Chapter 1: Globalization

Globalization = the shift toward a more integrated and interdependent world economy.
Globalization of markets = the merging of historically distinct and separate national markets into one huge global marketspace. The most global of markets are markets for industrial goods and materials that serve universal needs (oil).
Globalization of production = the sourcing of goods and services from locations around the globe to take advantage of national differences in cost and quantity of production factors. Companies hope to lower their overall cost or improve the quality or functionality of their product offering.
Global institutions: help manage, regulate and police the global marketplace and promote the establishment of multinational treaties to govern the global business system.
WTO (World Trade Organisation): responsible for policing the world trading system, making sure nation-states adhere to the rules laid down in trade treaties and facilitating the establishment of additional multinational agreements.
GATT (General Agreement on Tariffs and Trade): several rounds of negotiations worked to lower barriers to the free flow of goods and services.
IMF (International Monetary Fund): established to maintain order in the international monetary system. Often seen as the lender of last resort.
World Bank: set up to promote economic development. It has focussed on making low-interest loans to cash-strapped governments in poor nations that which to undertake significant infrastructure investments.
UN (United Nations): has 4 purposes:

- maintain international peace and security;
- develop friendly relations among nations;
- cooperate in solving international problems and in promoting respect for human rights;
- harmonizing the actions of nations.

G20: originally established to formulate a coordinated policy response to financial crises in developing nations, in 2008 it became the forum through which major nations attempted to launch a coordinated policy response to the global financial crisis.

Drivers of globalisation:

(1) Declining trade and investment barriers
International trade = a firm exports goods or services to consumers in another country.
FDI (Foreign Direct Investment) = a firm invests resources in business activities outside its home country.

(2) Technological change:
- Microprocessors and telecommunications
  Moore's Law: the cost of microprocessors continues to fall, while their power increases.
- The Internet
- Transportation technology → containerization

The changing demographics of globalisation:

(1) The changing world output and world trade picture
As emerging economies (China, India, Russia & Brazil) continue to grow, a relative decline in the share of the world output and world exports accounted for by the US and other long-established developed nations seems likely. The relative decline reflects the growing economic development and industrialization of the world economy.

(2) The changing FDI picture
Beginning in the 1970s, European and Japanese firms began to shift labour-intensive manufacturing operations from their home markets to developing nations where labour costs were lower.

(3) The changing nature of MNEs
MNE (Multinational Enterprise) = any business that has productive activities in 2 or more countries.
2 notable trends: the rise of non-US multinationals and the growth of mini-multinationals.

(4) The changing world order
China may move from third-world to industrial superpower status even more rapidly than Japan did. The changes in China are creating both opportunities and threats for established international businesses.
The attractiveness of Latin America increased, both for a market for exports and as a site for FDI, but there is no guarantee that these favourable trends will continue.

Globalization unstoppable?
The world may be moving toward a more global economic system, but globalization is not inevitable: countries may pull back if their experiences do not match their expectations. Also, globalization brings risks: a severe crisis in one region can affect the entire globe.

The globalisation debate:

- Supporters believe that increased trade and cross-border investment will result in:

- lower prices for goods and services;
- greater economic growth;
- higher consumer income and more jobs.

- Critics worry that globalisation will cause:
  - job losses;
  - downward pressure on the wage rates of unskilled workers;
  - environmental degradation;
  - the cultural imperialism of global media and MNEs.

Globalisation, jobs & income:

- Critics: failing trade barriers allow firms to move manufacturing activities to countries where wage rates are much lower and destroy manufacturing jobs in advanced countries.
- Supporters: countries will specialize in what they do most efficiently and trade for other goods.

Globalisation, labour policies and the environment:

- Critics: firms avoid costly efforts to adhere to labour and environmental regulations by moving production to countries where such regulations do not exist, or are not enforced.
- Supporters: as countries get richer, they enact tougher environmental and labour regulations.
  → Empirical support: this hump-shaped relationship seems to hold across a wide range of pollutants but not for carbon dioxide emissions.

Globalisation and national sovereignty:

- Critics: today's increasingly interdependent global economy shifts economy power away from national governments toward supranational organisations such as the WTO, the EU and the UN. Unelected bureaucrats now impose policies on the democratically elected governments of nation-states, thereby undermining the sovereignty of those states and limiting the nation's ability to control its own destiny.
- Supporters: real power still resides with individual nation-states as those states will withdraw their support if these bodies fail to serve the collective interests of member states.

Globalisation and the world's poor:

- Critics: despite the supposed benefits associated with free trade and investment, the gap between the rich and poor nations of the world has gotten wider.
- Supporters: free trade and large-scale debt relief is needed to help these countries bootstrap themselves out of poverty. Debt relief must be matched by wise investment in public projects that boost economic growth and the adoption of economic policies that facilitate investment and trade.

International business: any firm that engages in international trade or investment.

Managing an international business differs from managing a domestic business:

- countries are different;
- managers in an international business are confronted with a wider range of problems and more complex problems;
- managers in an international business must deal with government restrictions on international trade and investment;
- managers in an international business must develop policies for dealing with exchange rate movements.

Chapter 9: Regional Economic Integration

Regional economic integration = agreements between countries in a geographic region to reduce tariff and non-tariff barriers to the free flow of goods, services and production factors. While the move toward regional economic integration is generally seen as a good thing, some worry that it will lead to a world in which regional trade blocs compete against each other.

Free trade area: all the barriers to the trade of goods and services among member countries are removed. No discriminatory tariffs, quotas, subsidies or administrative impediments are allowed to distort trade between members. Each country is allowed to determine its own trade policies with regard to non-members. (EFTA)
EFTA (European Free Trade Association): free trade area in industrial goods between Norway, Iceland, Liechtenstein and Switzerland.

Customer union: eliminates trade barriers between member countries and adopts a common external trade policy.
Common market: no barriers to trade among member countries, includes a common external trade policy and allows production factors to move freely among members. Labour and capital are free to move because there are no restrictions on immigration, emigration or cross-border flows of capital among member countries.
Economic union: involves the free flow of products and production factors among member countries and the adoption of a common external trade policy, but also requires a common currency, harmonization of members' tax rates and a common

monetary and fiscal policy. (EU – although imperfect because not all members have adopted the euro, differences in tax rates and regulations across countries still remain and some markets, such as the market for energy, are still not fully deregulated)
Political union: a central political apparatus coordinates the economic, social and foreign policy of the member states.

The economic case for integration: regional economic integration can be seen as an attempt to achieve additional gains from the free flow of trade and investment between countries beyond those attainable under global agreements such as the WTO.

The political case for integration: linking neighbouring economies and making them increasingly dependent on each other create incentives for political cooperation between the neighbouring states and reduce the potential for violent conflict. In addition, by grouping their economies, the countries can enhance their political weight in the world.

Impediments to integration: economic integration costs and concerns over national sovereignty.

Trade creation: occurs when low cost producers within the free trade area replace high cost domestic producers or high cost external producers.
Trade diversion: occurs when high cost producers within the free trade area replace low cost external producers.
→ A regional free trade agreement will benefit the world only if the amount of trade it creates exceeds the amount it diverts. Suppose the US and Mexico set up a free trade area. If the US previously imported textiles from Costa Rica, which produced them more cheaply than either Mexico or the US, this would be a change for the worse.

European Coal and Steel Community: formed in 1951 by Belgium, France, West Germany, Italy Luxembourg and the Netherlands with the objective to remove the barriers to intragroup shipments of coal, iron, steel and scrap metal.
European Community: common market established in 1957 with the signing of the Treaty of Rome.
European Union: established in 1993 with the signing of the Maastricht Treaty.

European Commission: responsible for proposing EU legislation, implementing it and monitoring compliance with EU laws by member states. There are 27 commissioners, one from every member state, appointed for five years.
Competition commissioner: the role of the competition commissioner is to ensure that no one enterprise uses its market power to drive out competitors and monopolize markets. He also reviews proposed mergers and acquisitions to make sure they do not create a dominant enterprise with substantial market power.
European Council: represents the interests of member states. It is the ultimate controlling authority within the EU because draft legislation from commission can become EU law only in the council agrees. The council is composed of one representative from the government of each member state. The membership, however, varies depending on the topic being discussed. When agricultural issues are being discussed, the agriculture ministers from each state attend council meetings. The votes a country gets in the council are related to the size of the country and most issues require unanimity.
European Parliament: consultative body which has 754 members directly elected by the populations of the member states. It debates legislation proposed by the commission and forwarded to the council and can propose amendments. The power of the parliament recently has been increasing. The European Parliament now has the right to vote on the appointment of commissioners as well as veto some laws.
Treaty of Lisbon: increased the power of the European Parliament and created a new position, a president of the European Council, who serves a 30-month term and represents the nation-states that make up the EU.
Court of Justice: the supreme appeals court for EU law, comprised of one judge from each country. The judges are required to act as independent officials, rather than as representatives of national interests.

The single European Act: the purpose of the Single European Act was to have one market in place by 31/12/1992. The act proposed the following changes:

- remove all frontier controls among EC countries, thereby abolishing delays and reducing the resources required for complying with trade bureaucracy;
- apply the principle of mutual recognition to product standards: a standard developed in one EC country should be accepted in another, provided it met basic requirements in such matters as health and safety;
- institute open public procurement to non-national suppliers, reducing costs directly by allowing lower-cost suppliers into national economies and indirectly by foreign national suppliers to compete;
- lift barriers to competition in the retail banking and insurance businesses which should drive down the costs of financial services, including borrowing throughout the EC;
- remove all restrictions on foreign exchange transactions between member countries;
- abolish restrictions on cabotage: the right of foreign truckers to pick up and deliver goods within another member state's borders.

Maastricht Treaty: committed the EC members adopting a common currency by 01/01/1999. The euro is now used by 17 of 27 member states of the EU.
Benefits of the euro:
- business and individuals realize significant savings: lower foreign exchange and hedging costs;
- the adoption of a common currency makes it easier to compare prices across Europe and has led to lower prices;
- to face with lower prices, European producers have been forced to look for ways to reduce their production costs so the introduction of a common currency has produced long-run gains in the economic efficiency;
- the introduction of a common currency has given a boost to the development of a highly liquid European capital market and this should lower the cost of capital and lead to an increase in the level of investment and the efficiency with which investment funds are allocated;
- the introduction of a common currency will increase the range of investment options open to both individuals and institutions.

Costs of the euro:
- national authorities have lost control over monetary policy → the ECB sets interest rates and determines monetary policy across the euro zone;
- the EU is not an optimal currency area, many of the European economies are very dissimilar.
  Optimal currency area: similarities in the underlying structure of economic activity make it feasible to adopt a single currency and use a single exchange rate as an instrument of macroeconomic policy. Example: a common monetary policy may mean that interest rates are too high for depressed regions and too low for booming regions.

NAFTA (North American Free Trade Agreement): aims to remove all barriers to the free flow of goods and services among Canada, Mexico and the US.
Supporters:
- the free trade area should be viewed as an opportunity to create an enlarged and more efficient productive base for the entire region;
- Mexico would benefit from much-needed inward investment and employment;
- The US and Canada would benefit because the increased incomes of the Mexicans would allow them to import more US and Canadian goods, thereby increasing demand and making up for the jobs lost in the industries that moved production to Mexico. US and Canadian consumers would benefit from the lower prices and US and Canadian firms that moved production to Mexico would benefit the lower labour costs.

Critics:
- ratification would be followed by a mass exodus of jobs from the US and Canada into Mexico as employers sought profit from Mexico's lower wages and less strict environmental and labour laws;
- the country would be dominated by US firms that would not really contribute to Mexico's economic growth, but instead use Mexico as a low-cost assembly site keeping their high-paying, high-skilled jobs north of the border.

Results:
- overall impact has been small but positive;
- all 3 countries experienced strong productivity growth;
- many observers credit NAFTA with helping create the background for increased political stability in Mexico. However, recent events have cast a cloud over Mexico's future.

Regional economic integration in the Americas
Andean Community: custom union as of 1995 between Bolivia, Colombia, Ecuador and Peru.
Mercusor: free trade pact between Argentina, Brazil (1988), Paraguay and Uruguay. (1990)
CAFTA (Central American Free Trade Agreement): free trade agreement between Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the US with the aim to lower trade barriers for most goods and services. (2005)
CARICOM: wannabe customs union between the English-speaking Caribbean countries under the auspices of the Caribbean Community. (1973)
CSME (Caribbean Single Market and Economy): six CARICOM members formed CSME to lower trade barriers and harmonize the macro-economic and monetary policy between member states. (2006)
FTAA (Free Trade Area of the Americas): very much a work in progress. (1994)

Regional economic integration elsewhere
ASEAN (Association of Southeast Asian Nations): the basis objective of ASEAN is to foster free trade among member countries and to achieve cooperation in their industrial policies. Progress so far has been limited, however. (1967)
AFTA (ASEAN Free Trade Area): the six original members of ASEAN cut tariffs on manufacturing and agricultural products to less than 5 percent. However, there are some significant exceptions to this tariff reduction. (2003)

APEC (Asian-Pacific Economic Cooperation): 21 member states, including the US, Japan and China, try to increase multilateral cooperation in view of the economic rise of the Pacific nations and the growing interdependence within the regions. Note: not much has been accomplished yet. (1990)

Regional economic integration in Africa
9 trade blocs on the African continent → although this number is impressive, progress toward the establishment of meaningful trade blocs has been slow!
EAC (East African Community): intend to establish a customs union, regional court, legislative assembly and eventually, a political federation. In 2005 the EAC start to implement a customs union and in 2007 Burundi and Rwanda joined the EAC. The EAC established a common market in 2010 and is now striving toward an eventual goal of monetary union. (2001)

Implications for managers:
- *opportunities*: regional economic integration opens new markets and allows firms to realize cost economies, although differences in culture and competitive practices often limit the ability to realize cost economies and to produce standardized products.
- *threats*: the business environment becomes more competitive (→ firms outside the trading areas should respond to the emerge of more capable European competitors by reducing their own cost structures) and there is the risk of being shut out of the EU fortress (→ non-EU firms should set up their own EU operations).

