4 The Global Context of Business

Delicious Chocolate...But at What Price?

After reading this chapter, you should be able to:

1. **Discuss the rise of international business and describe the major world marketplaces, trade agreements, and alliances.**
2. **Explain how differences in import-export balances, exchange rates, and foreign competition determine the ways in which countries and businesses respond to the international environment.**
3. **Discuss the factors involved in deciding to do business internationally and in selecting the appropriate levels of international involvement and international organizational structure.**
4. **Describe some of the ways in which social, cultural, economic, legal, and political differences among nations affect international business.**

Did you ever wonder where the chocolate in your favorite candy bar comes from? It might surprise you to know that virtually all of the chocolate you consume starts out halfway around the world. Chocolate comes from small beans that grow on cocoa trees. It takes about 400 beans to make a pound of chocolate. To harvest the beans, laborers have to chop them from the trees, slice them open, scoop out the beans, spread them on mats, and cover them to ferment. Once the beans are fermented, they're dried, packed in heavy bags, and carried to waiting trucks by the same laborers. At that point, they've entered the supply chain that will take them to the United States or Europe, where they'll be turned into Snickers candy bars or Dreyer's Double Fudge Brownie ice cream.

Over 40 percent of the world's cocoa bean supply comes from small farms scattered throughout the West African nation of Ivory Coast, which may ship as much as 47,000 tons per month to the United States. Unfortunately, though, according to reports issued about ten years ago by the United Nations Children's Fund and the U.S. State Department, much of the labor involved in Ivory Coast cocoa production is performed by children, mostly boys ranging in age from 12 to 16. The children—perhaps as many as 15,000 of them—work 12 hours a day, 7 days a week. They are often beaten to maintain productivity quotas and they sleep on bare wooden planks in cramped rooms. Most of them were tricked or sold into forced labor, many by destitute parents who couldn't feed them. In the decade following the initial reports of abusive conditions, efforts to alleviate the problem have met with relatively little success.

How did enslaving children become business as usual in the Ivory Coast cocoa industry? Because a full one-third of the country's economy is based on cocoa exports, Ivory Coast is heavily dependent on world market prices for cocoa. Unfortunately, cocoa is an extremely unstable commodity—global prices fluctuate significantly. Profitability in the cocoa industry, therefore, depends on prices over which farmers have no control. This problem is compounded by unpredictable natural conditions, such as drought, over which they also have no control. To improve their chances of making a profit, they look for ways to cut costs, and the use of slave labor—in their mind—is the most effective money-saving measure.

Photo Researchers

WHAT'S IN IT FOR ME?

Regardless of whether you see yourself living abroad, working for a big company, or starting your own business, the global economy will affect you in some way. Exchange rates for different currencies and global markets for buying and selling are all of major importance to everyone, regardless of their role or perspective. As a result, this chapter will better enable you to (1) understand how global forces affect you as a customer, (2) understand how globalization affects you as an employee, and (3) assess how global opportunities and challenges can affect you as a business owner and as an investor. You will also gain insights into how wages and working conditions in different regions are linked to what we buy and the prices we pay.

This chapter explores the global context of business. We begin with an exploration of the major world marketplaces and trade agreements that affect international business. Next, we examine several factors that help determine how countries and businesses respond to international opportunities and challenges. We then direct our attention to some of the decisions managers must make if they intend to compete in international markets. Finally, we conclude with a discussion of some of the social, cultural, economic, legal, and political factors that affect international business.

MyBizLab Where you see MyBizLab in this chapter, go to **www.mybizlab.com** for additional activities on the topic being discussed.

This is where the idea of "fair trade" comes in. *Fair trade* refers to programs designed to ensure that export-dependent farmers in developing countries receive fair prices for their crops. Several such programs are sponsored by Fairtrade Labelling Organizations International (FLO), a global nonprofit network of fair-trade groups headquartered in Germany. Here's how it works. FLO partners with cooperatives representing cocoa producers in Africa and Latin America to establish certain standards, not only for the producers' products but also for their operations and socially relevant policies (such as enforcing anti–child labor laws and providing education and health care services). In return, FLO guarantees producers a "Fairtrade Minimum Price" for their products. In early 2011, FLO guaranteed cocoa farmers a price of $1,750 per ton. If the market price falls below that level, FLO covers the difference. If the market price tops $1,750, FLO pays producers a premium of $150 per ton.

Where does the money come from? The cost is borne by the importers, manufacturers, and distributors who buy and sell cocoa from FLO-certified producers. These companies are in turn monitored by a network of FLO-owned organizations called TransFair, which ensures that FLO criteria are met and that FLO-certified producers receive the fair prices guaranteed by FLO. Products that meet the appropriate FLO-TransFair criteria are entitled to bear labels attesting that they're "Fair Trade Certified™." At present, semifinished and branded chocolate products certified by TransFair USA can be found in more than 1,600 U.S. retail locations, including Safeway and Whole Foods stores.

What incentive encourages importers, manufacturers, and distributors not only to adopt FLO-TransFair standards but also to bear the costs of subsidizing overseas producers? They get the right to promote their chocolate products not only as "fair-trade" but, often, as "organic" products as well—categories that typically command premium retail prices. In fact, FLO pays an even higher premium on organically certified cocoa—$200 instead of $150 per ton—and the extra cost, of course, shows up in retail prices. Organic chocolate products are priced in the same range as luxury chocolates, but consumers appear to be willing to pay the relatively high asking prices—not only for organic products but also for all kinds of chocolate products bearing the Fair Trade Certified label. TransFair USA chief executive Paul Rice explains that when consumers know they're supporting programs to empower farmers in developing countries, sellers and resellers can charge "dramatically higher prices, often two to three times higher." Consumers, he says, "put their money where their mouth is and pay a little more."

A 3.5-ounce candy bar labeled "organic fair trade" may sell for $3.49, compared to about $1.50 for one that's not. Why so much? Because the fair-trade candy bar, says TransFair USA spokesperson Nicole Chettero, still occupies a niche market. "As the demand and volume of Fair Trade-certified products increase," she predicts, "the market will work itself out….[R]etailers will naturally start to drop prices to remain competitive." Ultimately, she concludes, "there is no reason why fair-trade [products] should cost astronomically more than traditional products."[1]

Our opening story continues on page 106.

The Contemporary Global Economy

1 **Discuss the rise of international business and describe the major world marketplaces, trade agreements, and alliances.**

The total volume of world trade is immense—over $12 trillion in merchandise trade each year. Foreign investment in the United States is over $150 billion, and U.S. investment abroad exceeds $300 billion. As more firms engage in international business, the world economy is fast becoming an interdependent system—a process called **globalization.**

We often take for granted the diversity of products we can buy as a result of international trade. Your television, your shoes, and even your morning coffee or juice are probably **imports**—products made or grown abroad and sold domestically in the United States. At the same time, the success of many U.S. firms depends on **exports**—products made or grown here, such as machinery, electronic equipment, and grains, and shipped for sale abroad.

Firms like McDonald's, Microsoft, Apple, and Starbucks have found international markets to be a fruitful area for growth. But firms sometime stumble when they try to expand abroad. Home Depot has closed most of the stores it opened in China, for example, because labor costs are so low there few homeowners are interested in "do-it-yourself" projects. Similarly, Best Buy also closed its stores in China because consumers there tend to buy their electronics goods at lower prices from local merchants or from online merchants.[2]

And the impact of globalization doesn't stop with firms looking to open locations abroad or having to close locations that fail. Small firms with no international operations (such as an independent coffee shop) may still buy from international suppliers, and even individual contractors or self-employed people can be affected by fluctuations in exchange rates.

Indeed, international trade is becoming increasingly important to most nations and their businesses. Many countries that once followed strict policies to protect domestic business now encourage trade just as aggressively. They are opening borders to foreign business, offering incentives for domestic businesses to expand internationally, and making it easier for foreign firms to partner with local firms. Likewise, as more industries and markets become global, so, too, are the firms that compete in them.

Several forces have combined to spark and sustain globalization. For one thing, governments and businesses are more aware of the benefits of globalization to businesses and shareholders. These benefits include the potential for higher standards of living and improved business profitability. New technologies have made international travel, communication, and commerce faster and cheaper than ever before. Finally, there are competitive pressures: Sometimes a firm must expand into foreign markets simply to keep up with competitors.

MyBizLab

Gain hands-on experience through an interactive, real-world scenario. This chapter's simulation entitled Going Global is located at **www.mybizlab.com.**

Globalization process by which the world economy is becoming a single interdependent system

Import product made or grown abroad but sold domestically

Export product made or grown domestically but shipped and sold abroad

Islemount Images/Alamy

Some globalization protestors like this man fear that multinational companies will wipe out small domestic businesses like family farms.

Globalization is not without its detractors. Some critics charge that globalization allows businesses to exploit workers in less developed countries and bypass domestic environmental and tax regulations. They also charge that globalization leads to the loss of cultural heritages and often benefits the rich more than the poor. As a result, many international gatherings of global economic leaders are marked by protests and demonstrations.

The Major World Marketplaces

Managers involved with international businesses need to have a solid understanding of the global economy, including the major world marketplaces. This section examines some fundamental economic distinctions between countries based on wealth and then looks at some of the world's major international marketplaces.

