

AFM 333 Midterm Notes

Globalization

Globalization refers to the interconnectedness of national economies and the growing interdependence of buyers, producers, suppliers, and governments around the world

Globalization of markets: convergence in buyer preferences in markets around the world

Globalization of production: dispersal of production activities worldwide to minimize costs or maximize quality

Accenture's 2007 report "The Rise of the Multi-Polar World identified 3 mutually reinforcing trends that are driving the diffusion of economic power and activity from the triad economies - the United States, Europe and Japan - to those of the developing world:

The increasing power of information and communications technology

Government policies to increase economic openness

The increasing size and geographical reach of the multinational enterprise

Globalization and technological advances have altered the international business landscape more than any other trends

Globalization allows firms to view the world as one large marketplace for goods, services, capital, labor and knowledge

Key term here: integration, distance doesn't matter, we are now interrelated and interconnected

2008: ninja loan, no income, no job, or no assets and given bank loans because belief was that the value of the asset was going to continue to increase, pools of securitized debt, it was great until it wasn't, worldwide recession, referred to as contagion (affected everyone, worldwide affect of what happened in us affected Canada, etc.)

Phases of Globalization

Phase 1: 1830 to late 1800s

Aided by railroads and ocean transport; the rise of manufacturing and trading companies

Phase 2: 1900 to 1930

Fuelled by electricity and steel; early MNEs

Phase 3: 1948 to 1970s

GATT, post-war era; reduction of trade barriers worldwide; rise of global capital markets

Phase 4: 1980 to present

Fuelled by Internet and other technologies; rapid liberalization in emerging markets

Allowed us to move from walking distance to ocean transport, railroads, electricity, steel, ability to make things faster, bigger, stronger

The World is Flat (Friedman)

Globalization 1.0

Countries globalizing

Old to new world trade: 1492-1800

Globalization 2.0

Companies globalizing

The rise of multinationals: 1800-2000

Globalization 3.0

The power of the individual to collaborate and compete globally

Software + Information + Connectivity = Power

Work flow revolution: suddenly everyone could collaborate on their content

Uploading because the world is now flat, downloading was when the world was round

The Death of Distance

Subjective nature of the future: if trump gets in, what does that mean to business? Midterm info*, he wants to tear up nafta, make sure t.p.p. doesn't happen

2000 and Beyond: Information Technology, Internet, Digitalization: Bits and bytes literally, moving at the speed of light

Key Players

Nation States

Multinational corporation: business that has direct investments abroad in multiple countries

Small businesses and entrepreneurs: small companies and individuals becoming increasingly active in international trade and investment

Born global firm: adopts a global perspective and engages in international business from or near its inception

Drivers of Globalization

Man of the year in china, opened up their country to the world

Berlin wall: 1979, separation of east to the west, soviet empire, death of communism

Indian flag: grew from 2000 in terms of GDP from \$200 billion to \$2 trillion, decrease in child mortality, increase in middle class, etc. second largest population in the world, india is emerging as a very powerful place

Drivers of Market Globalization

1. Drivers of Market Globalization

Worldwide reduction of barriers to trade and investment

National governments have sought to reduce trade and investment barriers, which has accelerated global economic integration.

The **World Trade Organization** (WTO) has facilitated this.

The WTO is a multilateral governing body empowered to regulate international trade and investment, and has been engaged in an ongoing liberalization of member states' economies since the late 1940s.

Joining the WTO in 2001, even China has committed to make its market more accessible to foreign companies.

Market opening is closely associated with the emergence of regional trade blocs, a key dimension of market globalization.

2. Market liberalization and adoption of free markets

The tearing down of the Berlin Wall in 1989, the collapse of the Soviet Union's economy that same year, and China's free-market reforms signalled the end of the 50-year Cold War between communist regimes and democracy.

It was the transition of **command economies** to **market-driven economies** that facilitated their membership into the global economy.

The East Asian nations, stretching from South Korea to Malaysia and Indonesia, had already embarked upon an ambitious program of market liberalization in the 1980s. India joined this trend of economic liberalization in 1991.

These events opened roughly **one-third** of the world to freer international trade and investment. With privatization of previously state-owned industries, these countries have enjoyed greater economic efficiency, simultaneously attracting foreign capital.

3. Industrialization, economic development, and modernization

Industrialization transitions emerging markets- Asia, Latin America, and Eastern Europe- from being **low value-adding** commodity producers, dependent on low-cost labor, to sophisticated competitive producers and exporters of premium products (**higher-value products**) such as electronics, computers, and aircraft.

The adoption of modern technologies, improvement of living standards, higher discretionary income levels and adoption of modern legal and banking practices increase the attractiveness of emerging markets as investment targets and facilitate the spread of ideas, and products.

4. Integration of world financial markets

Integration of world financial markets enables internationally active firms to raise capital, borrow funds, and engage in foreign currency transactions wherever they go.

Cross-border transactions are made easier partly as a result of the ease with which funds can be transferred between buyers and sellers through a network of international commercial banks.

The globalization of finance enables firms to pay suppliers and collect payments from customers worldwide.

5. Advances in technology

Advances in technology provides the *means* for internationalization of firms

Advances in technology:

- facilitates the development and spread of new products and technologies;

- reduces the cost of doing business internationally;

- enables even smaller firms to go international

- helps coordinate worldwide activities;

- mitigates geographic distance by providing virtual interconnectedness with customers, subsidiaries, intermediaries, and suppliers

Technology as a Driver of Change

- Growing power

- Declining cost

- Increased accessibility

- Increased familiarity and comfort

- Reduced skill requirements

How Moment of Value is Changing Competition

The moment when we as consumers have a need or desire to do business is our “moment of value”. Businesses are using technology to get closer to our moment of value, and changing industry structure and the rules of competition. The traditional boundaries of time and place are being eliminated.

Examples:

- automated teller machines --> bank by phone --> internet banking

- extended retail hours --> home shopping --> online retailing

- Travelocity, Amazon.com, eBayMP3's, Apple, and the music industry

- the Kindle and the publishing industry

- The digitization of the Media and Entertainment Industry (Netflix, Blockbuster)

The Changing Role of Information Technology

Since 2000...

- Internet Penetration in Canada has more than doubled

- Broadband penetration has increased more than fivefold

- Social Networking has changed the way we interact

- Hand-held devices (Smartphones) were invented

- We've seen the launch of

 - Google, Facebook, YouTube, Blackberry, iTunes, iPod, iPad and iPhone, NetFlix

The Drivers and Dimensions of Market Globalization

2. Dimensions of Market Globalization

Integration and interdependence of national economies: results from firms' collective international activities, governments contribute by lowering trade and investment barriers

Rise of regional economic integration blocs: free trade areas are formed by 2 or more countries to reduce or eliminate barriers to trade and investment, such as the EU, NAFTA, and MERCOSUR

Growth of global investment and financial flows: associated with rapid growth in FDI, currency trading, and global capital markets

Convergence of buyer lifestyles and preferences: facilitated by global media, which emphasize lifestyles found in the US, Europe, etc.; firms market standardized products

Globalization of production activities: to cut costs, firms manufacture in low labor-cost locations, such as Mexico and Eastern Europe, firms also source services from abroad

Globalization of services: banking, hospitality, retailing and other service industries are rapidly internationalizing, firms outsource business processes and other services in the value chain to vendors overseas and in a new trend, many people go abroad to take advantage of low-cost services

3a. Societal Consequences of Market Globalization

- Contagion: Rapid spread of financial or monetary crises from one country to another
- Loss of national sovereignty
- Offshoring and the flight of jobs
- Effect on the poor
- Effect on the natural environment
- Effect on national culture

3b. Firm-level Consequences of Market Globalization: Internationalization of the Firm's Value Chain

- Countless new business opportunities for internationalizing firms
- New risks and intense rivalry from foreign competitors
- More demanding buyers who source from suppliers worldwide
- Greater emphasis on proactive internationalization
- Internationalization of firm's value chain

Implications for Management

Building interconnectedness: 'global orchestration' of value-chain activities

Exploiting knowledge

Search for maximum flexibility in manufacturing, sourcing and other value-adding activities

Relentless search for productivity gains and operational efficiency

Recognizing, cultivating, and measuring key global strategic assets of the organization

Gaining and sharpening partnering capabilities...

International Business

Performance of trade and investment activities by firms across national borders

Globalization: ongoing economic integration and growing interdependence of countries worldwide

The Nature of International Business

All value-adding activities including sourcing, manufacturing, and marketing, can be performed in international locations

The subject of cross-border trade can be products, services, capital, technology, know how, and labor

Firms internationalize through exporting, foreign direct investment, licensing, franchising, and collaborative ventures

5 Reasons MNE's Invest Abroad

Market Seeking

Efficiency (Cost) Seeking

Resource Seeking (natural resources)

Finance Seeking

Knowledge Seeking

Stages in Company Internationalization

Domestic Focus -> Pre-export Stage -> Experimental Involvement -> Active Involvement -> Committed Involvement

What's Different About International Business?