____

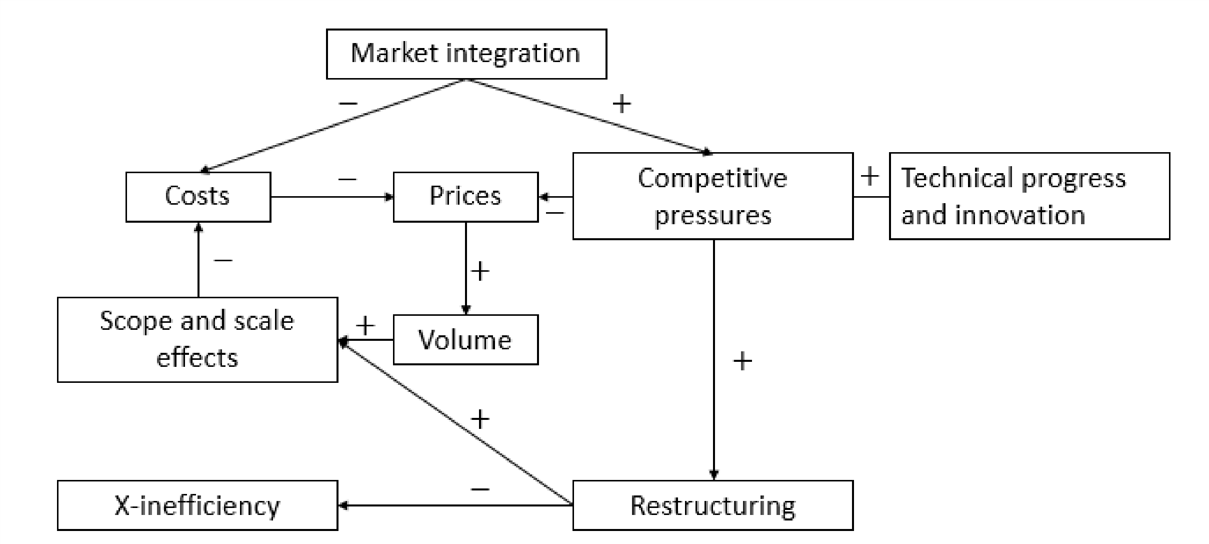
Languages in the EU:
- 24 official languages - 3 alphabets - more than 60 minority and regional languages in the EU;
- German is the most widely spoken mother tongue - 38% of EU citizens speak English.

The crisis has seriously affected the European economy:
- Industrial production: -20%;
- Unemployment levels: 10.8% in 2013 (7.4% in the US).

Structural challenges:
- Aging is accelerating: EU working age population will be reduced by 2 million by 2020 and the number of 60+ is increasing twice as fast as before 2007;
- Productivity levels are lagging behind: 2/3 of the EU income gap with the US is due to lower productivity. Factors explaining the US lead:
  - better/larger science base;
  - entrepreneurship;
  - venture capital;
  - flexible labour markets;
  - lagging productivity in services (= main problem!).

Europe 2020 = a new growth strategy for the EU launched by the European Commission.
The Commission identifies three key drivers for growth:
(1) smart growth (fostering innovation, education and digital society);
(2) sustainable growth (making our production more resource efficient while boosting our competitiveness);
(3) inclusive growth (raising participation in the labour market, the acquisition of skills and the fight against poverty).

The effects of EU market integration:



Impact on the value chain:

Component of value-added	Possible nature of the impact
R&D	growth in the number of joint projects more homogeneous environment at the EU level
Supply	wider range of suppliers lower prices
Logistics	lower transportation costs relocation of storage facilities
Production	increased production at each plant creation of new plants in markets to be targeted or reduction in the number of production plants
Marketing & Distribution	centralization of product management at EU level community-wide marketing campaigns
Consumers	availability of wider range of products increased demand (growth effect)

Blue Banana: the economically most developed region within Europe.

Brexit & Globalisation:
Globalisation, and in particular the Chinese import shock, was a key driver of the vote for Brexit. While free trade has generated significant welfare gains for advanced economies such as the UK, the distribution of these gains has been highly unequal. This has left some social groups and, importantly, some geographic areas, much worse off. Our results suggest that redistribution policies that spread the benefits of globalisation across society are crucial to ensure that globalisation itself is sustainable in the long run.

Chapter 2: National differences in political economy

Political economy: the political, economic and legal systems of a country are interdependent: they interact and influence each other and in doing so, they affect the level of economic well-being.

Political system = the system of government in a nation. Political systems can be assessed according two dimensions: (1) the degree to which they emphasize collectivism as opposed to individualism and (2) the degree to which they are democratic or totalitarian.
Collectivism = a political system that stresses the primacy of collective goals over individual goals. (Plato)
Socialists: trace their intellectual roots to Karl Marx. The idea is to manage state-owned enterprise to benefit society as a whole, rather than individual capitalists.
Communists: socialism could be achieved only through violent revolution and totalitarian dictatorship.
Social democrats: socialism could be achieved by democratic means.
→ In many countries, state-owned companies performed poorly. As a consequence, a number of democracies voted many social democratic parties out of office and started the privatization of the market.
Individualism = a philosophy that an individual should have freedom in his/her economic and political pursuits. (Aristotle)
Individualism is built on two central tenets: (1) the emphasis on the importance of guaranteeing individual freedom and self-expression and (2) the welfare of society is best served by letting people pursue their own economic self-interest.
Democracy = a political system in which government is by the people, exercised either directly or through representatives.

To guarantee the elected representatives can be held accountable for their actions, an ideal representative democracy has a number of safeguards that are typically enshrined in constitutional law:
(1) an individual's right to freedom of expression, opinion and organisation;
(2) a free media;
(3) regular elections in which all eligible citizens are allowed to vote;
(4) universal adult suffrage;
(5) limited term for elected representatives;
(6) a fair court system that is independent from the political system;
(7) a non-political state bureaucracy;
(8) a non-political police force and service;
(9) relatively free access to state information.

Totalitarianism = a form of government in which one person or political party exercises absolute control over all spheres of human life and prohibits opposing political parties. Four main forms of totalitarianism exist in the world today:
(1) Communist totalitarianism: totalitarian states that deny many basic civil liberties to their populations and communist in name because they have adopted wide-ranging, market-based economic reforms.
(2) Theocratic totalitarianism: political power is monopolized by a party, group or individual that governs according to religious principles. The most common form is based on Islam and is exemplified by states such as Iran and Saudi Arabia. These states limit freedom of political and religious expression with laws based on Islamic principles.
(3) Tribal totalitarianism: a political party that represents the interests of a particular tribe monopolizes power.
(4) Right-wing totalitarianism: permits some individual economic freedom but restricts individual political freedom, frequently on the grounds that it would lead to the rise of communism.

3 broad types of economic systems:
(1) Market economy: all productive activities are privately owned. Production is determined by the interaction of supply and demand and signalled to producers to the price system. For a market to work in this manner, supply must not be restricted (no monopolists).
(2) Command economy: the government plans the goods and services that a country produces, the quantity in which they are produced and the prices at which they are sold.
    Pure command economy: all businesses are state-owned.
    Risks: state-owned enterprises may have little incentive to control costs and be efficient or to look for better ways to serve consumer needs.
(3) Mixed economy: certain sectors of the economy are left to private ownership and free market mechanisms, while other sectors have significant state ownership and government planning.

Legal system: refers to the rules, or laws, that regulate behaviour along with the processes by which the laws are enforced and through which redress for grievances is obtained. There are three main types of legal systems:
(1) Common law: based on tradition (a country's legal history), precedent (cases that have come before courts in the past) and custom (ways in which laws are applied in specific situations). Judges have the power to interpret the law.
(2) Civil law: based on a detailed set of laws organised into codes. Judges have the power to apply the law.
(3) Theocratic law: based on religious teachings. Islamic law is the most widely practiced.

Contract law = the body of law that governs contract enforcement.
Contracts under a common law framework tend to be very detailed with all contingencies spelled out. In civil law, contracts tend to be much shorter and less specific.
CIGS (United Nations Convention on Contracts for the International Sale of Goods): establishes a uniform set of rules governing certain aspects of the making and performance of everyday commercial contracts between sellers and buyers who have their places of business in different nations.
Property rights = the legal rights over the use to which a resource is put and over the use made of any income that may be derived from that resource.
Private action = theft, piracy, blackmail by private individuals or groups.
Public action = public officials extort income, resources or the property itself from property holders. Legal: taking assets into state ownership without compensating the owners. Illegal: demanding bribes in return for the rights to operate in a country.
Foreign corrupt practices act: makes it illegal to bribe a foreign government official to obtain or maintain business over which that foreign official has authority and requires all publicly traded companies to keep detailed records that would reveal whether a violation of the acts has occurred.
Grease payments = speed money: payments to expedite or to secure the performance of a routine governmental action. For example: a payment made to speed up the issuance of permits or licenses.
Intellectual property = property that is the product of intellectual activity, such as the chemical formula for a new drug.

Patent: grants the inventor of a new product/process exclusive rights for a defined period to the manufacture, use or sale of that invention.
Copyrights = the exclusive legal rights of authors, composers, playwrights, artists and publishers to publish and disperse their work as they see fit.
Trademarks = designs and names, officially registered, by which merchants or manufacturers designate and differentiate their products.
Product safety laws: set certain safety standards to which a product must adhere.
Product liability: involves holding a firms and its officers responsible when a product causes injury, death or damage.

Implications for managers the political, economic and legal systems of a country:
- raise important ethical issues that have implications for the practice of international businesses;
- influence the attractiveness of that country.

Chapter 3: Political economy and economic development

GNI (Gross National Income) per capita = a common measure of economic development. To account for differences in the cost of living one can adjust GNI per capita by purchasing power.
PPP (Purchasing Power Parity): purchasing power.
Black economy: refers to the unrecorded cash transactions or barter agreements not included in official figures.
HDI (Human Development Index): measures the quality of human life in different nations. It is based on three measures:
(1) life expectancy at birth;
(2) educational attainment;
(3) whether average incomes based on PPP estimates are sufficient to meet the basic needs of life in a country.

Amartya Sen: played an important role in the development of the HDI. He argued that development should be seen as a process of expanding the real freedoms that people experience. So development requires the removal of major impediments to freedom like poverty, tyranny and neglect of public facilities. He emphasizes basic health care and education.

What is the relationship between political economy and economic progress? Experts agree that:
- innovation and entrepreneurship are the engines of long-run economic growth;
- democratic regimes are more conductive to long-term economic growth than a dictatorship;
- subsequent economic growth leads to the establishment of democratic regimes.

In addition to political and economic systems, geography and education are also important determinants of economic development:
- countries with favourable geography are more likely to engage in trade;
- countries that invest in education have higher growth rates because their workforce is more productive.

The political economy of many of the world's nation-states has changed radically since the late 1980s:
- a wave of democratic revolutions swept the world: totalitarian governments collapsed and were replaced by democratically elected governments that were typically more committed to free market capitalism;
- there has been a strong move away from centrally planned and mixed economics, toward a more free market economic model.

Three main reasons account for the spread of democracy:
(1) many totalitarian regimes failed to deliver economic progress to the vast bulk of their populations.
(2) new information and communication technologies have reduced a state's ability to control access to uncensored information → spread of democratic ideals and information from free societies;
(3) economic advances have led to the emergence of increasingly prosperous middle and working classes that have pushed for democratic reforms.

The new world and global terrorism:
- Fukuyama: a more harmonious world dominated by universal civilization characterized by democratic regimes and free market capitalism.
- Huntington: there is no 'universal' civilization based on widespread acceptance of Western liberal democratic ideals. Furthermore, global terrorism is a product of the tension between civilizations and the clash of value systems and ideology.

The shift toward a market-based economic system often entails a number of steps:
- deregulation: involves removing legal restrictions to the free play of markets, the establishment of private enterprises and the manner in which private enterprises operate;

- privatization: transfers the ownership of state property into the hands of private individuals, frequently by the sale of state assets through an auction. For privatization to work, it must also be accompanied by a more general deregulation and opening of the economy;
- creation of legal systems.

Implications for managers:

- By identifying and investing early in a potential future economic star, international firms may build brand loyalty and gain experience in that country's business practices. Early entrants into potential future economic stars may be able to reap substantial first-mover advantages, while late entrants may fall victim to later-mover disadvantages.
  First-mover advantages: the advantages that accrue to early entrants into a market.
  Late-mover disadvantages: the handicaps that late entrants might suffer.
- It may be more costly to do business in relatively primitive or undeveloped economies because of the lack of infrastructure and supporting businesses. McDonalds had to set up its own dairy farms, vegetable plots … in Russia. As for legal factors, it can be more costly to do business in a country where local laws and regulations set strict standards or that lacks well-established laws for regulating business practice.
- Political risk = the likelihood that political forces will cause drastic changes in a country's business environment that adversely affect the profit and other goals of a business enterprise. Indicators: social unrest.
  Economic risk = the likelihood that economic mismanagement will cause drastic changes in a country's business environment that hurt the profit and other goals of a particular business enterprise. Indicators: inflation rate & the level of business and government debt.
  Legal risk = the likelihood that a trading partner will opportunistically break a contract or expropriate property rights.