Distinctions Based on Wealth The World Bank, an agency of the United Nations, uses per-capita income—average income per person—to make distinctions among countries. Its current classification method consists of four different categories of countries:[3]

1. *High-income countries.* Those with annual per-capita income greater than $11,115
2. *Upper-middle-income countries.* Those with annual per-capita income of $11,115 or less but more than $3,595
3. *Lower-middle-income countries.* Those with annual per-capita income of $3,595 or lower but more than $905
4. *Low-income countries (often called developing countries).* Those with annual per-capita income of $905 or less

Geographic Clusters The world economy revolves around three major marketplaces: North America, Europe, and Pacific Asia. In general, these clusters include relatively more of the upper-middle and high-income nations but relatively few low- and lower-middle-income countries.

North America As the world's largest marketplace and most stable economy, the United States dominates the North American market. Canada also plays a major role in the international economy, and the United States and Canada are each other's largest trading partners.

Mexico has become a major manufacturing center, especially along the U.S. border, where cheap labor and low transportation costs have encouraged many firms from the United States and other countries to build factories. However, Mexico's role as a low-cost manufacturing center may have peaked. The emergence of China as a low-cost manufacturing center may lead companies to begin to shift their production from Mexico to China.[4] (The escalating drug-related violence along the northern Mexican border is also contributing to this shift.)

Europe Europe is often regarded as two regions—Western and Eastern. Western Europe, dominated by Germany, the United Kingdom, and France, has long been a mature but fragmented marketplace. The transformation of this region via the European Union (discussed later) into an integrated economic system has further increased its importance. E-commerce and technology have also become increasingly important in this region. There has been a surge in Internet start-ups in southeastern England, the Netherlands, and the Scandinavian countries; Ireland is now one of the world's largest exporters of software; Strasbourg, France, is a major center for biotech start-ups; Barcelona, Spain, has many flourishing software and Internet companies; and the Frankfurt region of Germany is dotted with software and biotech start-ups.

Eastern Europe, once primarily communist, has also gained in importance, both as a marketplace and as a producer. Such multinational corporations as Daewoo, Nestlé, General Motors, and ABB Asea Brown Boveri have all set up operations in Poland. Ford, General Motors, Suzuki, and Volkswagen have all built new factories in Hungary. On the other hand, governmental instability has hampered development in parts of Russia, Bulgaria, Albania, Romania, and other countries.

Pacific Asia Pacific Asia is generally agreed to consist of Japan, China, Thailand, Malaysia, Singapore, Indonesia, South Korea, Taiwan, the Philippines, and Australia. Fueled by strong entries in the automobile, electronics, and banking industries, the economies of these countries grew rapidly in the 1970s and 1980s. After a currency crisis in the late 1990s that slowed growth in virtually every country of the region, Pacific Asia was showing clear signs of revitalization until the global recession in 2009. As the global economy begins to regain its momentum, Pacific Asia is expected to again be on the forefront. This is especially true of Japan, which—led by firms such as Toyota, Toshiba, and Nippon Steel—dominates the region. South Korea (home to firms Samsung and Hyundai, among others), Taiwan (owner of Chinese Petroleum and the manufacturing home of many foreign firms), and Hong Kong (a major financial center) are also successful players in the international economy.

China, the world's most densely populated country, has emerged as an important market and now boasts the world's third-largest economy, behind only the European Union and the United States.[5] Although its per-capita income remains low, the sheer number of potential consumers makes it an important market. India, though not part of Pacific Asia, is also rapidly emerging as one of the globe's most important economies.

As in North America and Europe, technology promises to play an increasingly important role in the future of this region. In some parts of Asia, however, poorly developed electronic infrastructures, slower adoption of computers and information technology, and a higher percentage of lower-income consumers hamper the emergence of technology firms.

Trade Agreements and Alliances

Various legal agreements have sparked international trade and shaped the global business environment. Indeed, virtually every nation has formal trade treaties with other nations. A *treaty* is a legal agreement that specifies areas in which nations will cooperate with one another. Among the most significant treaties is the *North American Free Trade Agreement*. The *European Union*, the *Association of Southeast Asian Nations*, and the *World Trade Organization*, all governed by treaties, are also instrumental in promoting international business activity.

North American Free Trade Agreement

The **North American Free Trade Agreement (NAFTA)** removes most tariffs and other trade barriers among the United States, Canada, and Mexico and includes agreements on environmental issues and labor abuses.

Most observers agree that NAFTA is achieving its basic purpose—to create a more active North American market. It has created several hundred thousand new jobs, although this number is smaller than NAFTA proponents had hoped. One thing is clear, though—the flood of U.S. jobs lost to Mexico predicted by NAFTA critics, especially labor unions, has not occurred.

North American Free Trade Agreement (NAFTA) agreement to gradually eliminate tariffs and other trade barriers among the United States, Canada, and Mexico

The European Union The **European Union (EU)** includes most European nations, as shown in Figure 4.1. These nations have eliminated most quotas and set uniform tariff levels on products imported and exported within their group. In 1992, virtually all internal trade barriers went down, making the EU the largest free marketplace in the world. The adoption of a common currency—the euro—by most member nations further solidified the EU's position in the world economy.

The Association of Southeast Asian Nations (ASEAN) The **Association of Southeast Asian Nations (ASEAN)** was founded in 1967 as an organization for economic, political, social, and cultural cooperation. In 1995, Vietnam became the group's first Communist member. Figure 4.2 shows a map of the ASEAN countries. Because of its relative size, ASEAN does not have the same global economic significance as NAFTA and the EU.

The World Trade Organization The **General Agreement on Tariffs and Trade (GATT)** was signed in 1947. Its purpose was to reduce or eliminate trade barriers, such as tariffs and quotas. It did so by encouraging nations to protect domestic industries within agreed-upon limits and to engage in multilateral negotiations. The GATT proved to be relatively successful. So, to further promote globalization, most of the world's countries joined to create the **World Trade Organization (WTO)**, which began on January 1, 1995. (The GATT is the actual treaty that governs the WTO.) The 152 member countries are required to open markets to international trade, and the WTO is empowered to pursue three goals:[6]

1. Promote trade by encouraging members to adopt fair trade practices.
2. Reduce trade barriers by promoting multilateral negotiations.
3. Establish fair procedures for resolving disputes among members.

Figure 4.1 **The Nations of the European Union**
Source: Europe, at *http://europa.eu/abc/maps/index_en.htm*, accessed October 22, 2011.

Figure 4.2 **The Nations of the Association of Southeast Asian Nations (ASEAN)**
Source: Association of Southeast Asian Nations, at *http://www.aseansec.org/74.htm*, accessed October 22, 2011.

International Trade

2 **Explain how differences in import-export balances, exchange rates, and foreign competition determine the ways in which countries and businesses respond to the international environment.**

The global economy is essentially defined by international trade. International trade occurs when an exchange takes place across national boundaries. Although international trade has many advantages, it can also pose problems if a country's imports and exports don't maintain an acceptable balance. Table 4.1 lists the major trading partners of the United States. The left of the table shows the 10 largest markets for exports from the United States, while the right of the table shows the 10 largest markets that import to the United States.

Note that many countries are on both lists (China and Canada, for instance). However, the United States also does business with many more countries. For instance, in 2010, the United States exported $3.8 billion to Egypt, $1.96 billion to Kuwait, $645 million to Poland, and $29 million to Zambia; imports from those same countries were $1.14 billion, $1.55 billion, $1.27 billion, and $8.8 million, respectively. In deciding whether an overall balance exists between imports and exports, economists use two measures: *balance of trade* and *balance of payments*.

Balance of Trade A country's **balance of trade** is the total economic value of all the products that it exports minus the economic value of all the products that it imports. A *positive balance of trade* results when a country exports (sells to other countries) more than it imports (buys from other countries). A *negative balance of trade* results when a country imports more than it exports.

Relatively small trade imbalances are common and are unimportant. Large imbalances, however, are another matter. The biggest concern about trade balances involves the flow of currency. When U.S. consumers and businesses buy foreign

European Union (EU) agreement among major European nations to eliminate or make uniform most trade barriers affecting group members

Association of Southeast Asian Nations (ASEAN) organization for economic, political, social, and cultural cooperation among Southeast Asian nations

General Agreement on Tariffs and Trade (GATT) international trade agreement to encourage the multilateral reduction or elimination of trade barriers

World Trade Organization (WTO) organization through which member nations negotiate trading agreements and resolve disputes about trade policies and practices

Balance of Trade economic value of all products a country exports minus the economic value of all products it imports

TABLE 4.1 Major Trading Partners of the U.S.

Country	Imports ($ billions)	Rank	Country	Exports ($ billions)	Rank
China	345	1	Canada	235	1
Canada	258	2	Mexico	153	2
Mexico	215	3	China	90	3
Japan	112	4	Japan	61	4
Federal Republic of Germany	77	5	United Kingdom	49	5
United Kingdom	49	6	Federal Republic of Germany	48	6
South Korea	47	7	South Korea	39	7
France	38	8	Brazil	35	8
Taiwan	35	9	Netherlands	34	9
Ireland	32	10	Singapore	30	10

products, dollars flow from the United States to other countries; when U.S. businesses are selling to foreign consumers and businesses, dollars flow back into the United States. A large negative balance of trade means that many dollars are controlled by interests outside the United States.

Trade Deficits and Surpluses When a country's imports exceed its exports—that is, when it has a negative balance of trade—it suffers a **trade deficit.** When exports exceed imports, the nation enjoys a **trade surplus.** Several factors, such as general economic conditions and the effect of trade agreements, influence trade deficits and surpluses. For example, higher domestic costs, greater international competition, and continuing economic problems among some of its regional trading partners have slowed the tremendous growth in exports that Japan once enjoyed. But rising prosperity in China and India has led to strong increases in both exports from and imports to those countries.