Four Types of Risks

Commercial risk: firms potential loss of failure from poorly developed or executed business strategies, tactics, or procedures

Country risk: potentially adverse effects on company operations and profitability holes by developments in the political, legal and economic environment in a foreign country

Currency risk: risk of adverse unexpected fluctuations in exchange rates

Cross-cultural risk: a situation or event where a cultural miscommunication puts some human value at stake

Organizational Participants in International Business

4 Major Participants in International Business

1. Focal firm: initiator of in IB transaction; ex. MNEs and SMEs
2. Distribution channel intermediary: a specialist firm that provides distribution, logistics, and marketing services in the international value chain
3. Facilitator: a firm that provides special expertise in banking, the law, customs clearance, market research, or other
4. Governments: active in IB as suppliers, buyers, and regulators

Focal Firms

Multi-National Enterprise (MNE): a large company with substantial resources that performs various business activities through a network of subsidiaries and affiliates located in multiple countries

Small and Medium-sized Enterprise (SME): a company with 500 or fewer employees (US definition)..adjusted sometimes for other countries

Born global firm: a young entrepreneurial company that initiates international business activity very early in its evolution, moving rapidly into foreign markets

Theories of International Trade and Investment

Why Nations Trade: Classical Theories

Mercantilism: the belief that national prosperity is the result of a positive balance of trade: maximize exports and minimize imports

Absolute Advantage Principle: a country should produce only those products in which it has absolute advantage or can produce using fewer resources than another country

Comparative advantage principle: it is beneficial for two countries to trade even if one has absolute advantage in the production of all products; what matters is not the absolute cost of production but the relative efficiency with which it can produce the product

By specializing in what they produce best and trade for the rest, countries can use scarce resources more efficiently

Examples of National Comparative Advantage

China is a low labor cost production base

India's Bangalore region offers a critical mass of IT workers

Ireland's repositioning enabled a sophisticated service economy

Dubai, a previously obscure Emirate, has been transformed into a knowledge-based economy

Foundation Concepts

Comparative advantage: superior features of a country that provide it with unique benefits in global competition - derived from either national endowments or deliberate national policies

Competitive advantage: distinctive assets or competencies of a firm - derived from cost, size, or innovation strengths that are difficult for competitors to replicate or imitate

Perspectives of the Nation and the Firm

Comparative advantage: the concept that helps answer the question of all nations can gain and sustain national economic superiority

Competitive advantage: the concept that helps explain how individual firms can gain and sustain distinctive competence vis-a-vis competitors

Classical Theories: Factor Proportions Theory

Factor proportions (endowments) theory: each country should produce and export products that intensively use relatively abundant factors of production, and import goods that intensively use relatively scarce factors of production

Classical Theories: International Product Cycle Theory

International product cycle theory: each product and its associated manufacturing technologies go through three stages of evolution: introduction, growth, and maturity

In the introduction stage, the inventor country enjoys a monopoly both in manufacturing and exports

As the product's manufacturing becomes more standard, other countries will enter the global marketplace

When the product reaches maturity, the original innovator country will become a net importer of the product

Applicability to the contemporary global economy: Today, the cycle from innovation to maturity is much shorter making it harder for the innovator country to sustain its lead in a particular product

Limitations of Early Trade Theories

Do not take into account the cost of international transportation

Tariffs and import restrictions can distort trade flows

Scale economies can bring about additional efficiencies

When governments selectively target certain industries for strategic investment, this may cause trade patterns contrary to theoretical explanations

Today, countries can access needed low-cost capital on global markets

Some services do not lend themselves to cross-border trade

Porter's Competitive Advantage of Nations

Critical Role of Innovation in National Economic Success

Innovation is a key source of competitive advantage. The firm innovates in four major ways. It can develop:

1. A new product or improve an existing product
2. New ways of manufacturing
3. New ways of marketing
4. New ways of organizing company operations

Many innovative firms in a nation leads to national competitive advantage

At both the firm and national levels, competitive advantage and technological advances grow out of *innovation*.

Companies innovate in various ways: They develop new product designs, new production processes, new approaches to marketing, new ways of organizing or training, and so forth. Firms sustain innovation (and by extension, competitive advantage) by continually finding better products, services, and ways of doing things. For example, Australia's Vix ERG (www.vix-erg.com) is a world leader in fare collection equipment and software systems for the transit industry. The firm has installed systems in subways, bus networks, and other mass transit systems in major cities like Melbourne, Rome, San Francisco, Stockholm, and Singapore. It has won numerous awards for its innovative products, which have allowed the firm to internationalize quickly. Vix ERG's investment in R&D has been significant, running as high as 23 percent of the firm's revenue.

Innovation results primarily from research and development. Worldwide, more scientists and engineers are engaged in R&D than ever before. Among the industries most dependent on technological innovation are biotechnology, information technology, new materials, pharmaceuticals, robotics, medical equipment, fiber optics, and various electronics-based industries.

The management consultancy Booz & Company (www.booz.com) annually reports on MNEs that spend the most on R&D, the *Global Innovation 1000*. Most top European, Japanese, and U.S. firms spend half or more of their total R&D in countries other than where they are headquartered. They do this for several reasons. First, they can gain access to talent—gifted engineers and scientists located around the world in countries like China and India.

Second, they can cut costs by hiring lower-paid engineers and scientists abroad to replace higher-paid personnel in the home country. Third, by relocating R&D abroad, the firms can get closer to key markets, where they gain insights on specific characteristics of target markets during the product development process. This explains why, in addition to low-cost emerging markets, Europe and the United States are popular sites for R&D by foreign companies, as firms seek to understand and create new products for the world's most lucrative markets. The more innovative firms in a nation, the stronger the nation's competitive advantage.

Critical Role of Productivity in National Economic Success

Productivity is the value of the output produced by a unit of labor or capital

It is a key source of competitive advantage for firms

The greater the productivity of the firm, the more efficiently it uses its resources

The greater the aggregate productivity of the firms in a nation, the more efficiently the nation uses its resources

Aggregate productivity is a key determinant of the nation's standard of living

Innovation also promotes productivity, the value of the output produced by a unit of labor or capital. The more productive a firm is, the more efficiently it uses its resources. The more

productive the firms in a nation are, the more efficiently the nation uses its resources. At the national level, productivity is a key determinant of the nation's long-run standard of living and a basic source of national per-capita income growth.

How Nations Enhance Competitive Advantage

The contemporary view suggests that governments can proactively implement policies to enhance a nation's competitive advantage, beyond the natural endowments the country possesses

Governments can create national economic advantage by: stimulating innovation, targeting industries for development, providing low-cost capital, and through other incentives

National Industrial Policy

Proactive economic development plan implemented by the public sector to nurture or support promising industry sectors with potential for regional or global dominance. Public sector initiatives can include:

- Tax incentives

- Monetary and fiscal policies

- Rigorous educational systems

- Investment in national infrastructure

- Strong legal and regulatory systems

Vietnam's government in the 1990s privatized state enterprises and modernized the economy, emphasizing competitive, export-driven industries. Vietnam became one of the fastest-growing economies, averaging around 8 percent annual GDP growth.

Singapore adopted pro-business, pro-investment, export-oriented policies, combined with state-directed investments in strategic corporations. The approach stimulated economic growth that averaged 8 percent annually from 1960 to 1999.

The *Czech* government in the 1990s created a business-friendly legal and regulatory environment. The country privatized state-owned companies. Government FDI incentives attracted numerous MNEs, such as Daewoo, ING, Siemens, and Toyota.

New Zealand's government, starting in 1984, transformed the country from an agrarian, protectionist, regulated economy to an industrialized, free-market economy that today competes globally.

Michael Porter's Diamond Model

Michael Porter's Diamond Model: Sources of National Competitive Advantage

Firm strategy, structure, and rivalry – the presence of strong competitors at home serves as a national competitive advantage

Factor conditions – labor, natural resources, capital, technology, entrepreneurship, and know how

Demand conditions at home – the strengths and sophistication of customer demand

Related and supporting industries – availability of clusters of suppliers and complementary firms with distinctive competences

Industrial Clusters

A concentration of suppliers and supporting firms from the same industry located within the same geographic area

Examples include: the Silicon Valley, fashion cluster in northern Italy, pharma cluster in Switzerland, footwear industry in Pusan, South Korea, and the IT industry in Bangalore, India
Industrial clusters can serve as an export platform for individual nations

New Trade Theory

The argument that economies of scale are an important factor in some industries for superior international performance – even without any clear comparative advantage possessed by the nation. Some industries succeed best as their volume of production increases.

For example, the commercial aircraft industry has very high fixed costs that necessitate high-volume sales to achieve profitability.

Government Intervention

Governments intervene in trade and investment to achieve political, social, or economic objectives

Governments impose trade and investment barriers that benefit interest groups, such as domestic firms, industries, and labor unions

Government intervention alters the competitive landscape by hindering or helping the ability of firms to compete internationally

Government intervention is an important dimension of country risk

Protectionism: national economic policies that restrict free trade, usually intended to raise revenue or protect domestic industries from foreign competition

Customs: the checkpoint at national ports of entry where officials inspect imported goods and levy tariffs

Key Instruments

Tariff: a tax on imports (ex. citrus, textiles)

Non tariff trade barrier: government policy, regulation, or procedure that impedes trade

Quota: quantitative restriction on imports of a specific product (ex. imports on Japanese cars)

Investment barriers: rules or laws that hinder foreign direct investment (ex. Mexico's restrictions in its oil industry)

Consequences of Protectionism

Reduced supply of goods to buyers

Price inflation

Reduced variety, fewer choices available to buyers

Reduced industrial competitiveness

Various adverse unintended consequences (ex. while the home country dithers, other countries can race ahead)

General Rationale for Government Intervention

Tariffs can generate substantial government revenue, this is a key rationale for protectionism in undeveloped economies

Helps ensure the safety, security, and welfare of citizens, ex. most countries have basic regulations to protect the national food supply

Helps the government pursue broad economic, political, and social objectives for the nation

Can serve the interests of the nation's firms and industries

Defensive Rationale for Government Intervention

Protection of the national economy: weak or young economies sometimes need protection from foreign competitors, ex. India imposed barriers to shield its huge agricultural sector, which employs millions

Protection of an infant industry: a young industry may need protection, to give it a chance to grow and succeed, ex. Japan long protected its car industry

National security: the US prohibits exports of plutonium and similar products in North Korea

National culture and identity: Canada restricts foreign investment in its movie and TV industries

Offensive Rationale for Government Intervention

National strategic priorities – protection helps ensure the development of industries that bolster the nation’s economy. Countries create better jobs and higher tax revenues when they support high value-adding industries, such as IT, automotive, pharmaceuticals, or financial services.

Increase employment – protection helps preserve domestic jobs, at least in the short term. However, protected industries become less competitive over time, especially in global markets, leading to job loss in the long run.

Types and Effects of Government Intervention

Two major types of intervention: tariffs, subsidies

Tariffs are widespread

Harmonized code – standardized worldwide system that determines tariff amount.

In developing economies, tariffs are common.

In advanced economies, tariffs still provide significant revenue.

For example, in a given year the U.S. collects more tariff revenue on shoes than on cars (e.g., \$1.63 billion versus \$1.60 billion).

The European Union applies tariffs up to 215% on meat, 116% on cereals, and 17% on tennis shoes.

Import tariffs have been declining

Subsidies

Subsidies are government grants (monetary or other resources) to firm(s) intended to ensure their survival or success by facilitating production at reduced prices or by encouraging exports.

Grants include cash, tax breaks, infrastructure construction, or government contracts at inflated prices.

Examples

- In China, Shanghai Automotive (\$12b ann. sales) and numerous other MNEs are partly owned by the Chinese government and receive huge financial resources.
- Europe and the U.S. provide huge agricultural subsidies to farmers. EU subsidies represent 40% of the EU budget.

Consequences of Intervention

Economic Freedom is the absence of government coercion so that people can work, produce, consume, and invest however they want.

The *Index of Economic Freedom* assesses the rule of law, trade barriers, regulations, and other criteria.

Virtually all advanced economies are ‘free.’