The benefit-cost-risk trade-off is likely to be:

- most favourable in politically stable developed and developing nations that have a free market system and no dramatic upsurge in either inflation rate or private-sector debt;
- least favourable in politically unstable developing nations that operate with a mixed or command economy or in developing nations where speculative financial bubbles have led to excess borrowing.

Chapter 4: Differences in culture

Cross-cultural literacy: an understanding of how cultural differences across and within nations can affect the way business is practiced.

Culture = a system of values and norms that are shaped among a group of people and that when taken together constitute a design for living.
Values = abstract ideas about what a group believes to be good, right and desirable.
Norms = the social rules and guidelines that prescribe appropriate behaviour in particular situations. Norms can be subdivided further into two major categories: folkways and mores.
Folkways = the routine convention of everyday life. Folkways include rituals and symbolic behaviour. *good manners or a Japanese executive that will bow (= sign of respect) while presenting his business card*
Mores = norms that are seen as central to the functioning of a society and to its social life. They have much greater significance than folkways. Violating mores can bring serious retribution. *no incest*
Society =the group of people sharing a common set of values and norms.
The determinants of culture:

- economic philosophy
- political philosophy
- social structure
- religion
- language
- education

Social structure: refers to its basic social organisation. Two dimensions are particularly important when explaining differences among cultures:

(1) the degree to which the basic unit of social organisation is the individual as opposed to the group;
    Group = an association of two or more individuals who have a shared sense of identity and who interact with each other in structured ways on the basis of a common set of expectations about each other's behaviour.
(2) the degree to which society is stratified into classes or castes.

Social strata: all societies are stratified on a hierarchical basis into social categories, that is into social strata. These strata are typically defined on the basis of characteristics such as family background, occupation and income.

Social mobility = the extent to which individuals can move out the strata into which they are born.
Case system = a closed system of stratification in which social position is determined by the family into which a person is born. Change in that position is usually not possible during an individual's lifetime. It is the most rigid system of stratification.
Class system = a less rigid form of social stratification in which social mobility is possible. It is a form of open stratification in which the position a person has by birth can be changed through his or her own achievements or luck. Individuals born into a class at the bottom of the hierarchy can work their way up.
Class consciousness = a condition by which people tend to perceive themselves in terms of their class background and this shapes their relationships with members of other classes.

Religion = a system of shared beliefs and rituals that are concerned with the realm of the sacred.
Ethical systems = a set of moral principles or values that are used to guide and shape behaviour.

Language = both the spoken and unspoken means of communication:
- spoken: language shapes the way people perceive the world and helps define culture; *Flemish/French Belgians*
- unspoken: many nonverbal cues are culturally bound. *thumbs-up gesture is obscene in Greece*

The five dimensions of Hofstede summarizing different cultures:
(1) Power distance: how a society deals with the fact that people are unequal in physical and intellectual capabilities. High power distance cultures have beliefs such as *inequality is good*, *age and seniority matter*.
(2) Uncertainty avoidance: measured the extent to which different cultures socialized their members into accepting ambiguous situations and tolerating uncertainty. High uncertainty avoidance cultures have beliefs such as *conflict should be avoided*, *experts and authorities are usually correct*, *laws and rules are important*.
(3) Individualism versus collectivism: focused on the relationship between the individual and his/her fellows. Individualistic cultures have beliefs such as *people are responsible for themselves*, *individual achievement is ideal* and *people need not be emotionally dependent on groups*.
(4) Masculinity versus femininity: looked at the relationship between gender and work roles. Masculine cultures have beliefs such as *gender roles should be clearly distinguished*, *men should be decisive*.
(5) Long term orientation: captures attitudes toward time, persistence, protection of face, respect for tradition. Long term orientation cultures have beliefs such as *strategic planning is important*, *you need to be willing to invest*.

Important factors in cultural change:
- economic advancement → there is evidence that economic progress is accompanied by a shift in values away from collectivism and toward individualism;
- globalization → global corporations such as Disney are helping create conditions for the merging or convergence of cultures.

Implications for managers:
(1) cross-cultural literacy is critical to the success of international businesses: doing business in different cultures requires adaption to conform with the value systems and norms of that culture;
(2) the value systems and norms of a country influence the cost of doing business and hence the ability of firms to establish a competitive advantage in the global marketplace;
(3) there is a connection between culture and ethics in decision making.

Stereotyping = assuming that all people within one culture behave, believe, feel and act the same.
Ethnocentrism: a belief in the superiority of one's own ethnic group or culture.

____

CAGE framework = framework that helps managers identify and assess the impact of distance on various industries.

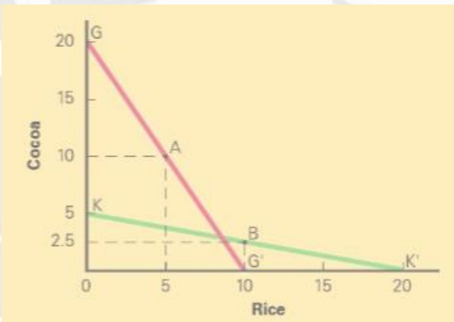
	Cultural distance	Administrative and political distance	Geographic distance	Economic distance
Distance between two countries increases with:	different languages, ethnicities, religions, social norms lack of connective ethnic or social networks	absence of shared monetary or political association political hostilities weak legal and financial institutions	lack of common border, waterway access, adequate transportations or communication links physical remoteness different climates	different consumer incomes different costs and quality of natural, financial and human resources

				different information or knowledge
Distance most affects industries or products:	with high linguistic content (*tv*) related to national identity (*food*) carrying country-specific quality associations (*wines*)	that a foreign government views as: • goods essential to their citizens' everyday lives (*electricity*) • entitlements (*drugs*) • large employers (*farming*) • large suppliers (mass transportation) • building national reputations (*aerospace*) • vital to national security (*telecommunications*) • exploiters of natural resources (*oil*) • subject to high sunk costs (*infrastructure*)	with low value-to-weight ratio (*cement*) that are fragile or perishable (*fruit*) in which communications are vital (*financial services*)	for which demand varies by income (*cars*) for which economies of scale or standardization are important (*mobile phones*) in which labour and other cost differences matter (*garments = kleding*)

Chapter 6: International trade theory

Mercantilism: advocated that countries should simultaneously encourage exports and discourage imports. By doing so, a country would accumulate gold and silver and increase national wealth, prestige and power. Flaw: it viewed trade as a zero-sum game: a gain by one country resulted in a loss by another.
↔ Hume: in the long run no country could sustain a surplus on the balance of trade and so accumulate gold and silver as the mercantilists had envisaged. Outflow of gold and silver in France would make prices fall and encourage France to import less and England to import more.
Free trade: refers to a situation in which a government does not attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country.
New trade theory (Krugman): stresses that in some cases countries specialize in the production and export of particular products not because of underlying differences in factor endowments, but because in certain industries the world market can support only a limited number of firms. The observed pattern of trade between nations may be due in part to the ability of firms within a given nation to capture first-mover advantages.
Theory of national competitive advantage (Porter): attempts to explain why particular nations achieve international success in particular industries.

Absolute advantage: a country has an absolute advantage in the production of a product when it is more efficient than any other country in producing it.
→ Smith: countries should specialize in the production of goods for which they have an absolute advantage and then trade these goods for those produced by other countries.



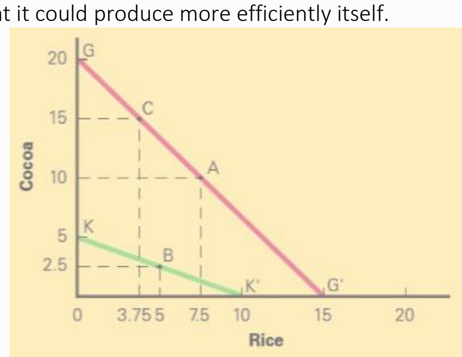
PPF (Production Possibility Frontier): indicates the different combinations a country can produce.

200 units of resources available – it takes 10 resources to produce 1 ton of cocoa – it takes 20 resources to produce 1 ton of rice – the country ca produce 20 tons of cocoa and no rice or 10 tons of rice and no cocoa

Resources Required to Produce 1 Ton of Cocoa and Rice	Cocoa	Rice
Ghana	10	20
South Korea	40	10
Production and Consumption without Trade		
Ghana	10.0	5.0
South Korea	2.5	10.0
Total production	12.5	15.0
Production with Specialization		
Ghana	20.0	0.0
South Korea	0.0	20.0
Total production	20.0	20.0
Consumption after Ghana Trades 6 Tons of Cocoa for 6 Tons of South Korean Rice		
Ghana	14.0	6.0
South Korea	6.0	14.0
Increase in Consumption as a Result of Specialization and Trade		
Ghana	4.0	1.0
South Korea	3.5	4.0

without trade: 100 units of resources for cocoa and 100 units for rice → (100/10 =) 10 tons of cocoa and (100/20 =) 5 tons of rice
with trade: 200 units of resources for cocoa → (200/10 =) 20 tons of cocoa

Theory of comparative advantage (Ricardo): it makes sense for a country to specialize in the production of those goods that it produces most efficiently and to buy the goods that it produces less efficiently form other countries, even if this means buying goods from other countries that it could produce more efficiently itself.



Although Ghana has an absolute advantage in the production of both cocoa and rice, it has a comparative advantage only in the production of cocoa: Ghana can produce 4 times as much cocoa as South Korea, but only 1.5 times as much rice. Ghana is comparatively more efficient at producing cocoa than it is in producing rice.

Resources Required to Produce 1 Ton of Cocoa and Rice	Cocoa	Rice
Ghana	10	13.33
South Korea	40	20
Production and Consumption without Trade		
Ghana	10.0	7.5
South Korea	2.5	5.0
Total production	12.5	12.5
Production with Specialization		
Ghana	15.0	3.75
South Korea	0.0	10.0
Total production	15.0	13.75
Consumption after Ghana Trades 4 Tons of Cocoa for 4 Tons of South Korean Rice		
Ghana	11.0	7.75
South Korea	4.0	6.0
Increase in Consumption as a Result of Specialization and Trade		
Ghana	1.0	0.25
South Korea	1.5	1.0

Imagine that Ghana exploits its comparative advantage in the production of cocoa to increase its output from 10 to 15 tons. This uses up 150 units of resources, leaving the remaining 50 to producing 3.75 tons of rice. (point C)

→ To an even greater degree than the theory of absolute advantage, the theory of comparative advantage suggests that trade is a positive-sum game in which all countries that participate realize economic gains.

Our simple model includes many unrealistic assumptions:

- only two countries and two goods;

- no transportation costs;
- no price differences in resources, no exchange rates;
- resources can move freely from the production of one good to another;
- constant returns to scale;
- a fixed stock of resources, no change in the efficiency with which a country uses its resources;
- no effects of trade on income distribution.

Diminishing returns to specialization: occur when more units of resources are required to produce each additional unit. It is more realistic to assume diminishing returns for two reasons:

(1) not all resources are of the same quality (*some land is more productive than other land and as yields per acre decline, Ghana must use more land to produce 1 ton of cocoa*);
(2) different goods use resources in different proportions.

Free trade is likely to generate dynamic gains of two sorts:

(1) free trade might increase a country's stock of resources as increased supplies of labour and capital from abroad become available for use within the country;
(2) free trade might increase the efficiency with which a country uses it resources.

→ dynamic gains will cause a country's PPF to shift outward.

Samuelson critique: being able to purchase groceries 20% cheaper at Walmart does not necessarily make up for the wage losses in America.

Heckscher-Ohlin theory: comparative advantage arises from differences in national factor endowments rather than differences in productivity. Countries will export those goods that make intensive use of factors that are locally abundant, while importing goods that make intensive use of factors that are locally scarce. Note that it is relative, not absolute, endowments that are important. Flaw: does not control for differences in technology.

Factor endowments: the extent to which a country is endowed with such resources as land, labour and capital.

Leontief paradox: Leontief postulated that because the US was relatively abundant in capital compared to other nations, the US would be an exporter of capital-intensive goods and an importer of labour-intensive goods. To his surprise, he found that the US exports were less capital-intensive than US imports.

Product life-cycle theory (Vernon):

- the wealth and size of the US market gave US firms a strong incentive to develop new consumer products and the high cost of US labour gave US firms an incentive to develop cost-saving process innovations;
- early in the life cycle: demand grows rapidly in the US and demand in other advanced countries is limited to high-income groups → exports from the US to those countries;
- over time: demand starts to grow in other advanced countries → US firms might set up production facilities;
- as the market matures: product becomes more standardized and the price becomes the main competitive weapon → exports from those other advanced countries to the US;
- later: → export from developing countries to the advanced countries and the US.

New trade theory: makes two important points:

(1) through its impact on economies of scale, trade can increase the variety of goods available to consumers and decrease the average cost of those goods;
(2) when the output required to attain economies of scale represents a significant proportion of total world demand, the global market may be able to support only a small number of enterprises: world trade in certain products may be dominated by countries whose firms were first movers.

Economies of scale: unit cost reductions associated with a large scale of output.

