

# Chapter 8

## What Would You Do?

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### Key Terms

### Concept Check

### Self-Assessment

### Management Decision

### Management Team Decision

### Develop Your Career Potential

### Take Two Video

## STUDENT RESOURCES

**ThomsonNOW** On the Job and Biz Flix video applications, concept tutorial, and concept exercise

**Xtra!** One exhibit worksheet, author FAQs, quiz, Management News, and video clips from the chapter with exercises

**Web** (<http://williams.swlearning.com>) Quiz, PowerPoint slides, and glossary terms for this chapter

**MTV International Headquarters, London, England.**<sup>1</sup> As a child of the 1980s, you can't get the words from that Dire Straits song out of your head, "I want my, I want my, I want my MTV." You grew up on MTV. But, then, who didn't? MTV and its sister station, VH1, revolutionized the music business and pioneered some of the first TV reality shows (*The Real World, The Osbournes, etc.*).

In the early 1990s, MTV created an international division, MTV International, to take MTV to the rest of the world. The initial format was simple: hire local English-speaking VJs (video disc jockeys) and have them talk in between introducing Western videos (e.g., The Police and Phil Collins). The only problem? The format didn't work. Divya Gupta, president of Media Edge, which helps companies buy advertising in India, said, "MTV, when it first entered the country [India], made the mistake of coming in as MTV. No changes. They didn't go anywhere." Though the world's youth clamored for Western artists and videos, they also wanted to see and hear artists

from their own countries.

**What Would You Do?**

The difficulty with adding local programming, however, is that while the international youth TV market is huge, industry revenues are low, costs are high, and competition is intense. Though MTV can command tens of thousands of dollars for a 30-second commercial in the United States, it gets only \$175 to \$250 per commercial in developing markets like India. If MTV buys or creates local broadcasting facilities in each major market or country, develops local programming (which can cost from \$200,000 to \$350,000 per half-hour), hires local VJs with whom local viewers will connect, and finds and sells to local, lower-paying advertisers, it will basically end up duplicating itself at very

high costs in each of the markets it enters. Finally, MTV International faces incredible competition across the globe. For example, in the United Kingdom, MTV UK battles with Emap Performance Television, whose seven music television channels are just as popular as MTV UK. In India, where most households have only one TV and families tend to watch TV shows together, MTV must compete with soap operas, sports, and news as well as with numerous alternative national and regional music channels. With the entire family sitting around the TV set, popular shows like *Pimp My Ride, Punk'd, and MTV Spring Break*, which appeal to Western youths, are unlikely to help MTV gain viewers in more conservative India.

Yet, with the number of people worldwide between the ages of 10 and 34 expected to reach 2.3 billion by 2010, the number of low-income families purchasing TVs in China, Brazil, Russia, and India, growing exponentially, and only 62 percent of the population outside the United States having cable or satellite TV, MTV International has tremendous opportunities for growth. The question is how? Should MTV International be consistent across countries, or should it be completely different in each culture? How should MTV International expand internationally? Should it license its MTV brand to local businesses in each area, form strategic alliances with key foreign business partners, or bear the risk itself and wholly own and control each MTV station throughout the world? Finally, deciding where to take your company global is always an important decision. But, with so many good foreign markets to enter, the question for MTV International isn't where to expand, but how it can expand successfully in so many different places at the same time. **If you were in charge of MTV International, what would you do?**

## STUDY TIP

Review your class notes. Do they give you enough information? Do they give you the right information? If not, visit your campus study center to learn how to take good notes.

MTV's struggle with international expansion is an example of the key issue in global business: How can you be sure that the way you run your business in one country is the right way to run that business in another? This chapter discusses how organizations make those decisions. We will start by examining global business in two ways: first, by exploring its impact on U.S. businesses, and then, by reviewing the basic rules and agreements that govern global trade. Next, we will examine how and when companies go global by examining the tradeoff between consistency and adaptation and by discussing how to organize a global company. Finally, we will look at how companies decide where to expand globally. Here, we will examine how to find the best business climate, how to adapt to cultural differences, and how to better prepare employees for international assignments.

## What Is Global Business?

### global business

The buying and selling of goods and services by people from different countries.

Business is the buying and selling of goods or services. Buying this textbook was a business transaction. So was selling your first car. So was getting paid for babysitting or for mowing lawns. **Global business** is the buying and selling of goods and services by people from different countries. The Timex watch on my wrist as I write this chapter was purchased at a Wal-Mart in Texas. But since it was made in the Philippines, I participated in global business when I wrote Wal-Mart a check. Wal-Mart, in turn, had already paid Timex, which had paid the company that employs the Filipino managers and workers who made my watch.

*Of course, there is more to global business than buying imported products at Wal-Mart. After reading the next section, you should be able to*

- 1 discuss the impact of global business and the trade rules and agreements that govern it.

## 1 GLOBAL BUSINESS, TRADE RULES, AND TRADE AGREEMENTS

If you want a simple demonstration of the impact of global business, look at the tag on your shirt, the inside of your shoes, and the inside of your cell phone (take your battery out). Chances are, all of these items were made in different places around the world. As I write this, my shirt, shoes, and cell phone were made in Thailand, China, and Korea. Where were yours made?

Although the United States imports products from around the world, the country of origin of some may surprise you. Many Japanese automakers have manufacturing facilities in the United States, like Honda's plant in Marysville, Ohio, and Toyota's plant in Georgetown, Kentucky.



HONDA OF AMERICA MANUFACTURING, INC.

Let's learn more about **1.1 the impact of global business**, **1.2 how tariff and nontariff trade barriers have historically restricted global business**, **1.3 how today global and regional trade agreements are reducing those trade barriers worldwide**, and **1.4 how consumers are responding to those changes in trade rules and agreements**.

### 1.1 The Impact of Global Business

Thomas Friedman, author and *New York Times* columnist, observed global business in action when he visited Infosys, a consulting and information technology company, in India:

*I guess the eureka moment came on a visit to the campus of Infosys Technologies, one of the crown jewels of the Indian outsourcing and software industry. Nandan Nilekani, the Infosys C.E.O.,*

was showing me his global video-conference room, pointing with pride to a wall-size flat-screen TV, which he said was the biggest in Asia. Infosys, he explained, could hold a virtual meeting of the key players from its entire global supply chain for any project at any time on that supersize screen. So its American designers could be on the screen speaking with their Indian software writers and their Asian manufacturers all at once. That's what globalization is all about today, Nilekani said. Above the screen there were eight clocks that pretty well summed up the Infosys workday: 24/7/365. The clocks were labeled United States West, United States East, G.M.T., India, Singapore, Hong Kong, Japan, Australia.<sup>2</sup>

Infosys does global business by selling products and services worldwide with managers and employees from different continents working together as seamlessly as if they were next door to each other. But Infosys isn't unique. There are thousands of other multinational companies just like it.

**Multinational corporations** are corporations that own businesses in two or more countries. In 1970, more than half of the world's 7,000 multinational corporations were headquartered in just two countries: the United States and the United Kingdom. Today, there are 61,582 multinational corporations, nearly nine times as many as in 1970, and only 3,235, or 5.3 percent, are based in the United States.<sup>3</sup> Today, 41,842 multinationals, or 67.9 percent, are based in other developed countries (e.g., Germany, Italy, Canada, Japan), while 14,192, or 23 percent, are based in developing countries (e.g., Colombia, South Africa, and Tunisia). So, today, multinational companies can be found by the thousands all over the world!

Another way to appreciate the impact of global business is by considering direct foreign investment. **Direct foreign investment** occurs when a company builds a new business or buys an existing business in a foreign country. Brazilian steelmaker Gerdau SA made a direct foreign investment when it began purchasing U.S. steel companies such as International Steel Group. Over the last five years, these U.S. acquisitions have made Gerdau SA the fourth largest steelmaker in the United States and the sixteenth largest in the world.<sup>4</sup> Of course, companies from many other countries also own businesses in the United States. As Exhibit 8.1 shows, companies from the United Kingdom, Germany, France, Canada, and the Netherlands have the largest direct foreign investment in the United States. Japanese companies, which popular opinion typically puts at the top of this list, rank seventh.

At the same time, direct foreign investment in the United States is just half the picture. U.S. companies also have made large direct foreign investments in countries throughout the world. For example, Anheuser-Busch, the brewer of Budweiser Beer, paid \$700 million to acquire Harbin Brewery Group, the fourth largest beer company in China.<sup>5</sup> As Exhibit 8.2 shows, U.S. companies have made their largest direct foreign investments in the United Kingdom, Canada, the Netherlands, Luxembourg, Switzerland, Mexico, Ireland, and Germany.

Overall, direct foreign investment throughout the world is typically around \$1 trillion per year!<sup>6</sup> So, whether foreign companies invest in the United States or U.S. companies

#### multinational corporation

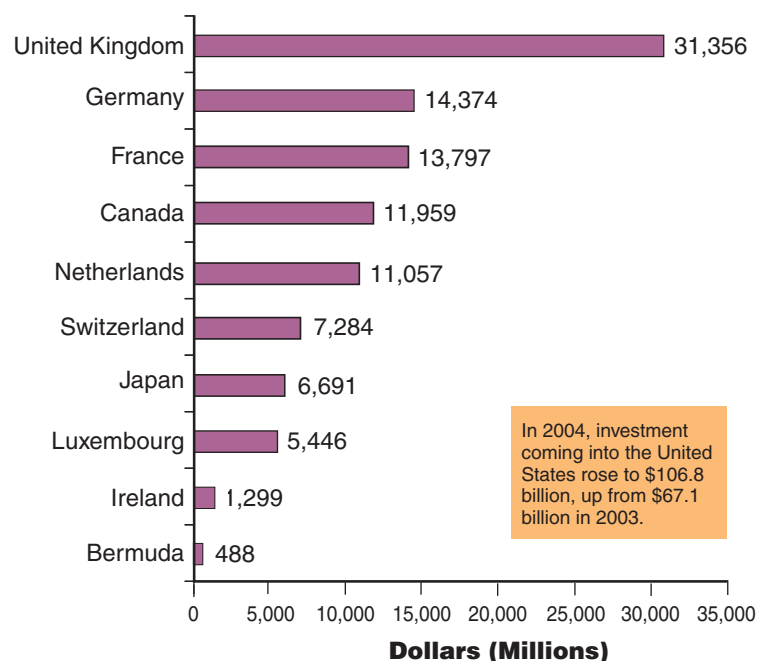
A corporation that owns businesses in two or more countries.

#### direct foreign investment

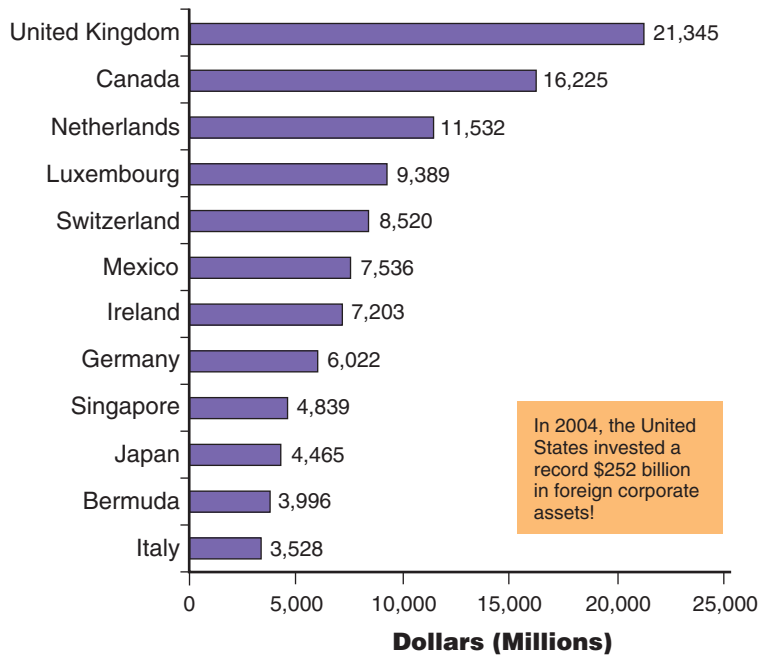
A method of investment in which a company builds a new business or buys an existing business in a foreign country.

#### Exhibit 8.1

Average Direct Foreign Investment in the United States, 2000–2004



Source: International Investment Data, Bureau of Economic Analysis, [Online] available at <http://www.bea.doc.gov/bea/di/fdi21web.xls>, 21 April 2005; J. Schuman, "U.S. Still Dominates as Global Investor," *Wall Street Journal*, 24 June 2005, online.



Source: International Accounts Data: United States Direct Investment Abroad, Bureau of Economic Analysis, [Online] available at <http://www.bea.doc.gov/bea/di/usdiacap.xls>, 21 April 2005; J. Schuman, "U.S. Still Dominates as Global Investor," *Wall Street Journal*, 24 June 2005, online.

### Exhibit 8.2

Average U.S. Direct Foreign Investment Abroad, 2000–2004

#### trade barriers

Government-imposed regulations that increase the cost and restrict the number of imported goods.

#### protectionism

A government's use of trade barriers to shield domestic companies and their workers from foreign competition.

#### tariff

A direct tax on imported goods.

#### nontariff barriers

Nontax methods of increasing the cost or reducing the volume of imported goods.

#### quota

A limit on the number or volume of imported products.

#### voluntary export restraints

Voluntarily imposed limits on the number or volume of products exported to a particular country.

invest abroad, direct foreign investment is an increasingly important and common method of conducting global business.