Emerging markets are either ‘free’ or ‘mostly free.’

Most developing economies are ‘mostly unfree’ or ‘repressed.’

Economic freedom flourishes with appropriate intervention; too much regulation harms the economy

Countries ranked by level of economic freedom

The Exhibit shows the degree of economic freedom for each country in the Index for 2009, based on criteria such as the level of trade barriers, rule of law, level of business regulation, and protection of intellectual property rights. 20 The Index classifies virtually all the advanced economies as “free,” all the emerging markets as either “free” or “mostly free,” and all the developing economies as “mostly unfree” or “repressed,” underscoring the close relationship between limited government intervention and economic freedom. Economic freedom flourishes when government supports the institutions necessary for that freedom and provides an appropriate level of intervention and regulation. In 2010 for the first time, the United States fell into the second highest category, due to increased U.S. federal government intervention in that nation’s economy, following the recent global financial crisis. Government intervention and trade barriers raise ethical concerns for developing economies. For example, United States import tariffs on clothing and shoes often exceed 20 percent. In 2007, duties on imported clothing alone produced \$10 billion in revenue for the U.S. government. The tariffs hurt poor countries like Bangladesh, Pakistan, India, and several nations in Africa, where clothing and shoe exporters are concentrated. The tariffs that confront such nations are often several times those faced by the richest countries. Government intervention can also offset harmful effects. For example, trade barriers can create or protect jobs. Subsidies can help counterbalance harmful consequences that disproportionately affect the poor. In Denmark, for example, globalization has affected thousands of workers whose jobs have been shifted to other countries with lower labor

costs. The Danish government provides generous subsidies to the unemployed, aimed at retraining workers to upgrade their job skills or find work in other fields.

Evolution of Government Intervention

Protectionist tendencies, the Great Depression, and isolationism shaped early 20th century world trade.

The Smoot-Hawley Act (1938) raised U.S. tariffs to more than 50% (compared to only 3% today).

Progressive trade policies reduced tariffs after WWII.

In 1947, 23 nations signed the General Agreement on Tariffs and Trade (GATT). The GATT:

reduced tariffs via continuous worldwide trade negotiations;

created an agency to supervise world trade; and

created a forum for resolving trade disputes.

Import Substitution vs. Export Led Development

Import substitution is a policy of restricting imports in order to protect home-country firms. It was widely tried in Latin America in the 1950s in an effort to promote industrialization and economic development. But most countries eventually rejected import substitution.

By contrast,....

Export-led development was tried in Singapore, Hong Kong, Taiwan, South Korea, and other Asian countries.

This model, which encouraged the development of export-intensive industries, proved very successful and led to rapid economic growth and high living standards.

The GATT

The GATT introduced the concept of **most favored nation** (renamed **normal trade relations**) by which each member nation agreed to extend the tariff reductions covered in a trade agreement with one country to all other countries. A concession to one became a concession to all.

In 1995 the GATT was superseded by the **World Trade Organization** (WTO) and grew to include 150 member nations.

The GATT and WTO presided over the greatest global decline in trade barriers in history.

Market Liberalization in China

In 1949, China established communism and centralized economic planning.

Agriculture and manufacturing were controlled by inefficient state-run industries.

The country was long closed to international trade.

In the 1980s, China liberalized its economy.

In 2001, China joined the WTO.

China is now a key member of the world trading system.

Market Liberalization in India

Following independence from Britain in 1947, India adopted a quasi-socialist model of isolationism and government control.

High trade barriers, state intervention, a large public sector, and central planning resulted in poor economic performance.

In the 1990s, markets opened to foreign trade and investment; state enterprises were privatized.

Protectionism has declined, but high tariffs (averaging 20%) and FDI limitations remain.

How Firms Should Respond to Government Intervention

Research to gather knowledge and intelligence. Understand trade and investment barriers abroad. Scan the business environment to identify the nature of government intervention.

Choose the most appropriate

entry strategies. Most firms choose exporting as their initial strategy, but if high tariffs are present, other strategies should be considered, such as licensing, or FDI and JVs that allow the firm to produce directly in the market.

How Governments Should Respond to Intervention

Take advantage of foreign trade zones. FTZs

are areas where imports receive preferential tariff treatment intended to stimulate local economic development.

E.g., a successful experiment with FTZs has been the maquiladoras — export-assembly plants in northern Mexico.

Seek favorable customs classifications for exported products. Reduce exposure to trade barriers by ensuring that products are classified properly.

Take advantage of investment incentives and other government support programs. **Lobby for freer trade and investment.** Increasingly, nations are liberalizing markets in order to create jobs and increase tax revenues.

Regional Economic Integration

Regional economic integration, refers to the growing economic interdependence that results when countries within a geographic region form an alliance aimed at reducing barriers to trade and investment.

Over 50% of world trade today is under some bloc preferential trade agreement.

Premise- mutual advantages for cooperating nations within a common geography, history, culture, language, economics, and/or politics

Free trade that results from economic integration helps nations attain higher living standards by encouraging specialization, lower prices, greater choices, increased productivity, and more efficient use of resources.

Economic bloc- the result of regional economic integration - a geographic area that consists of two or more countries that agree to pursue economic integration by reducing tariffs and other restrictions to cross-border flow of products, services, capital, and, in more advanced stages, labor.

Regional economic integration: Process whereby countries in a geographic region cooperate to reduce or eliminate barriers to the international flow of products, people, or capital

5 Potential Levels of Regional Integration

Levels of Regional Integration

Free trade area: Simplest, most common arrangement. Member countries agree to gradually eliminate formal trade barriers *within* the bloc, while each member maintains an independent international trade policy with countries *outside* the bloc. One example is NAFTA.

Customs union: Similar to a free trade area except the members harmonize their trade policies toward nonmember countries by enacting *common* tariff and nontariff barriers on imports from non member countries. MERCOSUR is an example.

Common market: Like a customs union, except products, services, and *factors of production* such as capital, labor, and technology can move freely among the member countries. E.g., the EU countries put in place many common labor and economic policies.

Economic union: Like a common market, but members also aim for common fiscal and monetary policies, and standardize commercial regulations. The EU is moving toward an economic union by forming a monetary union with a single currency, the euro.

The EU: Features of a Full-Fledged Economic Union

Market access. Tariffs and most non-tariff barriers have been eliminated for trade in products and services, and rules of origin favor manufacturing that uses parts and other inputs produced in the EU.

Common market. The EU removed barriers to the cross-national movement of production factors—labor, capital, and technology.

Trade rules. The member countries have largely eliminated customs procedures and regulations, which streamlines transportation and logistics within Europe.

Standards harmonization. The EU is harmonizing technical standards, regulations, and enforcement procedures that relate to products, services, and commercial activities. **Common fiscal, monetary, taxation, and social welfare policies** in the long run. The euro (common currency since 2002):

Creation of the EU

Simplified the process of cross-border trade and enhanced Europe's international competitiveness.

Eliminated exchange rate risk in much of the bloc and forced member countries to improve their fiscal and monetary policies.

Unified consumers and businesses to think of Europe as a single market

Forced national governments to relinquish monetary power to the European Central Bank, in Luxembourg, which oversees EU monetary functions.

4 Institutions that Govern the EU

Council of the European Union. The main decision-making body, it decides on economic policy, budgets, foreign relations, and admission of new member countries. **European Commission.** Represents the interests of the EU as a whole. Proposes legislation. Responsible for implementing decisions of the Parliament and the Council. **European Parliament.** Has up to 785 representatives who meet in session every month to devise EU legislation, supervise EU institutions, and decide on the EU budget. **European Court of Justice.** Interprets and enforces EU laws and settles legal disputes between member states.

EU Enlargement

Future EU members must meet the 4 Copenhagen Criteria
Stable institutions of human rights, democracy, and law
Functioning and capable market economy
Assume economic, monetary, and political obligations
Adopt rules of the Community, Court of Justice, and Treaties

European Free Trade Association

Iceland, Liechtenstein, Norway, Switzerland
Feared lost sovereignty
Feared destructive rivalry
Desired free-trade gains
Cooperates with EU

NAFTA (Canada, Mexico, the US)

The North American Free Trade Agreement took effect in January 1994 and seeks to eliminate trade barriers on most goods originating from North America.
The agreement calls for liberalized rules on government procurement practices, the granting of subsidies, and the imposition of countervailing duties.
Other provisions deal with trade in services, intellectual property rights, and standards of health, safety, and the environment.
Products may qualify for tariff-free status if they meet regional content requirements or if sufficient value was added to them within the NAFTA region.
NAFTA passage (1994) was facilitated by the *maquiladora* program - U.S. firms locate manufacturing facilities just south of the U.S. border and access low-cost labor without having to pay significant tariffs. NAFTA has:
Eliminated tariffs and most non-tariff barriers for products/services.
Initiated bidding for government contracts by member country firms
Established trade rules and uniform customs procedures.
Prohibited standards/technical regulations to be used as trade barriers.
Instituted rules for investment and intellectual property rights.
Provided for dispute settlement for investment, unfair pricing, labor issues, and the environment.

NAFTA Results

Trade among the members more than tripled and now exceeds \$1 trillion per year.
Between 1994 and 2008, annual exports from...
Canada to Mexico and the U.S. more than doubled;
Mexico to the U.S. grew from \$50 to \$220 billion;
the U.S. to Mexico grew from \$40 to \$150 billion;
the U.S. to Canada grew from \$120 to \$260 billion.
Both Canada and Mexico now have some 80 percent of their trade with and 60 percent of their FDI stocks in the United States.

How NAFTA Benefited the Mexican Economy

Mexican exports to the U.S. more than quadrupled
Access to Canada and the U.S. helped launch many
Mexican firms in industries such as cars, electronics,
textiles, medical products, and services

Yearly U.S. and Canadian investment in Mexico rose from \$4 billion in 1993 to over \$20 billion by 2008

Mexico's per capita income
rose to over \$10,000 by 2010,
making it a leading emerging
market worldwide

Mercosur

Also called Southern Common Market

Very successful early

Impaired by ideology and economic hardships

Future "SAFTA"?

Members of the Southern Common Market include Argentina, Brazil, Paraguay, Uruguay, and Venezuela.

Today, the group functions as a customs union and is busy liberalizing trade and investment among its members. It is emerging as the most powerful economic group throughout Latin America.

One day, the group may expand to incorporate all of South America into a single, massive free trade agreement.

El Mercado Comun del Sur (MERCOSUR)

1991- MERCOSUR or (the Southern Common Market) has become the strongest economic bloc in South America.