Implications of new trade theory:

- nations may benefit from trade even when they do not differ in resource endowments or technology;
- the theory generates an argument for government intervention and strategic trade policy: new trade theorists stress the role of luck, entrepreneurship and innovation in giving a firm first-mover advantages.

Porter's diamond: Porter tried to explain why a nation achieves international success in a particular industry and identified four attributes that promote or impede the creation of competitive advantage.

(1) factor endowments: he distinguishes basic (*natural resources, climate, location and demographics*) and advanced (*communication infrastructure, skilled labour, research facilities and technological know-how*) factors and argues that advanced factors are the most significant for competitive advantage;
(2) demand conditions: he argues that a nation's firms gain competitive advantage if their domestic consumers are sophisticated and demanding;
(3) relating and supporting industries: clusters are important because valuable knowledge can flow between the firms within a geographic cluster, benefiting all within that cluster;

(4) firm strategy, structure and rivalry: different nations are characterized by different management ideologies, which either help them or do not help them build national competitive advantage (*predominance of engineers or people with finance backgrounds?)* & there is a strong association between vigorous domestic rivalry and the creation and persistence of competitive advantage in an industry.

The government can influence each of the four attributes of the diamond:
- factor endowments: subsidies, policies toward capital markets, policies toward education;
- demand conditions: local product standards and regulations that mandate or influence buyer needs;
- relating and supporting industries: regulation;
- firm strategy, structure and rivalry: capital market regulation, tax policy and antitrust laws.

→ the diamond, government policy and chance create the conditions appropriate for competitive advantage.

Implications for managers:
- location implications: a firm should disperse its productive activities to those countries where they can be performed most efficiently;
- first-mover implications: it pays to invest substantial financial resources in trying to build a first-mover or early-mover advantage, even if that means several years of losses before a new venture becomes profitable;
- policy implications: according to Porter, businesses should urge government to increase investment in education, infrastructure and basic research and to adopt policies that promote strong competition within domestic markets.

Chapter 7: The political economy of international trade

Instruments of trade policy:
- tariffs;
- subsidies;
- import quotas;
- voluntary export restraints;
- local content requirements;
- administrative policies;
- antidumping duties.

Tariff = a tax levied on imports or exports:
- Import tariffs are generally pro-producer and anti-consumer. While they protect producers from foreign competitors, this restriction of supply also raises domestic prices. Import tariffs reduce the overall efficiency of the world economy because a protective tariff encourages domestic firms to produce products at home that could be produced more efficiently abroad.
- Export tariffs raise revenue for the government and reduce exports from a sector, often for political reasons.

Specific tariffs = taxes levied as a fixed charge for each unit of a good imported.
Ad valorem tariffs = taxes levied as a proportion of the value of the imported good.
Subsidies = a government payment to a domestic producer. Subsidies help domestic producers in two ways: (1) competing against foreign imports and (2) gaining export markets.
Import quota = a direct restriction on the quantity of some good that may be imported into a country. The restriction is usually enforced by issuing import licenses to a group of individuals or firms.
Tariff rate quota = a lower tariff rate is applied to imports within the quota than those over the quota.
Voluntary export restraint (VER) = quota on trade imposed by the exporting country, typically at the request of the importing country's government. Foreign producers agree to VERs because they fear more damaging punitive tariffs or import quotas might follow if they do not.
Quota rent = the extra profit producers make when supply is artificially limited by an import quota.
Local content requirement = a requirement that some specific fraction of a good be produced domestically. The requirement can be expressed in physical terms (*75% of the parts of the product*) or in value terms (*75% of the value of the product*).
Administrative trade policies = bureaucratic rules designed to make it difficult for imports to enter a country (*customs inspectors insisted on checking every tulip imported by the Netherlands by cutting it vertically down the middle*).
Dumping = selling goods in a foreign market below their costs of production.
Antidumping policies: designed to punish foreign firms that engage in dumping and protect domestic producers from unfair foreign competition.
Antidumping duties = countervailing duties = special tariffs on offending foreign imports.

Arguments for government intervention:
- political arguments: concerned with protecting the interests of certain groups within a nation (normally producers), often at the expense of other groups (normally consumers) or with achieving some political objective that lies outside the sphere of economic relations such as protecting the environment or human rights;
- economic arguments: concerned with the overall wealth of a nation, benefit both producers and consumers.

Political arguments for intervention:
- protecting jobs;
- protecting industries deemed important for national security → defence-related industries;
- retaliating against unfair foreign competition → to force trading partners to play by the rules of the game;
- protecting consumers from dangerous products → f.e. beef that might be tainted by mad cow disease;
- furthering the goals of foreign policy → to pressure states that do not abide by international law or norms;
- advancing the human rights of individuals in exporting countries → to sentence poor human rights practices.

Economic arguments:
- the infant industry argument;
- strategic trade policy argument.

Infant industry argument (Hamilton): many countries have a potential comparative advantage in manufacturing, but new manufacturing industries cannot initially compete with established industries in developed countries, so to allow manufacturing to get a toehold, the government should temporarily support new industries until they have grown strong enough to meet international competition.
Critics:
- protection does no good unless the protection helps make the industry efficient;
- firms should be capable of raising necessary funds without additional support from the government.

Strategic trade policy argument: (1) a government can help raise national income if it can somehow ensure that the firm or firms that gain first-mover advantages in an industry are domestic rather than foreign firms and (2) it might pay a government to intervene in an industry by helping domestic firms overcome the barriers to entry created by foreign firms that have already reaped first-mover advantages.
Krugman: although strategic trade policy looks appealing in theory, in practice it may be unworkable:
- a strategic trade policy aimed at establishing domestic firms in a dominant position in a global industry is a beggar-thy-neighbour policy that boosts national income at the expense of other countries → a country that attempts to use such policies will probably provoke retaliation (=wraak);
- a policy is almost certain to be captured by special-interest groups within the economy which will distort it to their own ends (*the CAP (Common Agricultural Policy) benefits arose because of the political power of farmers*).

Development of the world trading system:
- until Great Depression (1930s): protectionism
- after World War II (1947): GATT (General Agreement on Trade and tariffs)
- 1980s: protectionist trends emerged:
    - Japan's perceived protectionist policies created intense political pressures in other countries;
    - the world trade system was strained by the persistent trade deficit in the US;
    - many countries found ways to get around GATT regulations (VERs).
- 1986: Uruguay Round which focussed on:
    - extending GATT rules to cover trade in services;
    - writing rules governing the protection of intellectual property;
    - reducing agricultural subsidies;
    - strengthening the GATT's monitoring and enforcement mechanisms.
- WTO (World Trade Organisation): encompasses 3 bodies:
    - GATT;
    - GATS (General Agreement on Trade in Services): to extending free trade agreements to services;
    - TRIPS (Agreement on Trade-Related Aspects of Intellectual Property Rights): attempt to narrow the gaps in the way intellectual property rights are protected around the world and bring them under common international rules.

  The WTO has something the GATT never had: teeth → if offenders fail to comply, trading partners have the right to compensation or to impose trade sanctions.
- Future of the WTO: four issues at the forefront of the current agenda:
    - antidumping policies → the vague definition of dumping has proved to be a loophole;
    - the high level of protectionism in agriculture;
    - the lack of strong protection of intellectual property rights in many nations;
    - continued high tariff rates on non-agricultural goods and services in many nations.
- 2001: Doha Round which focusses on (talks are currently ongoing):
    - cutting tariffs on industrial goods and services;
    - phasing out subsidies to agricultural producers;

- reducing barriers to cross-border investment;
- limiting the use of anti-dumping laws.

Implications for managers:

- the impact of trade barriers on a firm's strategy:
  - tariff barriers raise the costs of exporting products to a country;
  - quotas may limit a firm's ability to serve a country from locations outside of that country;
  - to conform to local content regulations, a firm may have to locate more production activities in a given market than it would otherwise;
  - the threat of antidumping action limits the ability of a firm to use aggressive pricing to gain market share in a country.
- the role that business firms can play in promoting free trade or trade barriers.

Chapter 8: Foreign direct investment

FDI (Foreign Direct Investment): occurs whenever a US citizen, organisation or affiliated group takes an interest of 10% or more in a foreign business entity. Once a firm undertakes FDI, it becomes a multinational enterprise.
FDI takes on two main forms:

- greenfield investment = the establishment of a new operation in a foreign country;
- acquiring or merging with an existing firm in a foreign country.

Flow of FDI = the amount of FDI undertaken over a given time period.
Stock of FDI = the total accumulated value of foreign-owned assets at a given time.
Outflows of FDI = the flow of FDI out of a country.
Inflows of FDI = the flow of FDI into a country.

FDI has grown more rapidly than world trade and world output for several reasons:

- executives see FDI as a way of circumventing future trade barriers;
- the general shift toward democratic political institutions and free market economies has encouraged FDI;
- the globalisation of the world economy is also having a positive effect on the volume of FDI.

Firms prefer to acquire existing assets because:

- M&As are quicker to execute than greenfield investments;
- foreign firms have valuable strategic assets, such as brand loyalty, customer relationships or trademarks;
- firms believe they can increase the efficiency of the acquired unit by transferring capital, technology or management skills.

Exporting = producing goods at home and then shipping them to receiving country for sale.
Licensing = granting a foreign entity (the licensee) the right to produce and sell the firm's product in return for a royalty fee on every unit sold.
Why do firms prefer FDI over exporting or licensing?

- Limitations of exporting:
  - transportation costs → particularly true of products that have a low value-to-weight ratio and can be produced in almost any location (*cement*);
  - trade barriers such as import tariffs or quotas → important to understand that trade barriers do not have to be physically in place for FDI to be favoured over exporting.
- Limitations of licensing:
  Internationalization theory = market imperfections approach = theory that seeks to explain why firms often prefer FDI over licensing as a strategy for entering foreign markets:
  - licensing may result in a firm's giving away valuable technological know-how to a potential foreign competitor;
  - licensing does not give a firm the tight control over manufacturing, marketing and strategy in a foreign country that may be required to maximize its profitability;
  - management, marketing and manufacturing capabilities are often not amenable to licensing: this may be a problem when the firm's competitive advantage is based on such capabilities.

Firms in the same industry often undertake FDI at about the same time and tend to direct their investment activities toward the same target markets:

- Knickerbocker's theory: the imitative behaviour of firms in an oligopoly also characterizes FDI.
  Knickerbocker's theory can be extended to embrace the concept of multipoint competition.
  Multipoint competition: arises when two or more enterprises encounter each other in different regional markets, national markets or industries.
  Shortcomings:
  - Knickerbocker's theory does not explain why the first firm in an oligopoly decides to undertake FDI;
  - the theory also does not address the issue of whether FDI is more efficient than exporting or licensing.
- Dunning: argues that location-specific advantages are also of considerable importance in explaining both the rationale for and the direction of FDI.
  Location-specific advantages = the advantages that arise from utilizing resource endowments or assets that are tied to a particular foreign location and that a firm finds valuable to combine with its own unique assets.
  (*Silicon Valley has a location-specific advantage in the generation of knowledge related to computer industries: the advantage comes from the concentration of intellectual talent and the network of informal contacts*)

Political ideology toward FDI:

- Radical view: FDI of advanced capitalist nations keeps the less developed countries relatively backward and dependent on advanced capitalist nations for investment, jobs and technology.
  → By the early 1990s the radical view was in retreat almost everywhere, there seem to be three reasons:
  (1) the collapse of communism in eastern Europe;
  (2) the general poor economic performance of those countries that embraced the radical view and a growing belief by these countries that FDI can be an important source of technology and jobs and can stimulate economic growth;
  (3) the strong economic performance of those developing countries that embraced capitalism rather the radical view.
- Free market view: FDI increases the overall efficiency of the world economy. FDI is a benefit to both the source and the host country.
- Pragmatic nationalism: FDI has both benefits and costs:
  - FDI can benefit a host country by bringing capital, skills, technology and jobs;
  - when a foreign company rather than a domestic company produces products, the profits from that investment go abroad and a foreign owned manufacturing plant may import many components from its home country, which has negative implications for the home country's balance-of-payments position.

  → FDI should be allowed so long as the benefits outweigh the costs.

Host-country benefits of FDI:

- resource-transfer effects: a study by the OECD found that foreign investors invested significant amounts of capital in R&D in the countries in which they had invested, suggesting that not only were they transferring technology to those countries but they may also have been upgrading existing technology;
- employment effects: direct (a foreign MNE employs host-country citizens) and indirect (jobs are created in local suppliers as a result of the investment);
- balance-of-payments effects: two ways in which FDI can help to run a current account surplus:
  (1) FDI is a substitute for imports: Japanese FDI in the US approves the current account of the US;
  (2) a foreign subsidiary may contribute to the host-country's exports.
- effects on competition and economic growth: FDI in the form of greenfield investments should increase competition and this may lead to increased productivity growth, product and process innovations, greater economic growth and lower prices.

Home-country benefits of FDI:

- balance-of-payments effects: the balance benefits from the inward flow of foreign earnings;
- employment effects: positive employment effects arise when the foreign subsidiary creates demand for home-country exports;
- reverse resource-transfer effect: the home-country MNE learns valuable skills from its exposure to foreign markets that can subsequently be transferred back to the home country.

