making decisions.⁴ In the short term, for example, group aims often conflict. *Shareholders* want additional sales and increased productivity (which result in higher profits and returns). *Employees* want safer workplaces and higher compensation. *Customers* want higher-quality products at lower prices. *Society* would like to see more jobs, increased corporate taxes, more corporate support for social services, and more trustworthy behavior on the part of corporate executives.

In the *long* term, all of these aims must be adequately met. If they aren't, there's a good chance that none of them will be, especially if each stakeholder group is powerful enough to bring operations to a standstill. In addition, pressure groups—which may reflect the interests of any stakeholder group—lobby governments to regulate MNE activities both at home and abroad.

As we noted in our opening case, for example, GE's Ecomagination initiative has generated pressure from various constituencies, including clients and shareholders concerned about profitability, various governments concerned with drafting regulations, employees wondering about changes in the company's strategies and goals, and environmental lobbyists, NGOs, and fellow businesses trying to preserve the environment. Each group has a powerful influence on how GE does business and on how successful it is in the marketplace. However, GE has to satisfy a variety of stakeholders with different concerns. For that reason, it has many different initiatives working with different stakeholders, not just those interested in climate change.

THE ECONOMIC IMPACT OF THE MNE

As we examine globalization and society, let's begin with a discussion of the impact of MNEs on the countries where they operate. As discussed in Chapter 1, there are many ways a company can do business abroad, and its success or failure can be strongly affected by the operating environment, including physical, social, and competitive factors as illustrated in Figure 1.1. In addition, the MNE's activities can also affect the operating environment, such as through corruption and bribery, environmental impact (i.e., air and water pollution), and labor policies.

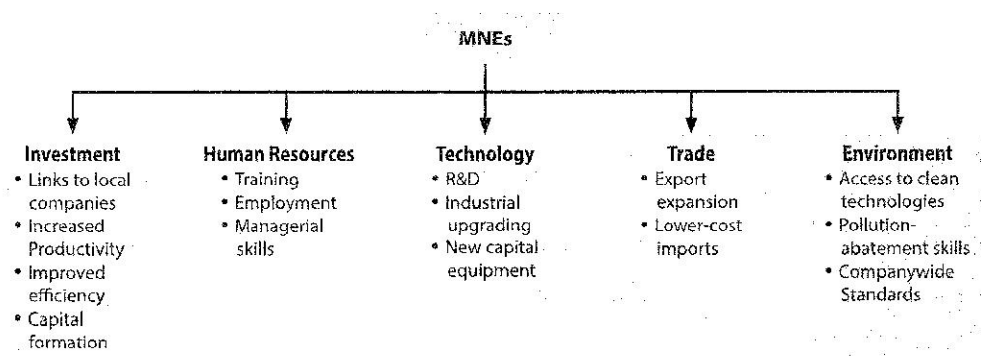
Although not all companies engage in foreign production, the dynamics involved in this decision raise lots of interesting issues. According to the eclectic paradigm of international production, there are three conditions that help explain the foreign production decision: ownership-advantages of MNEs that give them an advantage over companies in the host countries, location-specific advantages of the host country that make them attractive locations for FDI, and internalization advantages for the MNEs to utilize their specific ownership advantages rather than sell or license them to outsiders to exploit.⁵ Figure 5.1 identifies some of the ownership-specific advantages of the MNE, focusing on what the MNE has to offer.

Measuring the impact of the MNE on home and host societies depends on its stakeholders, the ability to understand cause-and-effect relationships, and individual versus aggregate effects.

Cause-and-effect relationships refer to the true impact of an MNE on a host country. Opponents of FDI persist in trying to link MNE activities to such problems in host countries as inequitable income distribution, political corruption, environmental debasement, and social deprivation.⁶ In contrast, proponents of MNE activities tend to assume a positive

It is hard to determine whether or not the actions of MNEs affect societal conditions.

FIGURE 5.1 What MNEs Have to Offer



The philosophy, goals, and actions of each MNE are unique.

The effect of an individual MNE may be positive or negative.

CONCEPT CHECK

On page 123 of Chapter 4, we mention how the balance-of-payments is a key feature of a country's economy.

The formula to determine the balance-of-payments effect is simple but the data used must be estimated and are subject to assumptions.

link between their activities and such effects in recipient countries as higher tax revenues, increased levels of employment and exports, and greater innovation. There may or may not be a link, but each side needs to provide evidence to back up their position.

In terms of individual versus aggregate effects, some countries evaluate MNEs and their activities on individual or case-by-case bases. Other countries prefer to apply the same policies and control mechanisms to all MNEs, even though this approach risks missing some good opportunities while steering clear of dubious ones. Moreover, it's hard to choose between these two approaches because the governments that have applied one or the other have been far from perfect in predicting the future impact of FDI activities in their jurisdictions.

BALANCE-OF-PAYMENTS EFFECTS

This refers to trade and capital flows that result from FDI. Under different conditions, these effects may be positive or negative, either for the host country or the home country.

Host countries want capital inflows because they provide the foreign exchange needed to import goods and services and to pay off foreign debt. Remember, however, that FDI results in both capital inflows and capital outflows. Many countries, therefore, are concerned about the net balance-of-payments effect and about the possibility that, when the books are ultimately balanced, the effect of FDI on their net balance of payments may be negative.

