Chapter 14

HUMAN RESOURCE SELECTION AND DEVELOPMENT ACROSS CULTURES

OBJECTIVES OF THE CHAPTER

Firms conducting international business need to be particularly concerned with human resource management issues—including selection, training, and development—to better prepare their personnel for overseas assignments. This chapter focuses on potential sources of human resources that can be employed for overseas assignments, procedures that are used in their selection process, and compensation issues. In this chapter we discuss training and development and the various types of training that are commonly offered. The specific objectives of this chapter are:

1. **IDENTIFY** the three basic sources that MNCs can tap when filling management vacancies in overseas operations in addition to options of subcontracting and outsourcing.
2. **DESCRIBE** the selection criteria and procedures used by organizations and individual managers when making final decisions.
3. **DISCUSS** the reasons why people return from overseas assignments, and present some of the strategies used to ensure a smooth transition back into the home-market operation.
4. **DESCRIBE** the training process, the most common reasons for training, and the types of training that often are provided.
5. **EXPLAIN** how cultural assimilators work and why they are so highly regarded.

The World of *International Management*

The Challenge of Talent Retention in India

Retaining talented employees is a challenge for managers around the world. Somewhat to the surprise of MNCs, this challenge has become particularly acute in India. More than 70 percent of CEOs in India say they have serious concerns about the lack of availability of people with key skills and the threat this poses to business growth, according to PricewaterhouseCoopers' 11th annual CEO survey.

A study conducted by the Chambers of Commerce of India found that employee turnover averaged 25–30 percent in the IT sector and averaged 30–35 percent in the business process outsourcing (BPO) sector. Such high employee turnover has a cost. Shyamal Majumdar of India's Business Standard explained that frontline employees in a top company cost 40 percent of their salaries to replace and top managers cost 150–200 percent of their salaries to replace.

Right Management's Executive Overview described the business implications of high Indian employee turnover:

> In IT, for example, it is important for clients to develop close relationships with employees working on projects. Frequent turnover means continually building new relationships with replacements, thereby slowing down projects and harming both efficiency and client trust. In manufacturing, high attrition results in the expensive and time-consuming exercise of training recent hires about new technologies.

Because of the cost of hiring and retraining employees, MNCs in India may not be able to secure the cost savings that led them to India in the first place.

More than Money

Discussing retaining talent in India, Elena Groznaya points out that MNCs sometimes mistakenly use the same methods to try to retain employees in India as in the home country. These methods are often compensation driven. In India's relationship-oriented culture, however, employees are primarily motivated not by compensation, but by a sense of "family" in their companies. Groznaya states: "Traditional Indian companies often play the role of a family extension for their staff" and give employees a feeling of belonging.

A comprehensive talent management and HR practices study in India supported the conclusion that compensation is not the main factor in retaining Indian employees. At the end of 2007, Villanova School of Business and Right Management conducted a survey of 4,811 individuals from 28 Indian companies in five industries. According to Right Management's Executive Overview, the researchers found:

> While the common perception is that pay is the key element in attracting and retaining talent in India, as well as other emerging countries, our results showed a more complex array of factors played a significant role. Most notably, they included the value of intrinsic rewards—the employees' sense of progress, competence, influence/choice, and opportunity to do meaningful work. Compensation was not the most significant factor in either retention or engagement, a phenomenon that held true across all industries. Among respondents who indicated an intent to stay, only 30 percent were "very satisfied" with their compensation.

The key to high retention is keeping employees engaged. The researchers discovered that "lack of engagement was by far the strongest single factor leading to intent to leave an organization. The lesson is clear: The more engaged an employee, the likelier he or she will stay."