The four largest members alone—Argentina, Brazil, Paraguay, and Uruguay—account for some **80 percent** of South America's GDP.

MERCOSUR established the free movement of products and services, a common external tariff and trade policy, and coordinated monetary and fiscal policies.

MERCOSUR eventually aims to become an economic union.

MERCOSUR may be integrated with NAFTA and the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA) as part of the proposed Free Trade Area of the Americas (FTAA). This integration would bring free trade to the western hemisphere.

Why Do Nations Pursue Economic Integration

Expand market size

Increases size of the marketplace for firms inside the economic bloc. Belgium has a population of just 10 million; the EU has a population of nearly 500m.

Buyers can access larger selection of goods.

Enhance productivity and economies of scale

Bigger market facilitates economies of scale.

Internationalization inside the bloc helps firms learn to compete outside the bloc.

Competition and efficient resource usage inside the bloc leads to lower prices for bloc consumers.

Attract investment from outside the bloc

Compared to investing in stand-alone countries, foreign firms prefer to invest in countries belonging to an economic bloc. General Mills, Samsung, and Tata have invested heavily in EU-member countries.

Acquire stronger defensive and political posture

Belonging to a bloc provides member countries with a stronger defensive posture relative to other nations and world regions. This was a key motive for formation of the EU.

What Factors Help Regional Integration Succeed?

Economic similarity. Strong similarity on wage rates, economic conditions, and other factors helps ensure success. Most EU countries are similar in this way.

Political similarity. Countries should have similar political systems, share aspirations, and be willing to surrender national autonomy. This is a key success factor of the EU. **Similarity of culture and language.** MERCOSUR and Australia/New Zealand CER are similar in this way.

Geographic proximity. Facilitates intra-bloc movement of products, labor, and other factors. Often, neighboring countries have a common history, culture, and language.

Implications of Regional Integration for the Firm

Internationalization by firms inside the economic bloc. Regional integration facilitates company internationalization. Expansion into neighboring countries provides valuable experience, prompting internationalization to other markets worldwide.

Rationalization of operations. By restructuring and consolidating company operations, managers can develop strategies and value-chain activities suited to the region as a whole, not just individual countries. Goal is to cut costs and redundancy, and increase efficiencies via scale economies.

Regional products and marketing strategy. Firms cut costs by standardizing products and services. Case Inc. reduced its Magnum line of tractors from 17 to only a few versions in Europe, following integration of the EU.

Internationalization by firms from outside the bloc. Because external trade barriers mainly affect exporting, many foreign firms prefer to enter a bloc through FDI. In this way, after formation of the EU, Britain became the largest recipient of FDI from the United States.

Drawbacks of Regional Integration

Trade creation – As barriers fall, trade is generated inside the bloc.

Trade diversion – As within-bloc trade becomes more attractive, member countries discontinue some trade with nonmember countries.

Aggregate effect – National trade patterns are altered. More trade occurs inside bloc; less trade occurs with countries outside the bloc.

A bloc can become an ‘economic fortress’ leading to more *within-bloc* trade and less *between-bloc* trade, which can reduce *global* free trade.

Loss of national identity. Increased cross-border contact makes members more similar to each other. In response to NAFTA, Canada has restricted the ability of U.S. movie and TV producers to invest in the Canadian film and broadcasting industries. **Sacrifice of autonomy.** In later stages, a central authority is set up to manage the bloc’s affairs. Members must sacrifice some autonomy to the central authority, such as control over their own economy. E.g., Britain in the EU.

Transfer of power to advantaged firms. Integration can concentrate economic power in the hands of fewer, larger firms, often in the most advantaged member countries. **Failure of small or weak firms.** As barriers fall, protections are eliminated that previously shielded smaller or weaker firms from foreign competition.

Corporate restructuring and job loss. Restructuring and increased competitive pressures may lead to layoffs or re-assigning employees to distant locations, disrupting workers and entire communities.

Understanding Emerging Markets

Classifying Countries based on Economic Development

Advanced economies are post-industrial countries characterized by high per capita income, highly competitive industries, and well-developed commercial infrastructure. **Examples-** world’s richest countries and include Australia, Canada, Japan, New Zealand, the United States, and Western European countries.

Developing economies are low-income countries characterized by limited industrialization and stagnant economies.

Examples- low-income countries, with limited industrialization and stagnant economies- e.g. Bangladesh, Nicaragua and Zaire.

Emerging market economies are a subset of former developing economies that have achieved substantial industrialization, modernization, improved living standards and remarkable economic growth.

Examples- some 27 countries in East and South Asia, Latin America, Middle East and Eastern Europe- including Brazil, Russia, India, China (so called BRIC countries).

Key Differences Among the 3 Major Country Groups *Blue Chart 1

National Characteristics of Major Country Groups *Blue Chart 2

The fastest-growing markets for power tool companies like Black & Decker and Robert Bosch are in Asia, Latin America, Africa, and the Middle East.¹⁰ Even during the global recession, technology firms such as Cisco, Hewlett-Packard, and Intel were generating a large and growing proportion of their revenues from sales to such countries. In 2008, firms in the global pharmaceutical companies such as Pfizer and Glaxo-SmithKline increased their emphasis on developing and marketing drugs in emerging markets. Industry insiders forecast that medication sales in the biggest emerging markets will hit \$300 billion by 2017, equal to today’s sales in the top five European markets and the United States combined. Already Merck and Pfizer have launched popular drugs in India, using

innovative pricing strategies that make once-expensive medications affordable for millions of low-income consumers. Businesses in emerging markets are important targets for machinery and equipment sales. In this category, markets are huge for textile machinery in India, for agricultural equipment in China, and for oil and gas exploration technology in Russia. In a similar way, governments and state enterprises in emerging markets are major targets for sales of infrastructure-related products and services such as machinery, power transmission equipment, transportation equipment, high-technology products, and other products that countries in the middle stage of development typically need.

Advanced Economies

Mature state of industrial development; transitioned from manufacturing economies into service-based economies.

Home to 14% of the world's population, and account for 65% of world GDP, over half of world trade in products, and three-quarters of world trade in services.

Political systems- democratic, multiparty systems of government.

Economic systems- typically based on capitalism, with relatively little government intervention in business.

Serious purchasing power; few restrictions on international trade and investment.

They host the world's largest MNEs.

Developing Economies

Low discretionary incomes, limited proportion of personal income spent on purchases other than food, clothing, and housing.

In developing economies, 17% live on less than \$1 per day; 40% live on less than \$2 per day.

The combination of low income and high birth rates tends to perpetuate poverty.

Misnomer-sometimes called *underdeveloped countries* or *third-world countries*- these terms are imprecise because, despite poor economic conditions, the countries tend to be highly developed in historical and cultural terms.

Emerging Market Dynamics

Emerging markets account for over 30 percent of world GDP. They represent over 30 percent of exports and receive over 30 percent of FDI.

Mid-2000s, the emerging markets collectively enjoyed an average annual GDP growth rate of nearly 7%, a remarkable feat – much faster than advanced economies

Benefit from: low-cost labor, knowledge workers, government support, low-cost capital, and powerful, highly networked conglomerates

What Makes Emerging Markets Attractive?

1. **Emerging Markets as Target Markets:** Many have huge middle classes with significant income for buying electronics, cars, health care services, and countless other products. Many exhibit high economic growth rates.
2. **Emerging Markets as Manufacturing Bases:** Home to low-wage, high-quality labor for manufacturing and assembly operations. Large reserves of raw materials and natural resources as in South Africa, Brazil, Russia
3. **Emerging Markets as Sourcing Destinations:** MNEs have established numerous call centers in Eastern Europe, India, the Philippines, and elsewhere. Dell and IBM outsource certain technological functions to knowledge workers in India. Intel and Microsoft have much of their programming activities performed in Bangalore, India. Investments from abroad benefit emerging markets as they lead to new jobs, production capacity, transfer of technology. and linkages to the global marketplace.

Estimating the Potential of Emerging Markets

Estimations are challenging because of peculiar economic and social environments in these countries.

Limited availability and reliability of data

Market research can be very costly and less precise, as compared to the advanced economies.

Market potential indicators include: GDP growth rate, income distribution, commercial infrastructure, unemployment rate, and consumer expenditures for discretionary items.

Purchasing Power Parity Adjustment to per capita GDP

In relying on per capita GDP for comparison of different countries, one should use purchasing power parity exchange rates, rather than the market exchange rates.

Purchasing power parity adjustment provides a more realistic indicator of purchasing power of consumers in emerging and developing economies.

PPP adjusted per capita GDP more accurately represents the amount of products that consumers can buy in a given country, using *their own currency* and consistent with *their own standard of living*.

Differences in Per Capita GDP, in Conventional and PPP Terms

Managers should exercise caution in relying on per-capita income as an indicator of market potential in an emerging or developing economy. There are four reasons for this caution.

- (1) Official data do not account for the *informal economy*, where economic transactions are not officially recorded and are thus left out of government calculations of a nation's GDP. In developing economies, the informal economy is often as large as the formal economy
- (2) Most the population is on the low end of the income scale in emerging markets and developing economies. "Mean" or "average" does not accurately represent a non-normal distribution; often, median income provides a more accurate depiction of purchasing power.
- (3) Household income is often much larger than per-capita income because of multiple wage earners within individual households in these countries. Multiple income households naturally more spending power than individuals.
- (4) Governments in these countries may underreport national income so they can qualify for low-interest loans and grants from international aid agencies and development banks.

The Big Mac Index*

2016 Market Potential Index

Top 10: China, Hong Kong, Singapore, India, Japan, Canada, Germany, UK, Qatar, Switzerland

Challenges of doing business in Emerging Markets

Political stability

Bureaucracy and lack of transparency

Weak intellectual property (IP) protection

Poor physical infrastructure

Partner availability and qualifications

Dominance of family conglomerates

Strategies for Doing Business in Emerging Markets

Customize Offerings to Unique Emerging Market Needs. Successful firms develop a deep understanding of the distinctive characteristics of buyers, local suppliers, and distribution channels in emerging markets, and customize offerings and business models accordingly.

Partner with a family conglomerate – FCs can provide various advantages, including financing, bank services, local suppliers, and distribution channels. FCs can help reduce risks, time, and capital requirements; develop relationships with governments and other key players; and overcome infrastructure hurdles.

Target governments, which buy enormous quantities of products, such as computers, furniture, office supplies, and motor vehicles, as well as services. State enterprises operate in areas such as railways, airlines, banking, oil, chemicals, and steel.