Figures 4.3 and 4.4 highlight two series of events: (1) recent trends in U.S. exports and imports and (2) the resulting trade deficit. As Figure 4.3 shows, both U.S. imports and U.S. exports have, with minor variations, increased over the past eight years—a trend that's projected to continue.

Trade deficits between 2000 and 2010 are shown in Figure 4.4. There was a deficit in each of these years because more money flowed out to pay for foreign imports than flowed in to pay for U.S. exports. For example, in 2008, the United States exported $1,300.50 billion in goods and services and imported $2,100.4 billion in goods and services. Because imports exceeded exports, the United States had a *trade deficit* of $800 billion (the difference between exports and imports). Note also that both experts and imports declined in 2008 and 2009 from the previous year. This was due to the global economic slowdown.

Balance of Payments The **balance of payments** refers to the flow of *money* into or out of a country. The money that a country pays for imports and receives for exports—its balance of trade—accounts for much of its balance of payments. Other financial exchanges are also factors. Money spent by tourists in a country, money spent by a country on foreign-aid programs, and money exchanged by buying and selling currency on international money markets affect the balance of payments.

For instance, suppose that the United States has a negative balance of trade of $1 million. Now, suppose that this year, U.S. citizens travel abroad as tourists and spend a total of $200,000 in other countries. This amount gets added to the balance of trade to form the balance of payments, which is now a negative $1.2 million dollars. Now, further suppose that tourists from other countries come to the United States and spend the equivalent of $300,000 while they are here. This has the effect of

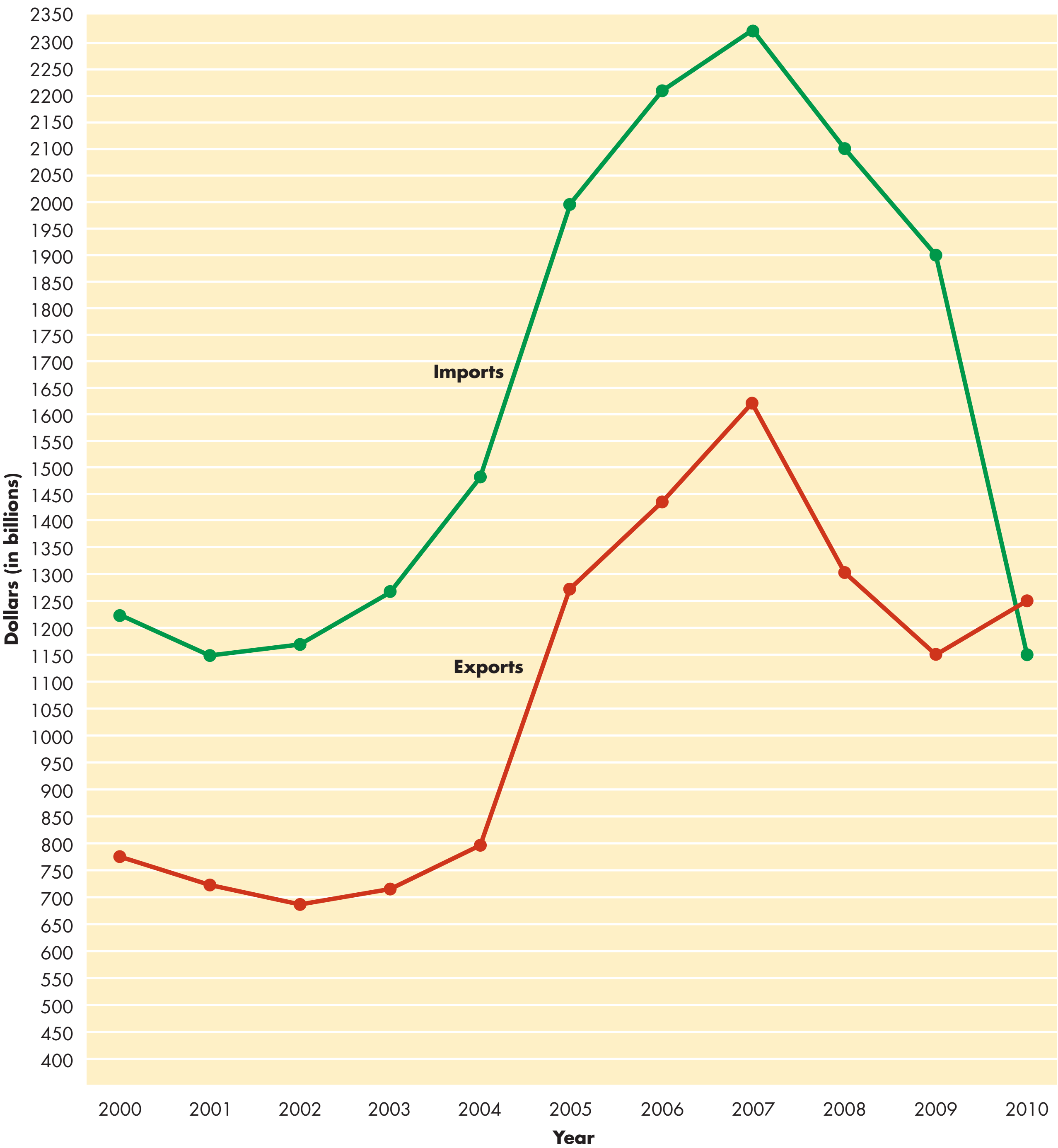


Figure 4.3 **U.S. Imports and Exports**
Source: U.S. Census Bureau: Foreign Trade Statistics, at *http://www.census.gov/foreign-trade/statistics/highlights/annual.html*, accessed November 11, 2011.

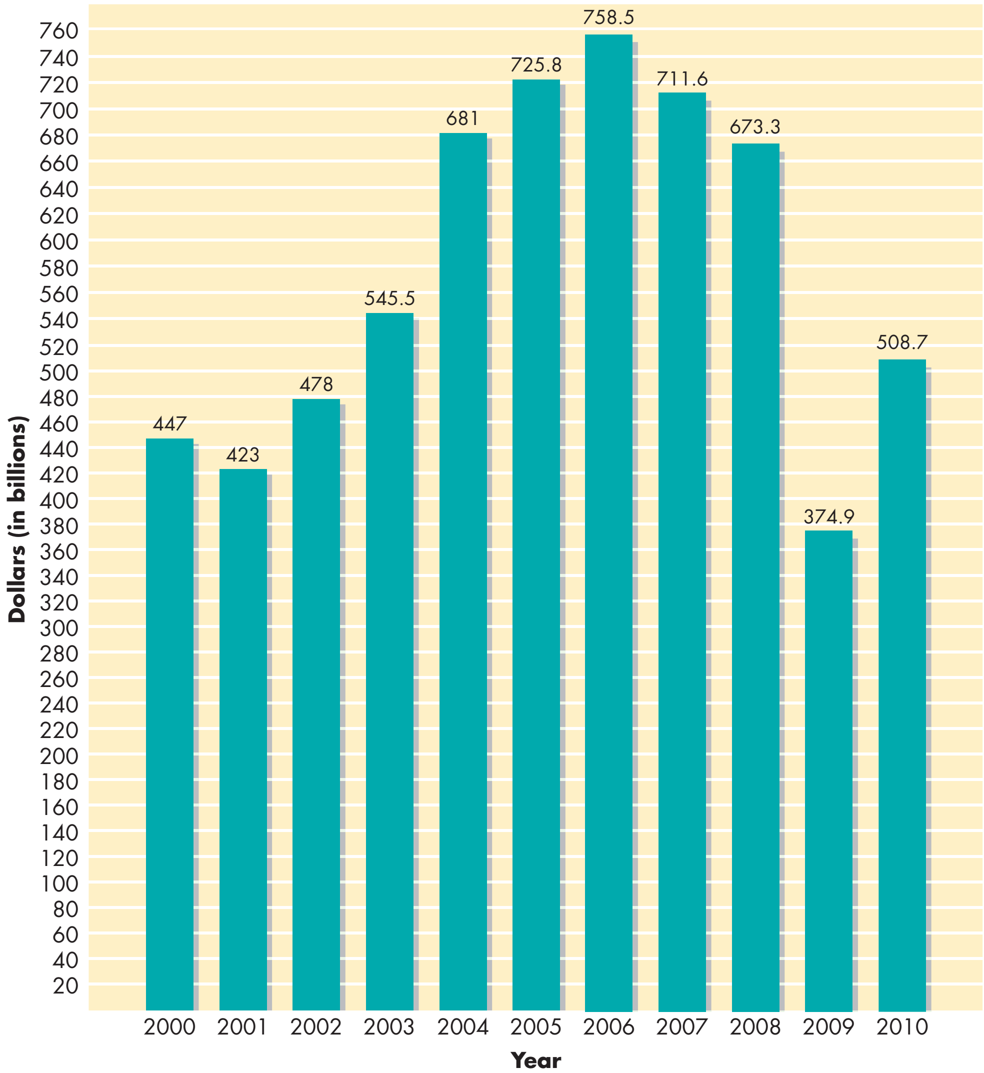
reducing the negative balance of payments to $900,000. Then, further suppose that the United States then sends $600,000 in aid to help the victims of a tsunami-ravaged country in Asia. Because this represents additional dollars leaving the United States, the balance of payments is now a negative $1.5 million. For many years, the United States enjoyed a positive balance of payments. Recently, however, the overall balance has become negative.

