

Learning 1 Reading

Learning Resource

Global Environment: Why It Matters

Why learn about the global business environment?

Grab your book bag, backpack, briefcase, or whatever you carry your school supplies in, and open it up. Sort the contents into two piles: items made in the United States and items made anywhere else. Now, how large is the stack of things made in the US compared to the imported items? Some may be labeled with the store brand and say something like "Manufactured in China for Company X." Others may simply have a tag that reads "Made in the Philippines." How many different countries are represented by the contents of your book bag? Do you realize that you just identified a small sample of countries that are US trading partners?

You should now have two stacks of items (made in the US and made elsewhere). Now, take everything that is NOT made in the US and put it aside. From this point forward all you have access to are the things left in the "100 percent made in the USA" stack. What do you have left? You will be lucky if you have a pencil and an eraser. It is global business and global trade that gives you access to everything else in your backpack.

Understanding the global business environment is critical to everyone who consumes any good, service or resource. Until we understand how the global business environment operates, why businesses and nations trade, and the forces at work in the global marketplace, we are naive consumers. You need to be informed so that you can make decisions about where you will work, who you will work for, who you will vote for, and what foreign policies you will either support or oppose. Without understanding the global business environment, you might find yourself facing daily life with nothing more than a pencil and an eraser.

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Learning Resource

Globalization

What you'll learn to do: Explain why nations and US firms engage in global business

In this section you'll learn about the drivers of the global economy and how companies and countries evaluate whether or not to pursue global opportunities.



Global Business

Learning Outcomes

- Explain the concept of globalization and its impact on global business
- Differentiate between comparative and absolute advantage

- Explain the roles of absolute and comparative advantage in global business

Globalization and Business

There was a time when consumers only had access to goods and services that were available locally. Their choices were limited by what they could access on foot, by horse, or by carriage. This is still the case for many people around the world, and in rural and remote parts of the United States, it's still necessary for families to make weekly trips to town to stock up on food, household items and other necessities. However, with the rise of internet-based business (think Amazon), there's been an explosion of international trade, and more and more consumers essentially have the world at their door. Of course, international trade isn't just a twentieth-century phenomenon. Trade across borders and between cultures has been a feature of human civilization for centuries—there's evidence of this dating back as far as the nineteenth century BCE. The Silk Road, one of the best-known and most enduring “international” trade routes, began sometime around 200 BCE and for centuries was central to cultural interaction from China through regions of the Asian continent all the way to the Mediterranean Sea.

So, if cultures and nations have been trading with one another for 4,000 years, what makes today's business landscape different? The answer lies in the distinction between international business and globalization.

International business refers to commerce in which goods, services, or resources cross the borders of two or more nations. This is what the Egyptians were doing when they sent goods across the Red Sea to Assyria. **Globalization** is broader than international business and describes a shift toward a more integrated world economy in which culture, ideas, and beliefs are exchanged in addition to goods, services, and resources. Globalization implies that the world is “getting smaller”: As a result of new transportation and communication technologies, people around the world can more readily connect with one another—both virtually and geographically.

Impact of Globalization on Global Business

Let's take a look at a particular example to think through the various implications of conducting business on a global scale. Consider McDonald's, which was started by two brothers in San Bernardino, California, 78 years ago. As a result of globalization, nearly 69 million people in 118 different countries eat at McDonald's every day. The first McDonald's outside the United States and Canada was established in Costa Rica in 1970, and since the

1990s, most of the company's growth has taken place in foreign countries. The process of building a global presence, entering new markets, and capitalizing on growing international demand for American fast food has enabled McDonald's to expand from a single location to a global corporation with revenues in excess of \$25.4 billion in 2015 ("McDonald's," n.d.). However, entering new markets—whether at home or abroad—means contending with increased competition in those markets, including competition with other globally minded companies. In 2010, Subway surpassed McDonald's to become the largest single-brand restaurant chain and the largest restaurant operator globally.

What is it like for companies that decide to take advantage of global opportunities as McDonald's and Subway have? Return to the discussion of "external forces", but now consider them from a global business perspective. Globalization certainly means that businesses can reach consumers around the world more rapidly and efficiently—thanks to cell phones, airplanes, and the internet, we are all so much more interconnected and "accessible" now. But globalization also means incredible complexity. The list below sketches out just a few of the complexities and challenges that an American fast-food company like McDonald's faces when it takes on the global business environment.

The Global Economic Environment. McDonald's is a corporation based in the United States, where all business transactions are conducted using the US dollar, but there are 167 official national currencies in the world, each with a different value and purchasing power. Imagine trying to balance the corporate checkbook at McDonald's when your deposits have been made in more than a hundred different currencies.

The Global Legal Environment. In Greece, there is a \$650 fine for eating ice cream at certain historic, artistic, and culturally important sites. If you are the operator of a McDonald's near the Parthenon, should you remove the ice cream cones and McFlurries from your menu to protect your customers against being fined, or not?

The Global Competitive Environment. How does McDonald's recapture the number-one position it lost to Subway in 2010? The company may need to make substantial changes to its operations, menu offerings, and/or marketing tactics. This is a steep, uphill climb in the United States alone, but consider trying to accomplish it in 118 different countries in 188 different markets—where you are competing not only with other global US fast-food companies like Subway and KFC but with local ones, like "McKebab," as well!

The Global Technological Environment. What does technology have to do with fast food or McDonald's? Consider the company's presence in China, where there are nearly 1.3 billion mobile users, and say hello to "McDonald's Next," a "modern and progressive" version of the restaurant that first opened in Hong Kong, featuring mobile-phone-charging platforms, free Wi-Fi, and self-ordering kiosks. This next generation of McDonald's is a response to increased

expectations around speed, service, economy, and availability across established and developing economies, mostly fueled by consumers' growing access to affordable technology. As global businesses respond to demands created *by* technology, they must also leverage technology to move products, people, and supplies around the globe in a cost-effective and efficient manner.

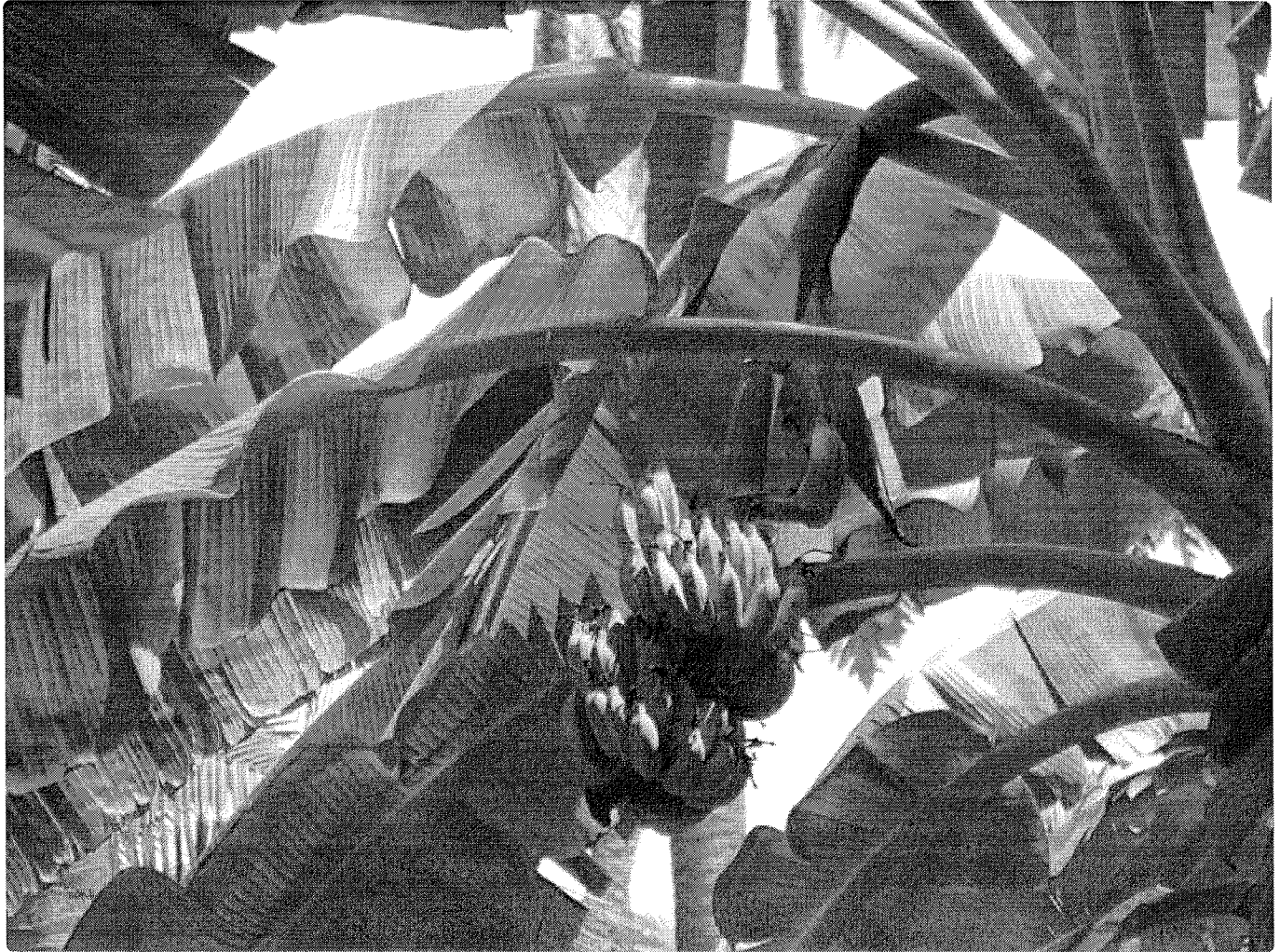
The Global Social Environment. McDonald's has had to adapt in countless ways to meet the demands of its customers around the world. While it prides itself on offering a consistent, internationally recognizable menu and brand, the company has also had to cater to local dining preferences and customs. In 1995, for example, the first kosher McDonald's opened in a Jerusalem suburb. In Arab countries, the restaurant chain offers "halal" menus, which comply with Islamic laws governing the preparation of meat. In 1996, McDonald's entered India for the first time, where it offered a Big Mac made with lamb called the Maharaja Mac ("History of McDonald's," n.d.).



McDonald's Maharaja Mac

McDonald's is not a complex business—after all, it sells inexpensive burgers and fries, not automobiles or airplanes or pharmaceuticals—but clearly the global environment presents challenges even for them. You may be wondering why nations and businesses decide to take on such challenges, given the ongoing difficulty, risk, and uncertainty. We'll investigate this question throughout the remainder of this chapter.

Absolute and Comparative Advantage



Banana Tree

Example: Bananas and Trade

Consider the humble banana. Even if you're not a big fan of this yellow fruit, you've surely seen them in the grocery store or in a market somewhere. If you walked through a US city with a banana and asked people to identify it, it's unlikely you would encounter anyone who had no idea what it was. What if you did the same thing with a picture of a banana tree? How many people could identify it? Maybe some, but not all. Why is that? In the United States, bananas are grown in Hawaii, and not everyone has been to Hawaii. In fact, most of the bananas in the world are grown in Ecuador. If we Americans love bananas and don't live in Hawaii and can't get to Ecuador regularly, without global trade, we're out of luck: no bananas for cereal in the morning or as snacks during the day, and worse, no banana splits at the local ice cream parlor. Why do Ecuador and Hawaii trade away their bananas instead of keeping them all to themselves? Probably because, although bananas are delicious and nutritious, it's

hard to build houses out of them. Instead, the state of Hawaii and nation of Ecuador choose to trade their bananas for things they lack, while considering the cost and profitability of exporting their product.

Ecuador and Hawaii offer an example of comparative advantage. Because bananas are not grown or readily available everywhere in the world, Ecuador and Hawaii can profitably export theirs to banana-less places like Iowa and Canada. At the same time, Ecuador may need computer systems to keep track of all of those bananas they are selling, but Ecuador is not a technologically advanced economy like the United States. The United States has a comparative advantage in computers, so we sell our computers to Ecuador and let them concentrate on selling us bananas.

The Concept of Advantage

In order to understand why businesses are willing to operate in a complex global environment, we must first understand two fundamental concepts that drive almost all business decisions: absolute and comparative advantage. Countries and companies are willing to assume the risk of engaging in global trade because they believe that they have an advantage over the competition that they can turn into profits. Not all countries have the same natural resources, infrastructure, labor force, or technology. These differences create advantages that can be exploited in global trade, to a country's (or company's) benefit.

Absolute Advantage

An entity (country, region, company, or individual) is considered to have an **absolute advantage** if either of the following conditions exists:

- It is the only source of a particular product, good, or service. This kind of absolute advantage is very rare and usually depends on a particular natural resource being available only within a certain region or country. An example might be the coveted edible red bird's nests found only in the caves of Thailand (and prized in Chinese cooking as the main ingredient in bird's nest soup). Similarly, if Ecuador were the only place in the world where bananas could be grown, it would have an absolute advantage. However, suppose some sneaky banana spy goes to Ecuador and pilfers some banana tree seedlings and takes them back to her home country, and begins growing and exporting bananas. At that point, Ecuador no longer has an absolute advantage on the basis of the "only-source" condition.
- An entity is also considered to have an absolute advantage if it is able to produce more of something than another entity while using the same amount of resources (factors of

production). When the sneaky banana spy started growing bananas in her home country, she didn't actually take away Ecuador's absolute advantage, because Ecuador can produce more bananas using the same amount of resources (labor, land, water, equipment, etc.). Put another way, Ecuador's direct cost of producing bananas is lower than the banana spy's. Assuming that the bananas can be grown in the new country, it will take that country a very long time to match Ecuador's skill, efficiency, and output level, and until it does, Ecuador will retain its absolute advantage.

Comparative Advantage

An entity (country, region, company, or individual) is considered to have a **comparative advantage** over another in producing a particular good or service if it can produce the good or service at a lower relative opportunity cost.

You'll recall from the economic environment chapter that opportunity cost is the value of the next best alternative. (The video, below, also includes a refresher on this concept.) Since countries and businesses have limited resources, they are forced to make choices about how they allocate those resources. As a student, you understand opportunity cost better than you think. You have a limited amount of time, and you must choose between reading this chapter and going out with your friends, because you can't do both. If you choose to go out with your friends, then the opportunity cost might be failure on your next exam because you did not use the time to prepare.

Ecuador has a comparative advantage in bananas over a long list of countries, including the United States. This comparative advantage is even better understood when you consider that their next best alternative product is oil. The Middle Eastern countries have been pumping oil from the ground for as long as Ecuador has been growing bananas. It makes as much sense for Kuwait to attempt to export bananas as it does for Ecuador to export oil. It's the reality of comparative advantage that encourages countries and businesses to do what they do best—leaving the production of other goods and services to other countries or companies—and in so doing, focusing on producing goods and services where they have advantage, thus maximizing their opportunities in a global environment.