Four Factors Correlated to Employee Engagement

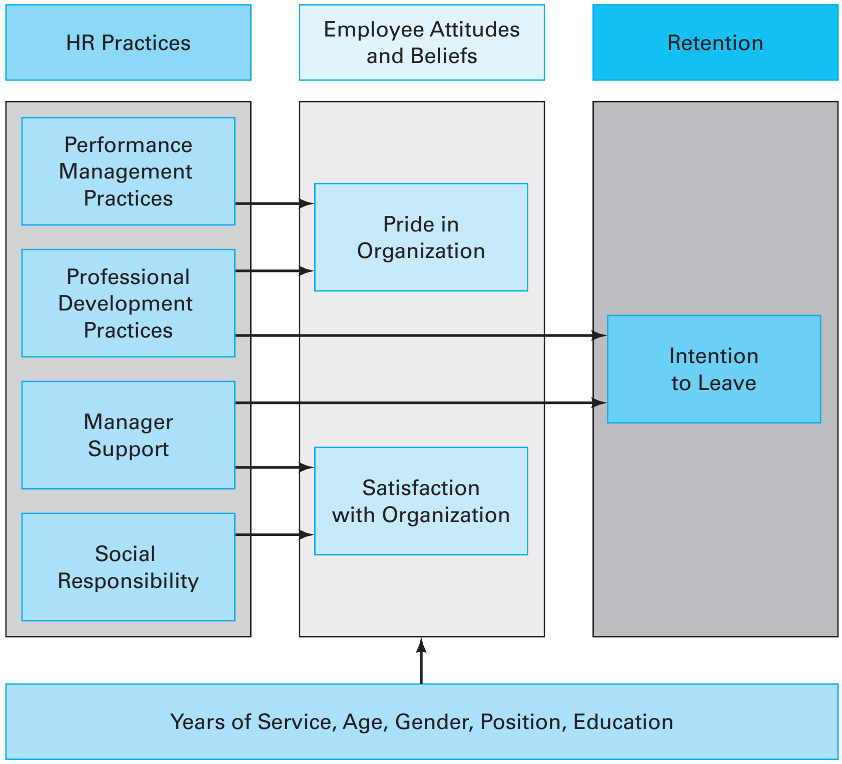
What steps can managers take to keep employees engaged? The researchers identified four HR practices that are correlated with employee engagement, as measured by employees' feelings of pride and satisfaction in the organization. These factors were performance management, professional development, manager support, and an organizational commitment to a larger social purpose.

Performance Management The researchers found a significant relationship between retention and a favorable assessment of a firm's performance management system. Of employees who were in the top third of those who rated their company's performance management practices highly, "56.1 percent had strong pride in the organization, 65.9 percent had strong satisfaction with the organization, and only 23.5 percent indicated a strong intention to leave." In contrast, of the bottom third, "only 17.3 percent had strong pride in the organization, 11.1 percent had strong satisfaction, and 48.8 percent expressed a strong intention to leave."

When setting up performance management systems at Indian firms, managers need to be coached on how to provide constructive feedback. Indian managers are often hesitant to criticize their employees, but with coaching, they can learn how to use criticism to help employees improve their performance.

Professional Development Employees who are satisfied with their firm's professional development opportunities are more likely to remain at the firm. For instance, the researchers found that of those respondents who did not like the professional development practices at their companies, "52.3 percent indicated intent to leave within 12 months vs. 18.7 percent in organizations that strongly supported those practices." Employees are more engaged when they have clear opportunities for growth in their career. A typical career path may involve the opportunity to work on different projects, participate in overseas assignments, and eventually take on a managerial role.

Employee assessments should be an important part of the development process. These assessments "can ensure that companies hire the right people for the right jobs and . . . will also help to pinpoint those people with the potential to move into management roles."



Management Support From the study, the researchers found that "Due to the urgent need for managerial level personnel, employees in India are often promoted to supervisory roles before they're ready to assume such responsibilities." Furthermore, many respondents in the study were dissatisfied with their manager's ability to engage with their team: "Only 47 percent of respondents agreed that their immediate supervisor was able to provide support and develop his or her team effectively." This gap in management skills has a negative impact on employee retention. If employees are working for a supervisor who lacks management skills, they are more likely to leave the company.

