

-**Political risk** is the possibility of a change in political environment or government policy that would adversely affect a company's ability to operate effectively and profitably.

-**Expropriation**—governmental action to dispossess a foreign company or investor. Compensation should be provided in a “prompt, effective, and adequate manner”

-**Free trade** – A situation where government doesn't attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country.

1. Assume that you are a senior manager with a Canadian-based manufacturer of skin care products. For the past three years, your company has been producing and marketing a non-prescription cream which actually prevents and cures acne. You have been asked to propose how to expand sales of the product into the United States. Identify four options that are available to you and discuss their benefits and short-comings. Which option would you recommend and why?

- Foreign Direct Investment: acquiring or merging with an existing firm in the foreign country
 - o Mergers and acquisitions are quicker to execute than Greenfield investments
 - o Foreign firms have strategic assets such as brand loyalty, customer relationship, trademarks or patents, etc.
 - o Firms make acquisitions because they can increase the efficiency of the acquired unit but transferring capital, technology or management skills.
- Greenfield investment: new operation in a foreign country
 - o Many mergers and acquisitions fail to realize their anticipated gains
 - o Foreign interest of 100 percent
- Exporting: producing goods at home and then shipping them to the receiving country for sale
 - o Actual or threatened trade barriers such as import tariffs or quotas
 - o Constrained by transportation costs and trade barriers
 - Becomes unprofitable to ship some products over a large distance
 - Low value-to-weight ratio
- Licensing: granting a foreign entity the right to produce and sell the firm's product in return for a royalty fee on every unit that the foreign entity sells. This can include franchising.
 - o May result in a firm's giving away valuable technological know-how to a potential foreign competitor
 - o Does not give a firm the tight control over manufacturing, marketing and strategy in a foreign country that may be required to maximize profitability
 - o Such capabilities are often not amenable to licensing

The option I would recommend would be the foreign Direct Investment because it has the most advantages when discussing how to expand a skin care product, and all the other options have many constraints.

2. Identify and discuss the benefits and costs of foreign direct investment to host countries. Are there any disadvantages? If so, what might these be?

Benefits of the host country:

- Resource-transfer effects
- Employment effects. FDI brings jobs to a host country
- Balance of payment effects
- FDI is a substitute for imports of goods and services
- MNE uses the subsidiary in the host country to export goods and services to other countries

Benefits of cost to the host country:

- Adverse effects on competition
Foreign subsidiaries have strong economic power to put out of market local competitors
- Adverse effects on the balance of payments.
Against the initial capital inflow that comes with FDI must be the outflow of earnings to be repatriated
- National sovereignty and autonomy

Yes there are disadvantages such as:

- If it was an acquisition, the immediate effect may be to reduce employment

3. The interests of producers are typically the beneficiaries of government trade policy usually at the expense of consumers. Why is this case? Can arguments be made for putting consumers' interests ahead of those of producers? What might these arguments be?

Political arguments of government intervention:

- Protecting jobs and industries. Canadian examples?
- National security
- Retaliation
- Protecting consumers (e.g. pharmaceuticals)
- Furthering foreign policy objectives (e.g. trade sanctions)
- Protecting human rights

Economic arguments of government intervention:

-**The infant industry argument** – based on the notion that many developing countries have a potential comparative advantage in manufacturing but new manufacturing industries cannot initially compete with established industries in developed nations.

-**Strategic trade policy** – argues that in industries in which the existence of substantial economies of scale implies that the world market will profitably support only a few firms, countries may predominate in the export of certain products simply because they had firms that were able to capture first-mover advantages. (e.g. US and GMO seeds)

Arguments can be made for putting consumers interests ahead of those of producers, arguments are:

-**Retaliation and trade war** – Paul Krugman has argued that a strategic trade policy – because it boosts national income at the expense of other countries - may provoke retaliation. (e.g. Bombardier in Canada and Embraer in Brazil)

-**Domestic policies** – Governments do not always act in the national interest when they intervene in the economy as politically important groups can influence them. (e.g. protection of inefficient dairy farmers in Canada)