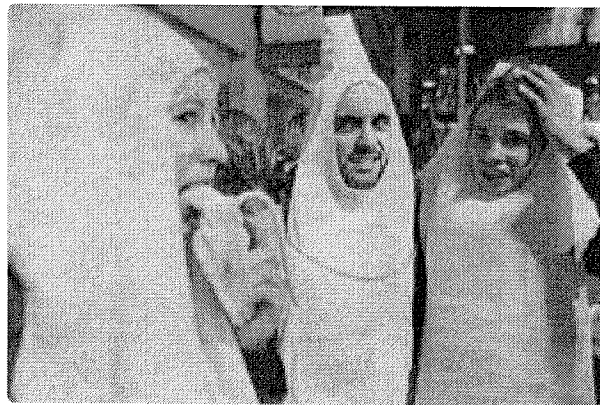
The following video provides an excellent illustration of comparative and absolute advantage and explains why they are such important considerations in how countries decide to specialize and trade.

<https://youtu.be/38hvvAzgXZY> (<https://youtu.be/38hvvAzgXZY>)

Global Markets and Business Opportunity



Increasingly nations and business use their comparative or absolute advantages to enter global markets driven by the same factor: the immense size of these markets.



Let's return to the banana for a moment. In 2015, Ecuador exported 6.55 million metric tons of bananas. Without a large global demand for bananas, every man, woman, and child in Ecuador would have to eat 834 pounds of them per year to consume all of the production. Of course that wouldn't happen: Instead, the country would simply cut back on the production of bananas—but, in so doing, it would lose an export that now accounts for more than 10 percent of its gross domestic product (GDP). Ecuador needs a large and vibrant global market to keep up with its tremendous supply of bananas, and it relies on the revenue from those bananas to purchase the other things it needs (in the same way that you traded cell phones for blue jeans in the island trader simulation).

Later in this chapter we'll discuss how nations like Ecuador enter foreign markets, but for now let's look more closely at the size of the world's largest markets. The following table shows population and GDP data for the top five economies in the world as of 2015 (Central Intelligence Agency, n.d.). You'll recall from the economic environment chapter that GDP is a monetary measure of the market value of all final goods and services produced in a period, and the GDP growth rate is the increase or decrease in GDP over a period of time, expressed as a percentage.

Country	GDP	Population	GDP Growth Rate
China	\$19,390,000,000,000	1,367,485,388	6.90%
European Union	\$19,180,000,000,000	513,949,445	2.20%
United States	\$17,950,000,000,000	321,368,864	2.40%
India	\$7,965,000,000,000	1,251,695,584	7.30%
Japan	\$4,830,000,000,000	126,919,659	0.50%

Looking at the figures in this table, it isn't hard to imagine that a country or company would like to have a foothold in one or all of these markets. Taken together, these five economies represent a lot of people, a lot of purchasing power, and a lot of economic growth. However, the immensity of the global market offers more than just new target customers. Consider some of the following benefits nations and firms realize by entering foreign markets.

Access to Factors of Production

You will recall that the factors of production required for a successful business venture are natural resources, capital, human capital, and entrepreneurship. Access to global markets enables countries and companies to acquire these factors of production when they are nonexistent, scarce, or just too costly at home. For example, India is one of the largest providers of telephone-based customer service (labor) worldwide, which makes sense given that its population is second only to China and almost four times that of the United States. In addition, labor costs in India are significantly lower than in the US.

Innovation and Ideas

Many companies enter global markets and, once there, discover unmet needs or unique products and services. They are then able to use their discoveries to expand an existing product line or introduce new products in other markets or at home. For example, many people credit the United Kingdom with inspiring the development of the craft beer industry in the United States.

Risk Reduction

Given the complexity of operating a business globally, it may seem like a contradiction that risk reduction is one of the benefits of a large global market, but it's actually true. If a country or a company trades or does business with multiple foreign partners, they are less dependent on the success of any single partnership. Likewise, if a nation or business has multiple global sources for factors of production, then if one source "dries up," they will still have access to what they need. For example, in 2010 China halted its export of rare earth minerals to Japan after the two countries were unable to resolve a territory dispute. Japan used these minerals in the production of everything from cars to computer chips, and to say that the Japanese were in a state of distress is an understatement. As a result of this, albeit brief, reduction in Chinese supply, Japan established a trade agreement with India for the import of the needed materials. Japan will no longer be totally dependent upon the Chinese for these important resources.

In summary, globalization makes business on a global scale possible, and the size of the global market makes it attractive. By using their absolute and comparative advantages, countries and companies can leverage their resources to produce and trade the things that benefit them the most.

References

McDonald's. (n.d.). In *Wikipedia*. Retrieved from <https://en.wikipedia.org/wiki/McDonald%27s>

Check Your Knowledge

Answer the following questions to see how well you understand the topics covered in this section. This short quiz does not count toward your grade in the class, and you can retake it as many times as you wish.

Use this quiz to decide whether to study the section further or move on.

Choose the **BEST** answer.

Question 1

If your country is the single source of a given product, good or service, you are said to have

- ☐ a marketing plan
- ☐ absolute advantage
- ☐ comparative advantage

Question 2

Managing multiple and varying currencies is a(n) _____ challenge in a global business environment.

- ☐ social
- ☐ economic
- ☐ technological

Question 3

Opportunity cost is a key consideration in determining:

- ☐ absolute advantage
- ☐ comparative advantage
- ☐ a company's tax rate

History of McDonald's. (n.d.). *In Wikipedia*. Retrieved from https://en.wikipedia.org/wiki/History_of_McDonald

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Learning Resource

Measuring Global Trade

What you'll learn to do: Describe how nations measure global trade

In the same way that nations measure their own economic productivity, they use specific tools to measure their trade with other nations. In this section you'll learn what some of those tools are and how they're used.

Learning Outcomes

- Differentiate between balance of trade and balance of payments
- Describe the difference between trade deficits and trade surpluses
- Explain how countertrade contributes to the measure of global trade

Two Key Measurements: Balance of Trade and Balance of Payments

Nations and businesses that trade back and forth, buy and sell companies, loan one another money, and invest in real estate around the globe need to have a way to evaluate the impact of these transactions on the economy. They need to make decisions about trade policies, regulations, and trade agreements, and until they can get a snapshot of what global trade is doing to hurt or help its economy, they can't make these decisions. It's a lot like your own finances, just on a much larger scale. At the end of the month, have you spent more than you earned? Do you have a large positive balance in your bank account as a result of receiving a financial aid check? Did you need to borrow money from your parents to buy books or clothes? Until you really examine where your money is coming from and balance your checkbook, it's hard to make long-term financial plans—like, say, deciding whether or not to buy a new car or purchase a home. This is very similar to what countries do when they measure the impact of trade on their economy.

In this section we'll look at two key measurements of trade: balance of trade and balance of payments.

Balance of Trade

One of the ways that a country measures global trade is by calculating its balance of trade.

Balance of trade is the difference between the value of a country's imports and its exports, as follows:

$$\text{value of exports} - \text{value of imports} = \text{balance of trade}$$

NOTE: It's important to use this formula just as it's presented, without altering the sequence of values.

The calculation of the balance of trade yields one of two outcomes: a trade deficit or a trade surplus. A **trade deficit** occurs when a nation imports more than it exports. Since 1976, the United States has consistently run trade deficits due to high imports of oil and consumer products. In recent years, the biggest trade deficits were recorded with China, Japan, Germany, and Mexico. This shouldn't come as a surprise to you if you emptied your backpack and counted up all the items not made in the USA. In contrast, a trade surplus occurs when a nation exports more than it imports. Although the US has run an overall trade deficit since 1976, it doesn't mean that we import more from every country than we export. On the contrary, the United States records trade surpluses with Hong Kong, the Netherlands, the United Arab Emirates, and Australia. Because the balance of trade is calculated using all imports and exports, it's possible for the US to run a surplus with some nations and a deficit with others. As with your checkbook, the balance reflects the difference between total exports ("deposits") and total imports ("withdrawals").

Let's look at the balance of trade for an imaginary country we'll call "Candyland."



Candyland is located in a region that lacks phosphate as a natural resource. However, it does have an abundance of sugarcane. As a result of its comparative advantages, Candyland imports phosphate from Christmas Island (it's a real place - a territory of Australia) to fertilize the sugarcane it grows, and it uses the sugarcane to manufacture saltwater taffy, which it exports to Christmas Island. The following table shows Candyland's imaginary imports and exports with Christmas Island in 2014.

	Imports (phosphates)	Exports (taffy)
2014	\$45,000,000	\$75,000,000

Using these figures, we can easily calculate Candyland's balance of trade in 2014: $\$75,000,000$ (exports) - $\$45,000,000$ (imports) = $\$30,000,000$. This means that Candyland had a trade surplus of $\$30,000,000$ with Christmas Island, since exports exceed imports. We can also say that Candyland was a "net exporter," meaning they exported more than they imported.

However, the picture changed in 2015 when the Australian government closed the phosphate mine on Christmas Island. Candyland had to import phosphate from Morocco, instead, and was not able to get the same favorable pricing as before. Consequently, sugarcane farmers paid more for fertilizer, the price of sugarcane went up, and Candyland had to raise the price on its saltwater taffy. Sadly, the people of Morocco aren't really big fans of saltwater taffy, so exports fell. The following table shows Candyland's imaginary imports and exports with Morocco in 2015.

	Imports (phosphates)	Exports(taffy)
2015	\$65,000,000	\$55, 000,000

We can use the figures to calculate Candyland's balance of trade: \$55,000,000 (exports) – \$65,000,000 (imports) = -\$10,000,000. The negative number indicates a trade deficit of \$10,000, showing that Candyland's imported more from Morocco than it exported. We would say that Candyland became a “net importer”—importing more than it was exporting.

Obviously this is a simple illustration. A country's global business doesn't amount to just trading phosphate and taffy or cell phones and blue jeans. It includes all kinds of financial transactions: goods and services imported and exported, foreign investments, loans, transfers, and so on. Tracking all these payments provides another way to measure the size of a country's international trade: the balance of payments.

Balance of Payments

Balance of Payments is the difference between the total flow of money coming into a country and the total flow of money going out of a country during a period of time. Although related to the balance of trade, balance of payments is the record of **all** economic transactions between individuals, firms, and government, and the rest of the world in a particular period. Thus the balance of payments includes **all** external transactions of a country, including payments for the country's exports and imports of goods, services, foreign investments, loans and foreign aid, financial capital, and financial transfers.

- For instance, if a US company buys land or a factory in another country, that investment is included in the US balance of payments as an outflow. Likewise, if a US company is sold to a foreign company, it's included in the balance of payments. Just recently, Didi Chuxing, the Chinese ride-hailing service, bought Uber's subsidiary in China in a deal

valued at \$35 billion. This sale will create a cash inflow to the United States, but over the long term it will decrease the revenue flowing in from China through Uber.

- If a nation receives foreign aid or borrows money from another country, this amount is also reflected in its balance of payments as a cash inflow. For example, the bailout Greece received from the Eurozone and the International Monetary Fund (IMF) in 2010 to help stabilize its failing economy affected the balance of payments for all of the nations involved. Greece recorded the €110 billion loan as an inflow in its balance of payments, while the Eurozone members recorded it as an outflow in their balance of payments.

A country's balance of payments is calculated as follows:

$$\text{total money coming into a country (inflow)} - \text{total money going out (outflow)} = \text{balance of payments}$$

NOTE: It's important to use this formula just as it's presented, without altering the sequence of values.

Let's examine Candyland's balance of payments in 2015. The following table shows all of its external transactions during the year.

Imports (phosphates)	Exports (taffy)	Foreign aid (loan) from Hooperland	Purchase of Wandaland assets
2015	\$55, 000, 000	\$25, 000, 000	\$30, 000, 000

When we calculated Candyland's balance of trade in 2015, we did not take into account the following two transactions:

1. Candyland received foreign aid in the form of a loan from the government of Hooperland in the amount of \$25,000,000. This *inflow of funds* will affect Candyland's balance of payments.
2. Candyland invested in a factory in Wandaland and purchased the factory from the government for \$30,000,000. This *outflow of funds* will affect Candyland's balance of payments.

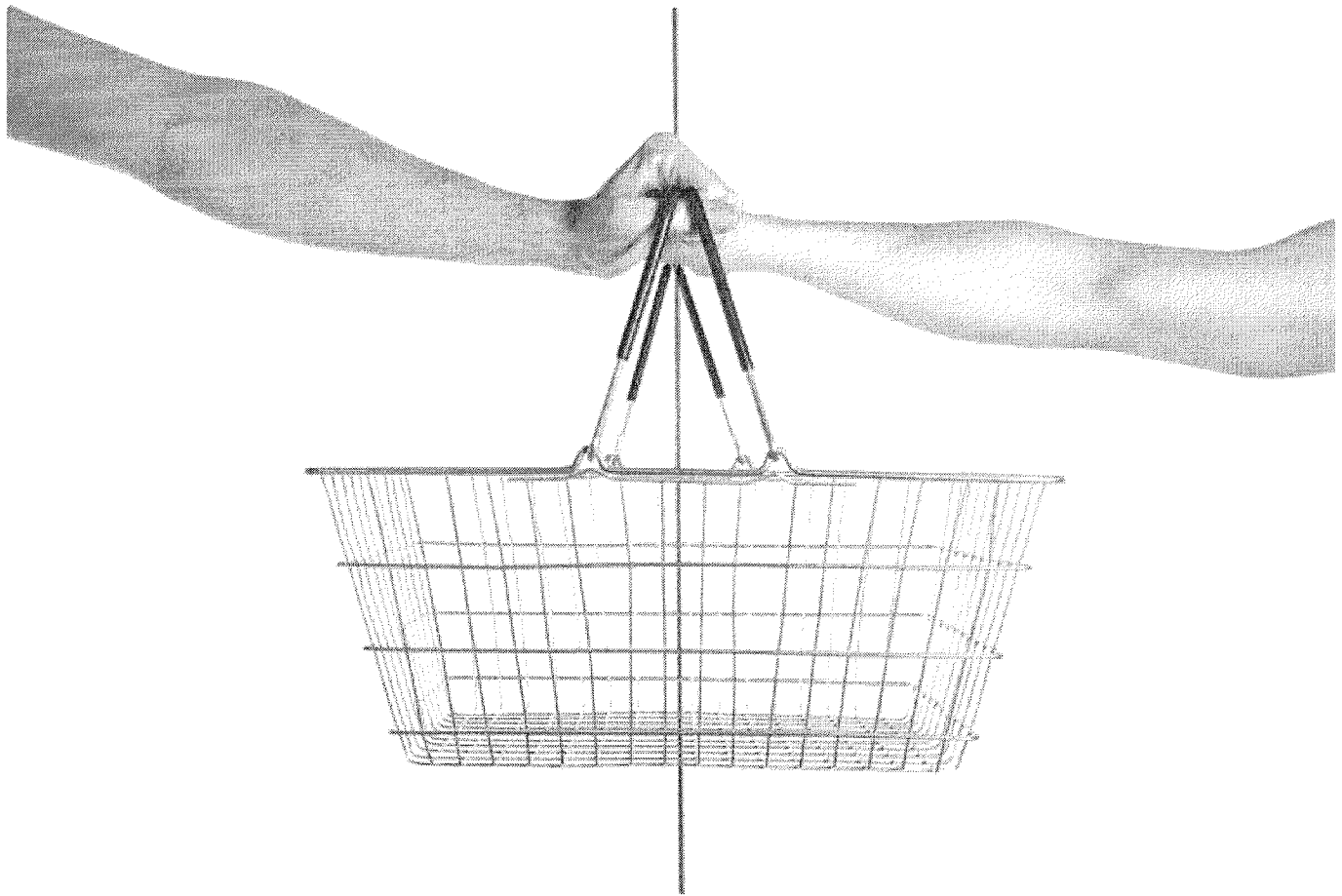
When we calculate Candyland's 2015 balance of payments by taking the inflows (revenue from exports and foreign aid) and subtracting the outflows (payments for imports and purchase of foreign assets), the balance is negative, as shown below:

$$(\$55,000,000 + \$25,000,000) \text{ (total inflow)} - (\$65,000,000 + \$30,000,000) \text{ (total outflow)} = -\$15,000,000$$

What effect will this have on Candyland? Well, when Candyland's leader is briefed by her council of international economic advisers, they will inform her that the country currently has an "unfavorable balance of payments." That is, less money is coming into the country than is going out. If, on the other hand, the balance of payments were a positive number (inflow exceeded outflow), Candyland could say that it has a "favorable balance of payments."