## 1.2 Trade Barriers

Although today's consumers usually don't care where the products they buy come from (more on this in Section 1.4), national governments have traditionally preferred that consumers buy domestically made products in hopes that such purchases would increase the number of domestic businesses and workers. Indeed, governments have done much more than hope that you will buy from domestic companies. Historically, governments have actively used **trade barriers** to make it much more expensive or difficult (or sometimes impossible) for consumers to buy or consume imported goods. For example, countries throughout the world restrict the number and kind of imported television shows and movies. The French government requires that 40 percent of all TV shows be French and that at least 60 percent be European; the Chinese government permits only 20 foreign films to be imported each year.<sup>7</sup> Likewise, the

European Union places a 24 percent tax on tuna imported from the Philippines and Thailand.<sup>8</sup> And the U.S. government imposes a 93 percent duty on fireworks imported from China, effectively doubling their price.<sup>9</sup> By establishing these restrictions and taxes, the European Union, and the French, Chinese, and U.S. governments are engaging in **protectionism**, which is the use of trade barriers to protect local companies and their workers from foreign competition.

Governments have used two general kinds of trade barriers: tariff and nontariff barriers. A **tariff** is a direct tax on imported goods. Like the U.S. government's 93 percent duty on fireworks imported from China, tariffs increase the cost of imported goods relative to that of domestic goods. For example, the U.S. import tax on trucks is 25 percent. This means that U.S. buyers must pay \$25,000 for a \$20,000 imported truck, with the \$5,000 tariff going to the U.S. government. As a result, less than 10,000 pickup trucks are imported by the United States each year.<sup>10</sup> **Nontariff barriers** are nontax methods of increasing the cost or reducing the volume of imported goods. There are five types of nontariff barriers: quotas, voluntary export restraints, government import standards, government subsidies, and customs valuation/classification. Because there are so many different kinds of nontariff barriers, they can be an even more potent method of shielding domestic industries from foreign competition.

**Quotas** are specific limits on the number or volume of imported products. For example, because of strict import quotas, raw sugarcane imports into the United States are limited to approximately 1.2 million metric tons per year.<sup>11</sup> Since this is well below the demand for sugar in the United States, domestic U.S. sugar prices are twice as high as sugar prices in the rest of the world.<sup>12</sup> Like quotas, **voluntary export restraints** limit the amount of a product that can be imported annually. The difference is that the exporting country, rather than the importing country, imposes restraints. Usually, however, the "voluntary" offer to limit exports occurs because the importing country has implicitly threatened to impose quotas. For example, to protect Japanese farmers from cheap and plentiful Chinese agricultural products, the Japanese government is trying to convince

China to “voluntarily” restrict the amount of leeks, shitake mushrooms, and rushes (used in making Japanese floor mats) that it exports to Japan each year.<sup>13</sup> According to the World Trade Organization (see the discussion in Section 1.3), however, voluntary export restraints are illegal and should have been phased out after 1999.<sup>14</sup>

In theory, **government import standards** are established to protect the health and safety of citizens. In reality, such standards are often used to restrict or ban imported goods. For example, Japan banned the importation of nearly all U.S. apples, which are one-third the cost of Japanese apples. Ostensibly, the ban was to prevent transmission of fire blight bacteria to Japanese apple orchards, but research conducted *jointly* by U.S. and Japanese scientists “does not support Japan’s assertion that mature, symptomless apples can transmit” the fire blight bacteria.<sup>15</sup> In other words, the Japanese government was actually using this government import standard to protect the economic health of its apple farmers, rather than the biological health of its apple orchards. Only after the World Trade Organization (see Section 1.3) ruled that there was no scientific basis for the ban did Japan allow U.S. apples to be imported without restrictions.<sup>16</sup>

Many nations also use **subsidies**, such as long-term, low-interest loans, cash grants, and tax deferments, to develop and protect companies in special industries. European and Japanese governments have invested billions of dollars to develop airplane manufacturers and steel companies, while the U.S. government has provided subsidies for manufacturers of computer chips. Not surprisingly, businesses complain about unfair trade practices when other companies receive government subsidies. For example, German-based Infineon Technologies, which makes computer memory chips, is upset about the \$4 billion in subsidies that state-run Korean banks have given to its Korean-based competitor Hynix Semiconductor to prevent it from going out of business. A spokesperson for Infineon complained, “With the decision that has been reached now [to subsidize Hynix], there is the threat of continuing unfair competition.”<sup>17</sup>

The last type of nontariff barrier is **customs classification**. As products are imported into a country, they are examined by customs agents, who must decide into which of nearly 9,000 categories they should classify a product (see the United States Official Harmonized Tariff Schedule at <http://www.usitc.gov/tata/hts/index.htm> for more information). Classification is important because the category assigned by customs agents can greatly affect the size of the tariff and whether the item is subject to import quotas. For example, the U.S. Customs Service has several customs classifications for imported shoes. Tariffs on imported leather or “nonrubber” shoes are about 8.5 percent, whereas tariffs on imported rubber shoes, such as athletic footwear or waterproof shoes, range from 20 to 67 percent.<sup>18</sup> The difference is large enough that some importers try to make their rubber shoes look like leather in hopes of receiving the nonrubber customs classification and lower tariff.

### 1.3 Trade Agreements

Thanks to the trade barriers described above, buying imported goods has often been much more expensive and difficult than buying domestic goods. During the 1990s, however, the regulations governing global trade were transformed. The most significant change was that 124 countries agreed to adopt the **General Agreement on Tariffs and Trade (GATT)**. Although GATT itself was replaced by the **World Trade Organization (WTO)** in 1995, the changes that it made continue to encourage international trade.

Through tremendous decreases in tariff and nontariff barriers, GATT made it much easier and cheaper for consumers in all countries to buy foreign products. First tariffs were cut 40 percent on average worldwide by 2005. Second,

#### **government import standard**

A standard ostensibly established to protect the health and safety of citizens but, in reality, often used to restrict imports.

#### **subsidies**

Government loans, grants, and tax deferments given to domestic companies to protect them from foreign competition.

#### **customs classification**

A classification assigned to imported products by government officials that affects the size of a tariff and the imposition of import quotas.

#### **General Agreement on Tariffs and Trade (GATT)**

A worldwide trade agreement that reduced and eliminated tariffs, limited government subsidies, and established protections for intellectual property.

#### **World Trade Organization (WTO)**

As the successor to GATT, the only international organization dealing with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably, and freely as possible.

 <b>FACT FILE</b>	 <b>WORLD TRADE ORGANIZATION</b>
<p><b>Location:</b> Geneva, Switzerland</p> <p><b>Established:</b> 1 January 1995</p> <p><b>Created by:</b> Uruguay Round negotiations (1986–1994)</p> <p><b>Membership:</b> 148 countries (as of 13 October 2004)</p> <p><b>Budget:</b> 169 million Swiss francs for 2005</p> <p><b>Secretariat staff:</b> 630</p> <p><b>Head:</b> Supachai Panitchpakdi (director-general)</p>	<p><b>Functions:</b></p> <ul style="list-style-type: none"> <li>• Administering WTO trade agreements</li> <li>• Forum for trade negotiations</li> <li>• Handling trade disputes</li> <li>• Monitoring national trade policies</li> <li>• Technical assistance and training for developing countries</li> <li>• Cooperation with other international organizations</li> </ul>

Source: "WTO: About the Organization," World Trade Organization, [Online] available at [http://www.wto.org/english/thewto\\_e/thewto\\_e.htm](http://www.wto.org/english/thewto_e/thewto_e.htm), 21 April 2005.

### Exhibit 8.3 World Trade Organization

as *The Lord of the Rings*, months before the movie studios release official copies to stores in the United States.<sup>20</sup> Product piracy like this costs movie companies \$3 billion to \$4 billion in lost revenue each year.<sup>21</sup> Finally, trade disputes between countries now are fully settled by arbitration panels from the WTO. In the past, countries could use their veto power to cancel a panel's decision. For instance, the French government routinely vetoed rulings that held that its large cash grants to French farmers constituted unfair subsidies. Now, however, countries that are members of the WTO (every country that agreed to GATT is a member) no longer have veto power. Thus, WTO rulings are complete and final. For more information about GATT and the WTO, go to the WTO's Web site at <http://www.wto.org>. Exhibit 8.3 provides a brief overview of the WTO and its functions.

The second major development that has reduced trade barriers has been the creation of **regional trading zones**, in which tariff and nontariff barriers are reduced or eliminated for countries within the trading zone. The largest and most important trading zones are in Europe (the Maastricht Treaty), North America (the North American Free Trade Agreement, or NAFTA), South America (the proposed Free Trade Area of the Americas, or FTAA), and Asia (the Association of Southeast Asian Nations, or ASEAN, and Asia-Pacific Economic Cooperation, or APEC). The map in Exhibit 8.4 shows the extent to which free trade agreements govern global trade.

In 1992, Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom implemented the **Maastricht Treaty of Europe**. The purpose of this treaty was to transform their 12 different economies and 12 currencies into one common economic market, called the European Union (EU), with one common currency. Austria, Finland, and Sweden joined the EU in 1995, followed by Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia in 2004, bringing the total membership to 25 countries.<sup>22</sup> Bulgaria, Croatia, Romania, and Turkey have since applied and are now being considered for membership.<sup>23</sup> On 1 January 2002, a single common currency, the euro, went into circulation in 12 of the EU's members (Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain).

Prior to the treaty, trucks carrying products were stopped and inspected by customs agents at each border. Furthermore, since the required paperwork, tariffs, and government product specifications could be radically different in

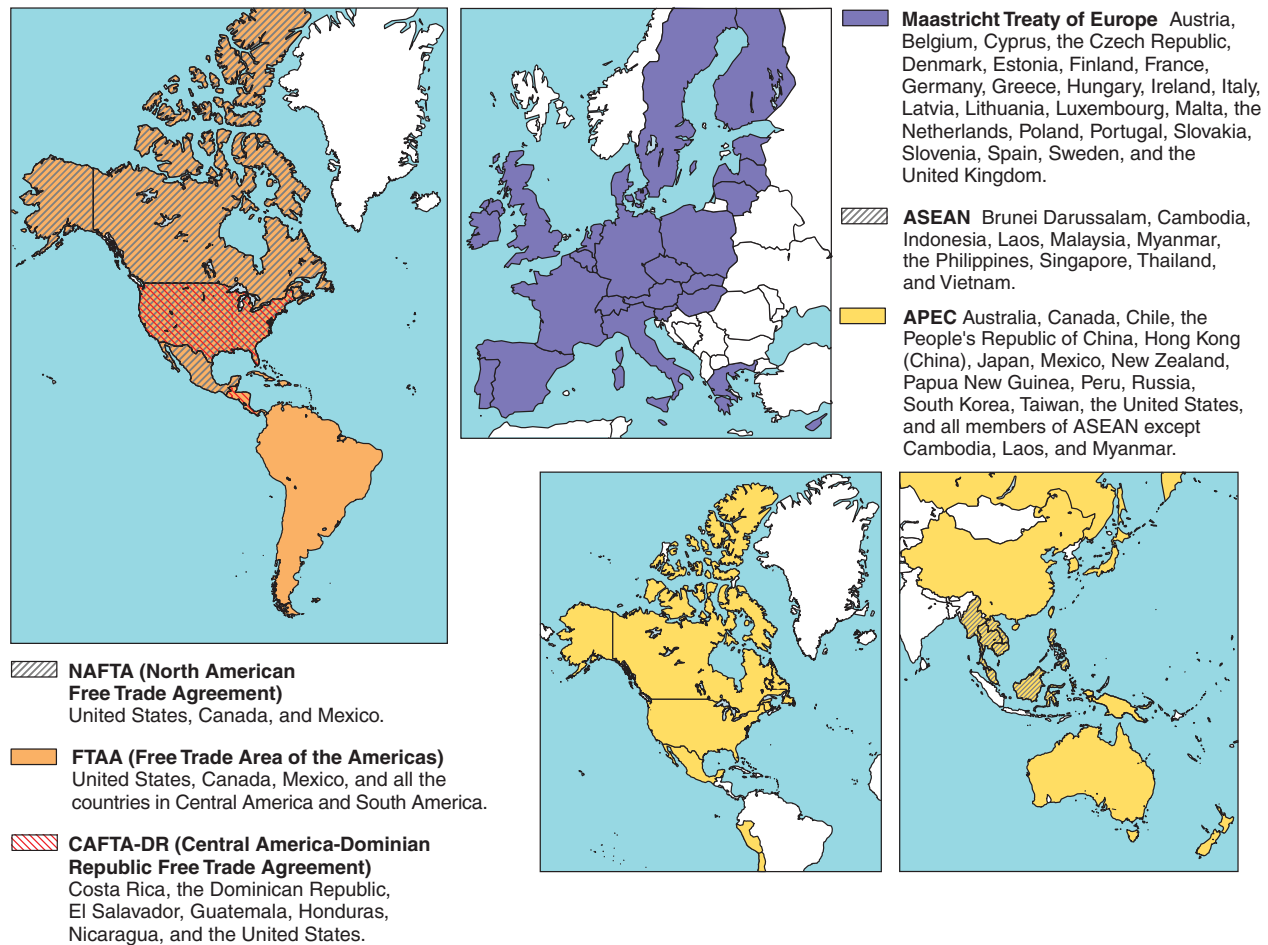
#### regional trading zones

Areas in which tariff and nontariff barriers on trade between countries are reduced or eliminated.

#### Maastricht Treaty of Europe

A regional trade agreement between most European countries.

tariffs were eliminated in 10 specific industries: beer, alcohol, construction equipment, farm machinery, furniture, medical equipment, paper, pharmaceuticals, steel, and toys. Third, stricter limits were put on government subsidies. For example, GATT put limits on how much national governments can subsidize company research in electronic and high-technology industries (see the discussion of subsidies in Section 1.2). Fourth, GATT established protections for intellectual property, such as trademarks, patents, and copyrights. Protection of intellectual property has become an increasingly important issue in global trade because of widespread product piracy. For example, 90 percent of the computer software and 95 percent of the video games in China are illegal pirated copies.<sup>19</sup> Likewise, Chinese bootleggers regularly sell illegal DVD copies of movies, such



each country, companies often had to file 12 different sets of paperwork, pay 12 different tariffs, produce 12 different versions of their basic product to meet various government specifications, and exchange money in 12 different currencies. Likewise, open business travel from state to state, which we take for granted in the United States, was complicated by inspections at each border crossing. If you lived in Germany, but worked in Luxembourg, your car was stopped and your passport was inspected twice every day, as you traveled to and from work. Also, every business transaction required a currency exchange, for example, from German deutsche marks to Italian lira, or from French francs to Dutch guilders. Imagine all of this happening to millions of trucks, cars, and businesspeople, and you can begin to appreciate the difficulty and cost of conducting business across Europe before the Maastricht Treaty. For more information about the Maastricht Treaty and the EU, go to <http://europa.eu.int/index-en.htm>. For more about Europe's new common currency, the euro, see <http://www.euro.ecb.int/en.html>.