Trade Deficit situation in which a country's imports exceed its exports, creating a negative balance of trade

Trade Surplus situation in which a country's exports exceed its imports, creating a positive balance of trade

Balance of Payments flow of all money into or out of a country

Figure 4.4 **U.S. Trade Deficit**
Source: U.S. Census Bureau: Foreign Trade Statistics, at *http://www.census.gov/foreign-trade/statistics/highlights/annual.html*, accessed November 11, 2011.



Exchange Rates

The balance of imports and exports between two countries is affected by the rate of exchange between their currencies. An **exchange rate** is the rate at which the currency of one nation can be exchanged for that of another. Suppose, for example, that the exchange rate between the U.S. dollar and the British pound was \$2 to £1. This means that it costs £1 to "buy" \$2 or \$1 to "buy" £0.5. Stated differently, £1 and \$2 have the same purchasing power, or £1 = \$2.

At the end of World War II, the major nations of the world agreed to set *fixed exchange rates*. The value of any country's currency relative to that of another would remain constant. The goal was to allow the global economy to stabilize. Today, however, *floating exchange rates* are the norm, and the value of one country's currency relative to that of another varies with market conditions. For example, when many British citizens want to spend pounds to buy U.S. dollars (or goods), the value of the dollar relative to the pound increases. Demand for the dollar is high, and a currency is strong when demand for it is high. It's also strong when there's high demand for the goods manufactured with that currency. On a daily basis, exchange rates fluctuate very little. Significant variations usually occur over longer time spans. Highly regulated economic systems like China are among the few that still use fixed exchange rates. The Chinese government regulates the flow of currency—its own as well as all others—into and out of China and determines the precise rate of exchange within its borders.

Exchange-rate fluctuation can have an important impact on balance of trade. Suppose you want to buy some English tea for £10 per box. At an exchange rate of \$2 to £1, a box will cost you \$20 (£10 × 2 = 20). But what if the pound is weaker? At an exchange rate of, say, \$1.25 to £1, the same box would cost you only \$12.50 (£10 ×

1.25 = 12.50). If the dollar is strong in relation to the pound, the prices of all United States–made products will rise in England, and the prices of all English-made products will fall in the United States. The English would buy fewer U.S. products, and Americans would be prompted to spend more on English-made products. The result would probably be a U.S. trade deficit with England.

One of the most significant developments in foreign exchange has been the introduction of the **euro**—the common currency of the European Union. The euro was officially introduced in 2002 and has replaced other currencies, such as the German Deutsche Mark and the French franc. The EU anticipates that the euro will become as important as the dollar and the yen in international commerce. When the euro was first introduced, its value was pegged as being equivalent to the dollar: €1 = $1. But because the dollar has been relatively weak in recent years, its value has eroded relative to that of the euro. In January 2011, for example, $1 was worth only about €0.75.

Companies with international operations must watch exchange-rate fluctuations closely because changes affect overseas demand for their products and can be a major factor in competition. In general, when the value of a country's currency rises—becomes stronger—companies based there find it harder to export products to foreign markets and easier for foreign companies to enter local markets. It also makes it more cost-efficient for domestic companies to move operations to lower-cost foreign sites. When the value of a currency declines—becomes weaker—the opposite occurs. As the value of a country's currency falls, its balance of trade usually improves because domestic companies should experience a boost in exports. There should also be less reason for foreign companies to ship products into the domestic market and less reason to establish operations in other countries.

Forms of Competitive Advantage

Before we discuss the fundamental issues involved in international business management, we must consider one last factor: forms of *competitive advantage*. Because no country can produce everything that it needs, countries tend to export what they can produce better or less expensively than other countries and use the proceeds to import what they can't produce as effectively. This principle doesn't fully explain why nations export and import what they do. Such decisions hinge partly on the advantages that a particular country enjoys regarding its abilities to create and/or sell certain products and resources.[7] Economists traditionally focused on absolute and comparative advantage to explain international trade. But because this approach focuses narrowly on such factors as natural resources and labor costs, a more contemporary view of national competitive advantage has emerged.

Absolute Advantage

An **absolute advantage** exists when a country can produce something that is cheaper and/or of higher quality than any other country. Saudi oil, Brazilian coffee beans, and Canadian timber come close (because these countries have such abundant supplies of these resources), but examples of true absolute advantage are rare. For example, many experts say that the vineyards of France produce the world's finest wines. But the burgeoning wine business in California demonstrates that producers there can also make very good wine—wines that rival those from France but come in more varieties and at lower prices.

Comparative Advantage

A country has a **comparative advantage** in goods that it can produce more efficiently or better than other nations. If businesses in a given country can make computers more efficiently than they can make automobiles, then that nation has a comparative advantage in computer manufacturing.

Exchange Rate rate at which the currency of one nation can be exchanged for the currency of another nation

Euro a common currency shared among most of the members of the European Union (excluding Denmark, Sweden, and the United Kingdom)

Absolute Advantage the ability to produce something more efficiently than any other country can

Comparative Advantage the ability to produce some products more efficiently than others

ENTREPRENEURSHIP AND NEW VENTURES

Rolling in the Worldwide Dough

Is any business more confined to a local market than a bakery? Breads and pastries get stale quickly, and even the largest operations, such as those that make buns for McDonald's, only move products over short distances. But a bakery in Paris has refused to accept geographic limitations and is now selling its famous bread in global markets.

When Lionel Poilâne took over the family business more than 30 years ago, he was determined to return breadmaking to its roots. Poilâne built clay ovens based on sixteenth-century plans and technology, trained his breadmakers in ancient techniques, and began selling old-style dark bread with a thick, chewy, fire-tinged flavor. It quickly became a favorite in Parisian bistros, and demand soared.

To help meet demand, Poilâne built two more bakeries in Paris; today they sell over 15,000 loaves of bread a day. Poilâne also opened a bakery in London, but his efforts to expand to Japan were stymied: Local ordinances prohibited wood-burning ovens, and Poilâne refused to compromise. During the negotiation process, however, he came to realize that he didn't really even *want* to build new bakeries all over the world.

Instead, he turned to modern technology to expand his old-fashioned business. The key was the big FedEx hub at Paris Roissy Charles de Gaulle Airport near Poilâne's largest Paris bakery. After launching a website, Poilâne started taking international orders. New orders are packaged as the bread cools and then picked up by FedEx. A quick warm-up in the customer's oven gives it the same taste as it had when it came out of Poilâne's oven. Today, a loaf of bread baked in Paris in the morning can easily be reheated for tomorrow night's dinner in more than 25 countries.[8]

MyBizLab

Brenda A. Carson/iStockphoto

In general, both absolute and comparative advantages translate into competitive advantage. Brazil, for instance, can produce and market coffee beans knowing full well that there are few other countries with the right mix of climate, terrain, and altitude to enter the coffee bean market. The United States has comparative advantages in the computer industry (because of technological sophistication) and in farming (because of large amounts of fertile land and a temperate climate). South Korea has a comparative advantage in electronics manufacturing because of efficient operations and cheap labor. As a result, U.S. firms export computers and grain to South Korea and import DVD players from South Korea. South Korea can produce food, and the United States can build DVD players, but each nation imports certain products because the other holds a comparative advantage in the relevant industry.

National Competitive Advantage In recent years, a theory of national competitive advantage has become a widely accepted model of why nations engage in international trade.[9] **National competitive advantage** derives from four conditions:

1. *Factor conditions* are the factors of production we discussed in Chapter 1—*labor*, *capital*, *entrepreneurs*, *physical resources*, and *information resources*.
2. *Demand conditions* reflect a large domestic consumer base that promotes strong demand for innovative products.
3. *Related and supporting industries* include strong local or regional suppliers and/or industrial customers.
4. *Strategies*, *structures*, *and rivalries* refer to firms and industries that stress cost reduction, product quality, higher productivity, and innovative products.

When all attributes of national competitive advantage exist, a nation is likely to be heavily involved in international business. Japan, for instance, has an abundance of natural resources and strong domestic demand for automobiles. Its carmakers have well-oiled supplier networks, and domestic firms have competed intensely with one another for decades. These circumstances explain why Japanese car companies like Toyota and Honda are successful in foreign markets.

International Business Management

3 **Discuss the factors involved in deciding to do business internationally and in selecting the appropriate levels of international involvement and international organizational structure.**

Regardless of where a firm is located, its success depends largely on how well it's managed. International business is so challenging because basic management tasks—planning, organizing, directing, and controlling—are much more difficult when a firm operates in markets scattered around the globe.

Managing means making decisions. In this section, we examine the three basic decisions that a company must make when considering globalization. The first decision is whether to go international at all. Once that decision has been made, managers must decide on the level of international involvement and on the organizational structure that will best meet the firm's global needs.

Going International

As the world economy becomes globalized, more firms are conducting international operations. U.S. firms are aggressively expanding abroad, while foreign companies such as BP and Nestlé continue to expand into foreign markets as well, including the U.S. market. This route, however, isn't appropriate for every company. If you buy and sell fresh fish, you'll find it more profitable to confine your activities to limited geographic areas because storage and transport costs may be too high to make international operations worthwhile. As Figure 4.5 shows, several factors affect the decision to go international.

Gauging International Demand In considering international expansion, a company must consider whether there is a demand for its products abroad. Products that are successful in one country may be useless in another. Even when there is demand, advertising may still need to be adjusted. For example, bicycles are largely used for recreation in the United States but are seen as basic transportation in China. Hence, a bicycle maker would need to have different advertising strategies in each of these two countries. Market research and/or the prior market entry of competitors may indicate whether there's an international demand for a firm's products.