At this point, it's tempting to make judgments about these different types of trade measurements and conclude that trade surpluses and favorable balance of payments are always indicators of a strong economy, but unfortunately it's not so cut and dried. Balance of trade and balance of payments are starting points—much in the way that an individual's credit rating might be a starting point for seeking a loan. How the numbers are interpreted and viewed by the country's leaders, other countries, and the world depends on many factors, such as where a country is in its economic development, the factors contributing to the balance of trade or payments, the health of the overall global economy, what the country is doing with its imports, and so on. As you might guess, assessments of these factors can be intensely political. You'll learn more about these considerations later in this chapter when we discuss how nations attempt to restrict or control trade.

Countertrade



Countertrade

So far we have discussed global trade measured in dollars, euros, or other traditional currency, which is the way that everyone assumes business is conducted today. For example, here in the United States, we express the size of the global market, or Global World Product (GWP), as US \$107.5 trillion. If we lived in Japan, we'd measure GWP using Japanese currency, yen (¥).

However, when we measure global trade only in terms of currency-based transactions, we omit a portion of the market known as countertrade. **Countertrade** is a system of exchange in which goods and services are used as payment rather than money. There are many types of countertrading. Some of the most common types are described below:

- **barter** - exchange of goods or services directly for other goods or services without the use of money as means of purchase or payment. Example: One party trades salt for sugar from another party.
- **switch trading** - practice in which one company sells to another its obligation to make a purchase in a given country. Example: Party A and Party B are countertrading salt for sugar. Party A may switch its obligation to pay Party B to a third party, known as the switch trader. The switch trader gets the sugar from Party B at a discount and sells it for money. The money is used as Party A's payment to Party B.

- **counterpurchase** - sale of goods and services to one company in another country by a company that promises to make a future purchase of a specific product from the same company in that country. Party A sells salt to Party B. Party A promises to make a future purchase of sugar from Party B.
- **buyback** - occurs when a firm builds a plant in a country, or supplies technology, equipment, training, or other services to the country, and agrees to take a certain percentage of the plant's output as partial payment for the contract. Example: Party A builds a salt-processing plant in Country B, providing capital to this developing nation. In return, Country B pays Party A with salt from the plant.
- **offset** - agreement that a company will offset a hard-currency purchase of an unspecified product from that nation in the future. Agreement by one nation to buy a product from another, subject to the purchase of some or all of the components and raw materials from the buyer of the finished product, or the assembly of such product in the buyer nation. Example: Party A and Country B enter a contract where Party A agrees to buy sugar from Country B to manufacture candy. Country B then buys that candy.

Countertrading is common among countries that lack sufficient hard currency (i.e., cash) or where other types of market trade are impossible. In developing countries, whose currency may be weak or devalued relative to another country's currency, bartering may be the only way to trade. For example, if the value of Venezuela's currency, the bolívar fuerte, falls relative to the US dollar (as it has in recent years), the exchange rate makes it unfavorable for Venezuela to sell its oil to the United States. Countertrade may be a much more financially beneficial arrangement.

Check Your Knowledge

Answer the following questions to see how well you understand the topics covered in this section. This short quiz does not count toward your grade in the class, and you can retake it as many times as you wish.

Use this quiz to decide whether to study the section further or move on.

Choose the **BEST** answer.

Question 1

The equation for balance of trade is

- ☐ value of exports - value of imports
- ☐ value of imports - value of exports
- ☐ assets - liabilities

Question 2

The equation for balance of payments is

- ☐ total inflow of money - total outflow of money
- ☐ total value of imports - total value of imports
- ☐ debt plus equity

Question 3

In the United States, more goods are imported from China than are sold and exported to China. We are said to be in a _____ with China.

- ☐ trade surplus
- ☐ trade deficit
- ☐ balance of trade

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Learning Resource

Global Business Strategies

What you'll learn to do: Evaluate common strategies used to reach global markets

Globalization introduces a number of challenges that are unique to operating simultaneously in different countries and global markets. What is the best way to enter or take advantage of a global market? When should you adjust a product's features to customize it to consumer needs in a different global market? How do you manage the costs and complexities of producing and/or promoting products in different locations, with different languages, cultural sensitivities, and consumer expectations?

While this next section doesn't attempt to answer all of these questions, it explains common strategies and approaches used by multinational corporations to take advantage of global business opportunities.

Learning Outcomes

- Explain how firms use importing and exporting to reach global markets
- Compare the advantages and disadvantages of licensing and franchising globally
- Discuss how joint ventures and strategic alliances operate in the global market
- Define foreign direct investments (FDIs) and their prevalence in the global market

In today's economy, once a nation or business has developed an advantage—either comparative or absolute—it's likely to look beyond its own borders or storefront to seek greater economic opportunity. But how do you enter a global market? It's certainly not as

simple as loading up your products in a van, driving to the next town, and knocking on doors. Below are some of the common strategies companies and countries use to get their goods and services into global markets.

Exporting/Importing

Exporting is the easiest and most straightforward way to engage with the global market.

Exporting is taking goods that were produced within a company's home country and shipping them to another country. The party sending the good is called an exporter. It is impossible to discuss exporting without mentioning its complement, importing. **Importing** is the process by which a good is brought into a jurisdiction, especially across a national border, from an external source. The party bringing in the good is called an importer. Simply put, one country's exports become another country's imports. Examples of US imports are everywhere: Take a look at the labels in your clothes or the contents of your backpack. From our vantage point, US exports may be a little harder to see, but they exist all the same and are plenty visible in other countries. According to World's Top Exports (2016), the following export product groups represent the highest dollar value in American global shipments during 2015. In parentheses is the percentage share each export category represents in terms of overall US exports:

1. Machines, engines, pumps: US\$205.8 billion (13.7% of total exports)
2. Electronic equipment: \$169.8 billion (11.3%)
3. Aircraft, spacecraft: \$131.1 billion (8.7%)
4. Vehicles: \$127.1 billion (8.4%)
5. Oil: \$106.1 billion (7.1%)
6. Medical, technical equipment: \$83.4 billion (5.5%)
7. Plastics: \$60.3 billion (4%)
8. Gems, precious metals, coins: \$58.7 billion (3.9%)
9. Pharmaceuticals: \$47.3 billion (3.1%)
10. Organic chemicals: \$38.8 billion (2.6%)

Advantages and Disadvantages

Since exporting doesn't require a company to manufacture its products in the target country, the company doesn't have to invest in factories, equipment, or other production facilities located halfway around the globe. Most of the costs involved in exporting are associated with

finding a buyer or distributor in the destination market. For these reasons, exporting is considered to be the quickest and least expensive means to enter the global market. However, there are disadvantages, too.

Once products arrive in the destination market, the business loses control of them, which can result in products being misrepresented, copied by other manufacturers, or even sold on a black market. In addition, because the business isn't active in the new market, it can't gain insight into or experience with local consumer preferences and demand. This lack of information can create uncertainty and potentially cost the company opportunities down the road. As you will learn later in this chapter, businesses operating in other countries may find themselves subject to taxes, regulations, and/or restrictions that can substantially affect the profitability of the entire export venture.



Garment Factory, Jiaxing, China

Outsourcing/Offshoring

Outsourcing and offshoring are two additional strategies that a business can use in order to take advantage of the global market. **Outsourcing** contracts out a business process to another party and may include foreign and domestic contracting, or both. You may be familiar with outsourcing if your college has outsourced the bookstore to a national chain such as Barnes &

Noble, or the food services are provided by a company such as Starbucks or Aramark.

Although the employees work on your college campus, they are not college employees.

Offshoring, on the other hand, is the actual relocation of a business process from one country to another—typically it's an operational process, such as manufacturing, or sometimes a supporting process, such as accounting. In the case of offshoring, the employees still work for the company that's offshoring its operations, but instead of working in a facility within the United States, they are located in a foreign country. In general, outsourcing and offshoring are strategies that companies use to try to lower their costs.

If a business chooses outsourcing as a way to engage with the global market, it might have a single component part manufactured in, say, Tibet and then shipped back to Iowa, where the factory workers in Iowa would use the outsourced part in the assembly of the final product. The business would have a contract with the company making the component part at an agreed-upon price, but it would not have an employer-employee relationship with the workers in Tibet. On the other hand, if the business wants to take advantage of offshoring, it would move the entire plant from Iowa to Tibet and hire workers in Tibet, who would work directly for the business.

The following video is an example of how a small business is outsourcing its manufacturing to China. Especially for small start-up companies, using established manufacturing facilities located outside of the United States allows them to enter the global marketplace. Cost, logistics, finances, and speed are just some of the things that this type of arrangement can bring to businesses looking to take advantage of the growing global demand for US-branded products.

<https://youtu.be/swZFYhe5Vjo> (<https://youtu.be/swZFYhe5Vjo>)

Advantages and Disadvantages

Offshoring and outsourcing are both the subject of ongoing heated public debate—both in the United States and in other countries. Those in favor assert that these strategies benefit both sides of the arrangement: Free trade is enhanced, the destination country gains jobs, and the origin country gets cheaper goods and services. Some supporters go further and assert that outsourcing and offshoring raise the gross domestic product (GDP) and increase the total number of jobs domestically, too. This claim is based on the idea that workers who lose their jobs will move to higher-paying jobs in industries where the origin country has a comparative advantage.

On the other hand, job losses and wage erosion “at home” have sparked opposition to offshoring and outsourcing. Many argue that the jobs that are shipped overseas are not replaced by better, higher-paying ones. And it's not just low-skilled workers who are feeling

the pain. Increasingly, critics say, even highly trained workers (such as software engineers) with high-paying jobs are finding themselves replaced by cheaper workers in India and China. Some firms, while realizing financial gains from lowering their production costs, are finding that offshoring and outsourcing are very costly in terms of lack of control over product quality, working conditions, and labor relations. For example, companies like Nike and Apple have come under fire by human rights organizations and consumers over reports of worker abuse, dangerous working conditions, and ridiculously low wages. It was recently reported that apparel workers in Bangladesh are sometimes paid as little as 21 cents per hour. We will explore some of the ethical issues raised by offshoring and outsourcing later in the course in the business ethics chapter.

Licensing and Franchising

Increasingly, businesses are getting their products and services into global markets via licensing and franchise agreements. Under a licensing agreement, the licensor agrees to let someone else (the licensee) use the property of the licensor in exchange for a fee. License agreements usually cover property that is intangible, such as trademarks, images, patents, or production techniques. Since its debut in the late 1970s, Star Wars remains the most lucrative source of licensing in the entertainment business, generating more than \$42 billion from the sale of licensed merchandise.

A longer-term and more comprehensive way to access the global market is through franchising. Under the terms of a franchise agreement, a party (franchisee) acquires access to the knowledge, processes, and trademarks of a business (the franchisor) in order to sell a product or service under the business's (franchise's) name. In exchange for the franchise, the franchisee usually pays the franchisor both initial and annual fees. McDonald's, Holiday Inn, Hertz Car Rental, and Dunkin' Donuts have all expanded into foreign markets through franchising.

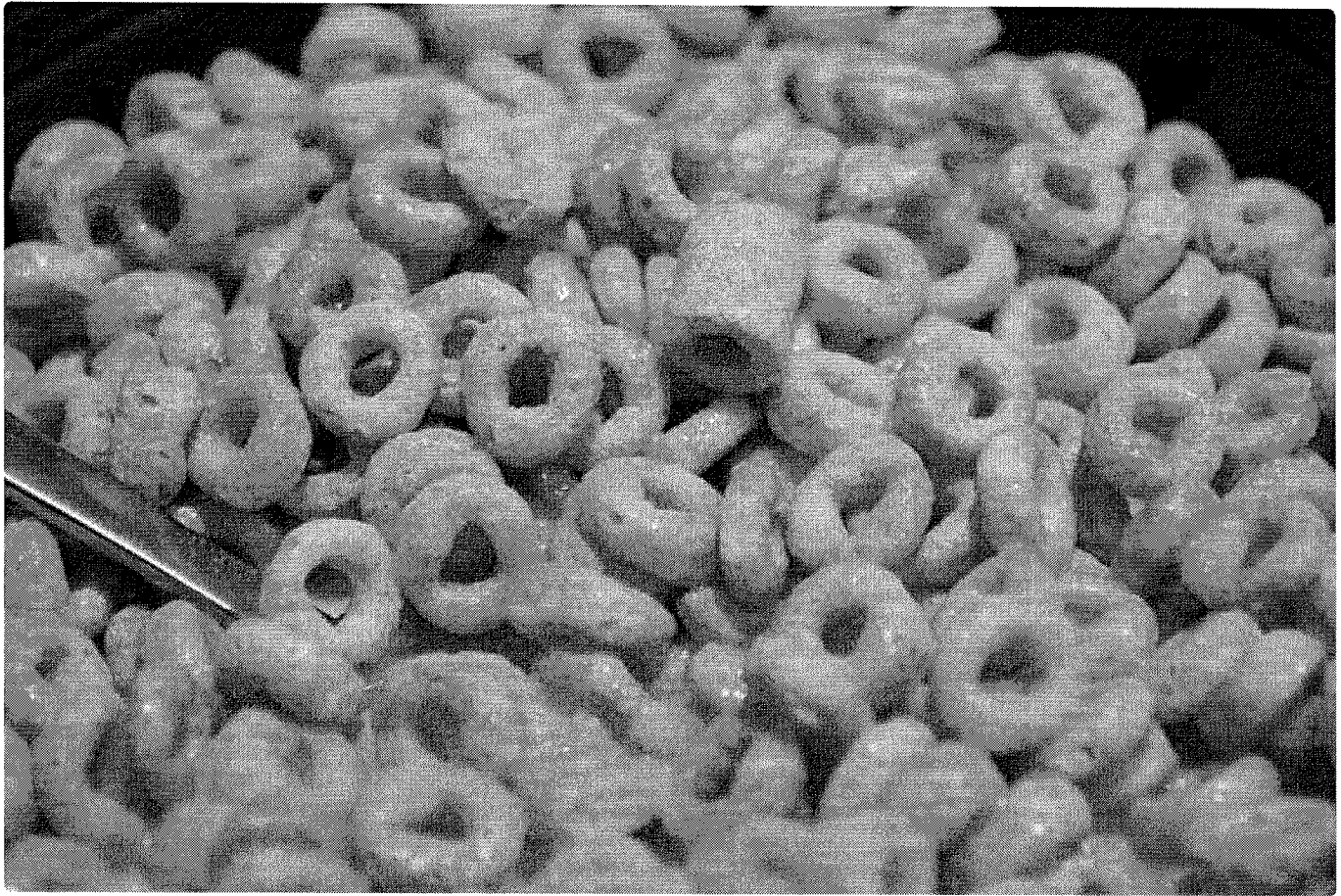
Advantages and Disadvantages

Licensing and franchising both offer advantages for the involved parties: The licensee and franchisee both gain a competitive advantage in the market. The licensee/franchisee gets immediate brand recognition and may quickly overtake the competition by offering a product or service for which there is existing unmet demand. For example, a local sandwich shop may have a hard time competing when a Subway franchise opens because the brand is so well known. Also, because franchises are usually "turnkey" operations in which processes, supply chains, training, and products are already in place, the new business can quickly begin efficient and profitable operations. For the franchisor, this arrangement enables them to gain

inexpensive access to a new market, since the initial cost of the franchise is borne by the franchisee. Under a licensing agreement, all of the costs of production, sales, and distribution are the responsibility of the licensee. If financial capital is scarce, both approaches allow companies to have a global presence without heavy investments.