Thus, Indian firms need to train new managers in the basics of management, such as how to reach team objectives and how to mentor employees. Mentoring is an essential management skill in India, where leaders often act as personal advisers. Having effective managers to support their employees is critical to increasing employee retention.

Social Responsibility Many Indian employees highly value commitment to the community. Firms can engage employees by providing them with opportunities to participate in initiatives to help social causes, such as alleviating poverty. These initiatives should be highlighted in annual reports.

Start on the First Day

The highlights of the research study mentioned were published in an article in *MIT Sloan Management Review.* According to the article, "The best companies drive employee satisfaction and pride by providing management support, training, and professional opportunities early on. . . . Employers should start an employee's professional development plan on his or her *first day*."

One of the researchers in the study, Dr. Jonathan Doh, told the *MIT Sloan Management Review,* "Our findings suggest that even six months from the start date is probably too late. [At that point] the employee is already making decisions about whether to stay around or not." MNCs can make the decision to stay an easy one by offering employees effective professional development, performance management systems, and manager support.

Once, India was seen as a source of never-ending talent. Today, India poses some of the same challenges in attracting, hiring, and retaining talent as do many developed countries, with some issues that are particular to the Indian context. Originally, MNCs searched overseas for inexpensive labor, but as countries become more developed and education levels increase, and as employers in home countries worry about a diminishing labor force, the search has shifted. As more highly skilled workers become available in other countries, MNCs have a growing number of sources for their human resources; however, as more MNCs and local firms vie for this talent, a "talent war" may ensue. MNCs may also be able to access foreign human resources by hiring them on a temporary or permanent basis in the home country. Often, they will subcontract or outsource work to foreign employees in home and host countries. This complex web of relationships creates significant managerial challenges and opportunities and suggests that there will always be a need for highly skilled, culturally sensitive, and geographically mobile managerial talent.

In this chapter we explore the procedure of international human resource (HR) selection and training and examine the difficulties of developing a global human resource management process in the presence of dissimilar cultural norms. At the same time, we survey emerging trends in international human resource management, including the increasing use of temporary and contingent staffing to fill the growing global HR needs of MNCs. We also review training and development programs designed to help employees prepare for and succeed in their foreign assignments and adjust to conditions once they return home.

The Importance of International Human Resources

Human resources is an essential part of any organization since it provides the human capital that keeps operations running. Human resource management is also key to an efficient, productive workplace. We discussed in Chapter 12 how financial compensation can motivate employees, but creative human resource management can play an even more important role. By focusing on the employees, or the human resources themselves, organizations have found that positive organizational structure leads to company success in the market.[1] Sometimes this is recognized through compensation, such as competitive salaries, good benefits, promotions, training, education opportunities, and so forth, which has been known to motivate employees and reduce turnover, since there are further incentives to strive for. Other times, companies will provide employees with daily comforts such as meals where an employee's family is welcome to attend, fitness centers, laundry rooms, or even services such as oil changes while at work. Showing the employees that they are not simply cogs in a machine, but that their time is valued and they are thanked for it, often builds morale and can increase company sales through a shared drive to succeed. Furthermore, recognizing the potential in employees and encouraging teamwork can lead to greater risk taking and innovations.[2]

Getting the Employee Perspective

Whether managers are trying to increase productivity or decrease turnover rates, it is good to get a sense of how the employees feel they are being treated. Times continue to change, and while employees in the past could be considered one unit, today people are realizing their individual talents and their need to be recognized. For instance, global companies are experiencing a labor shortage as skilled workers are in high demand.[3] In essence, skilled workers can almost walk in and request the kind of compensation they desire, and companies may be willing to accept the terms. Even outside this context of labor shortages, firms are restructuring how they look at employees for many good reasons. By segmenting the workforce into categories (but avoiding differentiation based on age or gender since that may imply a form of discrimination) and by offering choices, flexibility, and a personal touch to each employee package, employers are able to provide an underlying sense of commitment since the employee is getting what he or she wants. In other words, by focusing on employees and tailoring human resource management to the individual, people are naturally influenced to stay longer and be more committed to the organization they have joined.[4] However, before a company can keep the employee, it must first hire.