Adapting to Customer Needs If its product is in demand, a firm must decide whether and how to adapt it to meet the special demands of foreign customers. For example, to satisfy local tastes, McDonald's sells wine in France, beer in Germany, and provides some vegetarian sandwiches in India. Likewise, consumer electronics companies have to be aware that different countries use different kinds of electric sockets and different levels of electric power. Therefore, regardless of demand, customer needs must still be considered.

Outsourcing and Offshoring **Outsourcing**—the practice of paying suppliers and distributors to perform certain business processes or to provide needed materials or services—has become a very popular option for going international. It has become so popular because (1) it helps firms focus on their core activities and avoid getting

National Competitive Advantage international competitive advantage stemming from a combination of factor conditions, demand conditions, related and supporting industries, and firm strategies, structures, and rivalries

Outsourcing the practice of paying suppliers and distributors to perform certain business processes or to provide needed materials or services

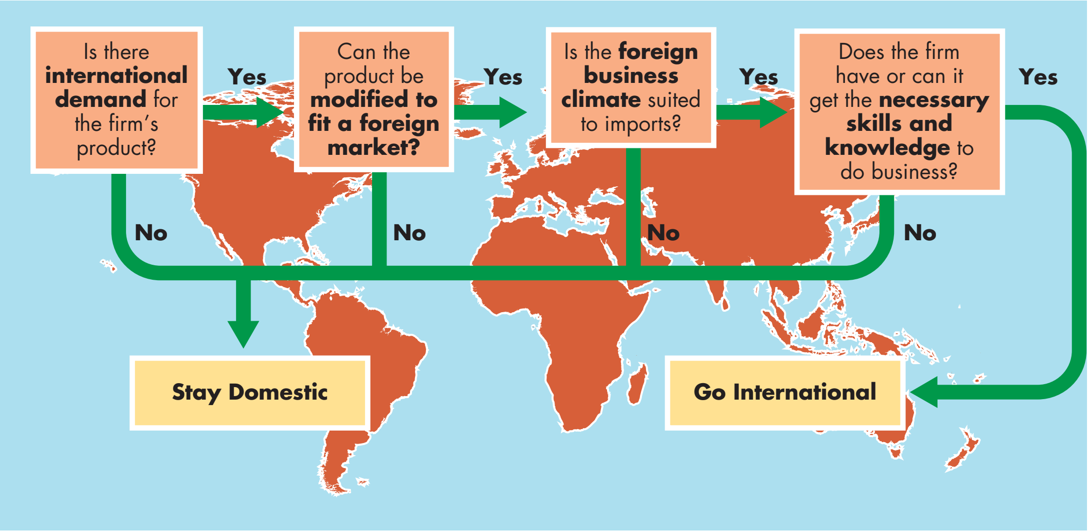


Figure 4.5 Going International

sidetracked on secondary activities, and (2) it reduces costs by locating certain business functions in areas where relevant costs are low.[10]

The practice of outsourcing to foreign countries is more specifically referred to as **offshoring.** Many companies today contract their manufacturing to low-cost factories in Asia. Similarly, many service call centers today are outsourced to businesses located in India. The 2008 Oscar winner *Slumdog Millionaire* featured a young Indian man who worked for an international call center in Mumbai.

Levels of International Involvement

After deciding to go international, a firm must determine the level of its involvement. Several levels are possible: A firm may act as an exporter or importer, organize as an international firm, or (like most of the world's largest industrial firms) operate as a multinational firm.

Exporters and Importers

An **exporter** makes products in one country to distribute and sell in others. An **importer** buys products in foreign markets and brings them home for resale. Both conduct most of their business in their home nations. Both entail the lowest level of involvement in international operations, and both are good ways to learn the fine points of global business. Many large firms entered international business as exporters. IBM and Coke, among others, exported to Europe for several years before setting up production sites there.

International Firms

As exporters and importers gain experience and grow, many move to the next level of involvement. **International firms** conduct a good deal of their business abroad and may even maintain overseas manufacturing facilities. An international firm may be large, but it's still basically a domestic company with international operations. Hershey, for instance, buys ingredients for its chocolates from several foreign suppliers, but makes all of its products in the United States. Moreover, while it sells its products in approximately 50 other countries, it generates most of its revenues from its domestic market.[11]

Multinational Firms

Most **multinational firms**—firms that design, produce, and market products in many nations—such as ExxonMobil, Nestlé, IBM, and Ford, don't think of themselves as having domestic and international divisions. Headquarters locations are almost irrelevant, and planning and decision making are geared to international markets. The world's largest multinationals in 2010 based on sales, profits, and employees are shown in Table 4.2.

TABLE 4.2 The World's Largest Non-U.S. Companies By Sales, Profits, and Number of Employees (2010)

Company	Sales ($ million)	Profits ($ million)	Employees
BP p.l.c.	246,138		
China Petroleum & Chemical	196,781		
Royal Dutch Shell	285,129		
Saudi Arabian Oil	233,300		
Toyota	204,443		
Barclays PLC		16,385	
BP p.l.c.		16,578	
China Mobile		16,849	
OAO Gazprom		25,722	
PETROBRAS		15,448	
Carrefour SA			475,976
Deutsche Post			436,651
OAO Gazprom			393,600
Siemens			405,000
Tesco PLC			472,094

We can't underestimate the economic impact of multinational firms. Consider just the impact of the 500 largest multinationals: In 2010, these 500 firms generated $12.3 trillion in revenues and $819.3 billion in owner profits. They employed tens of millions of people, bought materials and equipment from literally thousands of other firms, and paid billions in taxes. Moreover, their products affected the lives of hundreds of millions of consumers, competitors, investors, and even protestors.

International Organization Structures

Different levels of international involvement entail different kinds of organizational structure. A structure that would help coordinate an exporter's activities would be inadequate for those of a multinational. In this section, we consider the spectrum of organizational strategies, including *independent agents*, *licensing arrangements*, *branch offices*, *strategic alliances*, and *foreign direct investment*.

Independent Agents

An **independent agent** is a foreign individual or organization that represents an exporter in foreign markets. Independent agents often act as sales representatives: They sell the exporter's products, collect payment, and make sure that customers are satisfied. They often represent several firms at once and usually don't specialize in a particular product or market. Peter So operates an import-export office in Hong Kong. He and his staff of three handle imports from about 15 foreign companies into Hong Kong and about 10 Hong Kong firms that export products abroad.

Offshoring the practice of outsourcing to foreign countries

Exporter firm that distributes and sells products to one or more foreign countries

Importer firm that buys products in foreign markets and then imports them for resale in its home country

International Firm firm that conducts a significant portion of its business in foreign countries

Multinational Firm firm that designs, produces, and markets products in many nations

Independent Agent foreign individual or organization that agrees to represent an exporter's interests

MANAGING IN TURBULENT TIMES

The Ups and Downs of Globalization

International business has been around for thousands of years. For example, as far back as 2000 B.C., tribes in northern Africa took dates and clothing to Babylonia and Assyria in the Middle East and traded them for spices and olive oil. By 500 B.C., Chinese merchants were actively exporting silk and jade to India and Europe, and trade routes were being established between many countries in Europe, Asia, and Africa.

But even as recently as 100 years ago, international trade was only a small part of the global economy. The effects of any given country's economy had a minimal effect on the rest of the world. Indeed, it wasn't until the Great Depression that swept the world in 1929 that experts realized how interdependent the global economy had become.

Globalization—the process through which the world's economy is becoming one interdependent system—brings with it both advantages and disadvantages. On the plus side, globalization has increased the standard of living of billions of people and has helped to create enormous wealth in many different parts of the globe. On the other hand, there are many people who have not shared in the benefits of globalization, and some critics believe that globalization has both hurt less developed countries and destroyed or damaged the unique cultures that exist in different parts of the world.

Globalization has also led to such a high degree of interdependence that no major country's economy is immune from what happens in the rest of the world. The recession of 2008–2009 demonstrated this fact once again: As the economy of the United States ground to a halt, so did the economies of virtually all major European and Asian countries as well. Global stock trading, real-time information available on

Alexander Tovstenko/iStockphoto

the Internet, and worldwide financial networks combined to bring to a grinding halt just about every major business in the world.

Managers seeking to reverse the tide and get their businesses going again had to juggle more factors than ever before. Domestic forces such as consumer demand, interest rates, and production costs all had to be considered. But so too did international business conditions. And many businesses—Circuit City and Chrysler, for example—struggled mightily, and some failed. But those with managers and leaders who really understood the global economy did in fact regain their footing. And as global economic conditions improve, so too does the outlook for these businesses.

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Licensing Arrangements Companies seeking more involvement may opt for **licensing arrangements.** Firms give foreign individuals or companies exclusive rights (called *licensing agreements*) to manufacture or market their products in that market. In return, the exporter receives a fee plus ongoing payments (royalties) that are calculated as a percentage of the license holder's sales. Franchising is an increasingly popular form of licensing. For example, McDonald's and Pizza Hut franchise around the world.

Branch Offices Instead of developing relationships with foreign agents or licensing companies, a firm may send its own managers to overseas **branch offices,** where the firm has more direct control than it does over agents or license holders. Branch offices also furnish a more visible public presence in foreign countries, and foreign customers tend to feel more secure when there's a local branch office. Halliburton, a Houston-based oil field supply and services company, recently opened a branch office in Dubai in order to more effectively establish relationships with customers in the Middle East.