These methods do contain some risks and disadvantages, however. They are typically the least profitable way of entering a foreign market, since the profits go to the franchisee or licensee. Although the licensor or franchisor receives up-front money and/or a small percentage of future sales, the majority of the revenue remains in the destination country with the licensee or franchisee. Franchising entails a long-term commitment on the part of the franchisor to provide ongoing support in the form of training, logistics, product development, and brand marketing.

Once a business begins to establish a global franchise presence, the pressure to maintain brand integrity and fiscal responsibility becomes more intense as the failure of the franchise now has global consequences. For companies selling licensing rights, there is a risk that their intellectual property may be misrepresented or used in a manner that could tarnish the brand's image. Also, once a license to use an image or other intellectual property has been granted to a company in another country, the probability that knock-off products will enter the market goes up. For both franchisors and licensors, maintaining quality standards on a global scale is a massive undertaking, and for this reason many companies are choosing to exert a higher degree of control over their products, brands, and intellectual property than they have in the past.



Honey Nut Cheerios

Joint Ventures/Strategic Alliances

There are times when businesses have opportunities within the global market that are better undertaken with a partner. Sometimes these projects are extremely large and capital-intensive or are so comprehensive that it makes sense to include multiple businesses or even governments. These large-scale, global projects usually take one of two forms: strategic alliances or joint ventures.

A **joint venture** establishes a new business that is jointly owned by two or more otherwise independent businesses. The most common joint ventures involve two companies that are equal partners in the new firm, investing money and resources while sharing control of the newly formed firm. Often, the foreign partner provides expertise on the new market, business connections and networks, and access to other in-country aspects of business such as real estate and regulatory compliance. For example, in 2015 Fiat Chrysler entered into a joint venture with Tata Motors of India to expand the production of Jeeps in India. The company created in this joint venture is Fiat India Automobiles Private Limited.

Joint ventures require a greater commitment from firms than other global strategies, because they are riskier and less flexible. Joint ventures may afford tax advantages in many countries, particularly where foreign-owned businesses are taxed at higher rates than locally owned businesses. Some countries require all business ventures to be at least partially owned by domestic business partners.

A less permanent, but equally effective way to enter the global market is through a strategic alliance. A **strategic alliance** is formed between two or more corporations, each based in their home country, for a specified period of time. Unlike a joint venture, a new company is not formed. Generally, strategic alliances are pursued when businesses find that they have gained all they can from exporting and want to expand into a new geographic market or a related business. This approach can be particularly useful when a government prohibits imports in order to protect domestic industry. The cost of a strategic alliance is usually shared equitably among the corporations involved, and it's generally the least expensive way for all concerned to form a partnership. An example of this is the alliance between General Mills and Nestlé: Honey Nut Cheerios are manufactured in bulk by General Mills in the United States and then shipped to Nestlé Europe, where they are packaged and shipped to France, Spain, and Portugal.

Advantages and Disadvantages

The greatest advantage of joint ventures and strategic alliances is the knowledge and experience of the market offered by the local partner—on everything from consumer preferences to cultural differences, language, and political/economic systems. Another advantage is that the risk of entering the market with a new product is shared by more than one firm, thereby reducing each company's exposure to potential losses.

However, these types of partnerships also have their drawbacks. When companies share their technology and industry know-how, they run the risk that the partner firm will take that technology or innovation and use it to become a competitor in the future. This was a primary concern when Boeing collaborated with Mitsubishi (it was ultimately resolved in the legal details of the partnership agreement, which both companies signed). Conflicts over control of these partnerships can also arise if the owners of the partner firms do not agree on key business decisions.



BMW US Manufacturing Company, South Carolina

Foreign Direct Investment (FDI)

Of all of the ways that a business can reach the global market, the most intensive approach is through foreign direct investment or FDI. **Foreign direct investment** is an investment in the form of a controlling ownership in a business enterprise in one country by an entity based in another country. FDI can take one of two forms: Greenfield ventures or mergers/acquisitions. In a Greenfield venture, the company enters a foreign market and establishes a new subsidiary as a start-up business. A good example of this is the BMW US Manufacturing Company, a vehicle-assembly facility located in Greer, South Carolina, that is part of the BMW Group. Although it's BMW's only assembly plant in the United States, it represents a direct investment inside the United States by the German manufacturer, and it's one of the most successful Greenfield ventures in the U.S.

Businesses that are not ready to take on the challenge of establishing a new facility or subsidiary in a foreign country will usually choose either a merger or acquisition as a means of expanding their global reach. Mergers and acquisitions represent the vast majority of FDI and range from 50 percent to 80 percent of all FDI in some industries. According to Forbes (Rapoza, 2013),

US companies completed 116 emerging market acquisitions in the first half of 2013, up from 110 in the second half of 2012. . . . The most popular geographic targets for US companies in the first half of 2013 were Brazil (25 deals), India (18 deals), South American countries excluding Brazil (15), South and East Asia (15), and Central America and Caribbean (14).

Mergers and acquisitions aren't just carried out by US companies—it's an incredibly pervasive global business strategy, and ownership of many well-known products and brands has long been separated from the country of origin. For example, the Chinese just bought Smithfield Foods, Stolichnaya ("Stoli") Russian vodka is actually owned by a company in the United Kingdom, Anheuser-Busch is owned by Belgian-Brazilian conglomerate InBev, and 7-Eleven is owned by a Japanese company (Frohlich & Sauter, n.d.).

Advantages and Disadvantages

Because the level of commitment and investment associated with FDI is so high, companies expend a great deal of time and effort scrutinizing potential opportunities. With Greenfield ventures, the amount of time it takes to build a presence in the foreign country is substantial. If a business is not already established in other global locations and lacks experience with FDI, it may be in for a series of unpleasant surprises in the form of regulations, licensing, taxes, and other "red tape"—much of which we will look at later in this chapter.

On the other hand, mergers and acquisitions are faster to execute than Greenfield ventures, and by merging with or acquiring an existing foreign company already in the market, outside companies can quickly take advantage of that presence. Another benefit is that a merger or acquisition involves the purchase of assets such as property, plants, and equipment that are already producing a product with a known revenue stream. The key to a successful merger or acquisition is paying the right price for the company, because, no matter how successful the business was before it was acquired (or merged), overpaying can turn a formerly profitable operation into a money pit.

Check Your Knowledge

Answer the following questions to see how well you understand the topics covered in this section. This short quiz does not count toward your grade in the class, and you can retake it as many times as you wish.

Use this quiz to decide whether to study the section further or move on.

Choose the **BEST** answer.

Question 1

License agreements usually cover property that is _____, such as trademarks, images, patents, or production techniques.

- ☐ intangible
- ☐ published
- ☐ tangible

Question 2

A _____ establishes a new business that is jointly owned by two or more otherwise independent businesses.

- ☐ strategic alliance
- ☐ franchise agreement
- ☐ joint venture

Question 3

Exports are an important source of what for many countries?

- ☐ corporate connections
- ☐ marketing ventures
- ☐ revenue

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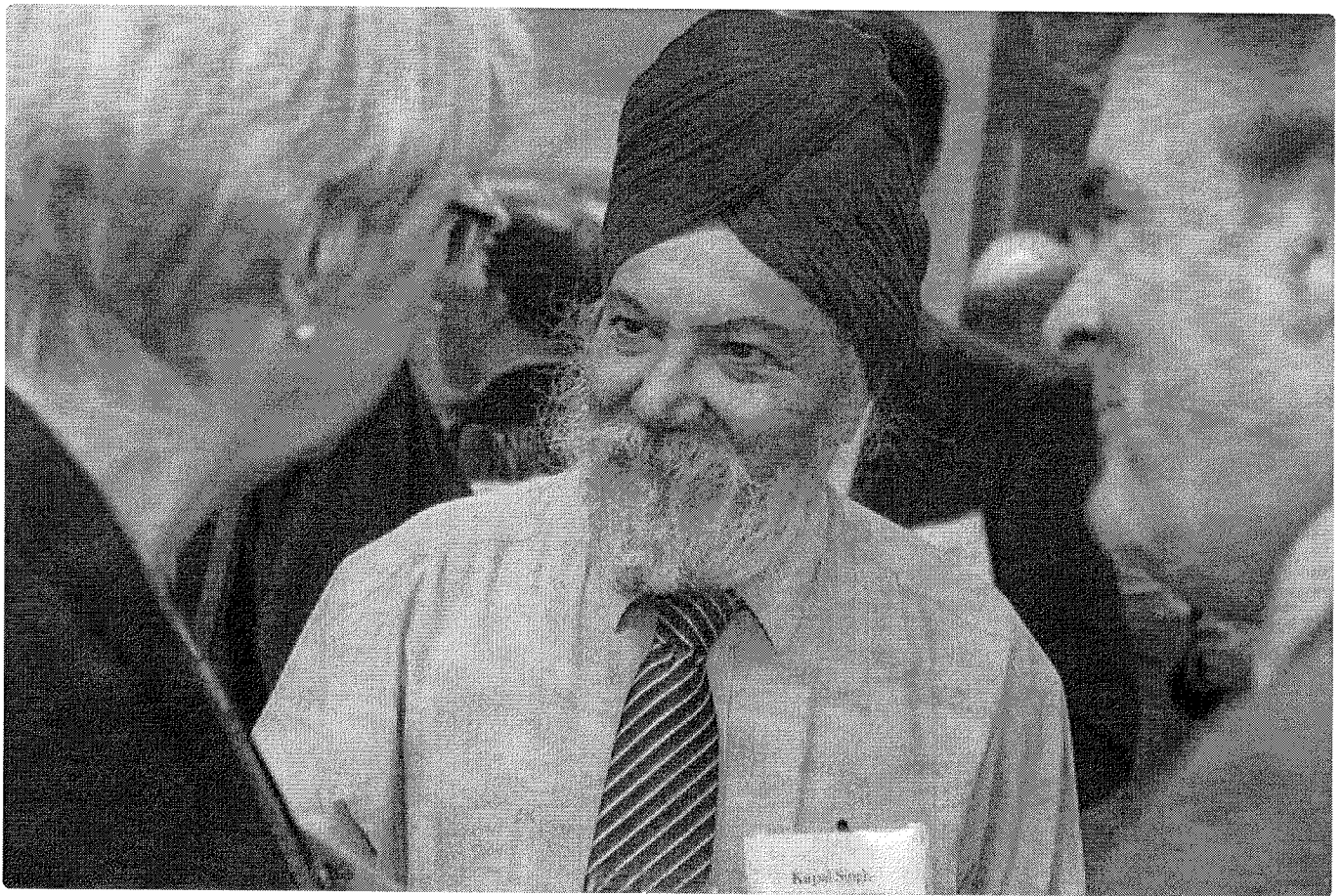
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Learning Resource

Global Trade Forces

What you'll learn to do: Identify and describe forces that affect global trade

In this section you'll learn about the range of forces that affect global trade. These forces include everything from culture and politics to the natural environment.



Learning Outcomes

- Explain the impact of sociocultural, political, and economic differences on global trade
- Describe the legal differences that impact businesses globally
- Summarize how physical and environmental factors affect global trade
- Discuss how countries use tariff and nontariff trade restrictions to protect local industries

Sociocultural Differences

Culture

Culture refers to the influence of religious, family, educational, and social systems on people, how they live their lives, and the choices they make. Business always exists in an environment shaped by culture. Organizations that intend to sell products and services in different countries must be sensitive to the cultural factors at work in their target markets. Even cultural differences between different countries—or between different regions in the same country—can seem small, but businesses that ignore them risk failure in their ventures.

Culture is complex, and fully appreciating its influence takes significant time, effort, and expertise. Certain features of a culture can create an illusion of similarity, but businesses need to delve deeply to make sure they truly understand the people and environments in which they work. Even a common language does not guarantee similarity of interpretation. For example, in the United States we purchase “cans” of various grocery products, but the British purchase “tins.” In India, where English is one of a number of officially recognized languages, “matrimonial” is used as a noun in casual conversation, referring to personal ads in newspapers seeking marriage partners.

Several dimensions of culture that require particular attention from global businesses are listed below.

Language

The importance of language differences can't be overemphasized, and there are nearly 3,000 languages in the world. Language differences can be a challenge for businesses designing international marketing campaigns, product labels, brand and product names, taglines, and so on. Finding a single brand name that works universally in terms of pronunciation, meaning, and

“ownability” is a monumental challenge. Of course, correct and grammatical use of language in business communication is essential for a product, brand, or company to be viewed as credible, trustworthy, and of high quality.

The language issue becomes more complicated when a country has more than one officially recognized language. To illustrate, in Canada, national law requires that labels include both English and French. In India and China, more than 200 different dialects are spoken. India has more than 20 officially recognized languages. Mainland China’s official spoken language is Standard Chinese, and several autonomous regions have designated other additional official languages. Meanwhile in Hong Kong and Macau, Cantonese Chinese, English, and Portuguese are the official languages. Clearly language can quickly become a very challenging issue for businesses.