Employees as Critical Resources

Attracting the most qualified employees and matching them to the jobs for which they are best suited are important for the success of any organization. For international organizations, the selection and development of human resources are especially challenging and vitally important. As prevalent and useful as e-mail and Web- and teleconferencing have become, and despite the increasing incidence of subcontracting and outsourcing, face-to-face human contact will remain an important means of communication and transferring "tacit" knowledge—knowledge that cannot be formalized in manuals or written guidelines. Hence, most companies continue to deploy human resources around the world as they are needed, although the range of options for filling human resources needs is expanding.

Investing in International Assignments

MNCs must send expatriate ("expat") managers overseas, no matter how good "virtual" communications become. There are quite a few costs involved, including pre-assignment training, and potential costs due to failure. According to one estimate, the cost of one assignment failure is between \$100,000 and \$300,000 per employee.[5] Given these high costs, many MNCs are turning to locally engaged employees or third-country nationals.[6] In addition, the improved education of many populations around the world gives MNCs more options when considering international human resource needs. The emergence of highly trained technical and scientific employees in emerging markets and the increased prevalence of MBA-type training in many developed and developing countries have dramatically expanded the pool of talent from which MNCs can draw. Yet some companies are still having difficulty in winning the "war for talent." A recent report from China noted that despite much greater levels of advanced education, there is still a shortage of skilled management. "We need a lot more people than we have now, and we need a higher caliber of people," said Guo Ming, Coca-Cola's human resource director for Greater China.[7]

Adjustment problems of expats undertaking international assignments can be reduced through careful selection and training. Language training and cross-culture training are especially important, but they are often neglected by MNCs in a hurry to deploy resources to meet critical needs.[8] The demand for globally adept managers will likely grow, and MNCs will need to continue to invest in recruiting and training the best future leaders.

MNCs are also under increasing pressure to keep jobs at home, and their international HR practices have come under close scrutiny. In particular, the "importing" of programmers from India at a fraction of domestic wages, combined with the offshore outsourcing of work to high-tech employees in lower cost countries, has created political and social challenges for MNCs seeking to manage their international human resources efficiently and effectively. All of this suggests an ongoing need for attention to and investment in this challenging area.

Economic Pressures

It is important to note that the human resources function within MNCs is itself changing as a result of ongoing pressures for reduced costs and increased efficiencies. There was a time when human resources departments handled every staffing need at a company, from hiring and firing to administering benefits and determining salaries. According to a study by the Society for Human Resource Management, the profession's largest association, the head count at the average HR department fell from 13 in 2007 to 9 in 2008. According to one senior HR manager, "HR departments are under pressure like never before." Further, some of what in-house HR departments oversaw is now being outsourced, because the costs associated with these "staff" (versus revenue-generating "line") functions are under increasing scrutiny. For those that remain in-house, HR departments are now focusing on boosting productivity by helping employees better understand what's expected of them and by showing managers how to be more effective.[9]

Table 14–1 shows how companies have indicated they are responding to the economic recession in terms of employee compensation and benefits. Despite these cutbacks, companies

Table 14–1
How Companies Are Responding to the Economic Crisis

	Completed	Planned	Considering	Not Considering	Too Soon to Tell
Freeze or reduce hiring	42%	18%	14%	22%	4%
Cut travel and entertainment spending	40	20	22	12	6
Reduce pay/merit increase budget	36	24	21	14	5
Scale back employee events	36	15	24	17	8
Reduce training budgets	20	12	26	32	10
Targeted reduction in head count (focus on less critical roles or lower performers)	19	21	18	30	12
Freeze salaries	18	7	16	50	9
Delay planned merit increases	12	6	14	62	6
Significant reduction in head count (10 percent or more)	11	8	11	55	15
Cut back on perquisites	10	3	20	58	9
Cut back on benefits	7	3	14	68	8
Provide lump-sum increase in lieu of merit increases	2	1	7	84	6
Reduce salaries across the board	1	1	7	85	6