Strategic Alliances In a **strategic alliance,** a company finds a partner in the country in which it wants to do business. Each party agrees to invest resources and capital into a new business or to cooperate in some mutually beneficial way. This new business—the alliance—is owned by the partners, who divide its profits. Such alliances are sometimes called *joint ventures*, but the term *strategic alliance* has arisen because such partnerships are playing increasingly important roles in the strategies of major companies. Ford and Russian automaker Sollers recently launched a new joint venture; Sollers will manufacture Ford products in Russia and the two partners will then work together on marketing them.[12] In many countries, such as Mexico, India, and China, laws make alliances virtually the only way to do international business. Mexico, for example, requires that all foreign firms investing there have local partners.

In addition to easing the way into new markets, alliances give firms greater control over foreign activities than agents and licensees. Alliances also allow firms to benefit from the knowledge and expertise of foreign partners. Microsoft, for example, relies heavily on alliances as it expands into international markets. This approach has helped the firm learn the intricacies of doing business in China and India, two of the hardest emerging markets to crack.

Foreign Direct Investment **Foreign direct investment (FDI)** involves buying or establishing tangible assets in another country. Dell Computer, for example, has built assembly plants in Europe and China. Volkswagen has built a factory in Brazil, and Disney has built theme parks in France and Hong Kong. Each of these activities represents FDI by a firm in another country.

Barriers to International Trade

4 Describe some of the ways in which social, cultural, economic, legal, and political differences among nations affect international business.

Whether a business is truly multinational or sells to only a few foreign markets, several factors will affect its international operations. Success in foreign markets will largely depend on the ways it responds to *social*, *economic*, *legal*, and *political barriers* to international trade.

Social and Cultural Differences

Any firm planning to conduct business abroad must understand the social and cultural differences between host country and home country. Some differences are obvious. You must, for example, consider language factors when adjusting packaging, signs, and logos. Pepsi is the same product in Seattle and Moscow—except for the lettering on the bottle. Less universal products, however, face several conditions that force them to make adjustments. When Bob's Big Boy launched new restaurants in Thailand, it had to add deep-fried shrimp to the menu. KFC has altered menus, ingredients, and hours of operation to suit Thai culture.

A wide range of subtle value differences can also affect operations. For example, many Europeans shop daily for groceries. To U.S. consumers accustomed to weekly supermarket trips, the European pattern may seem like a waste of time. For many Europeans, however, shopping is not just a matter of buying food; it's also an outlet for meeting friends and exchanging political views. Consider the implications of this difference for U.S. firms selling food and food-related products in Europe where large American supermarkets are not the norm in many parts of Europe.

Economic Differences

Although cultural differences are often subtle, economic differences can be fairly pronounced. As we discussed in Chapter 1, in dealing with mixed market economies like those of France and Sweden, firms must know when—and to what extent—the government is involved in a given industry. The French government, for instance, is heavily involved in all aspects of airplane design and manufacturing. The impact of

Licensing Arrangement arrangement in which firms choose foreign individuals or organizations to manufacture or market their products in another country

Branch Office foreign office set up by an international or multinational firm

Strategic Alliance arrangement (also called joint venture) in which a company finds a foreign partner to contribute approximately half of the resources needed to establish and operate a new business in the partner's country

Foreign Direct Investment (FDI) arrangement in which a firm buys or establishes tangible assets in another country economic differences can be even greater in planned economies like those of China and Vietnam, where the government owns and operates many factors of production.

Legal and Political Differences

Governments can affect international business in many ways. They can set conditions for doing business within their borders and even prohibit doing business altogether. They can control the flow of capital and use tax legislation to discourage or encourage activity in a given industry. They can even confiscate the property of foreign-owned companies. In this section, we discuss some of the more common legal and political issues in international business: *quotas*, *tariffs*, and *subsidies*; *local content laws*; and *business practice laws*.

Quotas, Tariffs, and Subsidies Even free market economies, such as the United States, have some quotas and/or tariffs, both of which affect prices and quantities of foreign-made products. A **quota** restricts the number of products of a certain type that can be imported and, by reducing supply, raises the prices of those imports. That's why Belgian ice-cream makers can't ship more than 922,315 kilograms to the United States each year, and Canada can ship no more than 14.7 billion board feet of softwood timber per year. Quotas are often determined by treaties. Better terms are often given to friendly trading partners, and quotas are typically adjusted to protect domestic producers.

The ultimate quota is an **embargo:** a government order forbidding exportation and/or importation of a particular product—or even all products—from a specific country. Many nations control bacteria and disease by banning certain agricultural products. Because the United States has embargoes against Cuba and Libya, American firms can't invest in these countries, and their products can't legally be sold on American markets.

Tariffs are taxes on imported products. They raise the prices of imports by making consumers pay not only for the products but also for tariff fees. Tariffs take two forms. Revenue tariffs are imposed to raise money for governments, but most tariffs, called protectionist tariffs, are meant to discourage particular imports. Did you know that firms that import ironing-board covers into the United States pay a 7-percent tariff on the price of the product? Firms that import women's athletic shoes pay a flat rate of $0.90 per pair plus 20 percent of the product price. Such figures are determined through a complicated process designed to put foreign and domestic firms on competitive footing (that is, to make the foreign goods about the same cost as the domestic goods).

Quotas and tariffs are imposed for numerous reasons. The U.S. government aids domestic automakers by restricting the number of Japanese cars imported into this country. Because of national security concerns, we limit the export of technology (for example, computer and nuclear technology to China). The United States isn't the only country that uses tariffs and quotas. To protect domestic firms, Italy imposes high tariffs on electronic goods. As a result, CD players are prohibitively expensive.

A **subsidy** is a government payment to help a domestic business compete with foreign firms. They're actually indirect tariffs that lower the prices of domestic goods rather than raise the prices of foreign goods. For example, many European governments subsidize farmers to help them compete against U.S. grain imports.

The Protectionism Debate In the United States, **protectionism**—the practice of protecting domestic business at the expense of free market competition—is controversial. Supporters argue that tariffs and quotas protect domestic firms and jobs as well as shelter new industries until they're able to compete internationally. They contend that we need such measures to counter steps taken by other nations. Other advocates justify protectionism in the name of national security. A nation, they argue, must be able to produce efficiently the goods needed for survival in case of war. Thus, the U.S. government requires the Air Force to buy planes only from U.S. manufacturers.

Critics cite protectionism as a source of friction between nations. They also charge that it drives up prices by reducing competition. They maintain that although jobs in some industries would be lost as a result of free trade, jobs in other industries (for example, electronics and automobiles) would be created if all nations abandoned protectionist tactics.

Protectionism sometimes takes on almost comic proportions. Neither Europe nor the United States grows bananas, but both European and U.S. firms buy and sell bananas in foreign markets. Problems arose when the EU put a quota on bananas imported from Latin America—a market dominated by two U.S. firms, Chiquita and Dole—in order to help firms based in current and former European colonies in the Caribbean. To retaliate, the United States imposed a 100-percent tariff on certain luxury products imported from Europe, including Louis Vuitton handbags, Scottish cashmere sweaters, and Parma ham.

Local Content Laws Many countries, including the United States, have **local content laws**—requirements that products sold in a country be at least partly made there. Firms seeking to do business in a country must either invest there directly or take on a domestic partner. In this way, some of the profits from doing business in a foreign country stay there rather than flow out to another nation. In some cases, the partnership arrangement is optional but wise. In Mexico, for instance, Radio Shack de México is a joint venture owned by Tandy Corp. (49 percent) and Mexico's Grupo Gigante (51 percent). This allows the retailer to promote a strong Mexican identity; it also makes it easier to address certain import regulations that are easier for Mexican than for U.S. firms. Both China and India currently require that when a foreign firm enters into a joint venture with a local firm, the local partner must have the controlling ownership stake.

Business Practice Laws Many businesses entering new markets encounter problems in complying with stringent regulations and bureaucratic obstacles. Such practices are affected by the **business practice laws** by which host countries govern business practices within their jurisdictions. As part of its entry strategy in Germany several years ago, Wal-Mart had to buy existing retailers rather than open brand-new stores because, at the time, the German government was not issuing new licenses to sell food products. Wal-Mart also was not allowed to follow its normal practice of refunding price differences on items sold for less by other stores because the practice is illegal in Germany. In addition, Wal-Mart had to comply with business-hour restrictions: Stores can't open before 7:00 A.M., must close by 8:00 P.M. on weeknights and 4:00 P.M. on Saturday, and must remain closed on Sunday. After a few years, Wal-Mart eventually decided its meager profits in Germany didn't warrant the effort it required to generate them and closed all of its stores there.

Cartels and Dumping Sometimes, a legal—even an accepted—practice in one country is illegal in another. In some South American countries, for example, it is sometimes legal to bribe business and government officials. The existence of **cartels**—associations of producers that control supply and prices—gives tremendous power to some nations, such as those belonging to the Organization of Petroleum Exporting Countries (OPEC). U.S. law forbids both bribery and cartels.

Finally, many (but not all) countries forbid **dumping**—selling a product abroad for less than the cost of production at home. U.S. antidumping legislation sets two conditions for determining whether dumping is being practiced:

1 Products are being priced at "less than fair value."

2 The result unfairly harms domestic industry.

Just a few years ago, the United States charged Japan and Brazil with dumping steel at prices 70 percent below normal value. To protect local manufacturers, the U.S. government imposed a significant tariff on steel imported from those countries.