**NAFTA**, the **North American Free Trade Agreement** between the United States, Canada, and Mexico, went into effect on 1 January 1994. More than any other regional trade agreement, NAFTA has liberalized trade between countries so that businesses can plan for one market, North America, rather than for three separate markets, the United States, Canada, and Mexico. One of NAFTA's most important achievements was to eliminate most product tariffs *and* prevent Canada, the United States, and Mexico from increasing existing tariffs or introducing new ones. Before NAFTA, Wal-Mart used expensive intermediaries to distribute goods to its stores, and Mexican officials often pressured managers for bribes. Because of burdensome paperwork, deliveries sometimes took months to clear customs. This all changed with NAFTA. Before NAFTA,

**Exhibit 8.4**  
Global Map of Regional Trade Agreements

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

A regional trade agreement between the United States, Canada, and Mexico.



Wal-Mart sold a Sony flat-screen TV imported from Japan with a 23 percent tariff for \$1,600 in Mexico! After NAFTA, Sony built a new factory in Mexico, enabling it to ship the TVs duty-free anywhere in the United States, Canada, or Mexico. With shipping costs now next to nothing and the 23 percent tariff eliminated, Wal-Mart sells the flat-screen TVs for \$600 in Mexico, or about what they sell for in the United States.<sup>24</sup>

Overall, both Mexican and Canadian exports to the United States have doubled since NAFTA went into effect. U.S. exports to Mexico and Canada have doubled, too, growing twice as fast as U.S. exports to any other part of the world.<sup>25</sup> In fact, U.S. companies now export more to Mexico than to the United Kingdom, France, Germany, and Italy combined!<sup>26</sup> For more information about NAFTA, see the Office of NAFTA & Inter-American Affairs at <http://www.mac.doc.gov/nafta/>.

#### **FTAA (Free Trade Area of the Americas)**

A regional trade agreement that, when signed, will create a regional trading zone encompassing 34 countries in North and South America.

The goal of the proposed **FTAA**, the **Free Trade Area of the Americas**, is to establish a free trade zone similar to NAFTA throughout the Western Hemisphere. If created, the FTAA would likely supplant Mercosur, a free trade agreement between Brazil, Argentina, Uruguay, and Paraguay. The FTAA would then become the largest trading zone in the world, encompassing 800 million people in 34 countries in both North and South America with a combined gross domestic product of \$11 trillion!<sup>27</sup> Like NAFTA, the FTAA will support trade “without barriers, without subsidies, without unfair practices, and with an increasing stream of productive investments.”<sup>28</sup> Over the next decade nontariff barriers will be removed, tariffs will gradually be reduced to zero, rules for investing and financial markets will be standardized, and a process for handling trade disputes will be established.<sup>29</sup> For more information about the FTAA, see <http://www.ftaa-alca.org>. For more information about Mercosur, see [http://www.sice.oas.org/agreements/Mercin\\_e.asp#MERCOSUR](http://www.sice.oas.org/agreements/Mercin_e.asp#MERCOSUR). Also see Exhibit 8.4 for information about **CAFTA**, the new **Central America Free Trade Agreement** between Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and the United States, which went into effect in August 2005.

#### **CAFTA (Central America Free Trade Agreement)**

A regional trade agreement between Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and the United States.

**ASEAN**, the **Association of Southeast Asian Nations**, and **APEC**, the **Asia-Pacific Economic Cooperation**, are the two largest and most important regional trading groups in Asia. ASEAN is a trade agreement between Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam, which form a market of more than 927 million people. U.S. trade with ASEAN countries exceeds \$120 billion a year.<sup>30</sup> In fact, the United States is ASEAN’s largest trading partner, and ASEAN’s member nations constitute the fifth largest trading partner of the United States. ASEAN’s members have agreed to create an ASEAN free trade area beginning in 2015 for the six original countries (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) and in 2018 for the newer member countries (Cambodia, Laos, Myanmar, and Vietnam).<sup>31</sup> For more information about ASEAN, see <http://www.aseansec.org>.

#### **ASEAN (Association of Southeast Asian Nations)**

A regional trade agreement between Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

#### **APEC (Asia-Pacific Economic Cooperation)**

A regional trade agreement between Australia, Canada, Chile, the People’s Republic of China, Hong Kong, Japan, Mexico, New Zealand, Papua New Guinea, Peru, Russia, South Korea, Taiwan, the United States, and all the members of ASEAN, except Cambodia, Laos, and Myanmar.

APEC is a broader agreement that includes Australia, Canada, Chile, the People’s Republic of China, Hong Kong (China), Japan, Mexico, New Zealand, Papua New Guinea, Peru, Russia, South Korea, Taiwan, the United States, and all the members of ASEAN, except Cambodia, Laos, and Myanmar.<sup>32</sup> APEC’s 21 member countries contain 2.6 billion people, account for 47 percent of all global trade, and have a combined gross domestic product of over \$19 trillion.<sup>33</sup> APEC countries began reducing trade barriers in 2000, though all the reductions will not be completely phased in until 2020. For more information about APEC, see <http://www.apecsec.org.sg>.

### **1.4 Consumers, Trade Barriers, and Trade Agreements**

In Tokyo, a Coke costs \$1.89.<sup>34</sup> In Geneva, Switzerland, a small cup of regular coffee costs \$1.70. In the United States, each of these items costs about a dollar. A McDonald’s Big Mac sandwich costs an average of \$2.90 in the United States,

\$3.37 in the United Kingdom, and \$4.90 in Switzerland.<sup>35</sup> Although not all products are more expensive in other countries (in some, they are cheaper; for example, a Big Mac costs \$1.26 in China and \$2.08 in Mexico), international studies find that American consumers get much more for their money than most other consumers in the world. For example, the average worker earns nearly \$40,680 a year in Switzerland, \$43,400 in Norway, \$34,180 in Japan, and \$37,870 in America.<sup>36</sup> Yet, after adjusting these incomes for how much they can buy, the Swiss income is equivalent to just \$32,220, the Norwegian income to \$37,910, and the Japanese income to \$28,450!<sup>37</sup> This is the same as saying that \$1 of income can buy you only 79 cents worth of goods in Switzerland, 87 cents worth in Norway, and 83 cents worth in Japan. In other words, Americans can buy much more with their incomes compared to those in other countries.

One reason that Americans get more for their money is that the U.S. marketplace has been one of the easiest for foreign companies to enter. Although some U.S. industries, such as textiles, have been heavily protected from foreign competition by trade barriers, for the most part, American consumers (and businesses) have had plentiful choices among American-made and foreign-made products. More important, the high level of competition between foreign and domestic companies that creates these choices helps to keep prices low in the United States. Furthermore, it is precisely the lack of choice and the low level of competition that keep prices higher in countries that have not been as open to foreign companies and products. For example, Japanese trade barriers are estimated to cost Japanese consumers more than \$100 billion a year. In fact, Japanese trade barriers amount to a 51 percent tax on food for the average Japanese family.<sup>38</sup>

So why do trade barriers and free trade agreements matter to consumers? They're important because free trade agreements increase choices, competition, and purchasing power and thus decrease what people pay for food, clothing, necessities, and luxuries. Accordingly, today's consumers rarely care where their products and services come from. For example, Mark Sneed, president of Phillips Foods, which imports blue crab from its Asian processing factories at one-third the cost of crab caught and processed in the United States, says, "I've never once had a customer ask me if we served domestic or imported crabs, just like they never ask if we have foreign shrimp."<sup>39</sup> Peter Germano, a New York jeweler who sells diamonds, says people don't care where the diamonds are from; they "just want to know which is cheaper."<sup>40</sup> Finally, Luis de Anda, who visits one of Wal-Mart's Sam's Wholesale Clubs in Mexico once a month to purchase diapers and toilet paper in bulk for his family and friends, says, "Why should I care where they're from? With the money I save, I take my family to the movies."<sup>41</sup>

And why do trade barriers and free trade agreements matter to managers? The reason, as you're about to read, is that while free trade agreements create new business opportunities, they also intensify competition, and addressing that competition is a manager's job.

### **Review 1: Global Business, Trade Rules, and Trade Agreements**

Today, there are more than 61,000 multinational corporations worldwide; just 5.3 percent are based in the United States. Global business affects the United States in two ways: through direct foreign investment in the United States by foreign companies, and through U.S. companies' investment in business in other countries. Direct foreign investment throughout the world typically amounts to about \$1 trillion per year. Historically, tariffs and nontariff trade barriers, such as quotas, voluntary export restraints, government import standards, government subsidies, and customs classifications, have made buying foreign goods much harder or more expensive than buying domestically produced products. In recent years, however, worldwide trade agreements, such as GATT, along

with regional trading agreements, like the Maastricht Treaty of Europe, NAFTA, ASEAN, and APEC, have substantially reduced tariff and nontariff barriers to international trade. Companies have responded by investing in growing markets in Asia, eastern Europe, and Latin America. Consumers have responded by purchasing products based on value, rather than geography.

## How to Go Global?

Once a company has decided that it *will* go global, it must decide *how* to go global. For example, if you decide to sell in Singapore, should you try to find a local business partner who speaks the language, knows the laws, and understands the customs and norms of Singapore's culture, or should you simply export your products from your home country? What do you do if you are also entering eastern Europe, perhaps starting in Hungary? Should you use the same approach in Hungary that you used in Singapore?

*Although there is no magical formula for answering these questions, after reading the next two sections, you should be able to*

- 2** explain why companies choose to standardize or adapt their business procedures.
- 3** explain the different ways that companies can organize to do business globally.

## 2 CONSISTENCY OR ADAPTATION?

In this section, we return to a key issue: How can you be sure that the way you run your business in one country is the right way to run that business in another? In other words, how can you strike the right balance between global consistency and local adaptation?

**Global consistency** means that when a multinational company has offices, manufacturing plants, and distribution facilities in different countries, it will use the same rules, guidelines, policies, and procedures to run those offices, plants, and facilities. Managers at company headquarters value global consistency because it simplifies decisions. In contrast, a company with a **local adaptation** policy modifies its standard operating procedures to adapt to differences in foreign customers, governments, and regulatory agencies. Local adaptation is typically more important to local managers who are charged with making the international business successful in their countries.

If companies lean too much toward global consistency, they run the risk of using management procedures poorly suited to particular countries' markets, cultures, and employees (i.e., a lack of local adaptation). For example, when Wal-Mart first entered Mexico, it focused too much on global consistency, filling its stores with items its American customers would want such as ice skates, riding lawn mowers, fishing tackle, and clay pigeons for skeet shooting. After Mexican store managers managed to sell all of these items at heavy discounts, Wal-Mart's computerized inventory system compounded the mistake by automatically reordering all of these "sold-out" items. Wal-Mart made the same mistake in South America, ordering live trout, American footballs, cordless tools, and leaf blowers.<sup>42</sup>

While Wal-Mart has learned to listen to local managers—and order sushi, soccer balls, and feijoada (a mixture of beef, pork, and black beans) in its South American stores—if companies focus too much on local adaptation, they run the risk of losing the cost efficiencies and productivity that result from using standardized rules and procedures throughout the world. Therefore, because of its vast purchasing power around the world, Wal-Mart hasn't given up completely on global consistency. Francisco Martinez, chief financial officer of Comercial Mexicana SA, Wal-Mart's key rival in Mexico explains why: "I buy 20,000 plastic toys, and

### global consistency

When a multinational company has offices, manufacturing plants, and distribution facilities in different countries and runs them all using the same rules, guidelines, policies, and procedures.

### local adaptation

When a multinational company modifies its rules, guidelines, policies, and procedures to adapt to differences in foreign customers, governments, and regulatory agencies.

Wal-Mart buys 20 million. Who do you think gets them cheaper?”<sup>43</sup> To systematically take advantage of this purchasing power, Wal-Mart has formed a new global sourcing team of 100 people who work together at its Bentonville, Arkansas headquarters to buy common global products like laundry detergent. The risk, of course, is that the global sourcing team may overlook local tastes and preferences (i.e., local adaptation). If these standard products are accepted by the locals at all of Wal-Mart’s 4,000 stores around the world, however, they’ll be much, much cheaper than anything Wal-Mart’s competition has to offer. Jay Allen, a Wal-Mart spokesperson, says, “There are economies of scale all the way around. We want to make sure we’re getting the best deal. Global sourcing is a big opportunity for us. [But] we’re not there yet.”<sup>44</sup>

### Review 2: Consistency or Adaptation?

Global business requires a balance between global consistency and local adaptation. Global consistency means using the same rules, guidelines, policies, and procedures in each location. Managers at company headquarters like global consistency because it simplifies decisions. Local adaptation means adapting standard procedures to differences in markets. Local managers prefer a policy of local adaptation because it gives them more control. Not all businesses need the same combinations of global consistency and local adaptation. Some thrive by emphasizing global consistency and ignoring local adaptation. Others succeed by ignoring global consistency and emphasizing local adaptation.

## 3 FORMS FOR GLOBAL BUSINESS

Besides determining whether to adapt organizational policies and procedures, a company must also determine how to organize itself for successful entry into foreign markets.