Host-country costs of FDI:

- effects on competition: because an acquisition does not result in a net increase in the number of players in a market, the effect on completion may be neutral or when a foreign investor acquires two or more firms and subsequently merges them, the effect may be to reduce competition and create monopoly power, reduce consumer choice and raise prices;
- balance-of-payments effects:
  (1) outflow of earnings from the foreign subsidiary to its parent company;
  (2) import of inputs from abroad by the foreign subsidiary.
- national sovereignty and autonomy: key decisions that can affect the host country's economy will be made by a foreign parent that has no real commitment to the host country and over which the host country's government has no real control.

Home-country costs:
- balance of payments effects:
  (1) the balance suffers from the initial capital outflow required to finance FDI;
  (2) the current amount suffers if the purpose of the foreign investment is to serve the home market from a low-cost production location;
  (3) the current amount suffers if the FDI is a substitute for direct exports.
- employment effects: the most serious concerns arise when FDI is seen as a substitute for domestic production.

Offshore production = FDI undertaken to serve the home market. Such FDI may actually stimulate economic growth and hence employment in the home country by freeing home-country resources to concentrate on activities where the home country has a comparative advantage.

Home-country policies to encourage outward FDI:
- foreign risk insurance: to cover major types of foreign investment risk and encourage firms to undertake investments in politically unstable countries;
- capital assistance: special funds or banks that make government loans to firms wishing to invest in developing countries;
- tax incentives: many countries have eliminated double taxation of foreign income;
- political pressure: a number of investor countries have used their political influence to persuade host countries to relax their restrictions on inbound FDI.

Home-country policies to restrict outward FDI:
- limit capital outflows;
- manipulate tax rules to try to encourage their firms to invest at home;
- prohibit national firms from investing in certain countries for political reasons.

Host-country policies to encourage inward FDI:
- offer incentives to foreign firms to invest in their countries (*low-interest loans*).

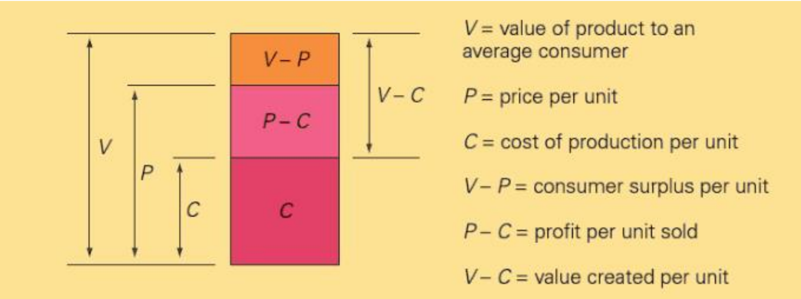
Host-country policies to restrict inward FDI:
- ownership restraints: foreign companies are excluded from specific fields or foreign ownership may be permitted although a significant proportion of the equity of the subsidiary must be owned by local investors → why?
  (1) on the grounds of national security or competition;
  (2) based on the belief that local owners can help maximize the resource-transfer and employment benefits of FDI for the host country;
- performance requirements: controls over the behaviour of the MNE's local subsidiary (*technology transfer*).

Implications for managers:
- Implications of the theory:
  - the location-specific advantages argument helps explain the direction of FDI, however it does not explain why firms prefer FDI to licensing or exporting;
  - the most useful theories focussing on why firms prefer FDI to licensing or exporting are those that focus on the limitations of the two, that is internationalization theories;
  - product life-cycle and Knickerbocker's theory of FDI tend to be less useful from a business perspective: they do a good job describing the evolution of FDI, but they do a relatively poor job identifying the factors that influence the relative profitability of FDI, licensing and exporting.

- Implications of government policy:
  - a host government's attitude toward FDI should be an important variable in decisions about where to locate foreign production facilities and where to make a FDI.

Chapter 13: The strategy of international business

Firm strategy = actions that managers take to attain the goals of the firm (maximize the value of the firm). To maximize the value of a firm, managers must pursue strategies that increase profitability and the rate of profit growth over time.
Profitability = ROIC (rate of return on invested capital) = net profits / total invested capital.
Profit growth = percentage increase in net profits over time.
Value creation = V – C

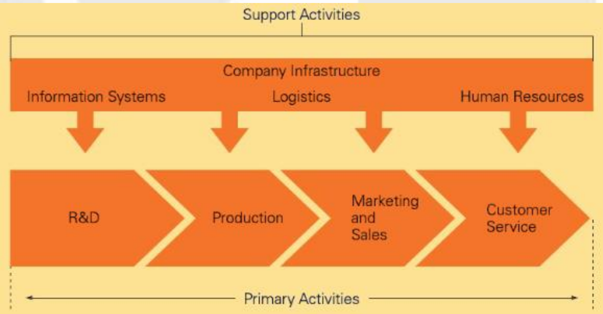


Low-cost strategy = strategy that focuses primarily on lowering production costs.
Differentiation strategy = strategy that focuses primarily on increasing the attractiveness of a product.
Note: superior value creation relative to rivals does not necessarily require a firm to have the lowest-cost structure or to create the most valuable product, it does require the gap between V and C to be the greatest.
Efficiency frontier: shows all of the different positions that a firm can adopt with regard to V and C assuming that its internal operations are configured efficiently to support a particular position. The frontier is convex because of diminishing returns.
Diminishing returns: when a firm already has significant value built into its product offering, increasing value by a relatively small amount requires significant additional costs or when a firm already has a low-cost structure, it has to give up a lot of value to get additional cost reductions.

To maximize its profitability, a firm must do three things:

(1) pick a position on the frontier where there is enough demand to support the choice;
(2) configure its internal operations so that they support that position;
(3) make sure that the firm has the right organisation structure in place to execute its strategy.

Value chain:



Note: support activities can be as important or even more important as primary activities.

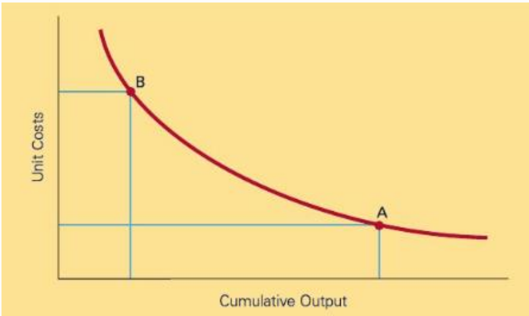
Expanding globally allows firms to increase their profitability and rate of profit growth in ways not available to purely domestic enterprises. Firms that operate internationally are able to:

- expand the market by selling in international markets;
- realize location economies by dispersing activities to locations where they can be performed most efficiently;
- realize greater cost economies from experience effects by serving global market from a central location;
- earn a greater return by leveraging valuable skills developed in foreign operations.

Core competence = skills within the firm that competitors cannot easily match or imitate.

Location economies = the economies that arise from performing a value creation activity in the optimal location for that activity, wherever in the world that might be.
Global web of value creation activities = the different stages of the value chain are being dispersed to those locations around the globe where perceived value is maximized or where the costs of value creation are minimized.
Experience curve: refers to systematic reductions in production costs that have been observed to occur over the life of a product. Two things explain this:

- Learning effects = cost savings that come from learning by doing. Production costs decline due to increasing labour productivity and management efficiency which increases the firm's profitability. Important in the start-up period.
- Economies of scale = reductions in unit cost achieved by producing a large volume of a product. Economies of scale have a number of sources:
  - the ability to spread fixed costs over a large volume;
  - the ability to attain an efficient scale of production → less switching costs;
  - the increase in bargaining power which may allow it to attain economies of scale in purchasing, bargaining down the cost of key inputs and boosting profitability.



Moving down the experience curve allows frim to reduce its cost of creating value and increase its profitability.
Firm A has a clear cost advantage over firm B.

Firms typically face two types of competitive pressure:

- pressures for cost reductions;
- pressures to be locally responsive, differentiate.

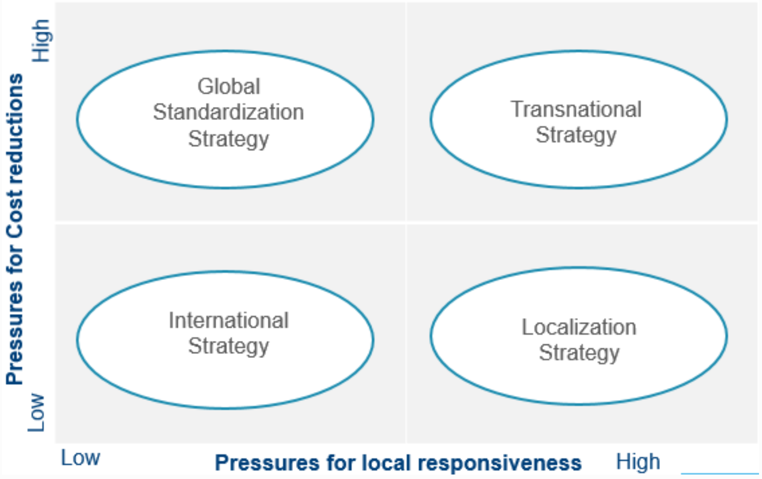
→ because differentiation across countries can involve significant duplication and a lack of product standardization, it may raise costs.
Pressures for cost reductions are intense in:

- industries serving universal needs where price is the main competitive weapon;
- industries where major competitors are based in low-cost locations where there is persistent excess capacity and consumers are powerful and face low switching costs.

Universal needs: the tastes and preferences of consumers in different nations are similar if not identical.
Pressures for local responsiveness arise from:

- national differences in customer tastes and preferences;
- differences in infrastructure and traditional business practices;
- differences in distribution channels → soft sell versus hard sell;
- host-government demands → informal rules with regard to local content favour people who use local workers.

Choosing a strategy → four basic strategies:



Global standardization strategy: the strategic goal is to pursue a low-cost strategy on a global scale → firms focus on increasing profitability and profit growth by reaping cost reductions that come from economies of scale, learning effects and location economies. The strategy makes most sense when there are strong pressures for cost reductions and demands for local responsiveness are minimal.
Localization strategy: firms focus on increasing profitability by customizing the firm's goods or services so that they provide a good match to tastes and preferences in different national markets. Localization is most appropriate when there are substantial differences across nations with regard to consumer tastes and preferences and cost pressures are not too intense.
Transnational strategy: firms are trying to simultaneously achieve low costs through location economies, economies of scale and learning effects: they differentiate their product offerings across geographic markets to account for local differences and foster a multidirectional flow of skills between different subsidiaries. The transnational strategy makes sense when both cost pressures as pressures for local responsiveness are intense.
International strategy: firms take products first produced for the domestic market and then selling them internationally with only minimal local customization. The international extension strategy makes sense when there are low cost pressures and low pressures for local responsiveness.
→ as competitors emerge, localization and international strategies tend to become less viable and managers need to direct their companies toward either globalization or transnational strategies.

____

Integration versus local responsiveness:
Global industries = industries in which firms can sustain competitive advantages if only:
- they are present in the key countries of the world;
- they are integrated and coordinate their activities across the world on a centralized manner.

Characteristics of global industries:
- similar needs and customer's behaviour;
- standardized products;
- beyond country economies of scale;
- speed of innovation;
- transferability of experience;
- global customers, pricing and competitors.

Local industries = industries in which firms can sustain competitive advantage within the boundaries of countries.
Characteristics of local industries:
- different needs and customer's behaviour;
- customized products and services;
- low economies of scale;
- complex distribution and high transport costs;
- transferability of experience;
- local customers.

Factors pushing for globalization:
- low entry barriers;
- high scale technology;
- convergence of consumption;

- transport.

Factors against globalization:

- cultural differences;
- customer proximity;
- transport costs;
- legal requirements.

Implications for managers:

- managers should recognize that valuable skills that could be applied elsewhere in the firm can arise anywhere within the firm's global network (not just at the corporate centre);
- managers should establish an incentive system that encourages local employees to acquire new skills;
- managers should have a process for identifying when valuable new skills have been created in a subsidiary.

How has Cemex achieved superior performance and in particular: what role has globalisation played?

- volume: there was little room for growth at home;
- margins: Cemex's advantage stems from higher average prices rather than lower average costs;
- costs: the company post-merger integration process has become quicker and more thorough over time → Cemex's investment and acquisition costs show a fairly steady decline;
- prices and willingness-to-pay:
    - much higher average prices than competitors;
    - the company's guaranteed delivery within fifteen minutes has contributed to buyer value and willingness-to-pay by reducing expensive downtime;
- prices and leverage:
    - Cemex buys capacity in countries or regions where it can (1) reduce the number of competitors, (2) wind up with the largest market share among those competitors and (3) own a controlling interest in its acquired companies → bargaining power;
    - Cemex also controls strategic narrows that allow it to influence the levels of imports into its key markets;
- risk: pooling across markets with different construction cycles helped reduce the standard deviation in Cemex quarterly cashflow margins from 22% to 12%;
- knowledge: best practices of Cemex are acquired across global operations.