Skillfully Challenge Emerging Market Competitors. New global challengers and other emerging market firms possess various advantages that require skillful strategies and due diligence to overcome.

Low-cost labor, skilled workforce, government support, and family conglomerates give emerging market firms various advantages. Advanced economy firms must:

Conduct research to understand target markets and the indigenous challengers;

Acquire new capabilities that build competitive advantage (e.g., develop new products, new ways of doing business, local alliances);

Leverage the same advantages in emerging markets enjoyed by local firms (e.g., low-cost labor, skilled workforce, cheap capital, key partnerships).

Culture

Culture: “Set of values, norms, beliefs, rules, and institutions held by a specific group of people”

Cross-cultural risk: A situation or event

where a cultural miscommunication puts some human value at stake. It arises in environments characterized by unfamiliar languages and unique value systems, beliefs, and behaviors.

Ethnocentricity: Belief that one’s own ethnic group or culture is superior to that of others

Cultural literacy: Detailed knowledge of a culture that enables a person to function happily and effectively within it

Culture is...

Not right or wrong – It is relative. There is no cultural absolute. Different nationalities simply perceive the world differently.

Not about individual behavior – It is about groups. It is a collective phenomenon of shared values and meanings.

Not inherited – It derives from the social environment. We are not born with a shared set of values and beliefs; we acquire them as we grow up.

Culture is Learned

Socialization: The process of learning the rules and behavioral patterns appropriate to one's society.

Acculturation: The process of adjusting and adapting to a culture other than one's own; commonly experienced by expatriate workers

Culture is like an **iceberg**—above the surface, certain characteristics are visible; below the surface is a massive base of assumptions, attitudes, and values that strongly influence decision-making, relationships, and other dimensions of business.

Culture learned while growing up in the culture is called socialization, while learning a new culture is called acculturation. Much of culture is not easily seen.

Culture is linked with particular groups based on various factors, including:

Geography. Different levels – the world, the nation, the region, cities -- elicit unique cultural perspectives.

Ethnicity. For example, people of African, Indian, and Latino heritage tend to perceive reality differently.

Gender. Men and women often experience the world differently.

Age. Seniors, baby boomers, teenagers, and children perceive their worlds differently.

Language. Language both reflects, and is reflected by, cultural differences.

Occupation. Perspectives differ among blue collar workers, professionals, or artists.

Sub-cultures

Larger cultures contain sub-cultures who share a unique way of life within the larger culture (language, race, lifestyle, attitudes, etc.)

Need to be aware of the sub-culture since it influences behaviour

It often extends across borders

National, Professional and Corporate Culture

Components of Culture

Aesthetics as all that a culture considers to be in “good taste” in the arts, the imagery evoked by certain expressions, and the symbolism of colours.

Manners are generally acceptable ways of behaving, speaking, and dressing.

Customs are habits and behaviors in specific circumstances and situations

Values are Ideas, beliefs, and customs to which people are emotionally attached

Attitudes are Positive or negative evaluations, feelings, and tendencies people hold toward objects or concepts

Social Structure consists of groupings such as family; stratification or the layers that exist in the structure; and mobility which is the ease with which people can move between the social strata.

Religion the major religions of the world are: Christian, Muslim, Hindu, Buddhism, Confucianism, Judaism.

Personal Communication – Language. Be aware of not only a nation’s core language but also of the many dialects when translating brands, advertising or documents

Education. Cultures pass on traditions, customs, and values through schooling, parenting, group memberships, etc.

Physical environment. Topography and climate can affect culture

Frameworks

Two well known frameworks used to describe culture are:

E.T Hall's Context typology

Low-context cultures rely on explicit explanations, with emphasis on spoken words. Such cultures emphasize clear, efficient, logical delivery of verbal messages. Communication is direct. Agreements are concluded with specific, legal contracts.

High-context cultures emphasize nonverbal or indirect language. Communication aims to promote smooth, harmonious relationships. Such cultures prefer a polite, "face-saving" style that emphasizes a mutual sense of care and respect for others. Care is taken not to embarrass or offend others.

Hofstede's Framework

Individualism versus Collectivism. *Individualist cultures* value hard work, entrepreneurial risk-taking, and freedom to focus on personal goals. *Collectivist cultures* emphasize a strong association with family and work groups to maintain harmony and to work toward collective goals.

Power Distance. Large power distance means greater inequality between superiors and subordinates, more hierarchical organizations, and power derives from prestige, force, and inheritance. Small power distance implies more equally shared prestige and rewards, and power derives from hard work and is often considered more legitimate.

Uncertainty Avoidance. Cultures having large uncertainty avoidance tend to value security, systems of rules and procedures, low employee turnover, and relatively slower change. Those with low uncertainty avoidance are more open to change and new ideas.

Masculinity versus Femininity. Cultures with high masculinity versus femininity scores emphasize assertiveness, the accumulation of wealth, and an entrepreneurial drive. Cultures rating low on masculinity versus femininity value relaxed lifestyles and are more concerned for others than they are with material gain.

Long-term Orientation. Cultures scoring high on long-term orientation place value on respect for tradition, thrift, perseverance, and a sense of personal shame. Cultures scoring low on long-term orientation tend to value individual stability and reputation, fulfilling social obligations, and reciprocation of greetings and gifts.

Cultures are different - so what!

Reflected in language - so affects communication and understanding

Reflected in perceptions of business – deal making vs. relationship building

Reflected in perceptions of time

Reflected in expected behaviour

Reflected in attitudes and values

Managerial Orientations

Ethnocentric orientation: Using our own culture as the standard for judging other cultures.

Polycentric orientation: A mindset in which the manager develops a greater affinity for the country in which he or she works than for the home country.

Geocentric orientation: A global mindset in which the manager is able to understand a business or market without regard to national boundaries.

Managers should strive for a geocentric orientation.

Developing a Global Mindset

Acquire factual and interpretive knowledge

Cultural adaptability means that a person must be knowledgeable of an unfamiliar culture, then alter his or her behavior accordingly.

Bridging the gap means employing creativity when Western ideas are applied in Eastern cultures, and vice versa.

Building global mentality involves developing openness and flexibility toward all things unfamiliar, understanding global business principles, and improving abilities to implement strategies.

Flexibility is key because the more behavioural the issue, the greater will be local culture's influence on that issue.

Avoid cultural bias and stereotypes

Managerial Guidelines for Cross-Cultural Success

Acquire factual and interpretive knowledge about the other culture; try to speak their language.

Avoid cultural bias.

Develop cross-cultural skills, such as perceptiveness, interpersonal skills, adaptability

Self-reference criterion: The tendency to view other cultures through the lens of one's own culture- understanding this is the first step.

Critical incident analysis: A method for analyzing awkward situations in cross cultural interactions by developing empathy for other points of view.

1. Identify situations where you need to be culturally aware to interact effectively with people from another culture.
2. When confronted with “strange” or awkward behavior, discipline yourself to not make judgments.
3. Develop your best interpretation of the foreigner’s behavior, and formulate your response
4. Learn from this process and continuously improve.

Personal Traits for Cross-Cultural Proficiency

Tolerance for ambiguity: Ability to tolerate uncertainty and lack of clarity in the thinking and actions of others.

Perceptiveness: Ability to closely observe and comprehend subtle information in the speech and behaviour of others.

Valuing personal relationships: Ability to appreciate personal relationships; which are often more important than achieving one-time goals or “winning” arguments.

Flexibility and adaptability: Ability to be creative in devising innovative solutions, be open-minded about outcomes, and show “grace under pressure”.

Political and Legal Systems

What is country risk?

Exposure to potential loss or adverse effects on company operations and profitability caused by developments in a country’s political and/or legal environments.

Also known as ‘political risk’

Each country has unique political and legal systems that often pose challenges for company performance

Dimensions of Country Risk

Top 10 Countries for Business: Denmark, Hong Kong, New Zealand, Ireland, Sweden, Canada, Norway, Singapore, Switzerland, Finland

Sources of Country Risk

Political System: government, political parties, legislative bodies, lobbying groups, trade unions, other political institutions

Legal System: laws, regulations, and rules that aim to: ensure order in commercial activities, resolve disputes, protect IP, tax economic output

Political Systems

Political system: A set of formal institutions that constitute a government. It includes legislative bodies, political parties, lobbying groups, and trade unions. The system also defines how these groups interact with each other.

Three major types of political systems:

Totalitarianism

Socialism

Democracy

These categories are not mutually exclusive.

Political Ideologies

We can arrange the world's three political ideologies on a horizontal scale.

At one extreme is **totalitarianism**—the belief that every aspect of people's lives must be controlled to preserve order.

At the other extreme is **anarchism**—the belief that only individuals and private groups can preserve political liberties.

In-between lies **pluralism**—the belief that both private and public groups belong in politics.

Political Systems: Totalitarianism

Government controls all economic and political matters

Either *theocratic* (religion-based) or *secular*

A state party is led by a dictator. Membership is mandatory for those wanting to advance.

Power is sustained via secret police, propaganda, and regulation of free discussion and criticism.

Today: Some countries in the Middle East and Africa; Cuba, North Korea.

Ex-totalitarian states tend to have much government intervention and bureaucracy

Political Systems: Socialism

Capital is vested in the state and used primarily as a means of production for use rather than for profit.

Group welfare outweighs individual welfare.

Government's role is to control the basic means of production, distribution, and commercial activity.

Socialism occurs in much of the world as social democracy (e.g., Western Europe, Brazil, India).

Government intervention in the private sector

Corporate income tax rates are higher

Political Systems: Democracy

Economic activity occurs freely, as per market forces

Limited government: The government performs only essential functions that serve all citizens, such as national defence, maintaining law and order, foreign relations, and providing basic infrastructure.

Private property rights: The ability to own property and assets and to increase one's asset base by accumulating private wealth. Property includes land, buildings, stocks, contracts, patents. Encourages initiative, ambition, innovation.

Democracy and Openness

Democracy is associated with 'openness,' the lack of regulation and barriers to the entry of firms in foreign markets.

Openness is associated with:

Successful market entry

Increased market demand

Competition on quality, which improves overall product quality.

Increased competition, leading to efficiencies and lower prices.

Political and Economic Systems

Totalitarianism is associated with **command economies**, wherein the state makes all decisions on what to produce, how much to produce, and what prices to charge.

Democracy is associated with **market economies** and capitalism in which decisions are largely left to market forces, that is, supply and demand.

Socialism is associated with **mixed economies**, which have features of both market and command economies, combining state intervention and market mechanisms (e.g., Sweden, Singapore).