Source: Towers Perrin.

remain concerned about retaining their most talented employees, according to a study from Towers Perrin, The Towers Perrin Pulse Survey. The Towers Perrin survey, conducted in January 2009, found that 42 percent of organizations were planning hiring freezes and reductions as well as pay cuts. Another survey, an update to ECA International's Salary Trends Survey, conducted annually for more than 50 countries, found that 40 percent of companies planned to freeze pay. On average, salary increases were half as high as anticipated before the economic crisis set in. In Canada, increases dropped from 4 percent to 1 percent. In South America, wage increases are only slightly lower than last year's forecasts, with some countries, such as Brazil, Chile, and Venezuela, expecting higher salaries. Salary increases in Western Europe averaged around 2 percent, according to the survey, while those in Eastern Europe were just under 5 percent. Russia, Romania, and Latvia saw the greatest increases, while workers in Lithuania, the Irish Republic, and Switzerland were expected to receive the smallest pay raises in the region. Despite plans for slow pay growth, 62 percent of companies in the Towers Perrin survey say they are concerned about the potential impact on their ability to retain high-performing talent or those in pivotal roles. In response, organizations reserved their salary increases and cash rewards for their most talented and top-performing employees, even while pay is cut for the rest of the workforce. The 2009 HR Executive's Agenda, a study from Aberdeen Group, found that the five most critical workforce challenges the respondents faced in 2009 were:

- Retaining top talent (rated 4.03 on a one-to-five scale)
- Developing leadership skills of existing managers (3.94)
- Recruiting top talent (3.9)
- Workforce productivity (3.87)
- Developing future leaders (3.82)[10]

Sources of Human Resources

MNCs can tap four basic sources for positions: (1) home-country nationals; (2) host-country nationals; (3) third-country nationals; and (4) inpatriates. In addition, many MNCs are outsourcing aspects of their global operations and in so doing are engaging temporary or contingent employees. The following sections analyze each of these major sources.

Home-Country Nationals

home-country nationals
Expatriate managers who are citizens of the country where the multinational corporation is headquartered.

expatriates
Managers who live and work outside their home country. They are citizens of the country where the multinational corporation is headquartered.

Home-country nationals are managers who are citizens of the country where the MNC is headquartered. In fact, sometimes the term *headquarters nationals* is used. These managers commonly are called **expatriates,** or simply "expats," which refers to those who live and work outside their home country. Historically, MNCs have staffed key positions in their foreign affiliates with home-country nationals or expatriates. For many companies and for the most senior positions, that trend persists. Major U.S. and European companies such as Cisco Systems have been sending expats to India, and according to a recent estimate, about 1,000 expat senior managers are there now, almost seven times that of two years ago. However, some research has shown that in many instances, host-country nationals may be better suited for the job. Richards, for example, investigated staffing practices for the purpose of determining when companies are more likely to use an expatriate rather than a local manager. She conducted interviews with senior-level headquarters managers at 24 U.S. multinational manufacturing firms and with managers at their U.K. and Thai subsidiaries. This study found that local managers were most effective in subsidiaries located in developing countries or those that relied on a local customer base. In contrast, expatriates were most effective when they were in charge of larger subsidiaries or those with a marketing theme similar to that at headquarters.[11]

There are a variety of reasons for using home-country nationals. One of the most common is to start up operations. Another is to provide technical expertise. A third is to help the MNC maintain financial control over the operation.[12] Other commonly cited reasons include the desire to provide the company's more promising managers with international experience to equip them better for more responsible positions; the need to maintain and facilitate organizational coordination and control; the unavailability of managerial talent in the host country; the company's view of the foreign operation as short lived; the host country's multiracial population, which might mean that selecting a manager of either race would result in political or social problems; the company's conviction that it must maintain a foreign image in the host country; and the belief of some companies that a home country manager is the best person for the job.[13]

In recent years, there has been a trend away from using home-country nationals, given the costs, somewhat uncertain returns, and increasing availability of host-country and third-country nationals and inpatriates.