Historically, companies have generally followed the *phase model of globalization*, in which a company makes the transition from a domestic company to a global company in the following sequential phases: **3.1 exporting**, **3.2 cooperative contracts**, **3.3 strategic alliances**, and **3.4 wholly owned affiliates**. At each step, the company grows much larger, uses those resources to enter more global markets, is less dependent on home country sales, and is more committed in its orientation to global business. Evidence suggests, however, that some companies do not follow the phase model of globalization.<sup>46</sup> Some skip phases on their way to becoming more global and less domestic. Others don’t follow the phase model at all. These are known as **3.5 global new ventures**. This section reviews these forms of global business.<sup>47</sup>

### 3.1 Exporting

When companies produce products in their home countries and sell those products to customers in foreign countries, they are **exporting**. For example, FremantleMedia, the London-based company that originally developed the *Pop Idol* TV show in Britain and then exported a nearly identical version to the United States as *American Idol*, now has exported similar versions of the show to 22 different countries.<sup>48</sup>

### FAIR AND SAFE WORKING CONDITIONS IN FOREIGN FACTORIES

Requiring workers to work 15-hour days or to work seven days a week with no overtime pay, beating them for arriving late, requiring workers to apply toxic materials with their bare hands, charging them excessive fees for food and lodging—these are just a few of the workplace violations found in the overseas factories that make shoes, clothes, bicycles, and other goods for large American and multinational companies. The Fair Labor Association, which now inspects these factories for Adidas-Salomon, Levi Strauss, Liz Claiborne, Nike, Reebok, Polo Ralph Lauren, and others, recommends the following workplace standards for foreign factories.

- Make sure there is no forced labor or child labor; no physical, sexual, psychological, or verbal abuse or harassment; and no discrimination.
- Provide a safe and healthy working environment to prevent accidents.
- Respect the right of employees to freedom of association and collective bargaining. Compensate employees fairly by paying the legally required minimum wage or the prevailing industry wage, whichever is higher.
- Provide legally required benefits. Employees should not be required to work more than 48 hours per week and 12 hours of overtime (for which they should receive additional pay), and they should have at least one day off per week.

Do the right thing. Investigate and monitor the working conditions of overseas factories where the goods sold by your company are made. Insist that improvements be made. Find another supplier if they aren’t.<sup>45</sup>

DOING THE RIGHT THING

### exporting

Selling domestically produced products to customers in foreign countries.



Local adaptation is a necessary consideration of global business. For example, since Germans associate the word 'idol' with Hitler, producers exporting the popular "American Idol" television show opted to change the name to "Deutschland sucht den SuperStar" (Germany Seeks the Superstar).

the show is basically the same worldwide—find undiscovered talents and turn them into major recording artists—and it's Bailey's job to ensure that consistency. When local Russian producers claimed that Russians want to see celebrities and pushed to have them on the show, Bailey refused, "We told them this is not about celebrities, it's about kids. They're your stars."

Though advantageous in a number of ways, exporting also has its disadvantages. The primary disadvantage is that many exported goods are subject to tariff and nontariff barriers that can substantially increase their final cost to consumers. A second disadvantage is that transportation costs can significantly increase the price of an exported product. For example, because of special safety requirements, such as maintaining particular temperatures and pressures, the ships that transport liquefied natural gas can cost up to \$350 million to build. Consequently, shipping costs account for as much as 20 to 30 percent of the total cost of liquefied natural gas.<sup>49</sup> Another disadvantage is that companies that export depend on foreign importers for product distribution. This means that if, for example, the foreign importer makes a mistake on the paperwork that accompanies a shipment of imported goods, those goods can be returned to the foreign manufacturer at the manufacturer's expense.

### 3.2 Cooperative Contracts

When an organization wants to expand its business globally without making a large financial commitment to do so, it may sign a **cooperative contract** with a foreign business owner, who pays the company a fee for the right to conduct that business in his or her country. There are two kinds of cooperative contracts: licensing and franchising.

Under a **licensing** agreement, a domestic company, the *licensor*, receives royalty payments for allowing another company, the *licensee*, to produce its product, sell its service, or use its brand name in a particular foreign market. For example, brands such as Peter Paul Mounds and Almond Joy, which consumers associate with American companies, are not really American products. A British company, Cadbury Schweppes, licenses Peter Paul Mounds and Almond Joy candy bars to Hershey for U.S. production.

One of the most important advantages of licensing is that it allows companies to earn additional profits without investing more money. As foreign sales increase, the royalties paid to the licensor by the foreign licensee increase. Moreover, the licensee, not the licensor, invests in production equipment and facilities to produce the licensed product. Licensing also helps companies avoid tariff and nontariff barriers. Since the licensee manufactures the product within the foreign country, tariff and nontariff barriers don't apply. For example, Britvic Corona is licensed to bottle and distribute Pepsi-Cola within the United

#### cooperative contract

An agreement in which a foreign business owner pays a company a fee for the right to conduct that business in his or her country.

#### licensing

An agreement in which a domestic company, the licensor, receives royalty payments for allowing another company, the licensee, to produce the licensor's product, sell its service, or use its brand name in a specified foreign market.

Kingdom. Because it bottles Pepsi in Britain, tariff and nontariff barriers do not affect the price or supply of these products.

The biggest disadvantage associated with licensing is that the licensor gives up control over the quality of the product or service sold by the foreign licensee. Unless the licensing agreement contains specific restrictions, the licensee controls the entire business, from production, to marketing, to final sales. Many licensors include inspection clauses in their license contracts, but closely monitoring product or service quality from thousands of miles away can be difficult. An additional disadvantage is that licensees can eventually become competitors, especially when a licensing agreement includes access to important technology or proprietary business knowledge.

A **franchise** is a collection of networked firms in which the manufacturer or marketer of a product or service, the *franchisor*, licenses the entire business to another person or organization, the *franchisee*. For the price of an initial franchise fee plus royalties, franchisors provide franchisees with training, assistance with marketing and advertising, and an exclusive right to conduct business in a particular location. Most franchise fees run between \$5,000 and \$35,000. Franchisees pay McDonald's, one of the largest franchisors in the world, an initial franchise fee of \$75,000. Another \$455,000 to \$768,500 is needed beyond that to pay for food inventory, kitchen equipment, construction, landscaping, and other expenses (the cost varies per country). While franchisees typically borrow part of this cost from a bank, McDonald's requires that they invest \$200,000 of their own money into a new McDonald's restaurant.<sup>50</sup> Since typical royalties range from 2.0 to 12.5 percent of gross sales, franchisors are well rewarded for the help they provide to franchisees.<sup>51</sup> More than 400 U.S. companies franchise their businesses to foreign franchise partners.

Overall, franchising is a fast way to enter foreign markets. Over the last 20 years, U.S. franchisors have more than doubled their global franchises for a total of more than 100,000 global franchise units! Because it gives the franchisor additional cash flows from franchisee fees and royalties, franchising can be a good strategy when a company's domestic sales have slowed. For example, Yum! Brands, which owns and runs Pizza Hut, Taco Bell, KFC, (formerly Kentucky Fried Chicken), A&W (Root Beer) Restaurants, and Long John Silvers, is accepting very few new United States franchises because the U.S. market is saturated with fast-food outlets. McDonald's opens only about 100 new restaurants a year in the United States.<sup>52</sup> Outside the United States, however, these restaurants are experiencing much stronger growth. In the last decade, McDonald's nearly doubled the number of its overseas restaurants and continues to add approximately 500 new international restaurants per year.<sup>53</sup> Between Pizza Hut, Taco Bell, KFC, A&W Restaurants, and Long John Silvers, Yum! Brands opens nearly 1,000 new international franchise restaurants a year.<sup>54</sup>

Despite franchising's many advantages, franchisors face a loss of control when they sell businesses to franchisees who are thousands of miles away. Although there are exceptions, franchising success may be somewhat culture-bound. In other words, because most global franchisors begin by franchising their businesses in similar countries or regions (Canada is by far the first choice for American companies taking their first step into global franchising), and because 65 percent of franchisors make absolutely no change in their business for overseas franchisees, that success may not generalize to cultures with different lifestyles, values, preferences, and technological infrastructures. When Jim Bryant began opening Subway Sandwich shops in China 10 years ago, Americans were elated (one kissed the floor), but Chinese customers didn't know how to order (he had to make signs explaining how) or how to eat a sandwich (they peeled it like a banana because they didn't want to physically touch their food). Likewise, because the tuna in the tuna salad didn't have a visible head or a tail, they didn't believe it was actually fish.<sup>55</sup> Management consultant Dennis

### franchise

A collection of networked firms in which the manufacturer or marketer of a product or service, the franchisor, licenses the entire business to another person or organization, the franchisee.

Custage says, “The number one mistake companies make is trying to run everything the way it was in their home country, with a bunch of expatriates.”<sup>56</sup> Furthermore, unlike McDonald’s, which added a new spicy chicken burger, and KFC, which replaced coleslaw with “shredded carrots, fungus, or bamboo shoots,” Subway didn’t change its menu for Chinese tastes. Luo Bing Ling, who runs a Subway store in Beijing, says, “Subway should have at least one item tailored to Chinese tastes to show they are respecting the local culture.”<sup>57</sup>

### 3.3 Strategic Alliances

#### strategic alliance

An agreement in which companies combine key resources, costs, risk, technology, and people.

#### joint venture

A strategic alliance in which two existing companies collaborate to form a third, independent company.

Companies forming **strategic alliances** combine key resources, costs, risks, technology, and people. The most common strategic alliance is a **joint venture**, which occurs when two existing companies collaborate to form a third company. The two founding companies remain intact and unchanged, except that, together, they now own the newly created joint venture.

One of the oldest, most successful global joint ventures is Fuji-Xerox, which is a joint venture between Fuji Photo Film of Japan and U.S.-based Xerox Corporation, which makes copiers and automated office systems. More than 43 years after its creation, Fuji-Xerox employs nearly 34,000 employees and has close to \$9.5 billion in revenues. Fuji-Xerox is largely responsible for copier sales in Asia, whereas Xerox is responsible for North American sales. Rank Xerox, a Xerox subsidiary, is responsible for sales in Europe.<sup>58</sup>

One of the advantages of global joint ventures is that, like licensing and franchising, they help companies avoid tariff and nontariff barriers to entry. Another advantage is that companies participating in a joint venture bear only part of the costs and the risks of that business. Many companies find this attractive because of the expense of entering foreign markets or developing new products. For example, General Electric and Mitsubishi Electric have formed Powerex, an international joint venture to share the high development costs of designing and making parts for hybrid cars that run on both gasoline and electric power. Powerex makes electronic parts that help convert brake heat into power that is stored in batteries to run the electric motor when the car starts and during acceleration. Once the car attains a stable speed, the gasoline engine takes over and recharges the batteries. Hybrid cars are capable of getting 70 percent more miles per gallon than standard cars in city driving.<sup>59</sup>

Global joint ventures can be especially advantageous to smaller local partners that link up with larger, more experienced foreign firms that can bring advanced management, resources, and business skills to the joint venture. For instance, SasolChevron is a global joint venture between Sasol, a small South African oil company with expertise in turning natural gas into extremely clean liquid fuel and gas, and ChevronTexaco, the second largest U.S. oil company with 47,000 employees in 180 countries worldwide. Sasol has what Chevron lacks, specialized expertise in turning natural gas into liquid fuels, and Chevron has what Sasol needs, access to global markets and extensive experience with product marketing and natural gas utilization.<sup>60</sup>

Global joint ventures are not without problems, though. Because companies share costs and risks with their joint venture partners, they must also share profits. At one time, sharing of profits created some tension at Fuji Color Film, Xerox, and their joint venture, Fuji-Xerox. In fact, until Xerox’s, recent turnaround, the company struggled for so long that business experts joked that Fuji-Xerox, which has been highly profitable, should purchase Xerox.<sup>61</sup>

Managing global joint ventures can also be difficult because they represent a merging of four cultures: the country and organizational cultures of the first partner, and the country and organizational cultures of the second partner. Oftentimes, to be “fair” to all involved, each partner in the global joint venture will have equal ownership and power. But this can result in power struggles and

a lack of leadership. For example, AT&T and British Telecom, two of the world's largest telecommunications companies, invested \$3 billion each to form a joint venture called Concert to provide communication services to multinational corporations, only to take \$7 billion in losses to close Concert down 18 months later.<sup>62</sup> According to industry analyst Jim Rawitsch, Concert failed because "whenever you go into a situation where power is equally shared, it becomes like a marriage. In order for anything to happen, both have to agree. If one partner had 51 percent, it would be easier."<sup>63</sup>

Because of these problems, companies forming global joint ventures should carefully develop detailed contracts that specify the obligations of each party. Toshiba, which participated in its first global joint ventures in the early 1900s by making light bulb filaments with General Electric, treats joint ventures like a marriage of the two companies and views the contract as a prenuptial agreement.<sup>64</sup> In other words, the joint venture contract specifies how much each company will invest, what its rights and responsibilities are, and what it is entitled to if the joint venture does not work out. These steps are important, because the rate of failure for global joint ventures is estimated to be as high as 33 to 50 percent.<sup>65</sup>

### 3.4 Wholly Owned Affiliates (Build or Buy)

Approximately one-third of multinational companies enter foreign markets through wholly owned affiliates. Unlike licensing arrangements, franchises, or joint ventures, **wholly owned affiliates** are 100 percent owned by the parent company. For example, Honda Motors of America in Marysville, Ohio, is 100 percent owned by Honda Motors of Japan. Ford Motor of Germany in Cologne is 100 percent owned by the Ford Motor Company in Detroit, Michigan.