Legal Systems

Legal system: A system for interpreting and enforcing laws. The laws, regulations, and rules establish norms for conduct. It incorporates institutions and procedures for ensuring order and resolving disputes in commercial activities, as well as protecting intellectual property and taxing economic output.

Four major types of legal systems:

Common Law

Civil Law

Religious Law

Mixed Systems

The Rule of Law

Existence of a legal system where rules are clear, publicly disclosed, fairly enforced, and widely respected by individuals, organizations, and the government.

Common in the advanced economies.

The legal system is: (i) applied to all citizens equally; (ii) issued via recognized government authorities; and (iii) enforced fairly and systematically by police forces and formally organized judicial bodies.

Economic activity suffers and uncertainty increases when the rule of law is weak.

Legal Systems: Common Law

A legal system that originated in England and spread to Australia, Canada, USA, and other former members of the British Commonwealth (also known as *case law*).

The basis of law is tradition, past practices, and legal precedents set by courts via interpretation of statutes, legislation, and past rulings.

Judges have much power to interpret laws based on the circumstances of individual cases. Thus, common law is relatively flexible.

Legal Systems: Civil Law

Found in France, Germany, Italy, Japan, Turkey, and much of Latin America.

Based on an all-inclusive system of laws that have been “codified”—clearly written by legislative bodies.

Laws are more ‘cast in stone’ and not strongly subject to interpretation by courts.

A key difference is that common law is mainly *judicial* in origin and based on court decisions, whereas civil law is mainly *legislative* and based on laws passed by national and state legislatures.

Legal Systems: Religious Law

Strongly influenced by religious beliefs, ethical codes, and moral values and viewed as mandated by a supreme being.

Most important religious legal systems are based on Hindu, Jewish, and Islamic law.

Islamic law spells out norms of behaviour regarding politics, economics, banking, contracts, marriage, and many other social and business issues.

Legal Systems: Mixed Systems

Two or more legal systems operating together.

The contrast between civil and common law has blurred as countries combine both systems.

Totalitarianism is most associated with religious law and socialist law.

Democracy is associated with common law, civil law, and mixed systems.

Example

Legal systems in Lebanon, Morocco, and Tunisia share elements of civil law and Islamic law.

Dominant Legal Systems in Selected Countries

Actors in Political and Legal Systems

The **government**, or the ‘public sector,’ operating at national and local levels.

International organizations such as the World Bank, World Trade Organization, and the United Nations

Regional economic blocs, such as the European Union, NAFTA, and many others.

Special interest groups such as labor unions and environmental advocates

Local **competing firms**, which oppose foreign firms.

Special Interest Groups Typical Issues

Country Risk Produced by Political Systems

Government Takeover of Corporate Assets

Confiscation: Seizure of corporate assets *without* compensation.

Expropriation: Asset seizure *with* compensation.

Nationalization: Takeover of an entire industry, with or without compensation.

Creeping Expropriation

Embargoes and Sanctions

Boycotts against Firms and Nations

Wars, Insurrection, and Violence

Types of Country Risk Produced by Legal Systems

Country risk arising from the host country legal environment:

Foreign investment laws

Controls on operating forms and practices

Marketing and distribution laws

Laws regarding income repatriation

Environmental laws

Contract laws

Inadequate or underdeveloped legal systems

Internet and e-commerce regulation

Country risk arising from the home country legal environment:

The Foreign Corrupt Practices Act (FCPA)

Anti-boycott regulations

Accounting and reporting laws

Transparency in financial reporting

Managing Country Risk

Proactive environmental scanning: Management should develop a comprehensive understanding of the political and legal environment in target countries. *Scanning* – ongoing assessment of potential risks and threats to the firm, via intelligence sources such as:

Employees working in the host country.

Embassy and trade association officials.

Consulting firms, such as Business Entrepreneurial Risk Intelligence (<http://www.beri.com>).

Minimize exposure to country risks.

Strict adherence to ethical standards: Firms that engage in questionable practices or operate outside the law invite redress from the governments of the host countries where they do business.

Alliances with qualified local partners: For example, firms often enter China and Russia by partnering with local firms who assist in navigating the complex legal and political landscape.

Protection through legal contracts: Contract law varies widely. The firm must follow the law in each country.

Three approaches for resolving contract disputes:

Conciliation is a formal process of negotiation whose objective is to resolve differences in a friendly manner. It is the least adversarial method. Common in China.

In **arbitration**, a neutral third party hears both sides of a case and decides in favor of one party or the other, based on an objective assessment of the facts.

Litigation occurs when one party files a lawsuit against another. The most adversarial approach, it is common in the United States.

What is Strategy?

A planned set of actions that managers take to make best use of the firm's resources and core competences to gain a competitive advantage

When developing strategies, managers examine the firm's strengths and weaknesses, and the opportunities and challenges facing the firm.

They then decide which customers to target, what product lines to offer, how best to contend with competitors, and how generally to configure and coordinate the firm's activities around the world.

Strategy-Formulation Process

Corporate Strategy

A.G. Lafley and Roger Martin in "*Playing to Win*" have simplified corporate strategy to these key points:

Strategy is all about CHOICE

Businesses must decide:

Where are they going to play

How are they going to win

How they can leverage their strengths to the greatest advantage

Porter's Competitive Strategies

International Strategy

Once an organization has chosen to look at markets outside its home country they need to choose to create either a predominantly GLOBAL strategy (Standardization) or a predominantly MULTINATIONAL strategy (Adaptation).

Note that this choice may be different for different products/services within a single company

Strategy carried out in two or more countries.

Managers develop international strategies to:

allocate scarce resources and configure value-adding activities on a worldwide scale

participate in major markets

implement valuable partnerships abroad

engage in competitive moves in response to foreign rivals.

Global, Sustainable Competitive Advantage

Managers should aim to "...develop, at one and the same time, global scale in efficiency, multinational flexibility, and the ability to develop innovations and leverage knowledge on a worldwide basis."

Thus, the firm that aspires to become a globally competitive enterprise should simultaneously strive for three strategic objectives:

- **efficiency**
- **flexibility**, and
- **learning**

Essentials of Successful Global Firms

The Global Firm -> Strategy, Visionary Leadership, Organizational Culture, Organizational Structure, Organizational Process

Global Integration (Standardization)

Coordination of the firm's value-chain activities across multiple countries to achieve worldwide efficiency, synergy, and cross-fertilization to take advantage of similarities between countries.

Firms that emphasize global integration:

Make and sell standardized products and

services to capitalize on converging customer needs and tastes

Compete on a regional or worldwide basis

Minimize operating costs by centralizing value chain activities and emphasizing scale economies

Global Industry

An industry in which competition is on a regional or worldwide scale

Firms that specialize in such industries as aerospace, cars, computers, chemicals, and industrial equipment, typically cater to customers on a regional or global scale. For example, Subaru markets similar cars worldwide.

In such industries, customer needs vary little from country to country. Firms sell relatively standardized offerings across entire regions or throughout the world.

The industry usually has only a handful of the same competitors that compete regionally or worldwide.

Local Responsiveness (Adaptation)

Meeting the specific needs of buyers in individual countries

Local responsiveness requires the firm to adapt to customer needs and the competitive environment.

Local managers are free to adjust offerings, marketing, and practices to suit conditions in individual markets.

When operating internationally, firms try to strike the right balance between global integration and local responsiveness

Multi domestic Industry

An industry in which competition takes place on a country-by-country basis.

Firms that specialize in such industries as processed food, consumer products, fashion, retailing, and publishing usually cater to specific conditions in each country where they do business.

In such industries, the firm must adapt its offerings to suit the language, culture, laws, income level, and other specific characteristics of each country.

Each country tends to have a unique set of competitors.

Standardization/Adaptation Framework

Summarizes the balance that firms seek to achieve between two basic strategic needs:

to integrate value chain activities globally, and

to create products and practices responsive to local market needs.

The main goal of firms that emphasize global integration is to maximize the efficiency of their value chain activities on a worldwide scale.

The main goal of firms that emphasize local responsiveness is to maximize sales and market share by being highly responsive to local needs.

Pressures for Global Integration/Standardization

Seek cost reduction through economies of scale. Concentrating manufacturing in a few advantageous locations achieves economies of mass production.

Capitalize on converging consumer trends and universal needs. Companies like Nike, Dell, ING, and Coca-Cola offer products that appeal to customers everywhere.

Provide uniform service to global customers. Services are easiest to standardize when firms centralize their creation and delivery.

Conduct global sourcing of raw materials, components, energy, and labor. Sourcing of inputs from large-scale, centralized suppliers provides economies of scale and consistent performance.

Monitor and respond to global competitors. Globally coordinating the firm's response to competitive threats is more efficient and effective.

Take advantage of global media. Firms leverage the Internet, cross-national TV, and other global media to advertise in many countries simultaneously.

Pressures for Local Responsiveness/Adaptation

Leverage natural endowments

available to the firm. Each country has specific national resources and other endowments that the foreign firm should access.

Cater to local customer needs. Businesses

in multi-domestic industries should adapt products, services, and marketing to suit local customer needs.

Accommodate differences in distribution channels. For example, Japan's distribution system for consumer goods is characterized mainly by small retailers.

Respond to local competition. To out-compete local rivals, successful firms devise offerings and practices that best meet local demand.

Adjust to cultural differences. For those products where cultural differences are important, the firm should adapt the product and marketing, especially when local competitors are numerous.

Meet host government requirements and regulations. They must always comply

with local legal and regulatory requirements, which can vary substantially from country to country.

Tradeoffs between Standardization and Adaptation

Four Strategies Emerging from the Standardization-Adaptation Framework

1. *Home replication strategy*

2. *Multi domestic strategy*

3. *Global strategy*

4. *Transnational strategy*

Four Strategies Emerging from the Integration Responsiveness Framework

Home Replication Strategy

The firm views international business as separate from, and secondary to, its domestic business. Expansion abroad is an opportunity to generate incremental sales for domestic product lines.

Products are designed for domestic customers, and international business is pursued mainly to extend the life of domestic products and replicate home market success.

Management holds little interest in foreign markets and expects little knowledge to flow from foreign operations.

Multi domestic Strategy

The firm develops subsidiaries or affiliates in each of its foreign markets and appoints local managers to operate independently and be locally responsive.

Products and services are adapted to suit the needs and wants of buyers in each country.

Because headquarters acknowledges differences between national markets, subsidiaries are allowed to vary products and practices by country.

Country managers are often nationals of the host country and generally don't share knowledge and experience with managers in other countries.

Global Strategy

Headquarters seeks substantial control over all country operations in order to minimize redundancy and achieve maximum efficiency, learning, and integration worldwide.