Quota restriction on the number of products of a certain type that can be imported into a country

Embargo government order banning exportation and/or importation of a particular product or all products from a particular country

Tariff tax levied on imported products

Subsidy government payment to help a domestic business compete with foreign firms

Protectionism practice of protecting domestic business against foreign competition

Local Content Law law requiring that products sold in a particular country be at least partly made there

Business Practice Law law or regulation governing business practices in given countries

Cartel association of producers whose purpose is to control supply and prices

Dumping practice of selling a product abroad for less than the cost of production

Photo Researchers

Continued from page 89

Fair Trade—Worth the Price?

Some critics of fair-trade practices and prices agree in principle with those who advocate its use but contend that consumers don't need to be paying such excessive prices even under *current* market conditions. They point out that, according to TransFair's own data, cocoa farmers get only 3 cents of the $3.49 that a socially conscious consumer pays for a Fair Trade–certified candy bar. "Farmers often receive very little," reports consumer researcher Lawrence Solomon. "Often fair trade is sold at a premium," he charges, "but the entire premium goes to the middlemen." Critics like Solomon suggest that sellers of fair-trade products are taking advantage of consumers who are socially but not particularly price conscious. They point out that if sellers priced that $3.49 candy bar at $2.49, farmers would still be entitled to 3 cents. The price, they charge, is inflated to $3.49 only because there's a small segment of the market willing to pay it (while farmers still get only 3 cents). Fair-trade programs, advises English economist Tim Harford, "make a promise that the producers will get a good deal. They do not promise that the consumer will get a good deal. That's up to you as a savvy shopper."

QUESTIONS FOR DISCUSSION

1. Do you think fair-trade is a viable solution to child-labor and related problems?
2. Are you willing to pay more for fair-trade products? Why or why not?
3. What other options can you identify that might help deal with child labor and other problems in the global cocoa market?

SUMMARY OF LEARNING OBJECTIVES MyBizLab

1. **Discuss the rise of international business and describe the major world marketplaces, trade agreements, and alliances. (pp. 89–92)**
Several forces combine to sustain *globalization*: (1) Governments and businesses are more aware of the benefits of globalization; (2) new technologies make international travel, communication, and commerce faster and cheaper; (3) competitive pressures sometimes force firms to expand into foreign markets just to keep up with competitors; (4) treaties and trade agreements also play a major role. The most important influences are (1) the *North American Free Trade Agreement* (*NAFTA*); (2) the *European Union* (*EU*); and (3) the *General Agreement on Tariffs and Trade* (*GATT*) and the *World Trade Organization* (*WTO*). The contemporary world economy revolves around three major marketplaces: North America, Europe, and Asia.

2. **Explain how differences in import-export balances, exchange rates, and foreign competition determine the ways in which countries and businesses respond to the international environment. (pp. 93–99)**
A nation's *balance of trade* is the total economic value of all products that it exports minus the total economic value of all products that it imports. When a country's imports exceed its exports—when it has a *negative balance of trade*—it suffers a *trade deficit*; a *positive balance of trade* occurs when exports exceed imports, resulting in a *trade surplus*. The *balance of payments* refers to the flow of money into or out of a country.
An *exchange rate* is the rate at which one nation's currency can be exchanged for that of another. Under *floating exchange rates,* the value of one currency relative to that of another varies with market conditions.
Countries *export* what they can produce better or less expensively than other countries and use the proceeds to *import* what they can't produce as effectively. Economists once focused on two forms of advantage to explain international trade: *absolute advantage* and *comparative advantage*. Today, the theory of *national competitive advantage* is a widely accepted model of why nations engage in international trade.

3. **Discuss the factors involved in deciding to do business internationally and in selecting the appropriate levels of international involvement and international organizational structure. (pp. 99–103)**
Several factors enter into the decision to go international. One overriding factor is the *business climate* in other nations. A company should also consider at least two other issues: (1) Is there a *demand* for its products abroad? (2) If so, must it *adapt* those products for international consumption?
After deciding to go international, a firm must decide on its level of involvement. Several levels are possible: (1) *exporters and importers*; (2) *international firms*; and (3) *multinational firms*. Different levels of involvement require different kinds of organizational structure. The spectrum of international organizational strategies includes the following: (1) *independent agents*; (2) *licensing arrangements*; (3) *branch offices*; (4) *strategic alliances* (or *joint ventures*); and (5) *foreign direct investment* (*FDI*).

4. **Describe some of the ways in which social, cultural, economic, legal, and political differences among nations affect international business. (pp. 103–106)**
Some social and cultural differences, like language, are obvious, but a wide range of subtle value differences can also affect operations. Economic differences can be fairly pronounced. Common legal and political issues in international business include *quotas*, *tariffs*, *subsidies*, *local content laws*, and *business practice laws*.

KEY TERMS MyBizLab

absolute advantage (p. 97)
Association of Southeast Asian Nations (ASEAN) (p. 92)
balance of payments (p. 94)
balance of trade (p. 93)
branch office (p. 102)
business practice law (p. 105)
cartel (p. 105)
comparative advantage (p. 97)
dumping (p. 105)
embargo (p. 104)
euro (p. 97)
European Union (EU) (p. 92)
exchange rate (p. 96)
export (p. 89)
exporter (p. 100)
foreign direct investment (FDI) (p. 103)
General Agreement on Tariffs and Trade (GATT) (p. 92)
globalization (p. 89)
import (p. 89)
importer (p. 100)
independent agent (p. 101)
international firm (p. 100)
licensing arrangement (p. 102)
local content law (p. 105)
multinational firm (p. 100)
national competitive advantage (p. 98)
North American Free Trade Agreement (NAFTA) (p. 91)
offshoring (p. 100)
outsourcing (p. 99)
protectionism (p. 104)
quota (p. 104)
strategic alliances (p. 102)
subsidy (p. 104)
tariff (p. 104)
trade deficit (p. 94)
trade surplus (p. 94)
World Trade Organization (WTO) (p. 92)

QUESTIONS AND EXERCISES

QUESTIONS FOR REVIEW

1. How does the balance of trade differ from the balance of payments?
2. What are the three possible levels of involvement in international business? Give examples of each.
3. How does a country's economic system affect the decisions of foreign firms interested in doing business there?
4. What aspects of the culture in your state or region would be of particular interest to a foreign firm thinking about locating there?

QUESTIONS FOR ANALYSIS

5. List all the major items in your bedroom, including furnishings. Try to identify the country in which each item was made. Offer possible reasons why a given nation might have a comparative advantage in producing a given good.
6. Suppose that you're the manager of a small firm seeking to enter the international arena. What basic information would you need about the market that you're thinking of entering?
7. Do you support protectionist tariffs for the United States? If so, in what instances and for what reasons? If not, why not?
8. Do you think that a firm operating internationally is better advised to adopt a single standard of ethical conduct or to adapt to local conditions? Under what kinds of conditions might each approach be preferable?

APPLICATION EXERCISES

9. Interview the manager of a local firm that does at least some business internationally. Why did the company decide to go international? Describe the level of the firm's international involvement and the organizational structure(s) it uses for international operations.
10. Select a product familiar to you. Using library reference works to gain some insight into the culture of India, identify the problems that might arise in trying to market this product to Indian consumers.

BUILDING YOUR BUSINESS SKILLS

Finding Your Place

Goal

To encourage you to apply global business strategies to a small-business situation.

Background Information

Some people might say that Yolanda Lang is a bit too confident. Others might say that she needs confidence—and more—to succeed in the business she's chosen. But one thing is certain: Lang is determined to grow INDE, her handbag design company, into a global enterprise. At only 28 years of age, she has time on her side—if she makes the right business moves now.

These days, Lang spends most of her time in Milan, Italy. Backed by $50,000 of her parents' personal savings, she is trying to compete with Gucci, Fendi, and other high-end handbag makers. Her target market is American women willing to spend $200 on a purse. Ironically, Lang was forced to set up shop in Italy because of the snobbishness of these customers, who buy high-end bags only if they're European-made. "Strangely enough," she muses, "I need to be in Europe to sell in America."

To succeed, she must first find ways to keep production costs down—a tough task for a woman in a male-dominated business culture. Her fluent Italian is an advantage, but she's often forced to turn down inappropriate dinner invitations. She also has to figure out how to get her 22-bag collection into stores worldwide. Retailers are showing her bags in Italy and Japan, but she's had little luck in the United States. "I intend to be a global company," says Lang. The question is how to succeed first as a small business.

Method

Step 1

Join together with three or four other students to discuss the steps that Lang has taken so far to break into the U.S. retail market. These steps include:

- Buying a mailing list of 5,000 shoppers from high-end department store Neiman Marcus and selling directly to these customers.
- Linking with a manufacturer's representative to sell her line in major U.S. cities while she herself concentrates on Europe.

Step 2

Based on what you learned in this chapter, suggest other strategies that might help Lang grow her business. Working with group members, consider whether the following options would help or hurt Lang's business. Explain why a strategy is likely to work or likely to fail.

- Lang could relocate to the United States and sell abroad through an independent agent.
- Lang could relocate to the United States and set up a branch office in Italy.
- Lang could find a partner in Italy and form a strategic alliance that would allow her to build her business on both continents.

FOLLOW-UP QUESTIONS

1. What are the most promising steps that Lang can take to grow her business? What are the least promising?
2. Lang thinks that her trouble breaking into the U.S. retail market stems from the fact that her company is unknown. How would this circumstance affect the strategies suggested in Steps 1 and 2?

