

# 4

## chapter

# Business in a Global Economy

*Better Business*

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# Why Study International Business?

- It will make you a better employee, business owner, person, and citizen.
- It will broaden your horizons to think outside your own domestic economic, social, and political frame of reference.
- It will help you understand the global economy, world cultures, and politics.
- It will help you interpret global news.

# Take a Personal International Inventory

- Check the labels on the following items to determine where they were made:
  - Shoes
  - Shirt
  - Pants
  - Purse or backpack
  - Technology device
    - Cell phone
    - Computer
    - MP3 player



# Imports and Exports

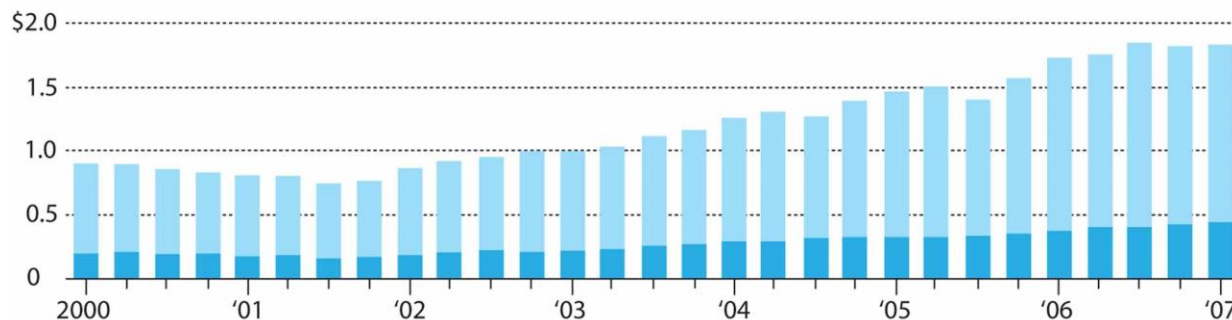
- The U.S. and other nations are increasingly
  - **Importing:** Buying products from other countries
  - **Exporting:** Selling domestically produced products to other countries

## Help From Overseas

■ Receipts from overseas operations      ■ Domestic operations

**U.S. corporate profits are getting a boost from overseas...**

In trillions; at a seasonally adjusted annual rate



Note: Corporate profits with inventory-valuation and capital-consumption adjustments (at current costs; quarterly data)

# What Is Globalization?

- An interconnected and interdependent world economy
  - **Globalization of markets:** Not a local or national market, but the whole world
  - **Globalization of production:** Moving production to locations to take advantage of lower costs or better quality
  - **Offshore outsourcing (offshoring):** Movement of production away from a domestic production site to a foreign location

# Why the Acceleration of Globalization?

- Two main factors:
  1. Decline in trade and investment barriers
  2. Technological innovations
    - Communications
    - Transportation
    - Information technology



# Global Business Trends

- Growing roles for developing nations
- Increase in non-U.S. foreign direct investment
  - FDI: Purchasing of property and businesses in foreign nations
- Increase in non-U.S. multinational enterprises
  - Mini-multinationals have also increased
- Increasing democratization

# International Trade and Competition

- Comparative advantage
- Absolute advantage
- National competitiveness
  - How can a country foster national competitiveness?

**Can a business or a country create a competitive or comparative advantage?**



# Benefits and Costs of International Trade

- Benefits
  - Higher standard of living
    - Greater quantity and variety of higher-quality product
    - Lower-priced products
- Costs
  - Threat to domestic businesses and their workers
- Benefits vs. costs
  - Depends on timing and the extent of both benefits and costs
  - Benefits spread across many members of a society, so they are difficult to see

# Free Trade and Trade Barriers

- What is free trade?
- Trade barriers
  - Tariffs and subsidies
  - Quotas and embargoes
  - Administrative trade barriers
    - Local content requirements
    - Other restrictive technical standards or bureaucratic rules

# Protectionism and Trade Barriers

- What is protectionism?