The primary advantage of wholly owned businesses is that the parent company receives all of the profits and has complete control over the foreign facilities. The biggest disadvantage is the expense of building new operations or buying existing businesses. While the payoff can be enormous if wholly owned affiliates succeed, the losses can be immense if they fail because the parent company assumes all of the risk. Two years after Vodafone, the world's largest cell phone company, paid \$2.2 billion to acquire J-Phone, the third largest Japanese cell phone company, annual revenues continue to fall, and the number of new subscribers has dropped by 87 percent—a bad sign for future sales. The problem is that Vodafone focuses on selling small, reliable phones that work anywhere in the world, but most Japanese customers don't care whether their phones work outside the country. They want stylish, flashy, high-tech G3 cell phones that can download music, games, videos, and email. And, because Vodafone owns J-Phone, it is bearing all the risk. Darryl Green, president of Vodafone in Japan, says, "We're losing our share of heavy users," the most profitable customers in the cell phone business.<sup>66</sup>

#### **wholly owned affiliates**

Foreign offices, facilities, and manufacturing plants that are 100 percent owned by the parent company.

### 3.5 Global New Ventures

Companies used to evolve slowly from small operations selling in their home markets to large businesses selling to foreign markets. Furthermore, as companies went global, they usually followed the phase model of globalization. Recently, however, three trends have combined to allow companies to skip the phase model when going global. First, quick, reliable air travel can transport people to nearly any point in the world within one day. Second, low-cost communication technologies, such as international email, teleconferencing, phone conferencing, and the Internet, make it easier to communicate with global customers, suppliers, managers, and employees. Third, there is now a critical mass of businesspeople with extensive personal experience in all aspects of global business.<sup>67</sup> This combination of developments has made it possible to



### global new ventures

New companies that are founded with an active global strategy and have sales, employees, and financing in different countries.

start companies that are global from inception. With sales, employees, and financing in different countries, **global new ventures** are new companies founded with an active global strategy.<sup>68</sup>

Although there are several different kinds of global new ventures, all share two common factors. First, the company founders successfully develop and communicate the company's global vision from inception. Winphoria Networks, which specializes in wireless networks, was global the day it started. Company investor Promod Haque explained: "Sales and marketing and the CEO were in Boston," but "the center of gravity was outside the United States. By having our employees based in Madrid [Spain] and Bangalore [India], we were [by design] bidding contracts in Europe and Asia" during a time when sales were slow in the United States.<sup>69</sup>

Second, rather than going global one country at a time, new global ventures bring a product or service to market in several foreign markets at the same time. For example, Bitfone Corporation provides software that allows mobile phone companies to wirelessly update the operating system in a user's mobile phone. Providing automatic, wireless updates to customers' phones helps mobile phone providers reduce costs, improve reliability, decrease problems, and provide new phone services and capabilities as they become available. With mobile phone providers and hundreds of millions of mobile phones in use on every continent but Antarctica, California-based Bitfone, which is able to sell its software anywhere mobile phones are used, was a global company from its inception.<sup>70</sup>

### Review 3: Forms for Global Business

The phase model of globalization says that as companies move from a domestic to a global orientation, they use these organizational forms in sequence: exporting, cooperative contracts (licensing and franchising), strategic alliances, and wholly owned affiliates. Yet not all companies follow the phase model. For example, global new ventures are global from their inception.

## Where to Go Global?

*Deciding where to go global is just as important as deciding how your company will go global. After reading the next three sections, you should be able to*

- 4** explain how to find a favorable business climate.
- 5** discuss the importance of identifying and adapting to cultural differences.
- 6** explain how to successfully prepare workers for international assignments.

### **4** FINDING THE BEST BUSINESS CLIMATE

When deciding where to go global, companies try to find countries or regions with promising business climates.

An attractive global business climate **4.1** positions the company for easy access to growing markets, **4.2** is an effective but cost-efficient place to build an office or manufacturing facility, and **4.3** minimizes the political risk to the company.

#### 4.1 Growing Markets

The most important factor in an attractive business climate is access to a growing market. For example, no product is known and purchased by as many people throughout the world as Coca-Cola. Yet, even Coke, which is available in over 200 countries, still has tremendous potential for further global growth. Currently, the Coca-Cola Company gets about 80 percent of its sales from its 16 largest markets.<sup>71</sup> The remaining 20 percent is spread across the other 200

countries in which Coke does business. Coke's former CEO said, "We have really just begun reaching out to the 95 percent of the world's population that lives outside the U.S."<sup>72</sup>

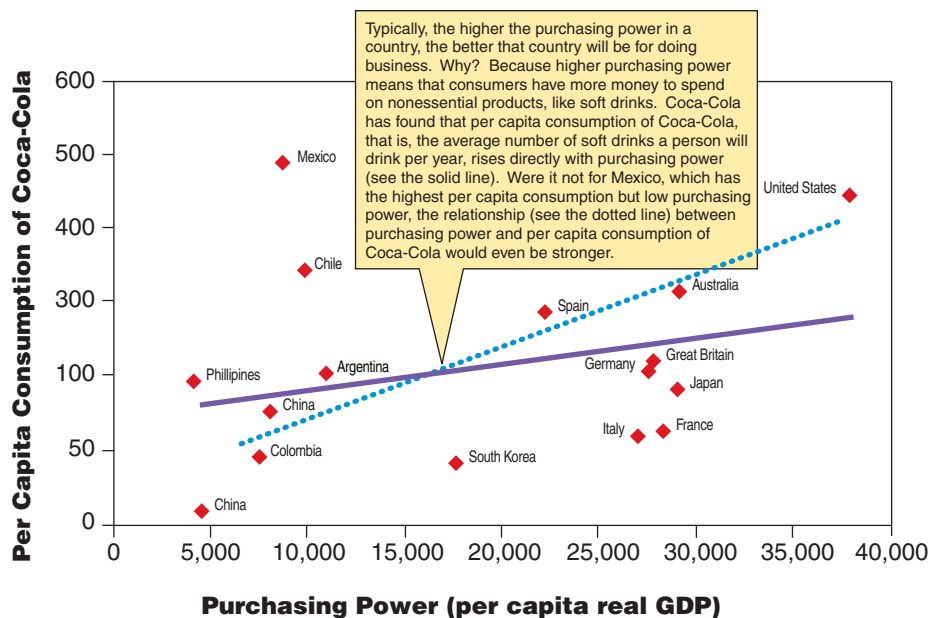
Two factors help companies determine the growth potential of foreign markets: purchasing power and foreign competitors. **Purchasing power** is measured by comparing the relative cost of a standard set of goods and services in different countries. Earlier in the chapter we noted that a Coke costs \$1.89 in Tokyo. Because a Coke costs only about \$1.00 in the United States, the average American would have more purchasing power than the average Japanese. Purchasing power is surprisingly strong in countries like Mexico, India, and China, which have low average levels of income. This is because basic living expenses, such as food, shelter, and transportation, are very inexpensive in those countries, so consumers still have money to spend after paying for necessities. To illustrate, the average Chinese household spends only 5 percent of its income on basic living expenses, whereas the average American household spends 45 to 50 percent.<sup>73</sup> Because basic living expenses are so low in China, Mexico, and India, purchasing power is strong, and millions of Chinese, Mexican, and Indian consumers increasingly have extra money to spend on what they want, in addition to what they need.<sup>74</sup>

Consequently, countries with high and growing levels of purchasing power are good choices for companies looking for attractive global markets. As Exhibit 8.5 shows, Coke has found that the per capita consumption of Coca-Cola, or the number of Cokes a person drinks per year, rises directly with purchasing power. For example, in eastern Europe, as countries began to embrace capitalism after the fall of communism, per capita consumption of Coke increased from 20 to 31 Cokes in just two years; now, more than a decade and a half later, it is at 238 Cokes per year.<sup>75</sup>

The second part of assessing the growth potential of global markets involves analyzing the degree of global competition, which is determined by the number and quality of companies that already compete in a foreign market. Intel has been in China for 20 years not only because of the size of the potential market—China has 1.3 billion people and 95 percent of Chinese homes still

#### purchasing power

A comparison of the relative cost of a standard set of goods and services in different countries.



#### Exhibit 8.5

How Consumption of Coca-Cola Varies with Purchasing Power around the World

Sources: "Rank Order—GDP—Per Capita," *The World Factbook*, [Online] available at <http://www.cia.gov/cia/publications/factbook/rankorder/2004rank.html>, 24 April 2005; "Operations Review: Selected Market Results," *The Coca-Cola Company 2000 Annual Report*, [Online] available at [http://www2.coca-cola.com/investors/annualreport/2002/or\\_smr.htm](http://www2.coca-cola.com/investors/annualreport/2002/or_smr.htm), 28 June 2003.

don't have a computer—but also because there was almost no competition. But now that China is the third largest computer chip market in the world, Intel faces competition from AMD, Intel's primary U.S. competitor, which entered China four years ago, and Shanghai Semiconductor Manufacturing International, a five-year-old Chinese company that manufactures low-end chips. Intel's 20-year head start, however, has given it a dominating 84 percent share of the Chinese market.<sup>76</sup>

#### 4.2 Choosing an Office/Manufacturing Location

Companies do not have to establish an office or manufacturing location in each country they enter. They can license, franchise, or export to foreign markets, or they can serve a larger region from one country. Thus, the criteria for choosing an office/manufacturing location are different from the criteria for entering a foreign market.

Rather than focusing on costs alone, companies should consider both qualitative and quantitative factors. Two key qualitative factors are work force quality and company strategy. Work force quality is important because it is often difficult to find workers with the specific skills, abilities, and experience that a company needs to run its business. Work force quality is one reason that many companies doing business in Europe locate their customer call centers in the Netherlands. As shown in Exhibit 8.6, workers in the Netherlands are the most linguistically gifted in Europe, with 73 percent speaking two languages, 44 percent speaking three languages, and 12 percent speaking more than three. Of course, with employees who speak several languages, call centers located in the Netherlands can handle calls from more countries and generally employ 30 to 50 percent fewer employees than those located in other parts of Europe. Another advantage of locating a call center in the Netherlands is that 60 percent of call center workers have university or advanced degrees in technology or management.<sup>77</sup>

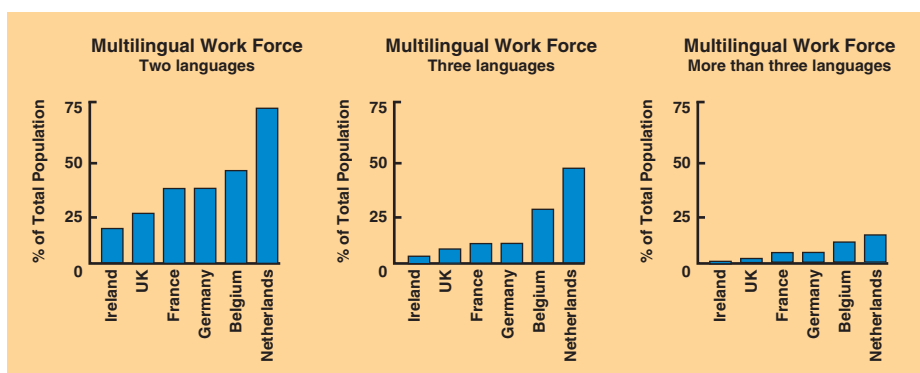
A company's strategy is also important when choosing a location. For example, a company pursuing a low-cost strategy may need plentiful raw materials, low-cost transportation, and low-cost labor. A company pursuing a differentiation strategy (typically a higher-priced, better product or service) may need access to high-quality materials and a highly skilled and educated work force.

Quantitative factors, such as the kind of facility being built, tariff and non-tariff barriers, exchange rates, and transportation and labor costs, should also be considered when choosing an office/manufacturing location. Regarding the kind of facility being built, a real estate specialist in company location decisions explained: "If it's an assembly plant, a company might be inclined to look for

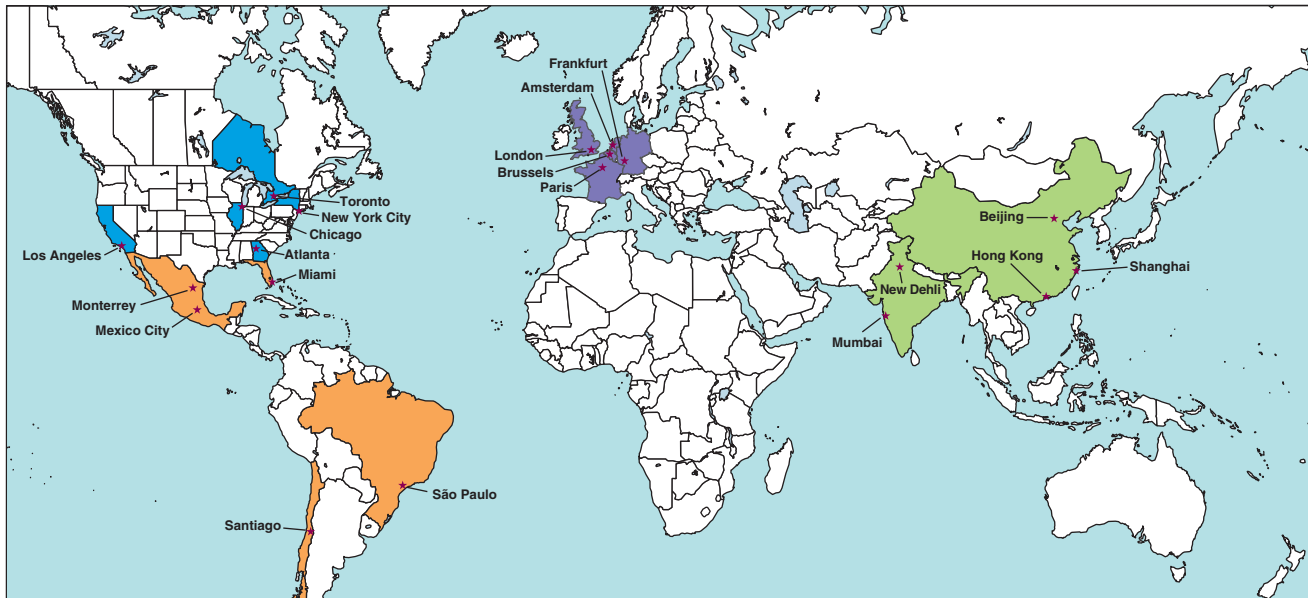
incentives that would subsidize its hiring. With a distribution facility, an adequate transportation network will likely be critical. A corporate headquarters will need a good communications network, a multilingual labor force, and easy access by air. On the other hand, a research and development operation will require proximity to a high-tech infrastructure and access to good universities."<sup>78</sup>

Exhibit 8.7 shows the world's top cities for global business. This information is a

**Exhibit 8.6**  
Quality of the Netherlands Work  
Force for Call Center Jobs



Sources: "Fact Sheet, Call Center Solutions: How Call Centers Can Work for You," The Netherlands Foreign Investment Agency, [Online] available at <http://www.nfia.com/html/solution/fact.html>, 15 September 2001; "Customer Care Centers," *Netherlands Foreign Investment Agency Information Manual*, 26 April 2005, [Online] available at <http://www.nfia.com/downloads/customer-care.htm>.