Global strategy asks "why not make the same thing, the same way, everywhere?" Products, marketing, and company practices are relatively standardized.

R&D, manufacturing, marketing and other activities tend to be concentrated at headquarters, where they can be centrally coordinated and controlled.

Management views the world as one large marketplace.

Transnational Strategy

A coordinated approach to internationalization in which the firm strives to be more responsive to local needs *while* retaining sufficient central control of operations to ensure efficiency and learning.

The firm seeks to combine the major advantages of multi domestic and global strategies, while minimizing their disadvantages.

It's a flexible approach: standardize where feasible; adapt where appropriate.

But, most firms find implementing transnational strategy very challenging

Transnational Strategy requires the firm to:

Exploit scale economies by sourcing from a reduced set of global suppliers and concentrating production in relatively few locations where competitive advantages can be maximized

Organize production, marketing, and other value-chain activities on a global scale

Optimize local responsiveness and flexibility

Facilitate global learning and knowledge transfer

Coordinate global competitive moves — that is, deal with competitors on a global, integrated basis.

Global Market Opportunity Assessment

Global Market Opportunity

A favorable combination of circumstances, locations, or timing that offers prospects for exporting, investing, sourcing, or partnering in foreign markets

A favorable combination of circumstances, locations, or timing that offers prospects for exporting, investing, sourcing, or partnering in foreign markets

The 6 Tasks of Global Market Opportunity Assessment (GMOA)

1. Analyze organizational readiness to internationalize
2. Assess the suitability of the firm's products and services for foreign markets
3. Screen countries to identify attractive target markets
4. Assess the industry market potential or the market demand for the product(s) or service(s) in selected target markets

5. Choose qualified business partners, such as distributors or suppliers
6. Estimate company sales potential for each target market

Task 1. Organizational Readiness

Analyze organizational readiness to internationalize with an objective assessment of the firm's preparedness to engage in international business

Examine company strengths and weaknesses for international business by evaluating availability in the firm of key factors, such as:

appropriate financial and tangible resources

relevant skills and competencies

management's commitment to internationalization

Eliminate deficiencies that hinder company goal

Questions to Address in Organizational Readiness Analysis

What does the firm hope to gain from international business — increasing sales or profits, challenging competitors, or pursuing a global strategy?

Is international business expansion consistent with other company goals, now or in the future?

What demands will internationalization place on company resources like finance, personnel, and manufacturing capacity?

What is the basis of the firm's competitive advantage?

Task 2. Product Suitability

Assess suitability of the firm's products and services for foreign markets by conducting a systematic assessment of company offerings for international customers. Evaluate the fit between the offerings and foreign customer needs.

For each possible target market, identify the factors that may hinder market potential. Determine how the offering may need to be adapted for each market. Specifically, assess the offering regarding such factors as foreign customer characteristics, laws and regulations, channel intermediary requirements, and the nature of competitors.

Four Factors determining products with the best foreign sales prospects:

Sell well in the domestic market. For example, Microsoft Xbox, iPhone

Cater to universal needs. Such as a cancer drug, an energy efficient refrigerator

Address a need not well served in foreign markets. For example, mutual funds, mini notebooks

Address a new or emergent need abroad. For example, a major earthquake creates urgent need for portable housing; AIDS in Africa creates need for drugs and medical supplies

Questions to Measure International Market Potential

Who initiates purchasing?

Who uses the product or service?

Why do people buy the product or service?

Where do people purchase the product or service?

What economic, cultural, geographic, and other factors in the target market may limit sales?

Task 3. Country Screening

Screen countries to identify target markets.

Reduce the number of countries that warrant in-depth investigation as potential target markets to a manageable few.

Identify five or six countries that hold the best potential by assessing each country regarding such criteria as: size and growth rate, 'market intensity' (customers' buying power), 'consumption capacity' (size and growth rate of the middle class), country's receptivity to imports, infrastructure for doing business, economic freedom, and country risk

Specific Considerations

Cultural Similarity with Target Market may Matter. Some firms target countries that are “psychically” similar in terms of language and culture.

Nature of Information Sought varies with product and industry. For farming equipment, consider countries with much agricultural land and farmers with higher incomes. For semiconductors, target countries that manufacture computers.

Targeting a Region may Make Sense. For example, the European Union, Latin America

Screening Methodology for Potential Country Markets: Two Methods

1. With **Gradual Elimination**, the firm starts with numerous prospective target countries and narrows the choices by examining increasingly specific information. Initially, the researcher obtains macro-level indicators like population, income, and economic growth before delving into specific information.
2. With **Indexing and Ranking**, the firm assigns scores to countries based on their overall market attractiveness. For each country, the researcher identifies a set of market-potential indicators and ranks each country on each indicator. Weights are assigned to each variable to establish its relative importance.

Country Screening for Foreign Direct Investment

Researchers who attempt to identify the best locations for FDI typically consider these variables:

Long-term prospects for growth and sizeable returns

Cost of doing business based on available infrastructure, tax rates, wages, and worker skills

Country risk like regulatory, financial, political, and cultural barriers and intellectual property protections

Competitive environment

Government incentives such as tax holidays, subsidized training, grants, or low-interest loans

A.T. Kearney Foreign Direct Investment Confidence Index + Global Services Index*

Country Screening for Global Sourcing

Global sourcing is the practice of procuring finished products, intermediate goods, and services from suppliers located abroad.

When seeking foreign sources of supply, managers examine such factors as:

cost and quality of inputs,

stability of exchange rates,

reliability of suppliers,

presence of a work force with superior skills.

Task 4. Assess Industry Market Potential

The firm estimates the most likely share of sales that can be achieved in each target country including consideration of market entry barriers. Firm should develop a 3 to 5-year forecast of industry sales.

Assess industry market potential in each market by examining such criteria as:

Size and growth rate of the market and industry trends

Tariff and non-tariff trade barriers to market entry

Standards and regulations that affect the industry

Availability and sophistication of distribution

Unique customer requirements and preferences

Industry-specific market potential indicators

Industry Market Potential

An estimate of the likely sales that can be generated by all firms in a particular industry during a specific time period.

It is different from *company sales potential*, which refers to the share of industry sales *the firm itself* expects during a specific period.

Most companies forecast sales at least *three years* into the future of both industry market potential and company sales potential.

Methods for Estimating Industry Market Potential

Simple trend analysis examines aggregate production for the industry as a whole.

Monitoring key industry- specific indicators involves examining unique industry drivers of market demand.

Monitoring key competitors to estimate their sales levels can provide an estimate of market potential.

Following key customers around the world can provide an estimate of likely sales in an industry that the firm supplies.

Tapping into supplier networks can offer valuable information for assessing sales and competitor activity.

Attending international trade fairs facilitates learning about market characteristics and sales potential.

Task 5. Choose foreign business partners

The firm decides on the type of foreign business partner, clarifies ideal partner qualifications, and then crafts an appropriate market entry strategy.

Initially, the firm determines what value-adding activities must be performed by foreign business partners and then seeks the appropriate partners.

The firm assesses and selects partners based on criteria such as industry expertise, commitment to the venture, access to distribution channels, financial strength, quality of staff, and appropriate facilities.

Types of Foreign Business Partners

Exporters tend to collaborate with foreign market intermediaries, such as distributors and agents.

Licensing partners are independent businesses that apply intellectual property to produce products in their own country.

Franchising partners are franchisees – independent businesses abroad that acquire rights and skills from the focal firm to conduct local operations.

International collaborative ventures include joint venture and strategic alliance partners.

Other collaborations include global sourcing, contract manufacturing, and supplier partnerships.

Task 6. Estimate Company Sales Potential

The firm estimates the most likely share of industry sales that the company can achieve over a specific period of time for each target market.

Firm develops a 3 to 5-year forecast of its own sales in each target market based on criteria such as capabilities of partners; access to distribution; competitive intensity; pricing and financing; market penetration timetable of the firm; and risk tolerance of senior managers.

Determine the factors that will influence company sales potential

Company Sales Potential

An estimate of the share of annual industry sales that the firm expects to generate in a particular target market.

Requires obtaining highly refined information from the market.

Researcher must project the firm's revenues and expenses for 3-5 years into the future, which is very challenging.

Factors That Determine Company Sales Potential

Intensity of the competitive environment. Existing competitors may react strongly against entrants.

Pricing and financing of sales. Attractiveness of pricing and financing to buyers, channel members.

Human and financial resources. Major factor in the proficiency and speed of company success.

Partner capabilities. Partner skills and resources determine speed and effectiveness of entry.

Access to distribution channels. Ability to set up and use intermediaries and channel infrastructure.

Market penetration timetable. Fast or slow? Each has advantages and disadvantages.

Risk tolerance of senior managers.

Special links, contacts, capabilities of the firm. The firm's network in the market.

Reputation. Success may be faster if customers are already familiar with the firm's brands and reputation

A Framework for Estimating Company Sales Potential in the Foreign Market

Methods for Estimating Company Sales Potential

Survey end-users and intermediaries

Trade audits. Visit retail outlets and question channel members to assess competitors' offerings and strengths.

Audits reveal opportunities for new products and for differentiating existing products and marketing.

Competitor assessment. The firm can benchmark itself against main competitors in the market and estimate the level of sales it can potentially attract away from them.

Obtaining estimates from local partners. Collaborators such as distributors and franchisees already familiar with the market can often provide reliable estimates.

Limited marketing efforts to “test the waters.” A limited entry in the market helps gauge long-term sales potential and provides better understanding of the market.