Host-Country Nationals

host-country nationals
Local managers who are hired by the MNC.

Host-country nationals are local managers who are hired by the MNC. For a number of reasons, many MNCs use host-country managers at the middle- and lower-level ranks. One reason in particular is that many countries expect the MNC to hire local talent, and the use of host-country nationals is a good way to meet this expectation. Also, even if an MNC wanted to staff all management positions with home-country personnel, it would be unlikely to have this many available managers, and the cost of transferring and maintaining them in the host country would be prohibitive.

In some cases government regulations dictate selection practices and mandate at least some degree of "nativization." In Brazil, for example, two-thirds of the employees

International Management in Action

Important Tips on Working for Foreigners

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As the Japanese, South Koreans, and Europeans continue to expand their economic horizons, increased employment opportunities will be available worldwide. Is it a good idea to work for foreigners? Those who have done so have learned that there are both rewards and penalties associated with this career choice. Following are some useful tips that have been drawn from the experiences of those who have worked for foreign MNCs.

First, most U.S. managers are taught to make fast decisions, but most foreign managers take more time and view rapid decision making as unnecessary and sometimes bad. In the United States, we hear the cliché, "The effective manager is right 51 percent of the time." In Europe, this percentage is perceived as much too low, which helps explain why European managers analyze situations in much more depth than most U.S. managers do. Americans working for foreign-owned firms have to focus on making slower and more accurate decisions.

Second, most Americans are taught to operate without much direction. In Latin countries, managers are accustomed to giving a great deal of direction, and in East Asian firms, there is little structure and direction. Americans have to learn to adjust to the decision making process of the particular company.

Third, most Americans go home around 5 p.m. If there is more paperwork to do, they take it with them. Japanese managers, in contrast, stay late at the office and often view those who leave early as being lazy. Americans either have to adapt or have to convince the manager that they are working as hard as their peers but in a different physical location.

Fourth, many international firms say that their official language is English. However, important conversations always are carried out in the home-country's language, so it is important to learn that language.

Fifth, many foreign MNCs make use of fear to motivate their people. This is particularly true in manufacturing work, where personnel are under continuous pressure to maintain high output and quality. For instance, those who do not like to work under intense conditions would have a very difficult time succeeding in Japanese auto assembly plants. Americans have to understand that humanistic climates of work may be the exception rather than the rule.

Finally, despite the fact that discrimination in employment is outlawed in the United States, it is practiced by many MNCs, including those operating in the United States. Women seldom are given the same opportunities as men, and top-level jobs almost always are reserved for home-office personnel. In many cases, Americans have accepted or accommodated to this ethnocentric (nationalistic) approach.

Nevertheless, as Chapter 3 discussed, ethics and social responsibility are becoming a major issue in the international arena, and these moral challenges must be met now and in the future.

in any foreign subsidiary traditionally had to be Brazilian nationals. In addition, many countries exert real and subtle pressures to staff the upper-management ranks with nationals. In the past, these pressures by host countries have led companies such as Standard Oil to change their approach to selecting managers. These regulations have substantial costs in that shielding local employees from international competition may create a sense of entitlement and result in low productivity.

Sony is trying the host-country approach in the United States. Employees are encouraged to accept or decline styles that emerge from Japanese headquarters, depending on American tastes. Furthermore, innovative creations are birthed at the U.S. site, all with an American flavor. Sony believes that local citizens are the best qualified for the job, as opposed to Japanese managers, because they already have a working knowledge of the language and culture, and it may be difficult for Sony to understand preferred styles otherwise.[14] The nearby International Management in Action box, "Important Tips on Working for Foreigners," gives examples of how Americans can better adapt to foreign bosses.

Third-Country Nationals

third-country nationals (TCNs)
Managers who are citizens of countries other than the country in which the MNC is headquartered or the one in which they are assigned to work by the MNC.