North America	Latin America	Europe	Asia Pacific
1. New York City	1. Santiago	1. London	1. Shanghai
2. Chicago	2. Miami	2. Paris	2. Beijing
3. Toronto	3. São Paulo	3. Frankfurt	3. New Dehli
4. Atlanta	4. Monterrey (Mexico)	4. Brussels	4. Hong Kong
5. Los Angeles	5. Mexico City	5. Amsterdam	5. Mumbai

Sources: M. Borden, "The Best Cities for Business: Big, Established, Monied Metropolises—With a Tech Twist—Top *Fortune's* Annual Ranking at the Turn of the Century," *Fortune*, 27 November 2000, 218; C. Murphy, "Winners of the World," *Fortune*, 27 November 2000, 232; "Miami Is the Best City for Doing Business in Latin America, According to *AmericaEconomia Magazine*," *PR Newswire*, 24 April 2003; "Shanghai Takes Top Position as Destination for Future Worldwide Expansion in 'European Cities Monitor,'" *Cushman & Wakefield Asia Pacific*, 30 September 2004, [Online] available at <http://www.cushwakeasia.com/about-us/pdf/news/ECM%20PR%20asia%20version%202004%20release%20on%203009.pdf>.

**Exhibit 8.7**  
World's Best Cities for Business

good starting point if your company is trying to decide where to put an international office or manufacturing plant.

### 4.3 Minimizing Political Risk

When managers think about political risk in global business, they envision burning factories and riots in the streets. Although political events such as these receive dramatic and extended coverage from the media, the political risks that most companies face usually are not covered as breaking stories on FoxNews and CNN. Nonetheless, the negative consequences of ordinary political risk can be just as devastating to companies that fail to identify and minimize that risk.<sup>79</sup>

When conducting global business, companies should attempt to identify two types of political risk: political uncertainty and policy uncertainty.<sup>80</sup> **Political uncertainty** is associated with the risk of major changes in political regimes that can result from war, revolution, death of political leaders, social unrest, or other influential events. **Policy uncertainty** refers to the risk associated with changes in laws and government policies that directly affect the way foreign companies conduct business.

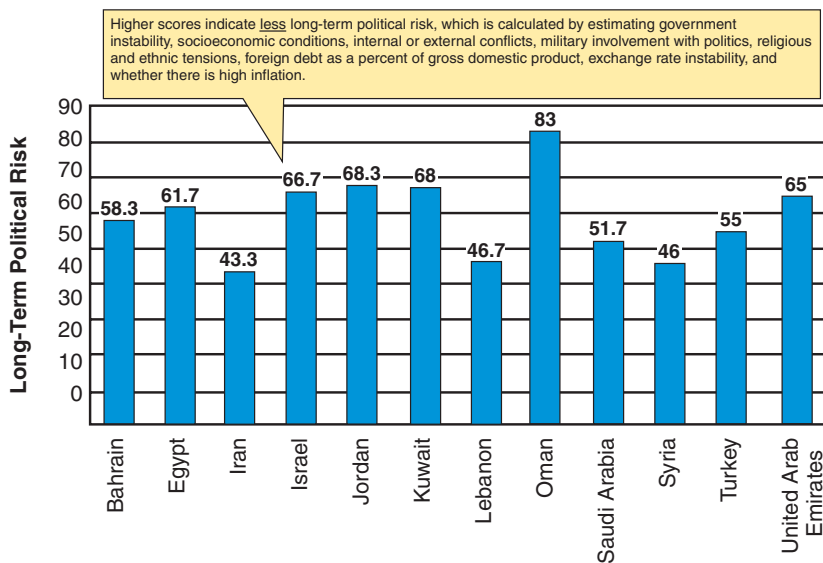
Policy uncertainty is the most common form of political risk in global business and perhaps the most frustrating. For example, nationalized health care is the norm in most of Europe. So, instead of dealing with insurance providers, and health maintenance organizations, pharmaceutical companies negotiate directly with European governments, which, to no one's surprise, pressure them for price cuts. Though the companies are used to being pressured for price cuts, they face the additional problem that reductions in prices in one European

**political uncertainty**

The risk of major changes in political regimes that can result from war, revolution, death of political leaders, social unrest, or other influential events.

**policy uncertainty**

The risk associated with changes in laws and government policies that directly affect the way foreign companies conduct business.



Source: "UAE Quarterly Forecast Report," *BMI Ratings*, 3rd Quarter 2004, 3–6.

**Exhibit 8.8**  
Long-Term Political Risk in the Middle East

Dehecq, CEO of Sanofi-Aventis, a French pharmaceutical company, says, "Step-by-step, the profitability of European markets is decreasing."<sup>81</sup>

Several strategies can be used to minimize or adapt to the political risk inherent in global business. An *avoidance strategy* is used when the political risks associated with a foreign country or region are viewed as too great. If firms are already invested in high-risk areas, they may divest or sell their businesses. If they have not yet invested, they will likely postpone their investment until the risk shrinks. Exhibit 8.8 shows the long-term political risk for various countries in the Middle East (higher scores indicate less political risk). The following factors,

which were used to compile these ratings, indicate greater political risk: government instability, poor socioeconomic conditions, internal or external conflict, military involvement in politics, religious and ethnic tensions, foreign debt as a percentage of gross domestic product, exchange rate instability, and high inflation.<sup>82</sup> An avoidance strategy would likely be used for the riskiest countries shown in Exhibit 8.8, such as Iran, Lebanon, and Syria, but would probably not be needed for the least risky countries, such as Israel, Jordan, Kuwait, or Oman. Risk conditions and factors change, so be sure to make risk decisions with the latest available information from resources such as the PRS Group, <http://www.prsgroup.com>, which supplies information about political risk to 80 percent of the *Fortune* 500 companies.

*Control* is an active strategy to prevent or reduce political risks. Firms using a control strategy lobby foreign governments or international trade agencies to change laws, regulations, or trade barriers that hurt their business in that country.

Another method for dealing with political risk is *cooperation*, which involves using joint ventures and collaborative contracts, such as franchising and licensing. Although cooperation does not eliminate the political risk of doing business in a country, it does limit the risk associated with foreign ownership of a business. For example, a German company forming a joint venture with a Chinese company to do business in China may structure the joint venture contract so that the Chinese company owns 51 percent or more of the joint venture. Doing

DOING THE RIGHT THING

#### FOREIGN CORRUPT BUSINESS PRACTICES ACT

The Foreign Corrupt Business Practices Act (FCPA) prohibits company managers, employees, or agents from offering money or anything else of value to bribe officials of foreign governments or political parties to use their influence to help that firm acquire new business or keep existing business in that country. Individuals violating the FCPA can be fined up to \$100,000 and imprisoned for up to 10 years. Companies that violate the FCPA can be fined up to \$2 million, suspended from government contracts, denied export licensing privileges, and investigated by the Securities and Exchange Commission. U.S. businesspeople often worry that the FCPA puts them at a disadvantage because other countries have permitted bribes to be deducted as business expenses. Recently, however, 33 major trading partners of the United States agreed to enact laws similar to the FCPA.<sup>83</sup>

so qualifies the joint venture as a Chinese company and exempts it from Chinese laws that apply to foreign-owned businesses.

#### Review 4: Finding the Best Business Climate

The first step in deciding where to take your company global is finding an attractive business climate. Be sure to look for a growing market where consumers have strong purchasing power and foreign competitors are weak. When locating an office or manufacturing facility, consider both qualitative and quantitative factors. In assessing political risk, be sure to examine political uncertainty and policy uncertainty. If the location you choose has considerable political risk, you can avoid it, try to control the risk, or use a cooperation strategy.

## 5 BECOMING AWARE OF CULTURAL DIFFERENCES

Some of the more interesting and amusing aspects of global business are the unexpected confrontations that people have with cultural differences, “the way they do things over there.” For example, as part of a class assignment in global business, a high school class in Dearborn, Michigan, and a high school class in Valle, Spain, agreed to form a global “joint venture.” The two classes agreed that the U.S. students would buy Spanish products from the Spanish students and resell them at a profit to other American students. Likewise, the Spanish students would purchase American products from the American students and then resell them at a profit to their Spanish friends. Now, what to buy from each other? The American students decided to buy giant beach towels showing teenage Spanish lovers. One towel showed a boy helping his girlfriend remove her shirt. Another showed him unzipping her jeans. In Spain’s culture, which is much more relaxed about sexuality than American culture, no one gives these towels a second thought. Of course, despite protestations of censorship, the U.S. high school teacher vetoed the towels as too suggestive.<sup>84</sup>

American sensitivities about sexual issues, however, are nothing compared to those in Islamic cultures where any display of sexual images may potentially offend customers or government agencies. For example, in Saudi Arabia, even store mannequins must not show male or female shapes or characteristics of any kind. Therefore, most Saudi mannequins are headless and have no fingers. Likewise, in Islamic Malaysia, models in ads cannot be shown in any state of undress (such as bras or underwear), and if a man and woman are shown alone in an ad, they must clearly be married.<sup>85</sup> **National culture** is the set of shared values and beliefs that affects the perceptions, decisions, and behavior of the people from a particular country. The first step in dealing with culture is to recognize that there are meaningful differences in national cultures. Geert Hofstede has spent the last 20 years studying cultural differences in 53 different countries. His research shows that there are five consistent cultural dimensions across countries: power distance, individualism, masculinity, uncertainty avoidance, and short-term versus long-term orientation.<sup>86</sup>

*Power distance* is the extent to which people in a country accept that power is distributed unequally in society and organizations. In countries where power distance is weak, such as Denmark and Sweden, employees don’t like their organization or their boss to have power over them or tell them what to do. They want to have a say in decisions that affect them. As Exhibit 8.9 shows, Russia and China, with scores of 95 and 80,

#### national culture

The set of shared values and beliefs that affects the perceptions, decisions, and behavior of the people from a particular country.

One area where comparisons of national culture are most striking is sexuality. In Saudi Arabia, even store mannequins must be without heads or limbs that would indicate gender.



AFP/GETTY IMAGES

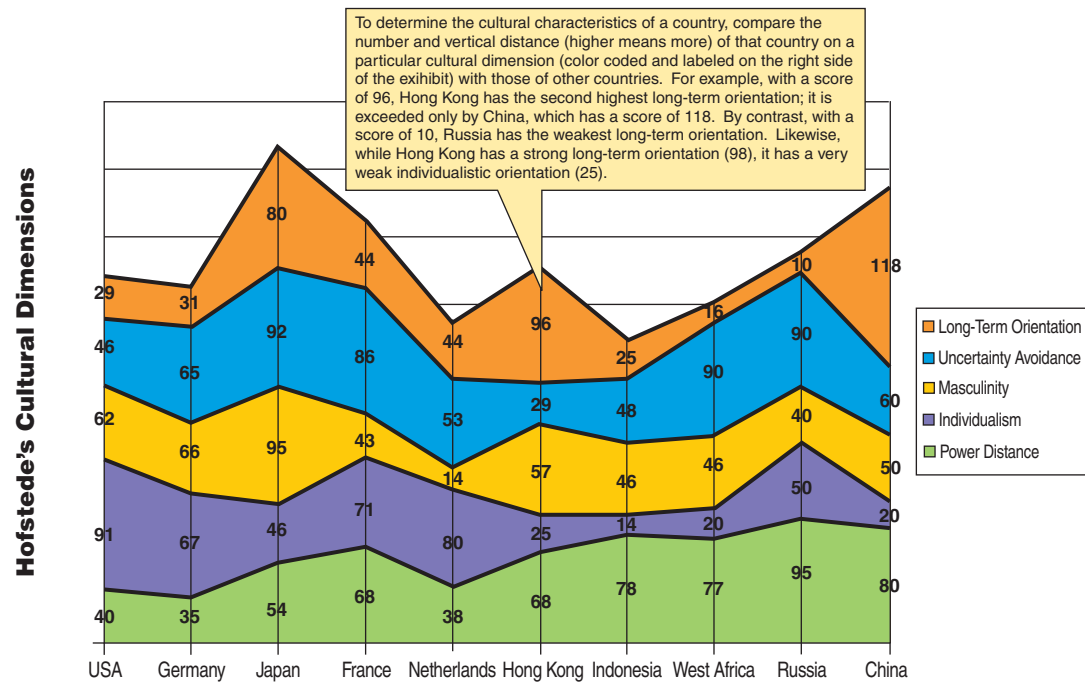


Exhibit 8.9

## Hofstede's Five Cultural Dimensions

Source: G. H. Hofstede, "Cultural Constraints in Management Theories," *Academy of Management Executive* 7, no. 1 (1993): 81–94.

respectively, are much stronger in power distance than Germany (35), the Netherlands (38), and the United States (40).

*Individualism* is the degree to which societies believe that individuals should be self-sufficient. In individualistic societies, employees put loyalty to themselves first and loyalty to their company and work group second. In Exhibit 8.9, the United States (91), the Netherlands (80), France (71), and Germany (67) are the strongest in individualism, while West Africa (20), China (20), and Indonesia (14) are the weakest.