Economic Benefits and Costs of Free Trade and Protectionism for a Nation		
	Free Trade	Protectionism
Economic Benefits	A greater quantity and variety of higher quality products at lower prices	Increased sales at higher prices improves the profitability of the protected domestic companies, creating greater job security for their workers
Economic Costs	Reduced sales and lower prices for domestic firms that find it difficult to compete internationally, which reduces their profitability and lowers job security for their workers	Lower quantity and variety of lower-quality products at higher prices

# Arguments in Favor of Protectionist Trade Barriers

- National security argument: Protecting industries critical to national security
- Infant-industry argument: Protecting fledging industries hoped to have competitive advantage once they grow
- Cheap foreign labor argument: Lower labor costs are unfair
- Threat of retaliation (bargaining chip) argument: Dumping is one possible action or retaliation
  - Dumping refers to selling a product at a price below the price charged in the producing country; it is illegal and can be difficult to prove

# Economists' Arguments Against Protectionist Trade Barriers

- Advocate free trade
  - The economic benefits of free trade outweigh the economic costs
- Trade barriers benefit domestic producers and their workers but hurt domestic consumers
- Educate displaced individuals so they may move into a line of business with comparative advantage and rising demand

# International Organizations Promoting Free Trade

- GATT
  - Created in 1948 with 23 member nations
  - Negotiated international trade treaties
  - Replaced by the WTO in 1995
- World Trade Organization
  - 152 member countries
  - Arbitrates global trade disputes
  - Has power to enforce decisions



# Regional Trade Agreement: The European Union

- Started in 1957 as European Economic Community
- Became more prominent in the 1990s
- 27 member countries
- Largest free trade area
  - 1/3 of the world's production
  - Largest exporter/second largest importer



# **North American Free Trade Agreement (NAFTA)**

- Free trade agreement between the United States, Mexico, and Canada
- Established on January 1, 1994
- Earlier claims made by both advocates and critics were exaggerated
- Proposal to expand into a greater Free Trade Area of the Americas (FTAA)



# Other Regional Free Trade Areas

- Merged South American areas
  - Andean Group
    - Bolivia, Chile, Ecuador, Colombia, Peru
  - Mercosur
    - Brazil, Argentina, Paraguay, Uruguay
- ASEAN (Association of Southeast Asian Nations)
  - Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Myanmar, and Cambodia
- APEC (Asia-Pacific Economic Cooperation)
  - 21 member countries

*None have the power and success of the EU and NAFTA*

# Three Strategies of International Business

- Global
  - Standardized product
  - Competing on price
- Multi-domestic
  - Custom products to meet unique local needs
  - Price considerations are secondary
- Transnational
  - Customized product
  - Lowest price possible

# Strategies for Entering Foreign Markets

- Companies may
  - Export their product
  - Implement a turnkey project
  - Undertake franchising
  - Enter into a licensing agreement, a joint venture, or a strategic alliance
  - Undertake contract manufacturing
  - Set up a wholly-owned subsidiary