Finally, businesses should be attuned to what they communicate when they choose which languages to use—or not to use. In Eastern Europe, for example, the long history of Soviet occupation during the Cold War has left many inhabitants with a negative perception of the Russian language. Products that carry Russian labeling may suffer accordingly.

Customs and Taboos

All cultures have their own unique sets of customs and taboos. It’s important for businesses to learn about these customs and taboos so they’ll know what is acceptable and unacceptable for their foreign operations. For example, in Japan, the number four is considered unlucky, and products packages containing four items are avoided by many consumers. In Middle Eastern countries where Islamic law is strictly observed, images displaying uncovered arms or legs of the female body are considered offensive. Meanwhile in Egypt, where many women wear the headscarf or hijab in public, an increasing number of younger women are in work and educational settings where gender segregation does not exist. Businesses struggle with whether to portray women with or without the hijab, knowing that they risk offending some of their target audience with either choice. Businesses should seek guidance from native experts familiar with local culture and customers.

Values

The role of values in society is to dictate what is acceptable or unacceptable. Values are part of the societal fabric of a culture, and they can also be expressed individually, arising from the influence of family, education, moral, and religious beliefs. Values are also learned through experiences. As a result, values can influence consumer perceptions and purchasing behavior. For example, consumers in some countries, such as the United States, tend to be individualistic and make many purchasing decisions based on their own personal preferences.

In other countries, such as Japan, the well-being of the group is more highly valued, and buying decisions are more influenced by the well-being of the group, such as the family. Based on these differences in values, it is not surprising that ads featuring individuals tend to do better in countries where individualism is an important value, and ads featuring groups do better in countries where the group's well-being is a higher value.

Time and Punctuality

Different cultures have different sensitivities around time and punctuality. In some countries, being slightly late to a meeting is acceptable, whereas in other countries it's very insulting. For cultures that highly value punctuality, being on time is a sign of good planning, organization, and respect. In cultures where precise punctuality is less important, there is often a greater emphasis on relationships. The fact that a meeting happens is more important than when it happens.

While there are cultural stereotypes about time management (such as the laid-back "island time" many residents of island nations refer to), the best rule of thumb in business is to be punctual and meet deadlines as promised. You will not insult people by following this rule. Also, it's wise not to apply popular stereotypes to individual people for whom the cultural stereotype may or may not be true. You should let a person's behavior speak for itself, and always treat others with the same level of courtesy you would expect from them.

Business Norms

Business norms vary from one country to the next and may present challenges to foreigners not used to operating according to the particular norms of the host country. In business meetings in Japan, for example, it's expected that the most senior person representing an organization will lead the discussion, and more junior-level colleagues may not speak at all. The role of alcohol in business meetings varies widely by culture: In Middle Eastern cultures where alcohol is forbidden, it may be insulting to serve or even offer an alcoholic beverage. In China, many rounds of toasts are customary as part of formal dinner meetings.

Likewise, business norms around greetings and physical contact also vary. American-style handshakes have become accepted as a business norm in many cultures, but this custom is not universal. In Japan and some other Asian cultures, a respectful bow is the traditional business greeting, although the handshake is becoming more common. In Islamic cultures, contact between men and women is a sensitive issue, even in business settings. In those regions and cultures, it's best to shake hands with a woman only if she extends her hand first. Similarly, Western women may avoid causing embarrassment by shaking hands only if a hand is

extended to her. In India, the namaste (a slight bow with hands brought together on the chest) remains a respectful, if traditional, business greeting particularly when interacting with women and older people.

Always seek guidance from a trusted colleague or friend who has experience in the local customs and can offer coaching on proper etiquette.

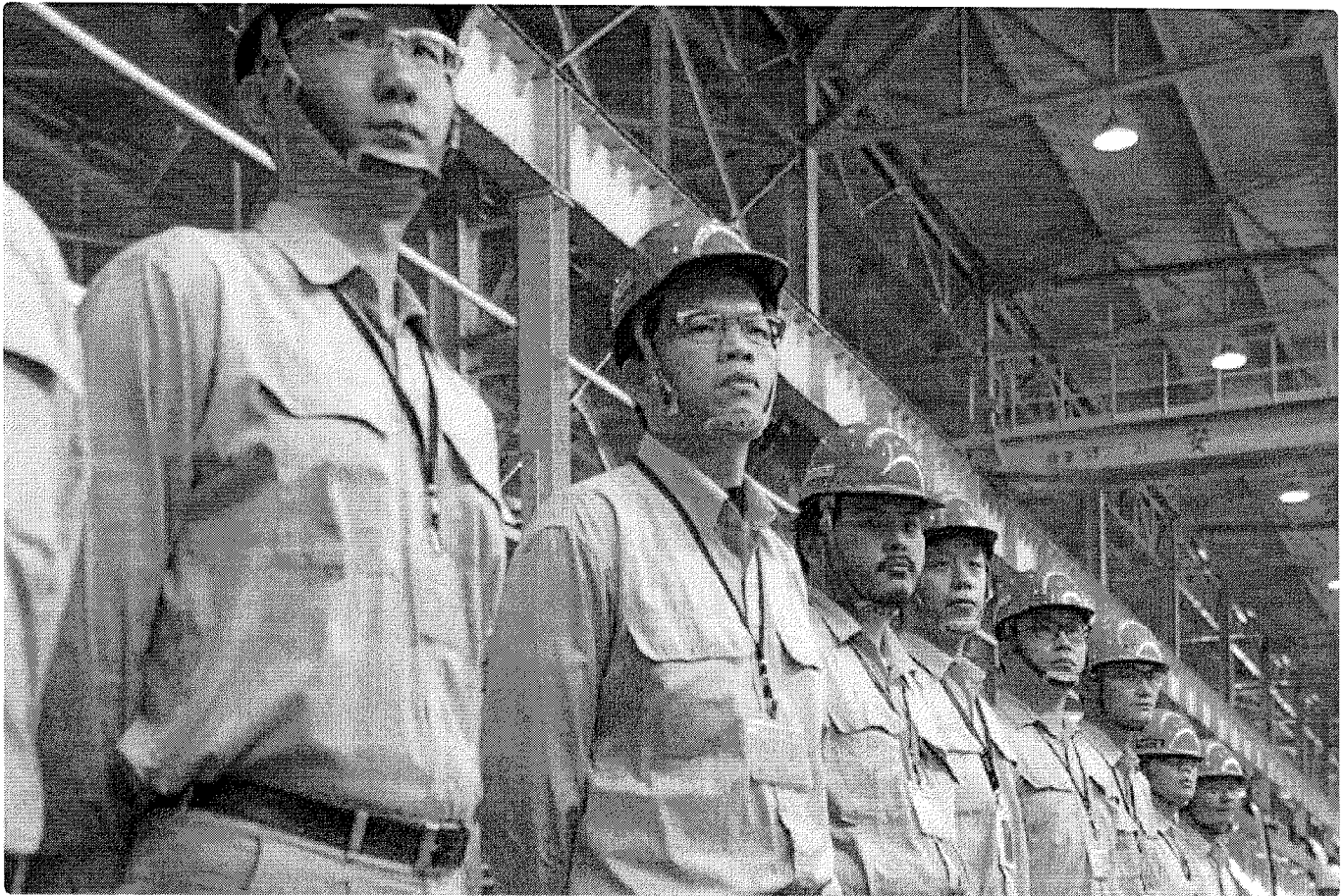
Religious Beliefs and Celebrations

As discussed earlier in this chapter, religious beliefs and practice can strongly influence what consumers buy (or don't buy), when and where they shop, and how they conduct business. It's important for companies to understand the influence of religion on consumer culture in the markets where they operate, so that their business activities can be appropriately sensitive. Failing to respect religious beliefs or cultures can seriously undermine the reputation of a company or brand. At the same time, businesses that are attuned to the impact of religion on culture can more easily integrate their operations and employees into the local culture.

For example, all the major world religions observe holidays that include feasting and gift giving. These festival seasons tend to be prime shopping seasons as well. Holidays originating from the prominent religion of a country or region create sensitivities about certain products: In the Hindu religion, cows are considered sacred and people refrain from eating beef. Some Jewish and Muslim people consume only kosher or halal meats, respectively. Adherents of many faiths, including Sikhs, Muslims, Mormons, Buddhists, and some Baptists eschew alcohol.

Religious beliefs may cause sensitivities around revealing images or sexually suggestive material. Religious beliefs associated with the symbolism of different colors may create either preferences for or rejection of certain products. The link between religious practice and gender roles may affect which members of the family influence which types of buying decisions. It is important, however, for businesses not to oversimplify how decision-making happens in these settings. Even if a woman, for example, is not the primary buyer, she may exercise strong influence over many consumer decisions. Here, as in other areas of cultural impact, it is crucial for businesses to educate themselves about the people and cultures they are targeting for business in order to use cultural knowledge to their advantage.

Political and Economic Differences

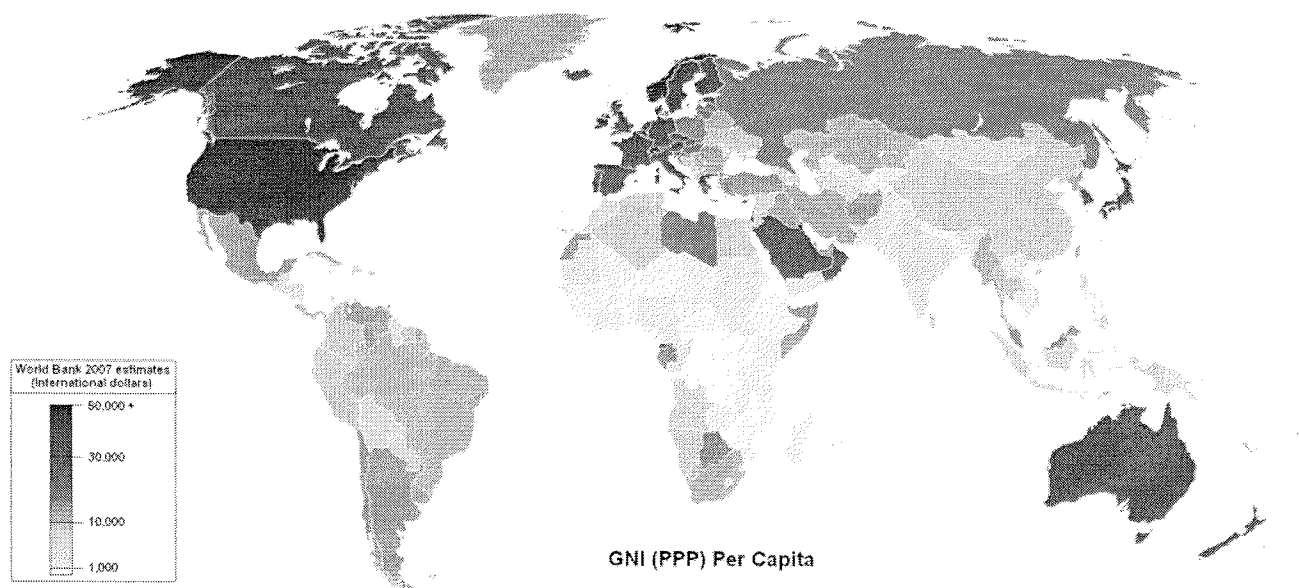


The **political economy** of a country refers to its political and economic systems together. The political system includes the set of formal and informal legal institutions and structures that comprise the government or state and its sovereignty over a territory or people. As you know, political systems can differ in the way they view the role of government and the rights of citizens (compare, for example, the democratic political system of Canada with the communist system of North Korea). As you'll recall, the **economic system** refers to the way in which a country organizes its economy: Most are command, market, or mixed economies.

The nature of a country's political economy plays a big role in whether it is attractive to foreign business and entrepreneurship. Historically, there has been a direct relationship between the degree of economic freedom in a country and its economic growth—the more freedom, the more growth, and vice versa. For decades, the Chinese government maintained an ironclad grip on all business enterprise, which effectively prevented foreign businesses from fully engaging with the Chinese market. That climate has tempered, however, and now the political economy of China is much more open to foreign investment, though it is still not as open as Europe or the United States.

Businesses seeking global opportunities must consider other economic factors beyond a country's political economy. For one thing, they will want to target the markets and countries where people have the highest incomes and the most disposable income. The world map

below shows just how much variation there is in the gross national income (GNI) per person among the nations of the world.



World Map of Gross National Income (PPP) Per Capita

However, often those markets are not where new opportunity exists, so businesses have to pursue what economists refer to as emerging markets. The four largest emerging and developing economies are the BRIC countries (Brazil, Russia, India, and China). One means of measuring a country's level of economic development is by its purchasing power parity (PPP), which enables economists to compare countries with very different standards of living. The PPP for a given country is determined by adjusting up or down as compared to the cost of living in the United States.

However, there is often more to a country's economic story than its PPP or GNI. Consider India: As an emerging market, India is attracting significant attention from businesses all around the globe. It has the second-fastest-growing automotive industry in the world. According to a 2011 report, India's GDP at purchasing power parity could overtake that of the United States by 2045. During the next four decades, Indian GDP is expected to grow at an annualized average of 8 percent, making it potentially the world's fastest-growing major economy until 2050. The report highlights key growth factors: a young and rapidly growing working-age population; growth in the manufacturing sector because of rising education and engineering skill levels; and sustained growth of the consumer market driven by a rapidly growing middle class.

At the same time, surveys continue to emphasize the chasm between two contrasting pictures of India—on one side, an urban India, which boasts of large-scale space and nuclear programs, billionaires, and information technology expertise; and a rural India on the other, in which 92

million households (51 percent) earn their living by manual labor. In 2014, a report by the Indian Government Planning Commission estimated that 363 million Indians, or 29.5 percent of the total population, were living below the poverty line.

Another aspect of a country's political economy is the stability of its current government. Business activity tends to grow and thrive when a country is politically stable. When a country is politically unstable, multinational firms can still conduct business profitably, but there are higher risks and often higher costs associated with business operations. Political instability makes a country less attractive from a business investment perspective, so foreign and domestic companies doing business there must often pay higher insurance rates, higher interest rates on business loans, and higher costs to protect the security of their employees and operations. Alternatively, in countries with stable political environments, the market and consumer behavior are more predictable, and organizations can rely on governments to enforce the rule of law.

As you can see, the desirability of a country as a potential market or investment site depends on a host of complex, interrelated factors. To further complicate matters, once a business arrives in a foreign market, it must also contend with the uncertainty of exchange rates. An **exchange rate** is the value of one country's currency relative to the value of another country's currency. For example, an exchange rate of 119 Japanese yen (JPY, ¥) to the US dollar means that ¥119 will be exchanged for each \$1, or \$1 will be exchanged for ¥119.

Each country, using various mechanisms, manages the value of its currency. A market-based exchange rate will change whenever the value of either of the two component currencies changes. A currency will tend to become more valuable whenever demand for it is greater than the available supply. It will become less valuable whenever demand is less than the available supply. (This does not mean that people no longer want money, only that they prefer to hang on to their wealth in some other form, possibly another currency.)