Third-country nationals (TCNs) are managers who are citizens of countries other than the country in which the MNC is headquartered or the one in which they are assigned to work by the MNC. Available data on third-country nationals are not as extensive as those on home- or host-country nationals.

A number of advantages have been cited for using TCNs. One is that the salary and benefit package usually is less than that of a home-country national, although in recent years, the salary gap between the two has begun to diminish. A second reason is that the TCN may have a very good working knowledge of the region or speak the same language as the local people. This helps explain why many U.S. MNCs hire English or Scottish managers for top positions at subsidiaries in former British colonies such as Jamaica, India, the West Indies, and Kenya. It also explains why successful MNCs such as Gillette, Coca-Cola, and IBM recruit local managers and train them to run overseas subsidiaries. Other cited benefits of using TCNs include:

1. TCN managers, particularly those who have had assignments in the headquarters country, can often achieve corporate objectives more effectively than expatriates or local nationals. In particular, they frequently have a deep understanding of the corporation's policies from the perspective of a foreigner and can communicate and implement those policies more effectively to others than can expats.
2. During periods of rapid expansion, TCNs can not only substitute for expatriates in new and growing operations but also offer different perspectives that can complement and expand on the sometimes narrowly focused viewpoints of both local nationals and headquarters personnel.
3. In joint ventures, TCNs can demonstrate a global or transnational image and bring unique cross-cultural skills to the relationship.[15]

inpatriates
Individuals from a host country or third-country nationals who are assigned to work in the home country.

In recent years a new term has emerged in international management—*inpatriates.* An **inpatriate,** or *inpat,* is an individual from a host country or a third-country national who is assigned to work in the home country. Even Japanese MNCs are now beginning to rely on inpatriates to help them meet their international challenges. Harvey and Buckley report:

> The Japanese are reducing their unicultural orientation in their global businesses. Yoichi Morishita, president of Matsushita, has ordered that top management must reflect the cultural diversity of the countries where Matsushita does business. Sony sells 80 percent of its products overseas and recently recognized the need to become multicultural. It has appointed two foreigners to its board of directors and has plans to hire host-country nationals who are to be integrated into the top management of the parent organization. At the same time, the Chairman of Sony has stated that in five years the board of directors of Sony will reflect the diversity of countries that are important to the future of the company. Similarly, Toshiba plans to have a more representative top management and board of directors to facilitate long-run global strategies.[16]

This growing use of inpats is helping MNCs better develop their global core competencies. As a result, today a new breed of multilingual, multiexperienced, so-called global managers or transnational managers is truly emerging.[17] These new managers are part of a growing group of international executives who can manage across borders and do not fit the traditional third-country nationals mold. With a unified Europe and other such developments in North America and Asia, these global managers are in great demand. Additionally, with labor shortages developing in certain regions, there is a wave of migration from regions with an abundance of personnel to those where the demand is strongest.

Subcontracting and Outsourcing

Other potential sources of international management talent are subcontracting and offshore outsourcing (introduced in Chapter 1). Offshore outsourcing is made possible by the increasing organizational and technological capacity of companies to separate, coordinate, and integrate geographically dispersed human resources—whether employed directly by the firm or contracted out—across distant geographic borders. The development of this capacity can be traced to the earlier growth of international subcontracting as well as to the international diffusion of lean production systems (which originated with Japanese auto manufacturers) to other manufacturing and service sectors. In particular, service industries are exploiting inexpensive telecommunications to transmit engineering, medical, legal, and accounting services to be performed in locations previously viewed as remote. Rising levels of educational attainment in developing countries such as China, India, and the Philippines, especially in the scientific and technical fields, make offshoring increasingly attractive for a range of international human resource needs.