*Masculinity* and *femininity* capture the difference between highly assertive and highly nurturing cultures. Masculine cultures emphasize assertiveness, competition, material success, and achievement, whereas feminine cultures emphasize the importance of relationships, modesty, caring for the weak, and quality of life. In Exhibit 8.9, Japan (95), Germany (66), and the United States (62) have the most masculine orientations, while the Netherlands (14) has the most feminine orientation.

The cultural difference of *uncertainty avoidance* is the degree to which people in a country are uncomfortable with unstructured, ambiguous, unpredictable situations. In countries with strong uncertainty avoidance, like Greece and Portugal, people tend to be aggressive and emotional and seek security (rather than uncertainty). In Exhibit 8.9, Japan (92), France (86), West Africa (90), and Russia (90) are strongest in uncertainty avoidance, while Hong Kong (29) is the weakest.

*Short-term/long-term orientation* addresses whether cultures are oriented to the present and seek immediate gratification, or to the future and defer gratification. Not surprisingly, countries with short-term orientations are consumer driven, whereas countries with long-term orientations are savings driven. In Exhibit 8.9, China (118) and Hong Kong (96) have very strong long-term orientations, while Russia (10), West Africa (16), Indonesia (25), the United States (29), and Germany (31) have very strong short-term orientations.

Cultural differences affect perceptions, understanding, and behavior. Recognizing cultural differences is critical to succeeding in global business. Nevertheless, as Hofstede pointed out, descriptions of cultural differences are

based on averages—the average level of uncertainty avoidance in Portugal, the average level of power distance in Argentina, and so forth. Accordingly, said Hofstede, “If you are going to spend time with a Japanese colleague, you shouldn’t assume that overall cultural statements about Japanese society automatically apply to this person.”<sup>87</sup> Similarly, cultural beliefs may differ significantly from one part of a country to another.<sup>88</sup>

After becoming aware of cultural differences, the second step is deciding how to adapt your company to those differences. Unfortunately, studies investigating the effects of cultural differences on management practice point more to difficulties than to easy solutions. One problem is that different cultures will probably perceive management policies and practices differently. For example, blue-collar workers in France and Argentina, all of whom performed the same factory jobs for the same multinational company, perceived its company-wide safety policy differently.<sup>89</sup> French workers perceived that safety wasn’t very important to the company, but Argentine workers thought that it was. The fact that something as simple as a safety policy can be perceived differently across cultures shows just how difficult it can be to standardize management practices across different countries and cultures.

Another difficulty is that cultural values are changing, albeit slowly, in many parts of the world. The fall of communism in eastern Europe and the former Soviet Union and the broad economic reforms in China have produced sweeping changes on two continents in the last decade. Thanks to increased global trade resulting from GATT and other regional free trade agreements, major economic transformations are also under way in India, Mexico, Central America, and South America. Consequently, when trying to adapt management practices to cultural differences, companies must ensure that they are not basing their adaptations on outdated and incorrect assumptions about a country’s culture.

### Review 5: Becoming Aware of Cultural Differences

National culture is the set of shared values and beliefs that affects the perceptions, decisions, and behavior of the people from a particular country. The first step in dealing with culture is to recognize meaningful differences, such as power distance, individualism, masculinity, uncertainty avoidance, and short-term/long-term orientation. Cultural differences should be carefully interpreted because they are based on averages, not individuals. Adapting managerial practices to cultural differences is difficult because policies and practices can be perceived differently in different cultures. Another difficulty is that cultural values may be changing in many parts of the world. Consequently, when companies try to adapt management practices to cultural differences, they need to be sure that they are not using outdated assumptions about a country’s culture.

## 6 PREPARING FOR AN INTERNATIONAL ASSIGNMENT

*Around a conference table in a large U.S. office tower, three American executives sat with their new boss, Mr. Akiro Kusumoto, the newly appointed head of a Japanese firm’s American subsidiary, and two of his Japanese lieutenants. The meeting was called to discuss ideas for reducing operating costs. Mr. Kusumoto began by outlining his company’s aspirations for its long-term U.S. presence. He then turned to the budgetary matter. One Japanese manager politely offered one suggestion, and an American then proposed another. After gingerly discussing the alternatives for quite some time, the exasperated American blurted out: “Look, that idea is just not going to have much impact. Look at the numbers!” In the face of such bluntness, uncommon and unacceptable in Japan, Mr. Kusumoto fell silent. He leaned back, drew air between his teeth, and felt a deep longing to return home. He realized his life in this country would be filled with many such jarring encounters and lamented his posting to a land of such rudeness.<sup>90</sup>*



**expatriate**

Someone who lives and works outside his or her native country.

Mr. Kusumoto is a Japanese **expatriate**, someone who lives and works outside his or her native country. The cultural shock that he was experiencing is common. The difficulty of adjusting to language, cultural, and social differences is the primary reason for expatriate failure in overseas assignments. For example, although there have recently been disagreements among researchers about these numbers, it is probably safe to say that 5 to 20 percent of American expatriates sent abroad by their companies will return to the United States before they have successfully completed their assignments.<sup>91</sup> Of those who do complete their international assignments, about one-third are judged by their companies to be no better than marginally effective.<sup>92</sup>

Since the average cost of sending an employee on an international assignment can run between \$500,000 and \$3 million (depending on the length of the assignment and the employee's position), failure in those assignments can be extraordinarily expensive.<sup>93</sup>

The chances for a successful international assignment can be increased through **6.1 language and cross-cultural training** and **6.2 consideration of spouse, family, and dual-career issues**.

### 6.1 Language and Cross-Cultural Training

Predeparture language and cross-cultural training can reduce the uncertainty that expatriates feel, the misunderstandings that take place between expatriates and natives, and the inappropriate behaviors that expatriates unknowingly commit when they travel to a foreign country. Indeed, simple things like using a phone, finding a public toilet, asking for directions, knowing how much things cost, exchanging greetings, or understanding what people want can become tremendously complex when expatriates don't know a foreign language or a country's customs and cultures. In his book *Blunders in International Business*, David Ricks tells the story of an American manager working in the South Pacific who, by hiring too many local workers from one native group, unknowingly upset the balance of power in the island's traditional status system. The islanders met on their own and quickly worked out a solution to the problem. After concluding their meeting at 3 A.M., they calmly went to the manager's home to discuss their solution with him (time was not important in their culture). But, since the American didn't speak their language and didn't understand why they had shown up en masse outside his home at 3 A.M., he called in the Marines, who were stationed nearby, to disperse what he thought was a "riot."

Expatriates who receive predeparture language and cross-cultural training make faster adjustments to foreign cultures and perform better on their international assignments.<sup>94</sup> Unfortunately, only a third of the managers who go on international assignments are offered any kind of predeparture training, and only half of those actually participate in the training!<sup>95</sup> Suzanne Bernard, director of international mobility at Bombardier, Inc. in Canada, says, "We always offer cross-cultural training, but it's very seldom used by executives leaving in a rush at the last minute."<sup>96</sup> This is somewhat surprising given the failure rates for expatriates and the high cost of those failures. Furthermore, with the exception of some language courses, predeparture training is not particularly expensive or difficult to provide. Three methods can be used to prepare workers for international assignments: documentary training, cultural simulations, and field experiences.

*Documentary training* focuses on identifying specific critical differences between cultures. For example, when 60 workers at Axcellis Technologies in Beverly, Massachusetts, were preparing to do business in India, they learned that while Americans make eye contact and shake hands firmly when greeting others, Indians, as a sign of respect, do just the opposite, avoiding eye contact and shaking hands limply.<sup>97</sup>

After learning specific critical differences through documentary training, trainees can then participate in *cultural simulations*, in which they practice adapting to cultural differences. After the workers at Axcellis Technologies learned about key differences between themselves and Indian workers, they practiced adapting to those differences by participating in role-plays: some Axcellis workers would take the roles of Indian workers, while other Axcellis workers would play themselves and try to behave in a way consistent with Indian culture. As they role-played, Indian music played loudly in the background, and they were coached on what to do or not do by Bidhan Chandra, an international consultant. Chandra says, “When people understand these differences, they’re less likely to make mistakes with each other.” Human resources director Randy Longo said, “At first, I was skeptical and wondered what I’d get out of the class. But it was enlightening for me. Not everyone operates like we do in America.”

Finally, *field simulation* training, a technique made popular by the U.S. Peace Corps, places trainees in an ethnic neighborhood for three to four hours to talk to residents about cultural differences. For example, a U.S. electronics manufacturer prepared workers for assignments in South Korea by having trainees explore a nearby South Korean neighborhood and talk to shopkeepers and people on the street about South Korean politics, family orientation, and day-to-day living practices.

## 6.2 Spouse, Family, and Dual-Career Issues

At the request of his company, Sam and his wife Janet moved to London for Sam’s international assignment. Their plush apartment was across the street from the world-famous Harrod’s department store and was also close to London’s best parks, museums, and gardens. Sam’s salary was high enough to enable them to afford full-time child care. By most accounts, Sam and Janet should have had a wonderful experience in London. Nonetheless, Janet was miserable, and consequently, so was Sam. Their social life was active but revolved around Sam’s business clients. Janet was lonely. She missed her job, which she gave up to come to London. She also missed her friends in Atlanta. Sam and Janet divorced after they returned to the United States.<sup>98</sup>

Not all international assignments turn out so badly for expatriates and their families, but the evidence clearly shows that how well an expatriate’s spouse and family adjust to the foreign culture is the most important factor in determining the success or failure of an international assignment.<sup>99</sup> Barry Kozloff, of Selection Research International, says, “The cost of sending a family on a foreign assignment is around a million dollars and their failure to adjust is an enormous loss.”<sup>100</sup> Unfortunately, despite its importance, there has been little systematic research on what does and does not help expatriates’ families successfully adapt. A number of companies, however, have found that adaptability screening and intercultural training for families can lead to more successful overseas adjustment.

*Adaptability screening* is used to assess how well managers and their families are likely to adjust to foreign cultures. For example, Prudential Relocation Management’s international division has developed an “Overseas Assignment Inventory” to assess a spouse and family’s open-mindedness, respect for others’ beliefs, sense of humor, and marital communication. Likewise, AMP, based in Pennsylvania, conducts extensive psychological screening on expatriates and their spouses when making international assignments. But adaptability screening does not just involve a company assessing an employee; it can also involve an employee screening international assignments for desirability. Since more employees are becoming aware of the costs of international assignments (spouses having to give up or change jobs, children having to change schools,

# WHAT REALLY WORKS

## Cross-Cultural Training

Most expatriates will tell you that cross-cultural training helped them adjust to foreign cultures. Such anecdotal data, however, are not as convincing as systematic studies. Twenty-one studies, with a combined total of 1,611 participants, have examined whether cross-cultural training affects the self-development, relationships, perceptions, adjustment, and job performance of expatriates. Overall, they show that cross-cultural training works extremely well in most instances.

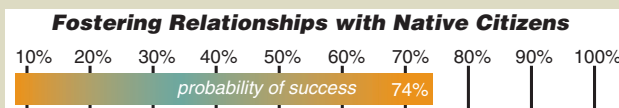
### SELF-DEVELOPMENT

When you first arrive in another country, you must learn how to make decisions that you took for granted in your home country: how to get to work, how to get to the grocery, how to pay your bills, and so on. If you've generally been confident about yourself and your abilities, an overseas assignment can challenge that sense of self. Cross-cultural training helps expatriates deal with these and other challenges. Expatriates who receive cross-cultural training are 79 percent more likely to report healthy psychological well-being and self-development than those who don't receive training.



### FOSTERING RELATIONSHIPS

One of the most important aspects of an overseas assignment is establishing and maintaining relationships with host nationals. If you're in Brazil, you need to make friends with Brazilians. Many expatriates, however, make the mistake of making friends only with other expatriates from their home country. In effect, they become social isolates in a foreign country. They work and live there, but as much as they can, they speak their native language, eat their native foods, and socialize with other expatriates from their home country. Cross-cultural training makes a big difference in whether expatriates establish relationships with host nationals. Expatriates who receive cross-cultural training are 74 percent more likely to establish such relationships.



### ACCURATE PERCEPTIONS OF CULTURE

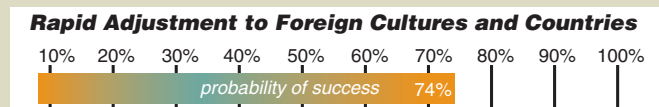
Another characteristic of successful expatriates is that they understand the cultural norms and practices of the host country. For example, many Americans do not understand the famous pictures of Japanese troops turning their backs to American military commanders on V-J Day, when Japan surrendered to the United

States at the end of World War II. Americans viewed this as a lack of respect, when, in fact, in Japan turning one's back in this way is a sign of respect. Cross-cultural training makes a big difference in the accuracy of perceptions concerning host country norms and practices. Expatriates who receive cross-cultural training are 74 percent more likely to have accurate perceptions.



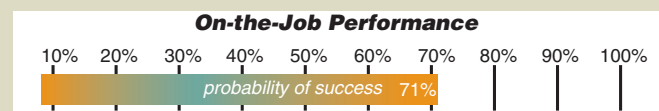
### RAPID ADJUSTMENT

New employees are most likely to quit in the first six months because this initial period requires the most adjustment: learning new names, new faces, new procedures, and new information. It's tough. Of course, expatriates have a much harder time making a successful adjustment because besides learning new names, faces, procedures, and information, expatriates are learning new languages, new foods, new customs, and often new lifestyles. Expatriates who receive cross-cultural training are 74 percent more likely to make a rapid adjustment to a foreign country.