Using the ADDING value scorecard:

- comprehensiveness: you will come closer to maximizing your potential if you have a suitable broad conception of how crossing borders might add value;
- unbundling: it often makes sense to break firms down into discrete activities or processes and then analyse how each contributes to the components of the ADDING value scorecard;
- quantification: not every interest can be quantified → quantify as best as you can the expected value from doing one thing as opposed to another and then weigh the results against the qualitative considerations left out of the calculations;
- comparisons:
    - joint evaluation may make it easier to take hard-to evaluate considerations (option A versus B, C …);
    - position at one point in time versus another;
    - comparisons with competitors are helpful for diagnostic purposes;
    - comparisons with market contracting to assess mergers and stretch strategic thinking by forcing a company to rethink what it does in-house;

The ADDING value scorecard:

Applying the ADDING Value scorecard

Components of value	Guidelines
Adding volume, or growth	• Look at the true economic profitability of incremental volume. • Probe the level at which additional volume yields economies of scale (or scope): globally, nationally, at the plant or customer level. • Calibrate the strength of scale effects (slope, percentage of costs or revenues affected). • Assess the other effects of volume.
Decreasing costs	• Unbundle cost effects and price effects. • Unbundle costs into subcategories. • Consider cost increases (e.g., due to complexity, adaptation) as well as decreases, and net them out. • Look at cost drivers other than scale or scope. • Look at labor costs-to-sales ratios for your industry (or company).
Differentiating or increasing willingness-to-pay	• Look at the R&D-to-sales and advertising-to-sales ratios for your industry. • Focus on willingness-to-pay rather than prices paid. • Think through how globality affects willingness-to-pay. • Analyze, in particular, how cross-border (CAGE) heterogeneity in preferences affects willingness-to-pay for products on offer. • Segment the market appropriately.
Improving industry attractiveness or bargaining power	• Account for international differences in industry profitability. • Understand the concentration dynamics of your industry. • Look broadly at the impact of changes in industry structure. • In particular, think through how you can deescalate or escalate rivalry. • Recognize the implications of what you do for rivals' costs or willingness-to-pay for their products. (Worsening their positions can do as much for added value as improving one's own.) • Attend to regulatory and other nonmarket restraints—and ethics.
Normalizing (or optimizing) risk	• Characterize the extent and key sources of risk in your business (e.g., capital intensity, other correlates of irreversibility, demand volatility). • Assess how much cross-border operations reduce or increase risk. • Recognize any benefits that might accrue from increasing risk. • Consider multiple modes of managing exposure to risk or the exploitation of optionality.
Generating knowledge (and other resources and capabilities)	• Assess the location-specificity versus mobility of knowledge. • Consider multiple modes of generating (and diffusing) knowledge. • Think of other resources or capabilities in similar terms. • Avoid double-counting.

Asses the other effect of volume → additional volume may raise costs if a key input is in short supply or because of adjustment costs such as those associated with post-merger integration.
Unbundle cost and price effects → separating out cost and price effects rules out the expression of costs as a fraction of revenues, instead you can use the quantification of costs and revenues in per-employee terms.
Unbundle costs into subcategories → fixed and variable costs.
Look at cost drivers other than scale or scope → location, capacity utilization, vertical integration, timing, functional policies, institutional factors such as unionization and governmental regulations such as tariffs.
Look at the R&D-to-sales and advertising-to-sales ratios: these are the two longest-established and most robust indicators of multinationalization → a low ration (1%) means that the room for differentiation is more limited. 1% - 2% - 3,5%
Think through how globalism affects willingness-to-pay → Häagen-Dazs gives a faux-Scandinavian appeal to US ice cream.
Understand the concentration dynamics of your industry → concentration data indicates that there has been a decline in global concentration in the car-industry while the common belief is that this industry is getting more concentrated.
Think through how you can deescalate or escalate rivalry → figuring out a competitor's response to a move is better undertaken on the basis of detailed structural and competitive analyses.
Recognize the implications of your actions for rivals 'costs or willingness-to-pay for their products → Western firms such as IBM have built up significant operations in India to raise their Indian competitors' labour costs and reduce their own.
Characterize the extent and key sources of risk in your business → a rough and ready way of unbundling risk is to classify it into the following categories:

- supply-and demand-side risks;
- financial risks;
- competitive risks;
- nonmarket risks.

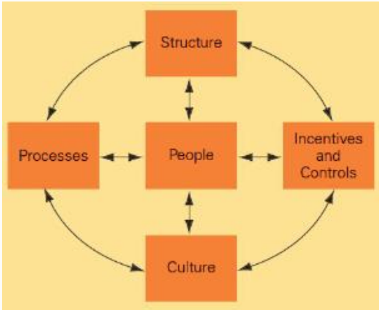
Chapter 14: The organization of international business

Superior enterprise profitability requires three conditions to be fulfilled:

(1) the different elements of a firm's organizational architecture must be internally consistent;

(2) the organizational architecture must match the strategy of the firm;
(3) the architecture and strategy must not only be consistent with each other but make sense given the competitive conditions prevailing in the firm's market.

Organizational architecture = the totality of a firm's organization, including formal organizational structure, control systems and incentives, processes, organizational culture and people.



Organizational structure: can be thought of in terms of three dimensions:

1) vertical differentiation: the location of decision-making responsibilities within a structure;
2) horizontal differentiation: the formal division of the organization into subunits;
3) integrating mechanisms: mechanisms for coordinating subunits.

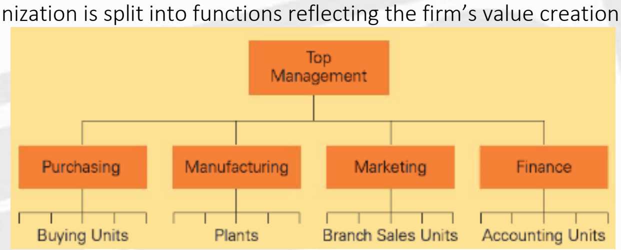
Four main arguments for centralization:

- centralization can facilitate coordination;
- centralization can help ensure that decisions are consistent with organizational objectives;
- by concentrating power and authority in one individual or management team, centralization can give top-level managers the means to bring about needed major organizational changes;
- centralization can avoid the duplication of activities that occurs when similar activities are carried on by various subunits within the organization.

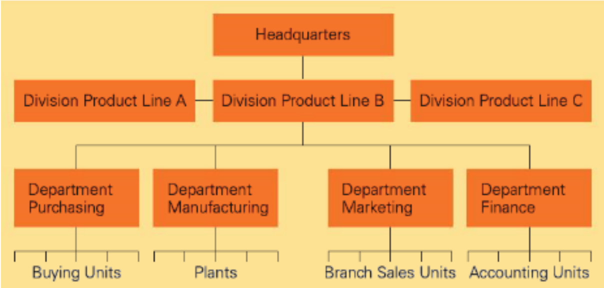
Arguments for decentralization:

- decentralization gives top management time to focus on critical issues by delegating more routine issues to lower-level managers;
- people are willing to give more to their jobs when they have a greater degree of individual freedom and control over their work;
- decentralization permits greater flexibility because decisions do not have to be referred up the hierarchy;
- decisions are made closer to the spot by individuals who have better information;
- decentralization can be used to establish relatively autonomous, self-contained subunits within an organization and the more responsibility subunit managers have, the fewer excuses they have for poor performance.

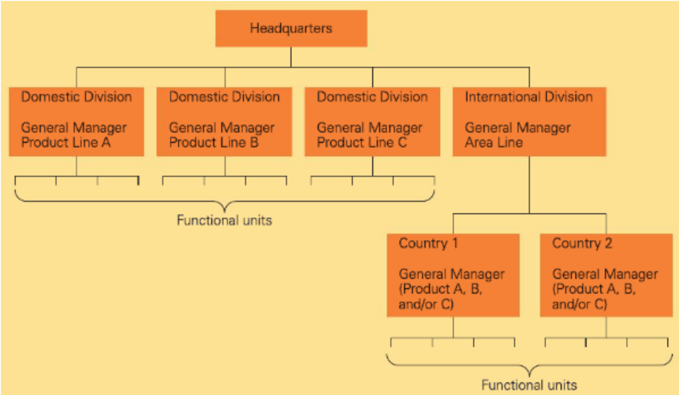
Functional structure: the organization is split into functions reflecting the firm's value creation activities.



Product division structure: each division is responsible for a distinct product line (business area). Each product division is set up as a self-contained, largely autonomous entity with its own functions.



International division structure: when firms expand internationally, they often group all of their international activities into an international division which tends to be organized on geography.

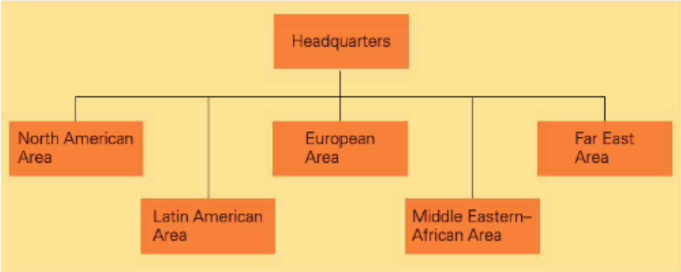


Problems with this structure:

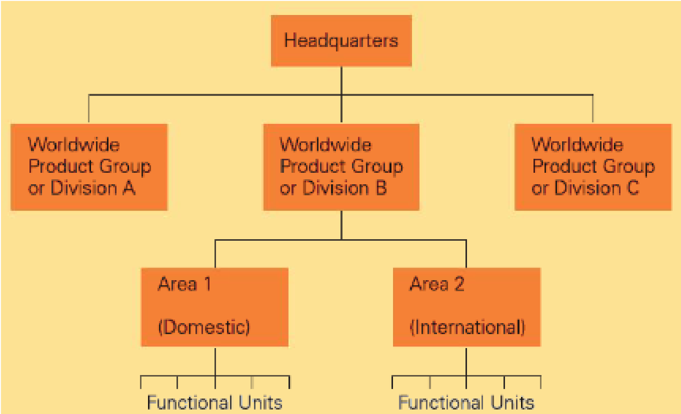
- the heads of foreign subsidiaries are not given as much voice in the organization as the heads of domestic functions or divisions;
- domestic and foreign operations are isolated from each other in separate parts of the structural hierarchy: this can inhibit the worldwide introduction of new products and the consolidation of global production at key locations so as to realize location and experience curve economies.

→ two alternative paths of development: (1) worldwide product divisions (tends to be adopted by diversified firms that have domestic product divisions) and (2) a worldwide area structure (tends to be adopted by undiversified firms whose domestic structures are based on functions).

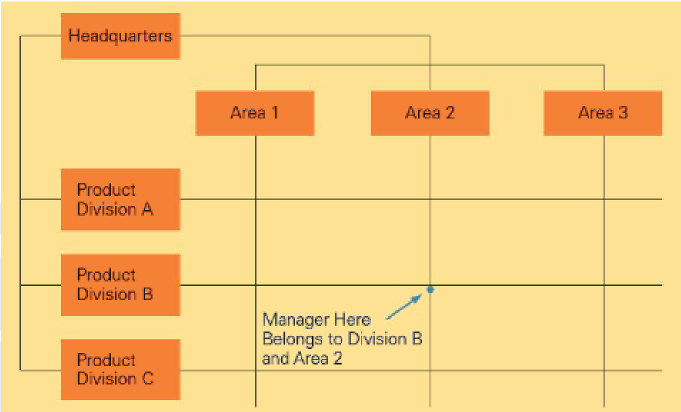
Worldwide area structure: the world is divided into geographic areas and each area tends to be a self-contained, largely autonomous entity with its own set of value creation activities. Operations authority and strategic decisions relating to each of these activities are typically decentralized to each area. This structure facilitates local responsiveness but encourages fragmentation of the organization, which can make it difficult to transfer core competencies and skills between areas and to realize location and experience curve economies.



Worldwide product division structure: the worldwide product division structure is designed to help overcome the coordination problems that arise with the international division and worldwide area structures. The structure provides an organizational context that enhances the consolidation of value creation activities at key locations necessary for realizing location and experience curve economies and it facilitates the transfer of core competencies and the simultaneous worldwide introduction of new products. The main problem is the limited voice it gives to area managers since they are seen as subservient to product division managers. The result can be a lack of local responsiveness.



Global matrix structure: horizontal differentiation proceeds along two dimensions: (1) product division and (2) geographic area. Dual decision-making responsibility can enable a firm to simultaneously achieve its particular objectives. An individual manager thus belongs to two hierarchies (a division and an area) and has two bosses (a divisional boss and an area boss). In practice the matrix is often clumsy and bureaucratic: when all critical decisions are the product of negotiation between divisions and areas, one side can always blame the other when things go wrong.

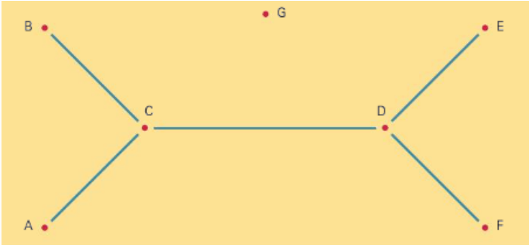


For a complex matrix structure to succeed, the firm must (1) try to establish an informal knowledge network and (2) build a common culture that promotes teamwork and cooperation.

Formal integration mechanisms:

- Direct contact: managers of the various subunits simply contact each other whenever they have a common concern. Direct contact may not be effective if the managers have differing orientations that act to impede coordination.
- Liaison roles: giving a person in each subunit responsibility for coordinating with another subunit on a regular basis.
- Teams: use teams composed of individuals from the subunits that need to achieve coordination.
- Matrix structure: designed to facilitate maximum integration among subunits. The most common matrix in multinational firms is based on geographic areas and worldwide production divisions.

Informal integrating mechanism:
- Knowledge network: network for transmitting information within an organization that is based not on formal organizational structure, but on informal contacts between managers within an enterprise and on distributed information systems. For a network to exist, managers at different locations need to be linked to each other at least indirectly.



Managers A, B and C all know each other personally, as do managers D, E and F. Although manager B does not know manager F personally, there are linked through manager C and D. Manager G is not part of the network.