# Entry Mode Considerations

## Advantages and Disadvantages of the Various Entry Modes

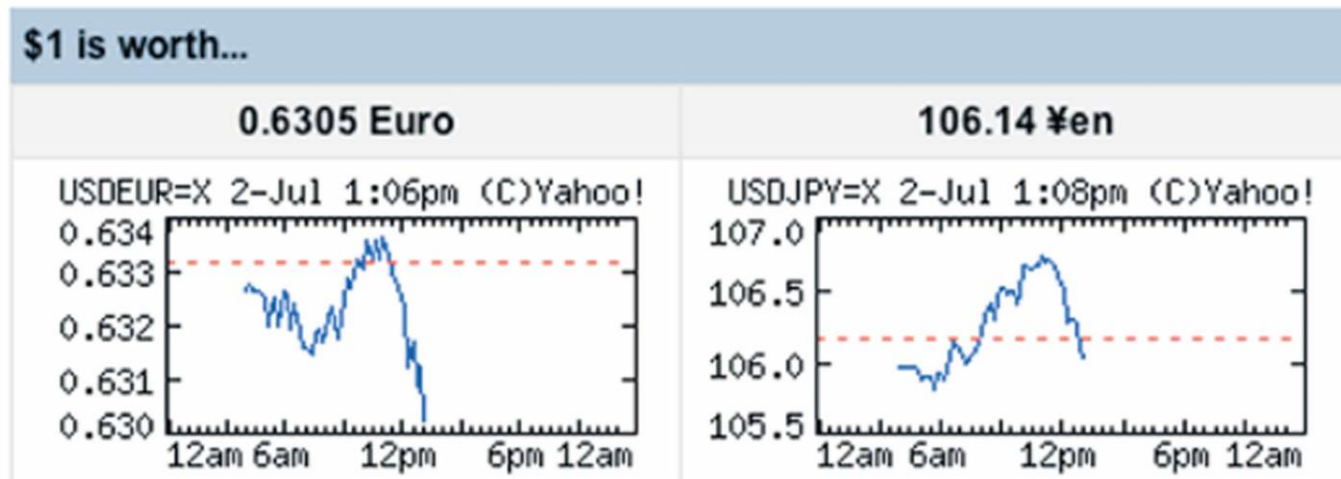
	<b>Advantages</b>	<b>Disadvantages</b>
<b>Exporting</b>	<ul style="list-style-type: none"> <li>• Speed of entry</li> <li>• Production site in lowest-cost location</li> </ul>	<ul style="list-style-type: none"> <li>• High transport costs</li> <li>• Threat of trade barriers such as tariffs</li> <li>• Lack of access to local information</li> </ul>
<b>Turnkey project</b>	<ul style="list-style-type: none"> <li>• Increased profits for high-tech firms</li> </ul>	<ul style="list-style-type: none"> <li>• Loss of technical know-how to potential competitors</li> </ul>
<b>Franchising</b>	<ul style="list-style-type: none"> <li>• Costs and risks of opening the foreign market fall on the franchisee</li> </ul>	<ul style="list-style-type: none"> <li>• Difficulty in maintaining quality control over distant franchises</li> </ul>
<b>Licensing</b>	<ul style="list-style-type: none"> <li>• Speed of entry</li> </ul>	<ul style="list-style-type: none"> <li>• Licensee may become competitor</li> <li>• Loss of knowledge to potential competitor</li> </ul>
<b>Joint venture</b>	<ul style="list-style-type: none"> <li>• High potential for learning</li> <li>• Benefit of combined resources</li> </ul>	<ul style="list-style-type: none"> <li>• Shared control of business</li> <li>• Risk of losing specialized technology to partner</li> </ul>
<b>Strategic alliance</b>	<ul style="list-style-type: none"> <li>• Pooled talents and expertise</li> <li>• Shared costs and risks</li> </ul>	<ul style="list-style-type: none"> <li>• Risk of losing specialized technology to partner</li> <li>• Difficulty in finding a compatible partner</li> </ul>
<b>Contract manufacturing</b>	<ul style="list-style-type: none"> <li>• Speed of entry</li> <li>• Low test-marketing costs</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of quality control over distant subcontractor</li> </ul>
<b>Wholly-owned subsidiary</b>	<ul style="list-style-type: none"> <li>• Total control over all operations</li> <li>• Preservation of proprietary technology</li> </ul>	<ul style="list-style-type: none"> <li>• Risks and costs of entering a foreign market</li> </ul>

# The Role of Exchange Rates in Global Expansion

- The rates at which currencies are converted into another currency
- Foreign exchange markets decide exchange rates
- A currency is weak when it devalues against currencies of major trading partner
  - Exporters typically prefer a weak dollar because their products are more affordable to foreigners
- A currency is strong when its value improves compared to trading partners' currencies
  - Importers prefer a strong dollar because the cost of importing foreign goods is less

# How Exchange Rates Affect International Business

- Currency appreciation
- Currency depreciation
- Trade deficit
- Trade surplus
- Fixed exchange rate
- Freely floating exchange rate
- Nonconvertible currency
- Countertrade



# Other International Economic Challenges

- Growth and development
- Government policies and the economic environment
- Socioeconomic factors