### JOB PERFORMANCE

It's good that cross-cultural training improves self-development, fosters relationships, improves the accuracy of perceptions, and helps expatriates make rapid adjustments to foreign cultures. From an organizational standpoint, however, the ultimate test of cross-cultural training is whether it improves expatriates' job performance. The evidence shows that cross-cultural training makes a significant difference in expatriates' job performance, although the difference is not quite as big as for the other factors. Nonetheless, it is estimated that cross-cultural training for 100 managers could bring about \$390,000 worth of benefits to a company, or nearly \$4,000 per manager. This is an outstanding return on investment, especially when you consider the high rate of failure for expatriates. Expatriates who have received cross-cultural training are 71 percent more likely to have better on-the-job performance than those who did not receive cross-cultural training.<sup>101</sup>



everyone having to learn a new language, etc.), some companies are willing to pay for a preassignment trip to enable the employee and his or her spouse to investigate the country *before* accepting the international assignment.<sup>102</sup>

Only 40 percent of expatriates' families receive language and cross-cultural training, yet such training is just as important for the families of expatriates as for the expatriates themselves.<sup>103</sup> In fact, it may be more important because, unlike expatriates, whose professional jobs often shield them from the full force of a country's culture, spouses and children are fully immersed in foreign neighborhoods and schools. Households must be run, shopping must be done, and bills must be paid. Likewise, children and their parents must deal with different cultural beliefs and practices about discipline, alcohol, dating, and other issues. For example, 15-year-old Holly Timmons from Lilburn, Georgia, fought with her parents about moving to China when her dad's company, John Deere, gave him a new assignment. In tears, she told him, "No, Dad. I want you to go. I just don't see why I have to go, too." Holly began to feel better about moving to China after the company arranged for her to talk to Cee Kung, a 17-year-old Canadian already attending Holly's new school in China. Holly learned that she would be able to play on the girls' basketball team, buy her favorite jeans (for less), and still be able to get U.S. fast food. Holly, who had thought about running away from home to avoid the move, said that talking to Cee Kung "took a lot of my fears away. I was worried that school would be a lot harder [in Beijing]. If I hadn't gotten to talk to Cee . . . I probably would have done something crazy the night before we got [ready] to go."<sup>104</sup> In addition to helping families prepare for the cultural differences they will encounter, language and cross-cultural training can help reduce uncertainty about how to act and decrease misunderstandings between expatriates and their families and locals.

### Review 6: Preparing for an International Assignment

Many expatriates return prematurely from international assignments because of poor performance. However, this is much less likely to happen if employees receive language and cross-cultural training, such as documentary training, cultural simulations, or field experiences, before going on assignment. Adjustment of expatriates' spouses and families, which is the most important determinant of success in international assignments, can be improved through adaptability screening and intercultural training.

## Key Terms

APEC (Asia-Pacific Economic Cooperation), 244  
 ASEAN (Association of Southeast Asian Nations), 244  
 CAFTA (Central America Free Trade Agreement) 244  
 cooperative contract, 248  
 customs classification, 241  
 direct foreign investment, 239  
 expatriate, 260  
 exporting, 247  
 franchise, 249  
 FTAA (Free Trade Area of the Americas), 244

GATT (General Agreement on Tariffs and Trade), 241  
 global business, 238  
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 Maastricht Treaty of Europe, 242  
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 wholly owned affiliates, 251  
 World Trade Organization (WTO), 241

## Concept Check

1. What is global business?
2. Describe the impact of global business as it relates to direct foreign investment.
3. List and define the barriers governments erect to control trade.
4. Identify the major trade agreements that govern global trade.
5. What are the tradeoffs between global consistency and local adaptation?
6. Identify the stages in the phase model of globalization and explain the level of risk inherent in each.
7. What is the relationship between the phase model of globalization and global new ventures?
8. What should companies consider when choosing a global location for doing business?
9. Describe Hofstede's dimensions of national culture.
10. How can companies prepare their managers to be successful expatriate managers?

## Self-Assessment

### ARE YOU NATION-MINDED OR WORLD-MINDED?

Attitudes about global business are as varied as managers are numerous. It seems that the business press can always find someone who is for globalization and someone who is against it. But regardless of your opinion on the subject, managers will increasingly confront issues related to the globalization of the business environment. It is probable that, as a manager, you will

need to develop global sensibilities (if you don't already have them). Understanding your own cultural perspective is the first step in doing so. The Self-Assessment Appendix contains a detailed survey that will reveal your global perspective and give you insights that will provide a baseline as you develop your managerial skills. Turn to page 617 to see if you tend to be more nation-minded or world-minded.

## Management Decision

### ARE STARBUCKS' EXPANSION PLANS OVERCAFFEINATED?

With the seemingly ubiquitous green mermaid peeking out from around street corners across the United States, it's hard to believe that Starbucks had roughly 1,000 stores overseas before it had stores in all 50 states.<sup>105</sup> Although some analysts say the specialty coffee market is saturated, Starbucks thinks the company is still in the early stages of growth.

Whichever perspective you lean toward, the numbers are the same. With only 17 stores at the end of 1987, Starbucks boasted over 9,200 stores at the beginning of 2005, and the company has pushed its long-term goal to 30,000 stores. International expansion is a big part of this plan: half of those stores are to be overseas. The company already has nearly 2,500 stores in foreign countries.

Starbucks opened its first overseas store in Toyko in 1996. Asia was chosen as the point of entry because the company decided that the European coffee market was extremely mature and wasn't going to change much over the years. In contrast, the Asian market was still developing. Starbucks had the opportunity to position itself as the leader of a new industry. And it did. Today, 1,141 of the company's 2,438 international retail outlets are in Asia.

The Pacific Rim, however, is not the only bean in the blend. Starbucks is also aggressively expanding in the Middle East, New Zealand, and Europe. The Brits have long succumbed to the charms of Starbucks, but succeeding in continental Europe may be more difficult. The first store opened there in Zurich in 2001, and new stores in Germany soon followed, with taste-sensitive Italy far down on the list. Most recently, Starbucks has

Asia-Pacific		Europe/Middle East/Africa		Americas	
Japan	534	United Kingdom	422	Canada	438
China	152	Germany	35	Hawaii	45
Taiwan	136	Saudi Arabia	32	Mexico	32
South Korea	102	United Arab Emirates	31	Chile	9
Philippines	70	Spain	27	Puerto Rico	6
Malaysia	52	Kuwait	27	Peru	3
Thailand	49	Greece	25		
Australia	44	Switzerland	18		
New Zealand	36	Turkey	15		
Singapore	35	Lebanon	10		
Indonesia	24	Austria	8		
		Qatar	6		
		Bahrain	5		
		France	4		
		Oman	3		
		Cyprus	2		
<b>TOTAL</b>	<b>1,235</b>		<b>670</b>		<b>533</b>

Source: Starbucks Annual Report, 2004, 14.

entered France, Turkey, Cyprus, and Peru. Exhibit A shows the operating regions for Starbucks international retail stores in October 2004.

Some countries are not very enthusiastic about Starbucks, however. A Chinese newspaper criticized Starbucks for operating a kiosk in Beijing's Forbidden City. The chamber of commerce in Trieste, home of one of Italy's most prominent coffee companies, formed an association of historic cafés to seek protection. "Whatever is coming from the States—Cokes, hamburgers—it always seems like an invasion," says an official of the Trieste chamber. In Seoul, Starbucks opened up shop in the Insadong area of the city, famous for Korean antiques and crafts. Even though the company sign is in Korean—not the standard board in English posted elsewhere around the world—owners of

other shops in the district were upset. They posted signs of their own reading, "Starbucks' invasion of Korea's pride, Insadong." None-the-less, Starbucks doubled the number of stores in Korea and in China over a two-year period. The French just scoff. "An American chain," laughs the barman of the Bar du Marché in Paris. "We are unique! This is Paris!" Still, the Starbucks near the iconic Opéra Garnier is bustling.

Howard Behar, president of Starbucks International, couldn't be more pleased that his division was profitable two years ahead of schedule, and he won't even rule out Italy. "Italy didn't create coffee," Behar says. "Nobody owns coffee." It may be that nobody owns coffee, but Starbucks certainly has a lock on it—in North America and, more and more, around the world.

fee," Behar says. "Nobody owns coffee." It may be that nobody owns coffee, but Starbucks certainly has a lock on it—in North America and, more and more, around the world.

### Questions

1. What risks are associated with Starbucks' aggressive global expansion plans?
2. What form of global business do you think best describes Starbucks' stores and products? Why?
3. Starbucks plans to open roughly 450 global locations this year. Should the company continue expanding in countries where it already operates, or should it open stores in new countries?
4. Where did you decide Starbucks should expand? Explain your decision.

## Management Team Decision

### **MEN OR WOMEN, WHO GOES ABROAD?**

As a member of the regional sales management team for a multinational corporation with offices located on almost every continent, you've made some tough decisions throughout your career.<sup>106</sup> Unfortunately, you feel that today's decision might possibly be the team's hardest yet. Sales in Asia have been dropping lately, and the team has been charged with choosing one of its best salespersons to take over as the new regional manager for that area.

Two salespeople immediately come to mind. Laura, one of the potential candidates, has been a sales representative for the North American region for seven years. She has a master's degree in business administration and was a foreign exchange student in Hong Kong for two years during college. She is extremely competent, knowledgeable, and confident and has consistently been a top performer at the company since she was hired. Adam, the other possible candidate, has been with the North American region for only four years, but he also served three-and-a-half years as a sales representative for the European region of a well-known competitor. He too is qualified, with a master's degree in business and considerable experience in international assignments, but his performance has not been as good as Laura's. He's good, just not as accomplished as she is. Neither candidate speaks any Asian languages.

Lingering in the back of your mind is a conversation you had with a colleague a few days ago. You and John, a fellow team member, were discussing international assignments, and the subject of sending women abroad came up. John said that in his experience, women do

not make good expatriate candidates for several reasons. First, they are not as willing as men to take assignments in foreign countries due to family obligations and other personal reasons. Second, women are typically not as successful as men in foreign assignments because certain cultures tend to view women as inferior to men. (Including some Asian cultures, you think to yourself.) Lastly, John said that women are more likely to be subjected to discrimination or sexual harassment than men are. Although you initially agreed with John's perception, you later concluded that times have changed: after all, the world is much smaller and more culturally diverse today than it was when you went on your first international assignment.

You can't stop thinking about John's comments, though. You enter the meeting room weighing the pros and cons of each candidate and wondering if Laura would be accepted by her Asian counterparts.

To work this Management Team Decision, you will need to assemble a team of four to six students to represent the sales management team in the scenario.

### **Questions**

1. Use either the stepladder technique or the nominal group technique (see Chapter 5) to decide which candidate the company should send abroad. Defend your decision.
2. Did the decision-making process change your mind? How so?
3. Determine what, if anything, the company should do to prepare the chosen candidate for the Asian assignment.

## Develop Your Career Potential

### **BUILDING CULTURAL BRIDGES INSIDE AMERICAN BUSINESS**

All savvy managers seem to be familiar with the Japanese custom of exchanging business cards, the French custom of the two-hour lunch, and the South American custom of getting to know potential business partners on a personal level before discussing business.<sup>107</sup> But how many managers are aware of the cultural differ-

ences that exist within the United States? For example, how many Manhattanites know that in some parts of the country, businesses close down on the first day of hunting season?

Political rhetoric often refers to "two Americas" and the differences between the heartland and the coasts, but many other oppositional geographic pairings also represent different sets of cultural norms.

Some other obvious examples are North–South, East–West, and the more general urban–rural. How many businesspeople know how to be effective in all these American cultures? Much has been made of the political and cultural implications of these divides, but not enough attention has been paid to what it means for business.

Cultural differences were addressed in Chapter 3 (Organizational Environments and Cultures) and will be again in Chapter 15 (Managing Communication). In the context of this chapter, however, it is important to note that many of the issues related to global management are applicable in any geographic context. Deciding whether to locate a firm in Alabama versus Oregon requires the same due diligence as deciding between Madrid and Madagascar. Managers need to assess the best business climate, identify and adapt to cultural differences, and prepare workers who will be transferred to the new location.

### Activities

1. Think of yourself as a member of a particular geographical cultural group. (In the United States, we are conditioned to think of cultural groups based on ethnicity and race, but for this exercise, it's important to think in terms of location.) What are the characteristics of this group?
2. Once you have an outline of your geographic culture, try to identify the most opposite group to your own. For example, if you consider yourself a New Yorker, you may think of a Mississippian or a Californian.
3. Research regional and local periodicals using the Business and Company Resource Center to learn about the norms in the other culture. You might also talk with a friend who attends college in a different region or state to get a more personal understanding of norms in other parts of the country. List of some of the norms in the other location, and compare them to the norms in your area of the country.



# Two Take



## Biz Flix *Mr. Baseball*

The New York Yankees trade aging baseball player Jack Elliot (Tom Selleck) to the Chunichi Dragons, a Japanese team. This lighthearted comedy traces Elliot's bungling entry into Japanese culture where he almost loses everything including Hiroko Uchiyama (Aya Takanashi). As Elliot slowly begins to understand Japanese culture and Japanese baseball, he finally is accepted by his teammates. This film shows many examples of Japanese culture, especially the Japanese love for baseball.

Unknown to Hiroko's father, she and Jack develop an intimate relationship. Meanwhile, Jack does not know that Hiroko's father is "The Chief" (Ken Takakura), the manager of the Chunichi Dragons. This scene takes place after "The Chief" has removed Jack from a baseball game. The scene shows Jack dining with Hiroko and her grandmother (Mineko Yorozyua), grandfather (Jun Hamamura), and father.

### What to Watch for and Ask Yourself

1. Does Jack Elliot behave as if he had had cross-cultural training before arriving in Japan?
2. Is he culturally sensitive or insensitive?
3. What do you propose that Elliot do for the rest of his time in Japan?



## Management Workplace King Company

David Arnold began his career as a wristwatch salesman, keeping excess inventory in his garage. He developed a strong customer base, expanded his business, and became a powerhouse in wristwatches. Watch the video to see how King Company used global management techniques to grow and prosper.

### What to Watch for and Ask Yourself

1. King Company is headquartered in the United States and sells products online in the United States. Is it a global business? Why or why not?
2. What forms of global business has King Company used to grow?
3. Given that King Company is based in the United States, does David Arnold have to contend with cultural issues? Explain.