Two techniques used to establish networks:
- information systems;
- management development policies → development programs that bring managers of subunits together in a single location so they can become acquainted.

Control systems = the metrics used to measure the performance of subunits and make judgments about how well managers are running those subunits.

Four main types of control systems:
(1) Personal control: control by personal contact with subordinates.
(2) Bureaucratic control: control through a system of rules and procedures that directs the actions of subunits. The most important bureaucratic controls in subunits are budgets and capital spending rules.
Budgets: a set of rules for allocating a firm's financial resources. Budgets allow headquarters to specify the amount a subunit can spend in a given year.
Capital spending rules: any capital expenditure by a subunit that exceeds a certain amount needs to be approved. Capital spending rules give headquarters additional control over how the money is spent.
(3) Output controls: involve setting goals for subunits to achieve and expressing those goals in terms of relatively objective performance metrics such as profitability, productivity, growth, market share and quality. The performance of subunit managers is then judged by their ability to achieve the goals.
(4) Cultural controls: exist when employees 'buy into' the norms and value systems of the firm. Employees tend to control their own behaviour, which reduces the need for direct supervision.

Incentives = devices used to reward appropriate managerial behaviour.

Several important points need to be made:
- incentives are usually closely tied to performance metrics used for output controls;
- incentives should vary depending on the employees and their tasks → you should make sure the incentive scheme for an individual employee is linked to an output target that he/she can influence;
- incentives should promote cooperation between managers in different subunits;
- incentives have to be adjusted to account for national differences in institutions and culture;
- incentives can have unintended consequences.

Performance ambiguity: when the causes of a subunit's poor performance are not clear. The level of performance ambiguity is a function of the interdependence of subunits in an organization. Performance ambiguity raises the costs of control.

The key to understanding the relation between international strategy, control systems and incentive systems is the concept of performance ambiguity:

Strategy	Interdependence	Performance Ambiguity	Costs of Control
Localization	Low	Low	Low
International	Moderate	Moderate	Moderate
Global	High	High	High
Transnational	Very high	Very high	Very high

Strategy: the higher profitability associated with a transnational strategy could be cancelled out by the higher costs of control.
Control: in firms pursuing global or transnational strategies, the usefulness of output controls is limited by performance ambiguity, these firms should place greater emphasis on cultural control.

Incentives: when ambiguity makes it difficult to judge the performance of subunits as stand-alone entities, linking the incentive pay of senior managers to the entity to which both subunits belong can reduce the resulting problems.

Processes = the manner in which decisions are made and work is performed within the organization.
Flow chart: illustrates the various steps and decision points involved in performing work.

Organizational culture = the norms and value systems that are shared among the employees of an organization.
Culture is maintained by a variety of mechanisms:

- hiring and promotional practices of the organization;
- reward strategies;
- socialization processes (training programs or friendly advice from peers);
- communication strategy.

The link between strategy and architecture:

	Strategy			
Structure and Controls	**Localization**	**International**	**Global Standardization**	**Transnational**
Vertical differentiation	Decentralized	Core competency more centralized; rest decentralized	Some centralization	Mixed centralization and decentralization
Horizontal differentiation	Worldwide area structure	Worldwide product divisions	Worldwide product divisions	Informal matrix
Need for coordination	Low	Moderate	High	Very high
Integrating mechanisms	None	Few	Many	Very many
Performance ambiguity	Low	Moderate	High	Very high
Need for cultural controls	Low	Moderate	High	Very high

Localization:

- firms focus on local responsiveness;
- no need for integrating mechanisms;
- performance ambiguity is low;
- cost of control is low;
- firms use a worldwide area structure.

International:

- firms create value by transferring core competencies from home to foreign subsidiaries;
- need for integrating mechanisms is moderate;
- performance ambiguity is relatively low;
- cost of control is relatively low;
- firms use a worldwide product division structure.

Global standardization:

- firms focus on the realization of location and experience curve economies;
- headquarters maintains control;
- need for integrating mechanisms is high;
- the cost of control is high;
- firms use a worldwide product division structure;
- strong organizational cultures are encouraged.

Transnational:

- firms focus on attaining location and experience curve economies, local responsiveness and global learning;
- need for coordination is high;
- cost of control is high;
- formal and informal integrating systems are used;
- firms use a matrix structure;
- a strong culture is encouraged.

For a firm to succeed, two conditions must be fulfilled:

(1) the firm's strategy must be consistent with the environment in which the firm operates;
(2) the firm's organizational architecture must be consistent with its strategy.

Comments regarding the sources of organizational change and the strategies for implementing organizational change:
Sources of inertia (= no change):

- the existing distribution of power and influence within an organisation;
- the existing culture, as expressed in norms and value systems;
- senior managers 'preconceptions about the appropriate business model → when a model has worked well in the past, managers might have trouble accepting it is no longer appropriate;
- institutional constraints.

Implementing change:

- unfreeze the organization through shock therapy;
- move the organization to a new state through proactive change in the architecture;
- refreeze the organization in its new state.

Chapter 17: Global production, outsourcing and logistics

Production and logistics functions have two important objectives:

(1) lower costs;
(2) increase product quality;

Link: improved quality control reduces costs by:

- increasing productivity because time is not wasted producing poor-quality;
- lowering rework and scrap costs associated with defective products;
- reducing the warranty costs and time associated with fixing defective products.

Six Sigma = the modern successor to TQM (Total Quality Management) = a statistically based philosophy that aims to reduce defects, boost productivity, eliminate waste and cut costs throughout a company.
ISO9000 = a quality standard to which the quality of a firm's manufacturing processes and products need to be certified to before the firm is allowed access to the EU marketplace.

For the firm contemplating international production, a number of factors must be considered:

- country factors:
  - differences in factor costs;
  - differences in political economy and national culture;
  - presence of global concentrations of activities at certain locations → externalities include the presence of an appropriately skilled labour pool and supporting industries;
  - formal and informal trade barriers;
  - transportation costs;
  - rules and regulations regarding FDI;
  - exchange rates → the low value of the yen helped strengthen Japan's position as low-cost location.
- technological factors;
  - level of fixed costs → the fixed costs of setting up a production plant can be so high that a firm must serve the world market from a single location;
  - minimum efficient scale = the level of output at which most plant-level scale economies are exhausted → the larger the minimum efficient scale relative to global demand, the greater the argument for centralizing production in a single location;
  - flexible manufacturing technology = lean production = a range of manufacturing technologies designed to (1) reduce setup times, (2) increase the utilization of individual machines through better scheduling, (3) improve quality control at all stages of the manufacturing process → when flexible manufacturing technologies are available, a firm can manufacture products customized to various national markets, without absorbing a significant cost penalty;
- product factors → two product features affect location decisions:
  (1) value-to-weight ratio → products with a low value-to-weight ratio should be made in multiple locations close to major markets to reduce transportation costs;
  (2) whether the product serves universal needs → if there are few national differences in consumer taste, production should be concentrated at one optimal location.

Two basic strategies for locating production facilities: (1) concentrate them or (2) decentralize them → the appropriate choice is determined by various factors:

	Concentrated Production Favored	Decentralized Production Favored
Country Factors		
Differences in political economy	Substantial	Few
Differences in culture	Substantial	Few
Differences in factor costs	Substantial	Few
Trade barriers	Few	Substantial
Location externalities	Important in industry	Not important in industry
Exchange rates	Stable	Volatile
Technological Factors		
Fixed costs	High	Low
Minimum efficient scale	High	Low
Flexible manufacturing technology	Available	Not available
Product Factors		
Value-to-weight ratio	High	Low
Serves universal needs	Yes	No

Flexible machine cells = common flexible manufacturing technology = a grouping of various types of machinery, a common materials handler and a centralized cell controller. The cell is dedicated to the production of a family of parts or products.

The strategic role of foreign production sites → when reviewing the location of production facilities, the international manager must consider the valuable skills that may have been accumulated at various locations and the impact of those skills on factors such as productivity and product design.

Make-or-buy decisions = decisions about whether they should perform a certain value creation activity themselves or outsource it to another entity.
Advantages of make:

- lower costs → the firm may be more efficient at producing than any other firms;
- facilitate investments in highly specialized assets → when substantial investments in specialized assets are required to manufacture a component, the firm will prefer to make the component internally, to avoid mutual dependency;
- protect proprietary product technology → the firm would not want competitors to get his technology;
- enable the firm to accumulate valuable skills and capabilities → firms learn through experience;
- ease the scheduling of adjacent processes.

Specialized asset: Ford developed a new, high-performance, high-quality and uniquely designed fuel injection system and had to decide whether to make or buy. Manufacturing these injection systems requires investment in equipment that can only be used for this purpose. Investment in this equipment constitutes an investment in specialized assets.
Dynamic capabilities: skills that become more valuable over time through learning.

Advantages of buy:

- greater flexibility → the flexibility to switch sourcing;
- drive down the cost structure → making all parts in-house increases an organization's scope and the resulting increase in organizational complexity can raise a firm's cost structure:
  - the greater the number of subunits, the more problems coordinating and controlling these units;
  - internal suppliers may lack an incentive to reduce costs because they have a captive customer;
  - internal suppliers have the ability to manipulate transfer prices to their advantage, passing cost increases downstream rather than looking for ways to reduce costs;
- help firms capture orders form international customers.

Strategic alliances build trust between the firm and its suppliers, these may encourage suppliers to undertake specialized investments but limit a firm's strategic flexibility.

The twin objectives of logistics are:

- to manage a firm's global supply chain at the lowest possible cost and in a way that best serves customer needs;
- to lower the costs of value creation and help the firm establish a competitive advantage through superior customer service.

JIT systems: the basic philosophy is to economize on inventory holding costs by having materials arrive at a manufacturing plant just in time to enter the production process and not before.
Advantages:

- cost savings: the major cost savings come from speeding up inventory turnover which reduces inventory holding costs, such as warehousing and storage costs;

- improved product quality: parts enter the manufacturing system immediately, which allows defective inputs to be spotted right away.

Disadvantages:

- no buffer stock of inventory: buffer stock helps a firm respond quickly to increases in demand and tides a firm over shortages brought about by disruption among suppliers.

The role of IT and the Internet:

- track component parts as they make their way across the globe toward an assembly plant and hereby enabling a firm to optimize its production scheduling according to when components are expected to arrive;
- locate components parts in supply chain precisely and hereby allowing the firm to accelerate production when needed by pulling key components out of the regular supply chain and having them flown to the plant.

Two consequences of EDI (Electronic Data Interchange) systems:

- suppliers, shippers and the purchasing firm can communicate with each other with no time delay, which increases the flexibility and responsiveness of the global supply system;
- much of the paperwork between suppliers, shippers and the purchasing firm is eliminated.

Chapter 15: Entry strategy and strategic alliances

Basic entry decision:

- Which foreign markets? → politically stable developed and developing nations that have free market systems and where there is not a dramatic upsurge of either inflation rates or private-sector debt.
- Timing of entry?

  First-mover advantages:

  - the ability to pre-empt rivals and capture demand by establishing a strong brand name;
  - the ability to build sales volume and ride down the experience curve ahead of rivals;
  - the ability to create switching costs that tie customers into their products or services.

  First-mover disadvantages:

  Pioneering costs = these costs arise when the business system in a foreign country is so different from that in a firm's home country that the enterprise has to devote considerable effort, time and expense to learning the rules of the game:

  - costs of business failure if the firm makes major mistakes;
  - costs of promoting and establishing a product offering, including the costs of educating customers;
  - regulation changes that invalid prior assumptions about the best business model.
- Scale of entry and strategic commitments → the risk-averse firm that enters a foreign market on a small scale may limit its potential losses, but it may also miss the change to capture first-mover advantages.

Entry modes:

(1) Exporting

- Advantages:
  - avoids the often substantial costs of establishing manufacturing operations in the host country;
  - may help a firm achieve experience curve and location economies.
- Disadvantages:
  - may not be appropriate if lower-cost locations for manufacturing can be found abroad;
  - may be uneconomical due to high transport costs and tariff barriers;
  - may lead a firm to delegate its marketing, sales and service to a local agent, but these often carry the products of competing firms and so have divided loyalties.

(2) Turnkey projects = the foreign client is handed the key to a plant that is ready for full operation.

- Advantages:
  - are useful where FDI is limited by host-government regulations, for example: the governments of many oil-rich countries have set out to build their own petroleum-refining industries, so they restrict FDI in their oil-refining sectors, but because many of these countries lack technology, they gain it by entering into turnkey projects with foreign firms that have the technology;
  - can be less risky than conventional FDI.
- Disadvantages:
  - are short-term projects: a firm that enters into a turnkey deal will have no long-term interest;
  - may inadvertently create a competitor;
  - may cause a firm selling his competitive advantage to potential or actual competitors.

(3) Licensing

- Advantages:
  - is attractive for firms lacking the capital to develop operations overseas;

- can be attractive when a firm is unwilling to commit substantial financial resources to an unfamiliar or politically volatile foreign market;
- used when a firm wish to participate in a foreign market but is prohibited by barriers to investment;
- used when a firm possesses some intangible property that might have business applications, but it does not want to develop those applications itself.

 Disadvantages:

- does not give a firm the tight control over manufacturing, marketing and strategy required for realizing experience curve and location economies;
- limits a firm's ability to coordinate strategic moves across countries by using profits earned in one country to support competitive attacks in another;
- may cause a firm losing his competitive advantage → two ways of reducing this risk: (1) entering in a cross-licensing agreement (= a firm might license some valuable intangible property to a foreign partner, but, in addition to a royalty payment, the firm might also request the foreign partner to license some of its valuable know-how to the firm) and (2) establishing a joint venture in which both companies have an important stake.