3. When Lang deals with Italian manufacturers, she is a young woman in a man's world. Often she must convince men that her purpose is business and nothing else. How should Lang handle personal invitations that get in the way of business? How can she say no while still maintaining business relationships? Why is it often difficult for American women to do business in male-dominated cultures?
4. The American consulate has given Lang little business help because her products are made in Italy. Do you think the consulate's treatment of an American businessperson is fair or unfair? Explain your answer.
5. Do you think Lang's relocation to Italy will pay off? Why or why not?
6. With Lang's goals of creating a global company, can INDE continue to be a one-person operation?

EXERCISING YOUR ETHICS: INDIVIDUAL EXERCISE

Paying Heed to Foreign Practices

The Situation

Assume that you're an up-and-coming manager in a regional U.S. distribution company. Firms in your industry are just beginning to enter foreign markets, and you've been assigned to head up your company's new operations in a Latin American country. Because at least two of your competitors are also trying to enter this same market, your boss wants you to move as quickly as possible. You also sense that your success in this assignment will likely determine your future with the company.

You have just completed meetings with local government officials, and you're pessimistic about your ability to get things moving quickly. You've learned, for example, that it will take 10 months to get a building permit for a needed facility. Moreover, once the building's up, it will take another 6 months to get utilities. Finally, the phone company says that it may take up to two years to install the phone lines that you need for high-speed Internet access.

The Dilemma

Various officials have indicated that time frames could be considerably shortened if you were willing to pay special "fees." You realize that these "fees" are bribes, and you're well aware that the practice of paying such "fees" is both unethical and illegal in the United States. In this foreign country, however, it's not illegal and not even considered unethical. Moreover, if you don't pay and one of your competitors does, you'll be at a major competitive disadvantage. In any case, your boss isn't likely to understand the long lead times necessary to get the operation running. Fortunately, you have access to a source of funds that you could spend without the knowledge of anyone in the home office.

QUESTIONS TO ADDRESS

1 What are the key ethical issues in this situation?
2 What do you think most managers would do in this situation?
3 What would you do?

EXERCISING YOUR ETHICS: TEAM EXERCISE

Weighing the Trade-offs

The Situation

A medium-size regional banking corporation has its headquarters in a small city in the Midwestern United States. The firm is privately owned; all managers own stock in the bank corporation. The company's senior managers (and majority owners) have decided to sell the bank to a major international banking company within the next two to three years. First, though, the bank corporation needs to trim its expenses in order to make it more attractive to a potential buyer.

The Dilemma

Because the bank corporation has been a locally owned and operated enterprise, it has maintained a full slate of operations within the local market. For instance, its corporate offices, many banking outlets, and all of its support activities are housed locally. The latter category includes a large call center—a staff of 300 people who handle most customer calls with questions about their accounts.

There has been a growing trend in banking, though, to outsource call centers to foreign countries, most notably India. Such markets have an abundance of potential English-speaking employees, excellent technology, and low wages. One senior manager has argued that the bank corporation should outsource its call center immediately. This would enable the firm to lower its costs, thus making it even more attractive to a potential buyer. When confronted with the prospect of cutting 300 jobs, the manager acknowledges that that will be tough but is certain that any buyer will eventually do the same anyway.

Another vocal senior manager, though, is opposed to this idea. This person argues that because the bank corporation was started locally and has longstanding ties throughout the local community, it should maintain its current operations until the bank is sold. Then, this manager argues, if a new owner decides to cut jobs, "it will be on their conscience, not ours."

Team Activity

Assemble a group of four students and assign each group member to one of the following roles:

- Senior manager (majority owner) of the bank
- Call center employee
- Bank customer
- Bank corporation investor

ACTION STEPS

1 Before hearing any of your group's comments on this situation, and from the perspective of your assigned role, do you think that the call center should be outsourced immediately? Write down the reasons for your position.
2 Before hearing any of your group's comments on this situation, and from the perspective of your assigned role, what are the underlying ethical issues, if any, in this situation? Write down the issues.
3 Gather your group together and reveal, in turn, each member's comments on whether the call center should be outsourced immediately. Next, reveal the ethical issues listed by each member.
4 Appoint someone to record main points of agreement and disagreement within the group. How do you explain the results? What accounts for any disagreement?
5 From an ethical standpoint, what does your group conclude is the most appropriate action for the bank to take in this situation?
6 Develop a group response to the following question: Can your team identify other solutions that might help satisfy both senior managers' views?

CRAFTING A BUSINESS PLAN

Part 1: The Contemporary Business Environment

Goal of the Exercise

In Chapter 3 we discussed how the starting point for virtually every new business is a *business plan*. Business plans describe the business strategy for any new business and demonstrate how that strategy will be implemented. One benefit of a business plan is that in preparing it, would-be entrepreneurs must develop their idea on paper and firm up their thinking about how to launch their business before investing time and money in it. In this exercise, you'll get started on creating your own business plan.

Exercise Background: Part 1 of the Business Plan

The starting point for any business plan is coming up with a "great idea." This might be a business that you've already considered setting up. If you don't have ideas for a business already, look around. What are some businesses that you come into contact with on a regular basis? Restaurants, childcare services, and specialty stores are a few examples you might consider. You may also wish to create a business that is connected with a talent or interest you have, such as crafts, cooking, or car repair. It's important that you create a company from "scratch" rather than use a company that already exists. You'll learn more if you use your own ideas.

Once you have your business idea, your next step is to create an "identity" for your business. This includes determining a name for your business and an idea of what your business will do. It also includes identifying the type of ownership your business will take, topics we discussed in Chapter 3. The first part of the plan also briefly looks at who your ideal customers are as well as how your business will stand out from the crowd. Part 1 of the plan also looks at how the business will interact with the community and demonstrate social responsibility, topics we discussed in Chapter 2. Finally, almost all business plans today include a perspective on the impact of global business.

Your Assignment

Step 1

To complete this assignment, you first need to download the *Business Plan Student Template* file from the book's Companion website at www.prenhall.com/ebert. This is a Microsoft Word file you can use to complete your business plan. For this assignment, you will fill in "Part 1" of the plan.

Step 2

Once you have the *Business Plan Student Template* file, you can begin to answer the following questions in "Part 1: The Contemporary Business Environment."

1 What is the name of your business?
Hint: When you think of the name of your business, make sure that it captures the spirit of the business you're creating.
2 What will your business do?
Hint: Imagine that you are explaining your idea to a family member or a friend. Keep your description to 30 words or less.
3 What form of business ownership (sole proprietorship, partnership, or corporation) will your business take? Why did you choose this form?
Hint: For more information on types of business ownership, refer to the discussion in Chapter 3.
4 Briefly describe your ideal customer. What are they like in terms of age, income level, and so on?
Hint: You don't have to give too much detail in this part of the plan; you'll provide more details about customers and marketing in later parts of the plan.
5 Why will customers choose to buy from your business instead of your competition?
Hint: In this section, describe what will be unique about your business. For example, is the product special or will you offer the product at a lower price?
6 All businesses have to deal with ethical issues. One way to address these issues is to create a code of ethics. List three core principles your business will follow.
Hint: To help you consider the ethical issues that your business might face, refer to the discussion in Chapter 2.
7 A business shows social responsibility by respecting all of its stakeholders. What steps will you take to create a socially responsible business?
Hint: Refer to the discussion of social responsibility in Chapter 2. What steps can you take to be a "good citizen" in the community? Consider also how you may need to be socially responsible toward your customers and, if applicable, investors, employees, and suppliers.

8 Will you sell your product in another country? If so, what countries and why? What challenges will you face?
Hint: To help you consider issues of global business, refer to Chapter 4. Consider how you will expand internationally (i.e., independent agent, licensing, etc.). Do you expect global competition for your product? What advantages will foreign competitors have?
***Note:* Once you have answered the questions, save your Word document. You'll be answering additional questions in later chapters.**

VIDEO EXERCISE MyBizLab

Mini

Learning Objectives

The purpose of this video is to help you:

1 Identify three levels of international involvement and describe how a firm selects the most appropriate level.
2 Discuss the ways in which social, cultural, and economic differences affect businesses with international operations.
3 Explain how legal and political differences influence international businesses.

Synopsis

The Mini was first introduced in 1959 by British Motor Corporation. It was sold briefly in the United States in the 1960s, but received a lukewarm reception from the American market who was interested in much larger vehicles. While the brand continued to be successful in Great Britain and Europe, it was not reintroduced into the American market until 2002. Mini, now owned by the German BMW auto group, has positioned itself as the premium small car brand, incorporating all the equipment, technology, and driving fun of larger and often more expensive competitors. With the exception of the Countryman, all Minis are produced in Oxford, England. Minis are now sold all over the world, including Argentina, Chile, Luxemburg, Malaysia, South Africa, and Turkey.

DISCUSSION QUESTIONS

1 A company wishing to enter the international market can consider several levels of involvement, including operating as an importer or exporter, international firm, or multinational firm. Which of these best describes Mini? Support your conclusion.
2 How do social and cultural factors influence the sales of Minis in the United States and around the world?
3 How does the buying process in the United States differ from other international markets?
4 Legal and political factors can influence a firm operating in the global economy. How would import tariffs influence the sales of Minis in the United States? What would be the potential impact of a quota on imported vehicles?
5 The most recent addition to the Mini product line is the Countryman. Do you think that this vehicle is well suited to the American market?

Online Exploration

Mini has sales operations around the globe. Start by taking a look at Mini's U.S. website at www.miniusa.com. After you have checked out the links on this site, take a look at a site from a few other countries, including Ireland (www.mini.ie), South Africa (www.mini.co.za), and Germany (www.mini.de). What similarities and differences do you notice between these sites? How do these reflect social, cultural, economic, political, and legal differences between the countries?

END NOTES

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