The video below will provide a complete picture of exchange rates and how they impact trade:

<https://youtu.be/geoe-6NBy10> (<https://youtu.be/geoe-6NBy10>)

Clearly, exchange rates are an important consideration for companies wanting to take their business global, since they will likely have to buy and sell even the most mundane commodities once they arrive in the foreign market. Local labor wants to be paid in its nation's currency, and if the exchange rate of that currency changes in a way that makes it more valuable, the business's costs rise unexpectedly. Although businesses try to anticipate and plan for fluctuations in exchange rates, currency values are determined by supply and demand, and businesses are at the mercy of market forces beyond their control.

Legal Differences



Governments around the world maintain laws that regulate business practices. In some countries, these laws are more heavy-handed, and in others, the business climate is less regulated and structured. Some laws and regulations, such as ones governing property rights and contracts, are designed to create a stable environment for business (both domestic and international)—through the establishment and enforcement of property rights and contracts, for example. Others are designed to protect consumers and the environment, requiring businesses to adhere to responsible, safe, and ethical practices. Still other laws and regulations privilege domestic businesses and protect or partially shield them from foreign competition. There are even laws and regulations that affect what marketers are allowed to include in marketing communications, although these are more strict in some countries than in others. And of course, some laws and regulations deal with taxation and other costs of conducting business.

Businesses must understand and conform to the legal and regulatory environments of the countries and regions in which they operate. The following is a short list of common regulatory areas that affect businesses globally:

- **contract law** governing agreements about the supply and delivery of goods and services
- **trademark** registration and enforcement for brand names, logos, taglines, and so forth
- **labeling** requirements for consumer safety, protection, and transparency
- **patents** to enforce intellectual property rights and business rights associated with unique inventions and “ownable” business ideas
- **decency, censorship, and freedom-of-expression** laws to which marketing communications are subject
- **price floors, ceilings, and other regulations** regarding the prices organizations can charge for certain types of goods and services
- **product safety**, testing, and quality-control
- **environmental protection** and conservation regulations, and permits governing acceptable and responsible business practices
- **privacy**, including laws governing data collection, storage, use, and permissions associated with consumers and their digital identities
- **financial reporting** and disclosure to ensure that organizations provide transparency around sound business and financial practices

In some cases, international laws and regulations designed to simplify these issues among regional allies and economic partners may also apply.

Physical and Environmental Differences

Physical and environmental factors can have a significant impact on a company's ability to do business in a foreign country. Some developing countries lack the infrastructure such as roads, railways, and port systems needed to transport goods, or they may not have adequate storage facilities. You can imagine that this would be a major barrier for businesses trying to sell fresh food or perishable goods. Add to that the limited access to electricity, clean water, and sanitation in many parts of the world, and you begin to understand some of the practical and logistical challenges of doing business globally.

A country's natural environment and the surrounding regulations aimed at protecting it may pose additional challenges. Many governments require foreign companies to undergo a complex permitting process if any of their planned activities will adversely affect the environment. Even in developing countries, minimum standards for air emissions, waste disposal, and hazardous-material handling are becoming the norm, and in places where such regulations are weak or lacking, companies often face considerable pressure from local

residents and consumer groups to clean up their act or leave. While all of these challenges can make companies think twice about setting up shop in a foreign country, the growing trend of corporate social responsibility shows that more companies are devising creative, collaborative solutions to doing global business more sustainably.

Tariff and Nontariff Trade Restrictions

Although many people find it hard to imagine, not every nation welcomes the expansion of businesses into their country. When a nation seeks to restrict the flow of incoming foreign goods and services, economists refer to this as *trade protectionism*. **Protectionism** is the economic policy of restraining trade between countries through methods such as tariffs on imported goods, restrictive quotas, and a variety of other government regulations designed to foster fair competition between imports and domestically produced goods and services.

According to proponents, protectionist policies protect the businesses and workers within a country by restricting or regulating trade with foreign nations. The doctrine of protectionism contrasts with the doctrine of free trade, according to which governments reduce the barriers to trade as much as possible. There is a broad consensus among economists that the impact of protectionism on economic growth and prosperity is largely negative.

Let's take a closer look at several of the most common tools used by nations hoping to protect local industry through trade restrictions.

Import Tariffs

Import tariffs are simply a type of tax that is levied on goods and services coming into a country. They increase the price of imported goods and services because the businesses pass the cost of the tariff on to consumers. Tariffs benefit local producers of goods and services while generating revenue for the government. They are one of the oldest forms of trade protectionism, one of the easiest to implement, and the most common subject in trade-agreement negotiations.

Nontariff Restrictions

Import quotas are another means of restricting the flow of foreign goods into a local economy. An **import quota** is exactly what its name implies: a limit on the amount or quantity of a particular good or service that can be imported into a country. Although not as common today as they have been historically, import quotas seek to protect local businesses from a flood of cheap foreign imports. Many countries have passed "antidumping" laws aimed at foreign

imports that they believe are priced below fair market value. **Dumping** is when a company exports a product at a price lower than the price it normally charges in its own home market. The economic impact of an import quota is similar to that of a tariff, except that the tax revenue generated by a tariff is instead paid to those who possess import licenses.

When a country is reluctant to impose quotas and tariffs, another way it can protect domestic markets is with local content requirements. **Local content requirements** are set by the government and require foreign businesses to use a certain quantity of local labor, resources, and/or suppliers in their operations. This kind of trade restriction has been a point of contention in recent trade negotiations between the United States and India. India's government has been aggressive about using local content requirements to its "Made in India" program, which it hopes will establish India as an international manufacturing hub. The United States and other countries argue that India's policies are detrimental to foreign competition. The situation is currently under review by the World Trade Organization, and given the size of the Indian economy, the rest of the world is watching.

The most extreme form of trade restriction is the embargo. An **embargo** is an official ban on trade or other commercial activity with a particular country. The reasons for a country to place an embargo on another country range from human rights violations to ideological differences to national security interests. Embargoes are considered strong diplomatic measures imposed in an effort, by the imposing country, to elicit a given national-interest result from the country on which it is imposed. Although trade and commercial activities are barred under an embargo, medical and humanitarian supplies are usually exempt. The most enduring of all trade embargoes is the United States' embargo against Cuba, which, after 55 years, appears to be coming to an end.

As you can see, global trade restrictions can be as narrow as a tariff on a particular imported good or as broad as an embargo, which stops the flow of goods and services between countries altogether. Since these types of restrictions are imposed by governments, businesses have no choice but to follow their rules—even when it means walking away from a lucrative opportunity.

The following video discusses the effects of different kinds of trade restrictions.

https://youtu.be/_e2gQxN1OBg (https://youtu.be/_e2gQxN1OBg)

Check Your Knowledge

Answer the following questions to see how well you understand the topics covered in this section. This short quiz does not count toward your grade in the class, and you can retake it as many times as you wish.

Use this quiz to decide whether to study the section further or move on.

Choose the **BEST** answer.

Question 1

Governments maintain laws that regulate business practices in order to

- ☐ turn the tables on global trade
- ☐ make money from foreign investment
- ☐ create a stable environment for business

Question 2

Infrastructure needed to transport goods in a foreign country include

- ☐ standards for air emissions, waste-disposal and hazardous-material handling
- ☐ tractor trailers
- ☐ roads, railways, and port systems

Question 3

Trade tariffs and quotas are designed to protect

- ☐ international trade
- ☐ domestic producers
- ☐ foreign aid

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Learning Resource

Global Trade Agreements and Organizations

What you'll learn to do: Describe global trade agreements and economic organizations that regulate and promote global trade

In this section, you'll learn about the organizations that oversee global economic cooperation and help facilitate global trade agreements.



2016 World Trade Organization Public Forum

Learning Outcomes

- Describe the role of the World Trade Organization in improving global trade
- Summarize how the World Bank promotes global economic development
- Explain the functions of the International Monetary Fund
- Define trade agreements and their effect on global business

The World Trade Organization

In the post–World War II environment, countries came to realize that a major component of achieving any degree of global peace was global cooperation—politically, economically, and socially. The intent was to level the trade playing field and reduce economic areas of disagreement, since inequality in these areas could lead to more serious conflicts. Nations agreed to work together to promote free trade and, with the help of key international organizations like the World Trade Organization (WTO), they entered into bilateral and multilateral agreements.

GATT: How the World Trade Organization Got Its Start

Before you begin your reading on the WTO, take a few minutes to watch the following video that will give you some background on General Agreement on Tariffs and Trade (GATT) and explain how it grew into the WTO we know today. Remember, the world is much smaller today than when your parents and grandparents were growing up, and international trade hasn't always been the norm. After watching the video, consider how impossible world trade would be without some type of agreement among nations.

Enjoy!

<https://youtu.be/27J3CByXKow> (<https://youtu.be/27J3CByXKow>)

As you saw in the video, what began with one agreement (GATT) eventually evolved into the WTO. In fact, GATT was the only multilateral instrument governing global trade from 1946 until 1995. Given the difficulty of trying to regulate trade among more than 100 nations according to a single document, it's easy to see why the WTO came into existence. It became clear to the participating nations that GATT was incapable of adapting to an increasingly globalized world economy. Moreover, when the Uruguay Round of GATT negotiations was launched in September 1986, it marked the largest global effort to structure trade in history. Today, GATT still exists as the WTO's umbrella treaty for trade in goods, but it's no longer the only legally binding global-trade agreement.

What does the WTO actually do? Among its various functions, the most important are the following:

- oversees the implementation and administration of the agreements between nations that fall under the WTO's scope of authority
- provides a forum for negotiations and settling disputes among nations

In recent years, the WTO has also made it a priority to assist developing nations as they come under WTO regulation. Many developing countries and emerging markets lack the experience and technical expertise needed to deal with large and very comprehensive trade agreements. The WTO provides them with critical training and support, thereby ensuring that the WTO is inclusive and equitable toward both the wealthiest and the poorest nations in the world.

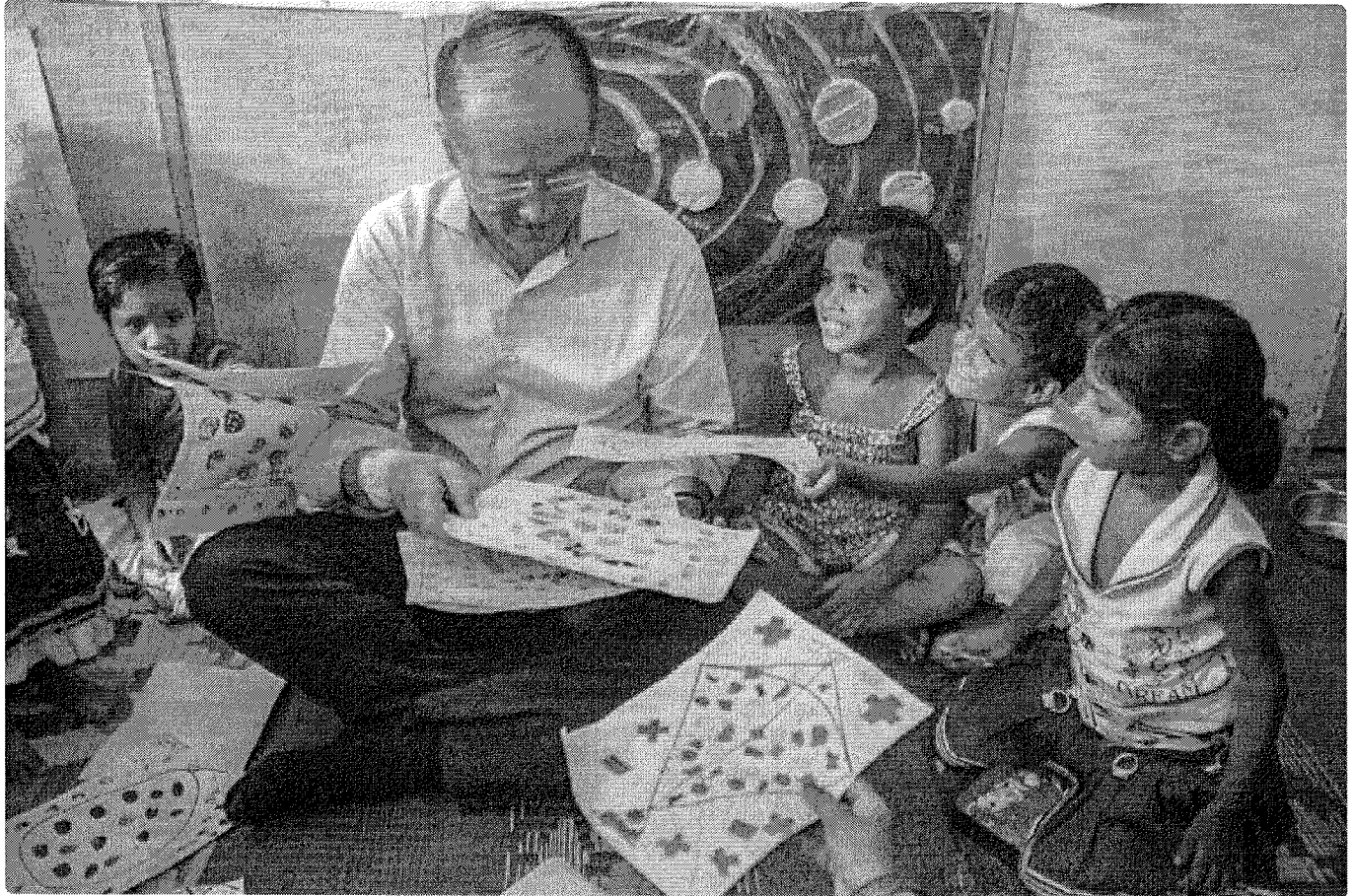
Part of the nondiscrimination mandate of the WTO is most-favored-nation (MFN) status. MFN status requires that a WTO member must apply the same terms and conditions to trade with any and all other WTO members. In other words, if a country grants another country (even a non-WTO member) a special favor, then every other WTO member must get the same treatment. You probably experienced a version of MFN status as a child, when an adult told you that if you were going to take gum or candy to class, you had to bring enough for everyone. In other words, you couldn't just give gum or candy to your best friends, and if you didn't have enough for everyone in the class, then nobody got any. That, in effect, is how MFN status works.

One of the other key elements to the success of the WTO is its transparency requirement. WTO members are required to publish their trade regulations and follow a system that allows external parties to review and evaluate any administrative decisions and their impact on trade regulations. When a WTO nation changes its trade policies, those changes must be reported to the WTO.

Overall, the WTO's mission is to improve the stability and predictability of global trade. As a result, it tends to support free-trade, as opposed to protectionist, policies and strongly discourages the use of quotas and other such restrictions on imports.

Whether or not the WTO is doing its duty and accomplishing its mission is a matter of ongoing debate. Nonetheless, the WTO currently has 104 members and 20 observer governments. WTO member states account for almost 97 percent of global trade and 98 percent of global GDP. Once the 20 observer governments become members, it is possible that the WTO will oversee the entire world economy. What began in 1947 in Geneva, with 23 nations focused solely on tariff reduction, has grown into a truly global organization that deals with agriculture, labor standards, environmental issues, competition, and intellectual property rights.