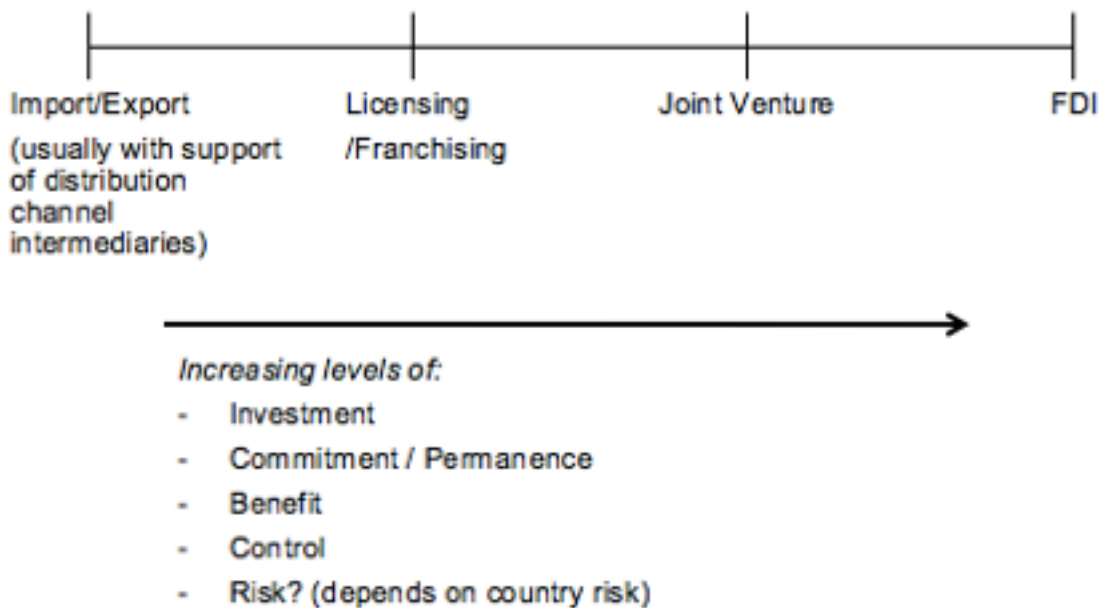
The **analogy** method and **proxy indicators** are useful for emerging markets and developing economies where information is often scarce.

With analogy, the researcher draws on known statistics from one country to gain insights into the same phenomenon in a similar country.

With proxy indicators, the researcher uses known information about one product category to infer potential about another product category, especially if the two are complementary.

Market Entry Strategies

Continuum of Market Entry Strategy



New Market Entry

Methods:

Exporting, importing and countertrade

Contractual Entry

Licensing

Franchising

Management Contract

Turn-key

Foreign Direct Investment

Wholly Owned Subsidiary

Joint Venture

Strategic Alliance

Exporting as an Entry Strategy

Usually the firm's first foreign entry strategy.

Low risk, low cost, and flexible.

Popular with SMEs.

When we talk about trade, trade deficits, trade surpluses, etc., we're talking exporting.

Most exports involve merchandise.
Export channels:
Independent distributor or agent; or
Firm's own marketing subsidiary abroad.

Services are Exported as Well

Examples: Architecture, education, banking, insurance, entertainment, information.

However, many *pure* services cannot be exported because they cannot be transported.

Retailers offer their services by establishing retail stores abroad, via FDI. Retailing requires direct contact with customers.

Overall, most services are provided to foreign customers via entry strategies other than exporting, especially FDI.

Advantages of Exporting

Increase sales volume; improve market share.

Generate better profit margins.

Increase economies of scale.

Diversify customer base.

Stabilize sales fluctuations.

Minimize the cost of foreign market entry.

Minimize risk.

Maximize flexibility.

Leverage the capabilities of foreign distributors and other business partners located abroad

Disadvantages of Exporting

Compared to FDI, exporting offers fewer opportunities to learn about customers, competitors, and other aspects of foreign markets.

Firm must acquire and dedicate new capabilities in international sales contracts and transactions, international financing methods, and logistics and documentation, all of which can strain organizational resources.

Exposes the firm to tariffs and other trade barriers as well as fluctuating exchange rates.

A systematic approach to exporting

Exporting

Direct

Selling direct to buyers

Distributor

Sales force

Indirect

Selling through an intermediary

Agent

Export management company

Export trading company

Countertrade

Barter: Direct exchange without money

Counter purchase: Sale to a nation in return for promise of future purchase from that nation

Offset agreement: Offset a hard-currency sale to a nation with future hard-currency purchase

Switch trading: Sale by a company of an obligation to purchase from a country

Buyback: Export of industrial equipment in return for products that the equipment produces

Contractual Entry

Unique Aspects of Contractual Relationships

Governed by a contract that provides the focal firm a moderate level of control over the foreign partner. Control reflects the ability of the firm to influence the decisions, operations, and strategic resources of a foreign venture.

Typically involve exchange of intangibles (intellectual property) and services. Examples include technical assistance, know-how, and trademarks.

Can be pursued independently or with other foreign market entry strategies, such as FDI and exporting.

Typical Types of Intellectual Property

A patent provides the right to prevent others from using an invention for a fixed period. It is granted to anyone who invents a new process, product, or useful improvement.

A trademark is a distinctive design or symbol that identifies a product or service. E.g., Nike's swoosh symbol.

A copyright protects original works of authorship. Typically covers works of music, art, literature, movies, or software.

Intellectual Property Rights

The legal claim through which the proprietary assets of firms and individuals are protected from unauthorized use by other parties.

Provide inventors with a monopoly advantage for a specified period of time, so they can exploit their inventions and create commercial advantage.

Without legal protection and the assurance of commercial rewards, most firms and individuals would have little incentive to invent.

Guidelines for Intellectual Property

Intellectual property laws are weak in many countries

Key international treaties include:

Paris Convention for the Protection of IP

Berne Convention for the Protection of Literary and Artistic Works

Rome Convention for the Protection of Performers and Broadcasting Organizations

The WTO created the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS).

Guidelines for Safeguarding Intellectual Property

Understand local IP laws and enforcement levels

Avoid countries with weak IP laws

Register IP in each country where firm does business

Ensure that agreements provide for IP oversight

Pursue IP infringers in court

Monitor intermediaries and partners for infringements

Develop close, trusting relationships with partners

Provide partners with superior resources and support

Train employees to protect assets

Licensing

A licensing agreement specifies the nature of the relationship between the licensor (owner of intellectual property) and the licensee (the user).

In a typical deal, the licensee pays the licensor a fixed amount upfront and an ongoing royalty (usually 2-5 %) on gross sales generated from using the licensed asset.

The fixed amount covers the licensor's initial costs of transferring the licensed asset to the licensee, including training, engineering, or adaptation. Certain types of licensable assets, such as copyrights and trademarks, have much lower transfer costs.

Licensing as a Foreign Market Entry Strategy

Licensing

Company owning intangible property (licensor) grants another firm (licensee) the right to use it for a specific time

Advantages:

- Finance expansion
- Reduce risks
- Reduce counterfeits
- Upgrade technologies

Disadvantages:

- Restrict licensor's activities
- Reduce global consistency
- Lend strategic property

Franchising

Most typical arrangement is **business format franchising** in which franchisor transfers to the franchisee a total business method -- including production and marketing methods, sales systems, procedures, training, and the use of its name.

More comprehensive and longer-term than licensing.

Master franchiser: an independent company authorized to establish, develop, and manage the entire franchising network in its market.

Franchising as an Entry Strategy

Franchising

Company (franchiser) supplies another (franchisee) with intangible property over an extended period

Advantages

- Low cost and low risk
- Rapid expansion
- Local knowledge

Disadvantages

- Cumbersome
- Maintaining control
- Lost flexibility

Other Contractual Agreements

Turnkey contracting: arrangement where a firm plans, finances, organizes, manages, and implements all phases of a project abroad and hands it over to a foreign country after training local personnel. Typical in the construction and engineering services industries.

Under a **management contract**, a contractor supplies managerial know-how to operate a hotel, resort, airport, hospital, or other facility in exchange for compensation

With **international leasing**, the lessor rents out machinery or equipment to clients abroad, often for several years at a time. E.g., airlines lease aircraft.

Management Contract

Company supplies another with managerial expertise for a specific period of time

Advantages

- Few assets risked
- Nations finance projects

Develops local workforce
Disadvantages
Personnel at risk
Create competitor

Turnkey Project

Company designs, constructs, and tests a production facility for a client

Advantages

Firms specialize in competency

Nations obtain infrastructure

Disadvantages

Politicized process

Create competitor

Foreign Direct Investment

FDI and Collaborative Ventures

FDI: strategy by which the firm establishes a physical presence abroad by acquiring productive assets such as capital, technology, labor, land, plant, and equipment

International collaborative venture: a cross border business alliance in which partnering firms pool their resources and share costs and risks of a venture

Joint venture: a form of collaboration between two or more firms to create a jointly owned enterprise

Nature of FDI

The most advanced, expensive, complex, and riskiest entry strategy, involving the establishment of manufacturing plants, marketing subsidiaries, or other facilities abroad

Undertaken by firms from both advanced economies and emerging markets

Target countries are both advanced economies and emerging markets

Occasionally raises patriotic sentiments among citizens

Motives for FDI

Markets-Seeking motives:

Gain access to new markets opportunities

Follow key customers

Compete with rivals in their own markets

Resource or asset seeking motives

Access raw materials

Gain access to knowledge or other assets

Access technological and managerial know-how available in a key market

Efficiency seeking motives

Reduce sourcing and production costs

Locate production near customers

Take advantage of government incentives

Avoid trade barriers

Factors Relevant to Selecting Locations for FDI

Types of FDI

Greenfield investment vs. mergers and acquisitions

Nature of ownership: whole owned direct investment vs. equity joint venture

Level of integration: vertical vs. horizontal FDI

Wholly Owned Subsidiary

Facility entirely owned and controlled by a single parent company

Advantages

Day to day control
Coordinate subsidiaries
Disadvantages
Expensive
High risk

International Collaborative Venture

A partnership between two or more firms

Includes equity joint ventures and non-equity, project-based ventures

Sometimes called partnerships or strategic alliances

Collaboration helps overcome the often substantial risk and high costs of international business. It makes possible the achievement of projects that exceed the capabilities of the individual firm.

Equity vs. Project Based Joint Ventures

Equity Joint Ventures are normally formed when no one party has all the assets needed to exploit an opportunity.

Typically, the local partner contributes a factory, market navigation know-how, connections, or low-cost labor.

A **project-based joint venture** has a narrow scope and limited timetable. No new legal entity is created.

Typically, partners collaborate on joint development of new technologies, products, or share other expertise with each other. Such cooperation helps them catch up with rivals in technology development.

Other Types of Collaborative Ventures

Consortium: project-based, usually non-equity venture with multiple partners fulfilling a large-scale project.

E.g., commercial aircraft manufacturing (Boeing and Airbus).

Cross-licensing agreement: type of a project-based, non-equity venture where partners agree to access licensed technology developed by the other on preferential terms. E.g., telecommunications industry for inventing new technologies.

Joint Venture

Company created and jointly owned by two or more entities to achieve a common objective

Advantages

Reduce risk level, Penetrate markets, Access channels

Disadvantages

Partner conflict, Lose control

Strategic Alliance

Entities cooperate (but do not form a separate company) to achieve strategic goals of each

Advantages

Share project cost, Tap competitors strengths, Gain channel access

Disadvantages

Partner conflict, Create/support competitor