(4) Franchising = a specialized form of licensing in which the franchiser not only sells intangible property to the franchisee but also insists that the franchisee agree to abide by strict rules as to how it does business.

 Advantages:

- allows a firm to build a global presence quickly and at a relatively low cost and risk.

 Disadvantages:

- may inhibit the firm's ability to take profits out of one country to support competitive attacks in another;
- can make poor quality difficult to detect.

(5) Joint venture with a foreign firm

 Advantages:

- provides the marketing expertise and the local knowledge necessary for competing in the country;
- lowers the costs and risks by sharing these with the local partner;
- can be the only feasible entry mode due to political considerations.

 Disadvantages:

- may cause a firm giving away its competitive advantage → two options to minimize that risk: (1) hold majority ownership in the venture and (2) wall off from a partner technology that is central to the core competence of the firm, while sharing other technology;
- does not give a firm tight control over subsidiaries that it might need to realize experience curve, location economies or engaging in coordinated global attacks against its rivals;
- can lead to conflicts and battles for control between the investing firms if their goals and objectives change or if they take different views as to what the strategy should be.

(6) Wholly owned subsidiary = a greenfield venture or an established firm in which the firm owns 100% of the stock.

 Advantages:

- reduces the risk of losing control over its core competence;
- gives a firm tight control over operations in different countries;
- may be required if a firm is trying to realize location and experience curve economies;
- gives the firm a 100% share in the profits generated in foreign markets.

 Disadvantages:

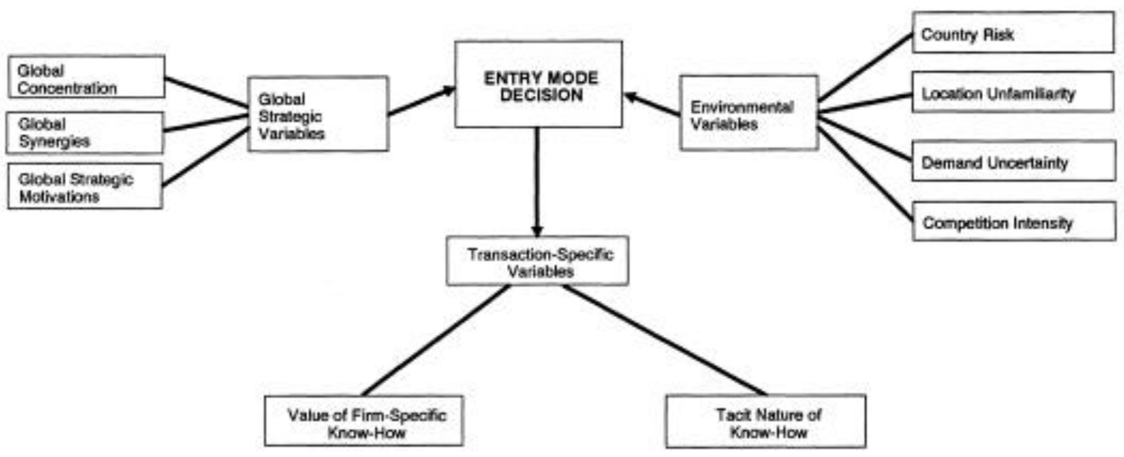
- must bear the full capital costs and risks setting up overseas operations;
- needs to marry divergent corporate cultures.

Overview:

Entry Mode	Advantages	Disadvantages
Exporting	Ability to realize location and experience curve economies	High transport costs Trade barriers Problems with local marketing agents
Turnkey contracts	Ability to earn returns from process technology skills in countries where FDI is restricted	Creating efficient competitors Lack of long-term market presence
Licensing	Low development costs and risks	Lack of control over technology Inability to realize location and experience curve economies Inability to engage in global strategic coordination
Franchising	Low development costs and risks	Lack of control over quality Inability to engage in global strategic coordination
Joint ventures	Access to local partner's knowledge Sharing development costs and risks Politically acceptable	Lack of control over technology Inability to engage in global strategic coordination Inability to realize location and experience economies
Wholly owned subsidiaries	Protection of technology Ability to engage in global strategic coordination Ability to realize location and experience economies	High costs and risks

The optimal entry mode for firms depends to some degree on the nature of their core competencies. A distinction can be drawn between firms whose core competency is technological know-how and those whose core competency is in management know-how:

- technological know-how → wholly owned subsidiary or licensing when a firm wants to license its technology as rapidly as possible to foreign firms to gain global acceptance before the imitation occurs: by licensing the firm may deter them from developing their own technology and establish its technology as the dominant design;
- management know-how → combination of franchising and (wholly owned or joint venture) master subsidiaries to control the franchises within particular countries or regions.



Three groups of variables are believed to influence the entry mode decision:

- Global strategic variables:
  - global concentration → when the global industry is highly concentrated, MNEs will favour high control entry modes;
  - global synergies → when the extent of potential global synergies is great, MNEs will demand a high level of control;
  - global strategic motivations → MNEs exercising global strategic motivations will favour high control entry modes.
- Environmental variables:

- country risk → when country risk is high, MNEs will favour entry modes that involve relatively low resource commitments;
- location unfamiliarity → when the perceived distance between the home and host country is great, MNEs will favour entry modes that involve relatively low resource commitments.
- demand uncertainty → when demand uncertainty is high, MNEs will favour entry modes that involve low resource commitments.
- competition intensity → when the intensity of competition is high, MNEs will favour entry modes that involve low resource commitments.

- Transaction-specific variables
  - value of firm-specific know-how → the greater the rent stream generated by an MNEs proprietary know-how, the greater the probability that the MNE will favour an entry mode with high control.
  - tacit nature of know-how → the greater the tacit nature of know-how, the more an MNE will favour high control entry modes.

Uppsala stage theory of internationalization = theory that explains how firms gradually intensify their activities in foreign markets. Four stages:

(1) indirect exporting;
(2) active exporting and/or licensing;
(3) active exporting, licensing and equity investment in foreign manufacture;
(4) full-scale multinational marketing and production.

Innovation-related model = model that views internationalization as a process in which the steps are analogous to that of a new product adoption. The decision of internationalization is affected by push or pull force:

- push: an external change which initiates the export decision;
- pull: an internal change which explains the shift from one step to another.

Sprinkler strategy = targeting multiple countries at once.
Waterfall strategy = slowly cascading from one country to the next.
The following market conditions favour waterfall strategies:

- very long life cycle of the product;
- small foreign market with a slow growth and low innovativeness;
- high fixed cost of entry;
- weak or no competitors and co-operative behaviour among the competitors.

Greenfield venture or acquisition?

- Pros acquisition:
  - acquisitions are quick to execute;
  - in many cases firms make acquisitions to preempt their competitors;
  - managers may believe acquisitions to be less risky than greenfield ventures: the revenue and profit stream that a greenfield venture might generate is uncertain because it does not yet exist;
- Why do acquisitions fail?
  - the management of the acquiring firm is often too optimistic about the value that can be created via an acquisition → hubris hypothesis = postulates that top managers typically overestimate their ability to create value from an acquisition, primarily because rising to the top of a corporation has given them an exaggerated sense of their own capabilities;
  - many acquisitions fail because there is a clash between the cultures of the acquiring and acquired firms;
  - many acquisitions fail because attempts to realize gains by integrating the operations of the acquired and acquiring entities often run into roadblocks and take much longer than forecast;
  - many acquisitions fail due to inadequate pre-acquisition screening.
- Reducing risks of failure:
  - screen the foreign enterprise, this can help make sure the firm (1) does not pay too much, (2) does not uncover any nasty surprises after acquisition, (3) acquires a firm whose organisation culture is not antagonistic to that of the acquiring enterprise;
  - move rapidly to put an integration plan in place and to act on that plan.
- Pros of greenfield ventures:
  - it gives the firm a much greater ability to build the kind of subsidiary company that it wants.
- Cons of greenfield ventures:
  - slower to establish and risky;

- possibility of being preempted by more aggressive global competitors who enter via acquisitions and build a big market presence that limits the market potential for a greenfield venture.

Strategic alliances = cooperative agreements between potential or actual competitors, for example: joint ventures.
Advantages:
- facilitate entry into a foreign market;
- allow firms to share the fixed costs and risks of developing new products or processes;
- bring together complementary skills and assets that neither company could easily develop on its own;
- establish technological standards for the industry that will benefit the firm.

Disadvantages:
- give competitors a low-cost route to new technology and markets.

Making alliances work:
- Partner selection
  → a good partner has three characteristics:
    - a good partner helps the firm achieve its strategic goals, he must have capabilities that the firm lacks and that it values;
    - a good partner shares the firm's vision for the purpose of the alliance;
    - a good partner is unlikely to try to opportunistically exploit the alliance for its own ends.

  → to increase the probability of selecting a good partner, the firm should:
    - collect as much pertinent, publicly available information;
    - gather data from informed third parties;
    - get to know the potential partner as well as possible before committing to an alliance.
- Alliance structure
  → the alliance should be structured so that the firm's risks of giving too much away are reduced:
    - alliances can be designed to make it difficult to transfer technology not meant to be transferred;
    - contractual safeguards can be written into an alliance agreement to guard against the risk of opportunism (= theft) by a partner;
    - both parties can agree in advance to swap skills and technologies, thereby ensuring a chance for equitable gain.

Managing the alliance:
- allow cultural differences;
- build interpersonal relationships.

Note: a major determinant of how much knowledge a company gains from an alliance is its ability to learn from its partner.

____

Coalition = partners group together to gain global access or to establish a common standard.
Co-specialisation = partners join their respective unique capabilities that complement each other to (1) create business, (2) develop new products or technology or (3) reinforce their competitiveness through specialisation.
Learning = partners group together to accommodate mutual learning from each other and to co-develop new knowledge.
Alliance planning model:
(1) corporate self-evaluation;
(2) strategic objective;
(3) role of alliances;
(4) alliance criteria;
(5) partner selection;
(6) alliance structure and organisation;
(7) negotiate and conclude the agreement;
(8) alliance management;
(9) alliance audit.

Renault – Nissan:
- strategic partnership based on the rationale that, due to substantial cross-shareholding investments, each company acts in the financial interest of the other, while maintaining individual brand identities and independent corporate cultures;
- like a marriage: a couple does not assume a converged, single identity when they get married, instead they retain their own individuality and join to build a life together, united by shared interests and goals, each bringing something different to the union;

- the alliance achieves scale and speeds time to market by jointly developing key components;
- collaboration also focuses on capital-intensive research projects such as sustainable, zero-emission transportation;
- the alliance also oversees purchasing for both companies, ensuring larger volume and thus better pricing;
- Renault and Nissan also have consolidated logistics operations under the alliance to reduce costs;
- the alliance develops 'best practices', borrowing systems and controls from one company to strengthen the other.

Daimler-Chrysler:
- (1998) Daimler bought 92% of Chrysler;
- the merger was contentious with investors launching lawsuits over whether the transaction was the merger of equals that senior management claimed;
- the synergy effects in development and production were too low;
- (2006) Chrysler reported huge losses;
- (2006) Chrysler announced plans to lay off employees, close a major assembly plant and reduce production;
- (2007) Daimler sold the Chrysler group for 80% while Daimler retained a stake of 20%;
- (2009) Chrysler filed bankruptcy.

Success M&A versus alliances (unsuccessful – successful):
- Domestic M&A: 90% – 10%
- Cross-border M&A: 40% - 60%
- Cross-border alliances: 30% - 70%

Merger motives:
- shareholder perspective:
    - neoclassical view of the firm → the firm's rationality to maximize profit;
    - maximizing the wealth of the shareholders;
    - discounted cash-flow from the decision should have a positive net present value.
- Managerial perspective:
    - empire-building motive =to pursue growth since remuneration, status and power are a function of size;
    - self-fulfilment motive = to deploy currently underused managerial talent;
    - job security motive = to avoid being taken over;
    - to diversify risk.

Risks of mergers and acquisitions:
- high transaction costs;
- underestimation of costs, overestimation of benefits;
- unrecognized risks, liabilities or responsibilities during due diligence;
- liquidity risks;
- unintended employee turnover;
- negative reactions by customer;
- problematic integration of different corporate cultures;
- differences in national cultures and regulatory systems;
- badly managed post-merger integration process.

Due diligence = research on a business entity to assist in the decision-making on a transaction.
The approach a company should take towards integration should be understood by considering two criteria:
- the need for strategic interdependence;
- the need for organizational autonomy.

→ depending on the score on these two factors, the preferred acquisition integration approaches are:
- absorption = management needs courage to ensure that its vision for the acquisition is carried out;
- preservation = management focus is to keep the source of the acquired benefits intact;
- symbiosis = management must ensure simultaneous boundary preservation and boundary permeability;
- holding = non intention of integrating and value is created only by financial transfers, risk-sharing or general management capability.

Acquisition Integration Approaches

		Need for Strategic Interdependence: Low	Need for Strategic Interdependence: High
Need for Organizational Autonomy	High	Preservation	Symbiosis
	Low	Holding	Absorption

Merger control regulation:

- aim: preserve and develop effective competition;
- factors taken into account:
    - market position;
    - alternatives to suppliers and users;
    - barriers to entry;
    - supply and demand trends;
    - technical and economic progress to the consumer’s advantage.