# Sociocultural International Business Challenges

- What is culture?
  - Cross-cultural awareness
  - Ethnocentrism
- Aesthetics
- Attitudes toward time and work
- Religion
- Language (verbal and non-verbal)





# Political International Business Challenges

- Not always a free market
- Not always stable, democratic governments
- Possible market failure
- Possible government failure

Failures of Markets and Government Interventions	
Market Failures	Government Intervention
Growth of monopoly power	Government enforces anti-trust laws.
Undesirable and desirable social side effects from production and consumption	Government curtails the production and consumption of undesirable goods and promotes desirable products.
Lack of public goods and services	Government provides them.
Unfair distribution of income	Government redistributes income.
Macroeconomic instability	Government uses fiscal and monetary policies to stabilize the business cycle.

# Legal International Business Challenges

- Laws
- Regulatory standards
- Access to unbiased judicial system
- No universal laws, regulatory standards, or global court exist to settle disputes in the global economy

# Ethical International Business Challenges

- Unique differences in economic conditions and cultural values give rise to many ethical dilemmas surrounding global business

**For example, should a firm conform to its home country's environmental, workplace, and product safety standards—even though it's not legally required to do so—while operating in another country?**

# Chapter Summary

1. What are the implications of the **globalization of markets** and the **globalization of production**?
2. Why has **globalization** accelerated so rapidly?
3. What are the costs and benefits of international trade?
4. What are the different types of **trade barriers**?
5. What are the three basic strategies of international business?
6. How can international firms successfully enter foreign markets?
7. What are **exchange rates** and how do they affect international business?
8. What economic factors and challenges play a role in conducting business on a global scale?
9. What are the sociocultural, political, legal, and ethical challenges to conducting business in a global marketplace?

# Beyond the Book

# 2009 US Trading Partners

Rank	Country	In 2009 Billions of Dollars
1	Canada	\$429
2	China	\$365
3	Mexico	\$305
4	Japan	\$147
5	Germany	\$114

# Top Five Countries Receiving U.S. Exports in 2007

Rank	Country	2007 Dollars
1	Canada	\$248,437,163,758
2	Mexico	\$136,541,261,807
3	China	\$65,238,309,506
4	Japan	\$62,664,975,645
5	United Kingdom	\$50,296,215,249

# Foreign Direct Investment Trends

- China gets most foreign direct investment (FDI) among developing countries

Country	2008 FDI Net Flows
China	147,800,000,000
Russia	\$72,800,000,000
Brazil	\$45,000,000,000
Mexico	\$22,400,000,000
Turkey	\$18,300,000,000
India	\$41,000,000,000
Chile	\$16,700,000,000



# NAFTA

## Advantages

- Removing tariffs reduces inflation by decreasing the cost of imports
- Increased trade in goods and services
- Increase in FDI
- Bidding allowed on government contracts in all member countries
- Intellectual properties protected

## Disadvantages

- Loss of jobs in the U.S.
- Lower U.S. wages
- Mexico's farmers driven out of business
- Exploitation of "maquiladora" workers
  - U.S. companies near the border employing Mexicans
- Increased degradation of Mexico's environment

# Tariff Barriers

- Hong Kong and Singapore have the least restrictive trade policies.
- Small, rich economies, such as Switzerland, tend to be the least protectionist.
- Turkey stands out as a big country with low tariff barriers—lower even than the United States.
- Of the fast-growing BRICs (Brazil, Russia, India and China), China is the most open to inward trade, followed by Russia. Brazil and (especially) India are protectionist by comparison.
- Mexico and South Korea have high tariff barriers compared with other members of the mostly rich Organization for Economic Co-operation and Development.

# U.S. Steel Industry Wins Case vs. China

- U.S. steel pipe manufacturers battling a surge in imports from China
- International Trade Commission found
  - China provides unfair subsidies to companies there and dumping product here
  - The U.S. industry was being harmed by the import of circular pipe
- U.S. can impose stiff tariffs (99% to 701%) on Chinese circular welded pipe for five years

# The U.S. Trade Deficit