The World Bank



World Bank Group President Visiting India

World Bank Group president Jim Yong Kim visits an integrated child development services and skills center in Delhi, India.

Created in 1944 at the Bretton Woods Conference in New Hampshire, the **World Bank** is an international financial institution that provides loans for capital programs to developing countries. It comprises two institutions: the International Bank for Reconstruction and Development (IBRD), and the International Development Association (IDA). Originally, the IBRD was tasked with supporting post-war reconstruction, but it has evolved to include the present-day mandate to alleviate poverty worldwide. The World Bank is a component of the World Bank Group, which is part of the United Nations system. The World Bank is comprised of 189 member countries represented by a board of governors. Although headquartered in Washington, DC, the World Bank has a presence in almost every nation in the world.

The World Bank has set two goals to achieve by 2030:

1. End extreme poverty by decreasing the percentage of the world's population that lives on less than \$1.90 per day to no more than 3 percent.

2. Promote shared prosperity by fostering the income growth of the bottom 40 percent in every country.

The World Bank's primary function is providing low-interest loans and grants to developing countries. It tends to fund projects focused on education, infrastructure, natural-resource management, and public health. In many instances, the World Bank provides technical assistance as well as research and policy advice to developing nations. One of the projects currently underway is the Education Sector Support Project for the Republic of the Congo. The primary objective of this project is to improve education outcomes for primary- and secondary-school children by providing quality education in an appropriate teaching and learning environment. Other World Bank projects are aimed at improving basic infrastructure, such as building and maintaining safe water supplies and sanitary sewer systems in Africa and parts of Asia. For developing nations, many of these improvements would be impossible without the World Bank's help. Although the World Bank has come under fire in the past for budget overruns and poor project oversight, its role in promoting economic development has been undeniable.

The following video shows how a World Bank project works:

https://youtu.be/_cLgcYCQUPI (https://youtu.be/_cLgcYCQUPI)

The International Monetary Fund



The **International Monetary Fund (IMF)** is an international organization headquartered in Washington, DC, comprised of 189 member countries. The IMF works to foster global growth and economic stability by providing policy, advice, and financing to its members. It also works with developing nations to help them reduce poverty and achieve macroeconomic stability. Formed in 1944 at the Bretton Woods Conference in New Hampshire, it came into formal existence in 1945 with 29 member countries and the goal of reconstructing the international payment system. It now plays a central role in the management of balance-of-payments difficulties and international financial crises.

IMF member countries contribute funds to a pool from which they can borrow if they are experiencing balance-of-payments problems. The rationale for this arrangement is that private international capital markets function imperfectly, and many countries have limited access to financial markets. Without access to IMF financing, many countries can only correct large external payment imbalances through drastic measures that can have adverse effects on their own economies and the world's. The IMF provides alternate sources of financing to countries in need that would not otherwise be available to them.

When the IMF was founded, its primary functions were to provide short-term capital to aid the balance of payments and to oversee fixed-exchange-rate arrangements between countries, thus helping national governments manage their exchange rates and prioritize economic growth. This assistance was meant to prevent the spread of international economic crises. The IMF was also formed to help put the pieces of the international economy back together after the Great Depression and World War II. In addition, it also sought to provide capital investments for economic growth and infrastructure projects.

The IMF's role was fundamentally altered by floating exchange rates post-1971. At that point, the organization began examining the economic policies of its loan recipients to determine whether a shortage of capital was due to economic fluctuations or economic policy. The IMF also researched what types of government policy would ensure economic recovery. The current challenge is to help countries implement economic policies that reduce the frequency of crises among the emerging-market countries, especially the middle-income countries that are vulnerable to massive capital outflows. In order to meet this challenge, the IMF's activities have expanded beyond the oversight of exchange rates to surveillance of the overall macroeconomic performance of its member countries. Today, it plays an active role in shaping and managing economic policy around the world.

Trade Agreements

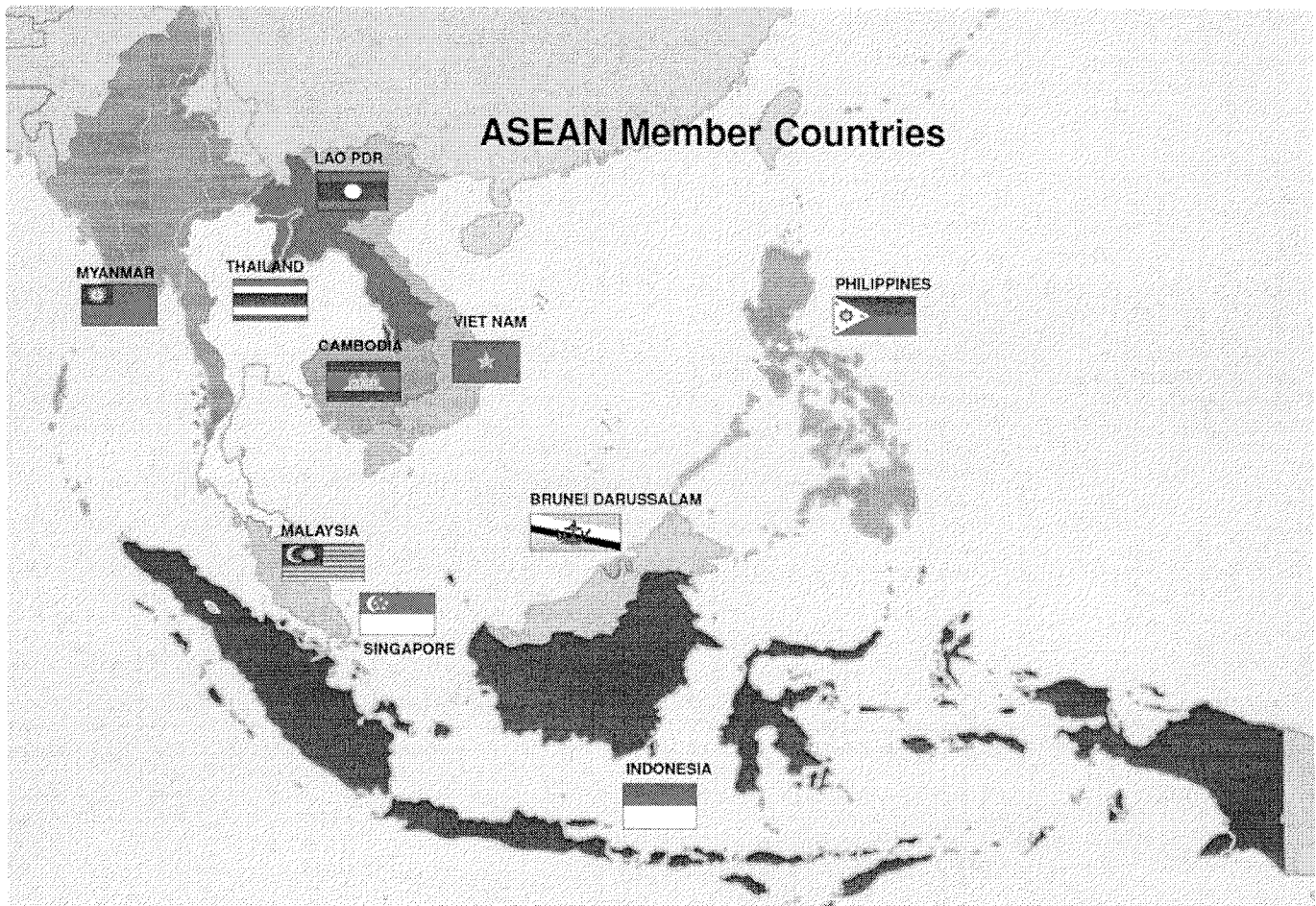


Shanghai Free Trade Zone

So far you have seen how international organizations such as the WTO, IMF, and World Bank support global trade, but this is only part of the story. Where global trade really gets a boost is from **trade agreements** (also called *trade blocs*). This is where the term **global economic integration** gets its legs—from the process of modifying barriers among and between nations to create a more fully integrated global economy. Trade agreements vary in the amount of free trade they allow among members and with nonmembers; each has a unique level of economic integration. We will look at four: regional trade agreement (RTA; also called a *free trade area*), customs unions, common markets, and economic unions.

Regional trade agreements are reciprocal trade agreements between two or more partners (nations). Almost all countries are part of at least one RTA. Under an RTA, countries “huddle together,” forming an international community that facilitates the movement of goods and services between them. For example, the North American Free Trade Agreement (NAFTA) enacted between Canada, the United States, and Mexico facilitates trade among these countries through tariff reductions and elimination. The Association of Southeast Asian Nations (ASEAN), shown below, provides for the free exchange of trade, service, labor, and capital across 10 independent member nations to provide a balance of power to China and

Japan. The Central American Free Trade Agreement (CAFTA; Costa Rica, Dominican Republic, Guatemala, Honduras, Nicaragua, and El Salvador) eliminated tariffs on more than 80 percent of US exports and opened US trade restrictions for Central American sugar, textiles, and apparel imports, thereby reducing costs on these products for American consumers (United States Trade Representative, n.d.).



Map of ASEAN Member Countries

The Association of Southeast Asian Nations (ASEAN) as of 2015.

Customs unions are arrangements among countries whereby the parties agree to allow free trade on products within the customs union, and they agree to a common external tariff (CET) on imports from the rest of the world. It is this CET that distinguishes a customs union from an RTA. It is important to note that although trade is unrestricted within the union, customs unions do not allow free movement of capital and labor among member countries. An example is the customs union of Russia, Belarus, and Kazakhstan, which was formed in 2010. These countries not only eliminated trade barriers among themselves but also agreed to some common policies for dealing with nonmember countries.

Common markets are similar to customs unions in that they eliminate internal barriers between members and adopt common external barriers against nonmembers. This difference is that common markets also allow free movement of resources (e.g., labor) among member countries. An example of a common market is the Economic Community of West African States (ECOWAS), comprised of Benin, Burkina Faso, Cape Verde, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo.

An even more economically integrated arrangement is the economic union. **Economic unions** eliminate internal barriers, adopt common external barriers, permit free movement of resources (e.g., labor), and adopt a common set of economic policies. The best-known example of an economic union is the European Union (EU). EU members all use the same currency, follow one monetary policy, and trade with one another without paying tariffs.

The following video further explains and compares the different types of trade agreements:

<https://youtu.be/YDUq0DINhYk> (<https://youtu.be/YDUq0DINhYk>)

Check Your Knowledge

Answer the following questions to see how well you understand the topics covered in this section. This short quiz does not count toward your grade in the class, and you can retake it as many times as you wish.

Use this quiz to decide whether to study the section further or move on.

Choose the **BEST** answer.

Question 1

In global finance the term IMF refers to _____.

- ☐ Industrial Monetary Finance
- ☐ International Money and Finance
- ☐ the International Monetary Fund

Question 2

The international monetary community created both the IMF and the World Bank because

- ☐ the U.S. established the World Bank solely as a check and balance of the power of the IMF
- ☐ the community could not agree and required a compromise
- ☐ the two organizations create an important division of labor

Question 3

When it was formed, the World Trade organization absorbed

- ☐ the World Bank
- ☐ all of GATT'S agreements
- ☐ the IMF

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Learning Resource

Ethical Challenges and Standards

What you'll learn to do: Describe ethical challenges that businesses face in a global environment

The ethical landscape of international business is cloudy, and the diverse nature of cultural, political, and legal systems around the world often makes the line between ethical and unethical business practices difficult to negotiate. In this section, you will learn about some of the ethical challenges and issues that businesses face in global markets.

Learning Outcomes

- Explain why forms of corruption such as bribery are so widespread and difficult to regulate
- Summarize the key parts of the Foreign Corrupt Practices Act
- Define sweatshop and explain how it relates to global business

Corruption



When a large corporation decides to enter a foreign market, it must usually secure a number of licenses, permits, registrations, or other government approvals. Certain types of business may even be impossible or illegal unless the corporation is first able to obtain a change or adjustment to the nation's laws or regulations. Since the power to authorize the foreign corporation's activities is vested in the hands of local politicians and officials, and since corporations have access to large financial resources, it should not be surprising that some corporate executives resort to financial incentives to influence foreign officials. While certain financial incentives, such as promises to invest in local infrastructure, may be legitimate, any form of direct payment to the foreign official that is intended to influence that official's public decisions will cross the line into **bribery**.

Bribery is one of the archetypal examples of a corporation engaged in unethical behavior. A number of problems can be attributed to business bribery. First, it is obviously illegal—all countries have laws that prohibit the bribery of government officials—so the foreign company engaging in bribery exposes its directors, executives, and employees to grave legal risks. Second, the rules and regulations that are circumvented by bribery often have a legitimate public purpose, so the corporation may be subverting local social interests and/or harming local competitors. Third, the giving of bribes may foment a culture of corruption in the foreign country, which can prove difficult to eradicate. Fourth, in light of laws such as the US Foreign Corrupt Practices Act and the Organization of Economic Cooperation and Development (OECD) Convention on Anti-Bribery (both discussed in greater detail below), bribery is illegal

not only in the target country but also in the corporation's home country. Fifth, a corporation that is formally accused or convicted of illicit behavior may suffer a serious public relations backlash.

Despite these considerable disincentives, experts report that worldwide business corruption shows little signs of abating. Transparency International, a leading anticorruption organization based in Berlin, estimates that one in four people worldwide paid a bribe in 2009. It appears that the total number of bribes continues to increase annually. The World Economic Forum calculated the cost of corruption in 2011 at more than 5 percent of global GDP (US\$2.6 trillion) with more than \$1 trillion paid in bribes each year.

Governments and intergovernmental organizations have redoubled their efforts to combat the perceived increase in international business corruption. Globalization, which accelerated in the final decades of the twentieth century, is often cited by specialists as contributing to the spread of corruption. Corporations and businesses in every nation have become increasingly dependent on global networks of suppliers, partners, customers, and governments. The increased interaction between parties in different countries has multiplied the opportunities for parties to seek advantage from illicit incentives and payoffs. Although outright bribery is clearly unethical and illegal, there is a great deal of behavior that falls into a gray zone that can be difficult to analyze according to a single global standard. When does a business gift become a bribe? What level of business entertainment is "right" or "wrong"? Over the past two decades, governments and regulators have sought to clearly define the types of behavior that are considered unethical and illegal.

Another factor that has heightened the sense of urgency among regulators is the magnitude of recent cases of corruption (several of which are described in greater detail below). The cost to shareholders as well as stakeholders and society has proven enormous. Governments and international organizations have ramped up their enforcement of anticorruption laws and sought increasingly severe penalties, sometimes imposing fines amounting to hundreds of millions of dollars. Largely as a result of these efforts, most multinational corporations have developed internal policies to ensure compliance with anticorruption legislation.

The following are examples of large-scale corruption in international business.