APPLYING THE CONCEPT To appreciate better why countries must evaluate the effect of each investment on their balance of payments, we can examine two extreme hypothetical scenarios reflecting the effects of FDI on a nation's balance of payments:

- **Scenario 1:** Assume that a Mexican MNE makes an FDI when purchasing a Haitian-owned company as a portfolio investment. If the MNE makes no changes in management, capitalization, or operations, profitability remains the same for the Haitian company. Dividends, however, now go to the Mexican owners rather than remaining in Haiti. This results in a drain on Haiti's foreign exchange and a corresponding inflow to Mexico.
- **Scenario 2:** A Mexican MNE purchases idle resources (land, labor, materials, equipment) in Haiti and converts them to the production of formerly imported goods. Rising consumer demand leads the MNE to reinvest its profits in Haiti, where import substitution increases the host country's foreign-exchange reserves.

Most FDI falls somewhere between these two extreme examples. That's why they're hard to evaluate, particularly when policymakers try to apply regulations to all in-bound investments.

There is, however, a basic equation for analyzing the effect of FDI on a host country's balance of payments:

$$B = (m - m_1) + (x - x_1) + (c - c_1)$$

where

B = balance-of-payments effect

m = import displacement

m_1 = import stimulus

x = export stimulus

x_1 = export reduction

c = capital inflow for other than import and export payment

c_1 = capital outflow for other than import and export payment

APPLYING THE CONCEPT Even though the equation itself is pretty straightforward, determining the value for each variable can be a challenge. Let's examine the effect of the decision to locate a Toyota automobile plant in Brazil—an instance of FDI by a Japanese MNE.

On the import side, the balance-of-payments is positive if the FDI results in a substitution for imports and negative if it results in an increase in imports.

First, to calculate the net import effect ($m - m_1$), we need to know how much Brazil would import if the Toyota plant were not built.

We must, of course, consider the amount that Toyota makes and sells in Brazil, but that would be only a rough indication of how much Brazil would import. Why? Because the selling price and product characteristics of the Brazilian-made cars may differ from those of the cars that Brazil would otherwise import from Japan. Moreover, sales of the Brazilian-made Toyota cars may come at the expense either of cars from other plants in Brazil or of imported foreign cars other than Toyotas. Note, too, that by definition, the value of m_1 should include the equipment, components, and materials brought by Toyota into Brazil. Remember, for example, that Toyota buys a lot of parts from suppliers that may be made locally or imported from other countries.

Finally, the value of m_1 should also include estimates of the increase in Brazilian imports due to increases in national income caused by the capital inflow from Japan. Assume, for instance, that, because of the Toyota investment, Brazilian national income rises R\$50 million (50 million reais). At this point, we have to consult the marginal propensity to import, which is the fraction of a change in imports due to a change in income and assumes that the recipients of that income will spend some portion of it on imports. If we calculate this portion as 10 percent, imports should rise by R\$5 million (that is, 10 percent of R\$50 million).

The net export effect is the *export stimulus* minus the *export reduction* ($x - x_1$), but bear in mind that this figure is particularly controversial, because different evaluators, starting out with different assumptions, regularly arrive at widely varying conclusions. Let's go back to our Toyota example. In this case, we can make the assumption that the Brazilian plant merely substitutes for imports from and production in Japan. If in fact we proceed on this assumption, we get no net export effect for Brazil. For Japan, we arrive at a negative net export effect because of Toyota's export reduction (it's now selling cars made in Brazil to Brazilian consumers instead of exporting Japanese-made cars to Brazil). Toyota, however, might well defend itself on the grounds that its moves abroad are (largely) defensive. How so? Under this assumption, Toyota can argue that it is capturing sales that would otherwise go to non-Japanese carmakers in Brazil. In that case, Toyota's export reduction from Japan amounts only to the export replacement (loss) resulting from the decision to build a production plant in Brazil.

In some cases, MNEs have argued that their overseas investments stimulate home-country exports of complementary products (say, in Toyota's case, auto parts) that they can sell in host countries through foreign-owned facilities.

The balance-of-payments effects in terms of capital flows for FDI are usually

- positive for the host country initially and negative for the home country,
- negative for host country and positive for the home country later.

TABLE 10.1 *Net capital flow* ($c - c_1$) is the easiest figure to calculate because of controls maintained by most central banks. There are, however, a few sticking points. Basing your evaluation on a given year is problematic because there's a time lag between a company's outward flow of investment funds and the inward flow of remitted earnings. Because companies eventually plan to take out more capital than they originally put in, what appears at a given time to be a favorable (or unfavorable) capital flow may prove, over a longer period, to be the opposite. The time it takes Toyota to recoup its capital outflow to Brazil depends on such factors as the need to reinvest funds in the host country, the ability to borrow locally, estimates of future exchange rates, and rules on the repatriation of capital.

As a rule, MNE investments are initially favorable to the host country and unfavorable to the home country in the short run. After some time, however, the situation usually reverses.⁷ Why? Because nearly all foreign investors eventually plan to have their subsidiaries remit dividends back to the parent company in excess of the amount they sent abroad. If the net value of the FDI continues to grow through retained earnings, dividend payments for a given year may ultimately exceed the total amount of capital transfers composing the initial investment.

GROWTH AND EMPLOYMENT EFFECTS

In contrast to balance-of-payments effects, MNE effects on growth and employment don't necessarily amount to *zero-sum games* (where gains must equal losses) between home and host countries. Classical economists assumed that production factors were always at full