Walmart in Mexico

According to a report issued by the Mexican Employers Association in 2011, companies operating in Mexico spend more than 10 percent of their revenue on corrupt acts. One of the most well-known cases was the Walmart scandal that came to light in September 2005 and resulted in the company's stock value dropping by as much as \$4.5 billion. Evidence unearthed by internal and external investigations revealed a widespread use of bribes, alleged to total

more than \$24 million. The bribes were paid to facilitate the construction of Walmart stores throughout Mexico. The country is a huge market for Walmart—one in every five Walmart stores is in Mexico. As of October 2014, the investigation continued, having implicated Walmart senior level management of complicity or awareness.

GlaxoSmithKline in China

In September 2013, China's Xinhua news agency reported that a police investigation into bribes paid by drug manufacturer GlaxoSmithKline (GSK) indicated that the bribes were organized and paid by GSK China and not by individuals operating on their own prerogative as had been reported by the company initially. Police also alleged that the corporate parent merely went through the motions of an internal audit process, indicating a knowledge and acceptance of the bribery. This case suggests that the Chinese government's widely publicized arrests and convictions for bribery had not served as a sufficient deterrent to corrupt practices by foreign corporations.

Alcatel in Costa Rica

In January 2010, mobile-device manufacturer Alcatel agreed to pay Costa Rica \$10 million in reparations for social damage caused by Alcatel's payment of \$2.5 million in bribes to get a contract to provide mobile phone services in that country. This case is notable for its application of the concept of social damage and the resulting order of compensation to the citizens of Costa Rica.

Anticorruption Laws and Regulations

The first major international anticorruption law was the US' **Foreign Corrupt Practices Act (FCPA)**, adopted in 1977. The FCPA criminalized bribery of foreign public officials by American business enterprises. Initially, the FCPA was not well received. Few other countries followed suit, and US companies complained that the FCPA shut them out of the competition for billions of dollars' worth of overseas business contracts. Slowly, however, the push for concerted anticorruption measures gathered momentum, and intergovernmental institutions such as the OECD, the African Union, and the United Nations eventually adopted anticorruption conventions. Further support for a global anticorruption agenda was provided by lending institutions such as the World Bank, by nongovernment organizations (NGOs) such as Transparency International, and by the rapidly evolving corporate social responsibility movement. Notable among these efforts was the Communist Party of China's promulgation of a code of ethics to fight the widespread corruption within the Communist Party of China.

The FCPA applies only to bribes paid (or offered) to foreign government officials to obtain or retain business or to develop an unfair competitive advantage. The concepts of *bribe* and *foreign government official* can be interpreted broadly. While companies and executives charged with FCPA violations have often sought to characterize their payments as business “gifts,” this has not shielded them from liability when there was evidence that the payments were intended as a means of obtaining illicit objectives. However, where payments have been characterized as “facilitation” or “lubrication” payments, meaning that they merely created an incentive for an official to promptly execute legal actions, such as mandatory customs inspections, the payments have been allowed. In numerous countries, the state owns all or part of commercial enterprises, so a great number of business executives could be classified as foreign government officials.

In 1997, the **Organization for Economic Cooperation and Development (OECD)** established legally binding standards for defining bribery in international business transactions. Similar to the FCPA, the OECD Anti-Bribery Convention focuses on the bribery of public officials. Like the FCPA, the OECD also potentially creates the opportunity for companies to circumvent the regulations by hiring consultants or agents. Notably excluded from the scope of the OECD Convention is a prohibition against bribing private parties. Despite such loopholes, the OECD Convention was an important step in the right direction. By 2012, 43 countries had ratified the agreement and begun its implementation.

Corruption from a Cross-Cultural Perspective

Compliance with anticorruption legislation raises complex ethical dilemmas for corporations. It remains difficult to regulate ethical behavior when social and cultural norms vary significantly from country to country. Acts that are considered unethical in one country may represent a traditional way of doing business in another. One legal scholar explains the difference as follows (Eiher, 2013):

A common misconception, held in both Western and developing countries, and even among many researchers on corruption, is to confuse what is corrupt with what is legal. Laws are defined by values, as are ethical norms, but the two are not equivalent.

The West tends to be universalist in its outlook: That is, every society works, or should work, essentially the same way. Its business practices, for example, should be based on a market system that is characterized by transparency and regulated by laws that apply to everyone. A country that fails to conform to this model is seen as underdeveloped or dysfunctional. It follows from this view that corruption is basically the same in Sweden as in Sudan.

The reality, however, is that different cultures use radically different systems to get things done. Whereas Western cultures are primarily rule-based, most of the world's cultures are relationship-based. Westerners tend to trust the system, while non-Westerners are cemented by personal honor, filial duty, friendship, or long-term mutual obligation. Loyalty to cronies is suspect behavior in the West, but represents high moral character in much of the world.

What is corrupt in the West may be acceptable elsewhere. The classic example of the purchasing agent illustrates this point. The Western purchasing agent is expected to award contracts based on the quality of bids and transparently available financial information about the bidders. An agent who favors personal friends is viewed as corrupt, because cronyism subverts this transparency-based system. It creates a conflict of interest: A choice that is good for the agent and his or her cronies may not be good for the company.

In much of the world, however, cronyism is a foundation for trust. A purchasing agent does business with friends because friends can be trusted. He or she may not even ask to see the company financials, since this could insult the other's honor. It is assumed that cronies will follow through on the deal, not because they fear a lawsuit, but because they do not wish to sacrifice a valuable relationship in an economy where relationships are the key to business. In such a system, it is in the company's interest for the agent to do business with friends, and cronyism may, therefore, present no conflict of interest.

Labor Abuses



Rana Plaza Building Collapse

Garment factory collapse, Rana Plaza, Bangladesh.

Sweatshops

The term **sweatshop** refers to a factory that is guilty of some sort of labor abuse or violation, such as unsafe working conditions, employment of children, mandatory overtime, payment of less than the minimum wage, unsafe working conditions, abusive discipline, sexual harassment, or violation of labor laws and regulations. The US Government Accounting Office has chosen to define a sweatshop as any manufacturing facility that is guilty of two or more of the above types of labor abuses. However, it is important to understand that the term sweatshop is not just a legally defined term, but a word that is used broadly and has entered the general lexicon.

Consider the following recent example of sweatshop labor:

On April 24, 2013, at Rana Plaza on the outskirts of Dhaka, Bangladesh, a building containing apparel factories collapsed, trapping and killing more than 1,100 employees. It was not only the worst industrial disaster in the history of the garment industry but also the world's most

fatal industrial building collapse. News reports soon emerged that the factory owners had ignored ominous warning signs, such as visible cracks in the wall, and had illegally added several stories to the top of the building, creating a weight the building could not bear. Many of the factories operating in the building were producing apparel for well-known Western brands, such as Walmart, Joe Fresh, and Mango.

Rescue workers struggled for more than a week to reach trapped survivors, while hospitals tended to the more than 2,500 workers who had escaped, many with severe injuries. Survivors told heart-rending tales of having lost mothers and sisters who had worked in the same factories. The deaths of so many innocent workers created a firestorm of controversy in Bangladesh and around the world. Accusations and recriminations were leveled at corporations and government officials. A period of intense and profound soul-searching ensued for the global fashion companies that relied on outsourced factory labor in Bangladesh. Within a few months, two major initiatives were announced, one American and one European, to increase safety and accountability in Bangladeshi factories.

How did this situation arise?

Thanks to international efforts to lower import tariffs, such as those instituted by GATT in 1947 and by the WTO in 1995, an outsourcing movement was born, and many companies saw the opportunity to lower their production costs by moving them overseas. Fashion and apparel companies were among the first to take advantage of the benefits of outsourcing—namely, gaining access to cheap foreign labor markets. Starting in 1970, employment in American apparel factories dropped sharply as companies moved production to countries like Indonesia, Vietnam, China, Mexico, and the Dominican Republic.

The outsourcing movement was accompanied by increasing reports of sweatshop abuses. As a result, a number of NGOs, such as the National Labor Committee, became involved in anti-sweatshop activities. Throughout the 1990s, a number of sweatshop-related abuses came to light in factories used by American brands. Several of these involved the island of Saipan, a small American protectorate in the Pacific. A number of factory owners discovered that since Saipan is technically American territory, clothing produced in Saipan could enter the United States duty-free and carry the label “Made in America.” Since Saipan is much closer to Vietnam and the Philippines than to the United States, a number of these factories recruited Vietnamese and Filipino natives as factory workers. Upon their arrival in Saipan, however, some of these workers were exposed to flagrant human rights abuses and, in the worst of cases, outright slavery. In one notorious case, workers were literally imprisoned in the factory and forced to work without pay. Eventually, these abuses were revealed, and US prosecutors filed charges against factory owners, some of whom were sentenced to substantial prison sentences.

In the early 1990s, one of America's most prominent footwear brands, Nike, also came under attack as reports emerged from Indonesia and Vietnam of worker abuse. In Vietnam, a young female factory employee was working on basketball shoes when her machine exploded and sent a bolt through her heart. At first, Nike refused to accept responsibility, pointing out that Nike had never manufactured its own footwear and apparel. Nike's contracts with its sourcing factories required the factories to obey labor regulations and, in Nike's view, this meant that any abuses were the factories' responsibility. However, by 1998, the continuing negative publicity obliged Nike to reverse its course by instituting a strict code of conduct for its factories.

By 2000, as a result of continued scrutiny from various watchdog organizations like the Worker Rights Consortium, the National Labor Committee, and other international groups such as the Clean Clothes Campaign, most large apparel brands developed and publicized their own internal codes of conduct for suppliers. Such codes of conduct were contractually imposed on all suppliers and required that factories comply with all local labor laws, refrain from employing children, and maintain safety programs. In addition, most brands began to require that factories make themselves available for inspections to make sure that they were complying with the standards set forth in the codes of conduct. A number of inspection companies sprang up to service the needs of the corporations, and groups of young inspectors soon scanned the globe, moving from factory to factory, checking them for fire violations, reviewing records to make sure that rules on overtime were respected, and so forth.

Despite all these efforts, reports of violations continued to be heard. The American consumer seemed to have wearied of the sweatshop issue to some extent, and companies like Walmart and Nike, which had often been accused of sweatshop abuses, saw their sales and stock valuations continue to rise. Many companies began to focus more on environmentalism and anti-global-warming issues, and a number of brands began to require that their supply factories obtain some sort of environmental certification, such as the Bluesign certification that was established in Germany under the auspices of SGS S.A., the world's largest inspection company. Then, in 2012 and 2013, a horrific series of accidents reminded the world's consumers that the sweatshop issue was still with us.

In 2012, a fire broke out at an apparel factory in Pakistan, killing some 270 Pakistani workers. Among the Western companies sourcing from that factory were the UK retailer Tesco and the German apparel brand Kix. Kix's offer to compensate the victims' families \$2,000 per fatality was viewed by many Pakistanis as insulting. Then, just a few months later, at the Tazreen Fashions factory in Dhaka, Bangladesh, another 112 factory workers perished in a fire. Again, it was discovered that well-known Western brands such as Walmart, Disney, and the Gap had sourced products from the factory. The world's attention was squarely focused on Pakistan and Bangladesh when the building collapse at Rana Plaza in Bangladesh became the worst industrial catastrophe in the history of apparel manufacturing.

Check Your Knowledge

Answer the following questions to see how well you understand the topics covered in this section. This short quiz does not count toward your grade in the class, and you can retake it as many times as you wish.

Use this quiz to decide whether to study the section further or move on.

Choose the **BEST** answer.

Question 1

Which of the following are accurate statements about corruption in the global business environment?

- ☐ Foreign companies that do business with the US government are not subject to the Foreign Corrupt Practices Act.
- ☐ Every country now enforces strict laws that govern and prevent bribery and corruption.
- ☐ In the United States, companies must abide by the Foreign Corrupt Practices Act.

Question 2

Bribery is one of _____ examples of a corporation engaged in unethical behavior.

- ☐ the least common
- ☐ the most common
- ☐ the only

Question 3

The FCPA applies only to bribes paid (or offered) to _____ to obtain or retain business or to develop an unfair competitive advantage.

- ☐ domestic government officials
- ☐ all employees
- ☐ foreign government officials

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Learning Resource

Putting It Together: Global Environment



Bananas' Final Destination

Synthesis

Remember the humble banana we talked about at the start of this chapter? Now you know at least some of what it takes to get bananas from Ecuador to your local grocery store: trade agreements, currency exchange rates, compliance with federal laws, bribery and possible corruption, national comparative advantages, tariffs, trade restrictions, cultural differences, and more. Those are just a few of the things that had to fall into place to get those bananas into your local market and ultimately into a banana split served at the local ice cream shop!

Summary

This chapter covered the global environment of business. Below is a summary of the topics covered in this chapter.

Globalization

Why do countries trade? Shouldn't a strong country such as the United States produce all of the computers, television sets, automobiles, and cameras it wants rather than import such products from Japan? Why do the Japanese and other countries buy wheat, corn, chemical

products, aircraft, manufactured goods, and informational services from the United States? Because countries have different natural, human, and capital resources and different ways of combining these resources, they are not equally efficient at producing the goods and services that their residents demand. The decision to produce any good or service has an **opportunity cost**, which is the amount of another good or service that might otherwise have been produced. Given a choice of producing one good or another, it is more efficient to produce the good with the lower opportunity cost, using the increased production of that good to trade for the good with the higher opportunity cost.

Measuring Global Trade

A nation has a **comparative advantage** at producing something if it can produce it at a lower cost than another. A **competitive advantage** is a term describing attributes that allows a nation to outperform competing nations. These attributes may include access to natural resources, such as high-grade ores or inexpensive power, highly skilled personnel, geographic location, high entry barriers, etc.

Global Business Strategies

The main strategies that companies use to enter the global market are exporting/importing, outsourcing/offshoring, licensing and franchising, joint ventures/strategic alliances, and foreign direct investment. Each has different advantages and disadvantages that must be weighed carefully.

Global Trade Forces

Firms desiring to enter international business have many forces and barriers. Common barriers to effective global business are cultural, social, and political barriers, and tariffs and trade restrictions.

Ethical Challenges in the Global Environment

Culture plays a big role in shaping and defining ethical behavior. As a result, what may be considered ethical in one country may be seen as unethical in another. In a global business context, such ethical challenges often arise in the form of corruption and labor abuse.

Global Trade Agreements and Organizations

The goal of the GATT is to make trade freer, and thus, the promises countries make must involve reductions in trade barriers. The WTO's main purpose is to monitor the trade liberalization agreements reached by GATT-member countries in the Uruguay Round. The most important "power" of the WTO is its ability to adjudicate disputes between member countries regarding compliance with the agreements. The IMF's key roles are the following: promote international monetary cooperation; facilitate the expansion and balanced growth of international trade; promote exchange stability; and assist in the establishment of a multilateral system of payments. The World Bank has one central purpose: to promote economic and social progress in developing countries by helping raise productivity so that their people can live a better and fuller life.

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