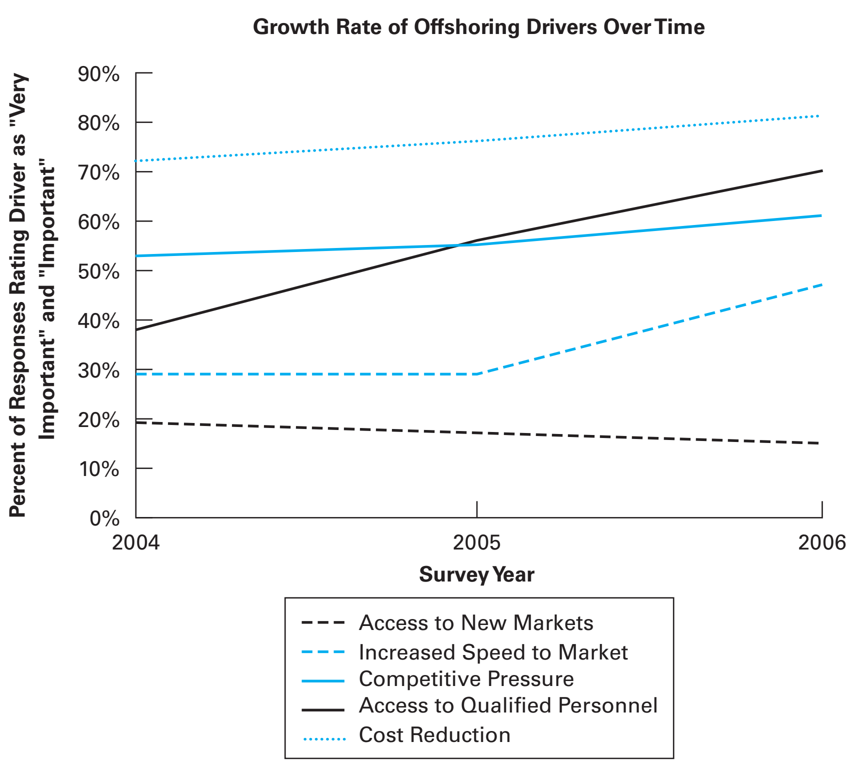
These developments are not without controversy, however. On the one hand, offshore outsourcing, as well as the hiring of temporary workers from abroad on special visas, similar to inpatriates, presents significant opportunities for cost savings and lower overhead. On the other hand, the recent wave of media attention has focused on widespread concern that in an age of cheap telecommunications, almost any job—professional or blue collar—can be performed in India for a fraction of U.S. wages. In particular, as discussed in Chapter 1, union groups, politicians, and NGOs have challenged MNCs' right to engage in labor "arbitrage."

Offshoring is reaching a new era, and while the top reason that MNCs look to other countries for labor is still to save money, there has been a decline all around in qualified personnel, which has brought about an emerging focus on other factors, notably access to qualified personnel. Figure 14–1 illustrates this.

Moreover, although the cost for a computer programmer or a middle manager in India remains a small fraction of the cost for a similar employee in the United

Figure 14–1

Reasons MNCs Look Abroad for Workforce



Source: Next Generation Offshoring: The Globalization of Innovation by Arie Y. Lewin and Vinay Couto; *2006 Survey Report,* Booz Allen Hamilton/Duke University Offshoring Research Network 2006 Survey. Reprinted with permission.

States (a programmer with three to five years' experience makes about $25,000 in India but about $65,000 in the United States), the wage savings do not necessarily translate directly into overall savings because the typical outsourcing contract between an American company and an Indian vendor saves less than half as much as the wage differences would imply.[18] Microsoft recently revealed that it has been paying two Indian outsourcing companies, Infosys and Satyam, to provide skilled software architects for Microsoft projects. In this case, the work of software architects and developers was being done by employees of the Indian companies working at Microsoft facilities in the United States. Although the actual employees were paid much less than U.S. counterparts ($30,000 to $40,000), Microsoft was billed $90 an hour for software architects, or at a yearly rate of more than $180,000. The on-site work was done by Indian software engineers who came to the United States on H-1B visas, which allow foreign workers to be employed in the United States for up to six years. Microsoft also contracted work in India through the firms, with billing rates of $23 to $36 an hour.[19]

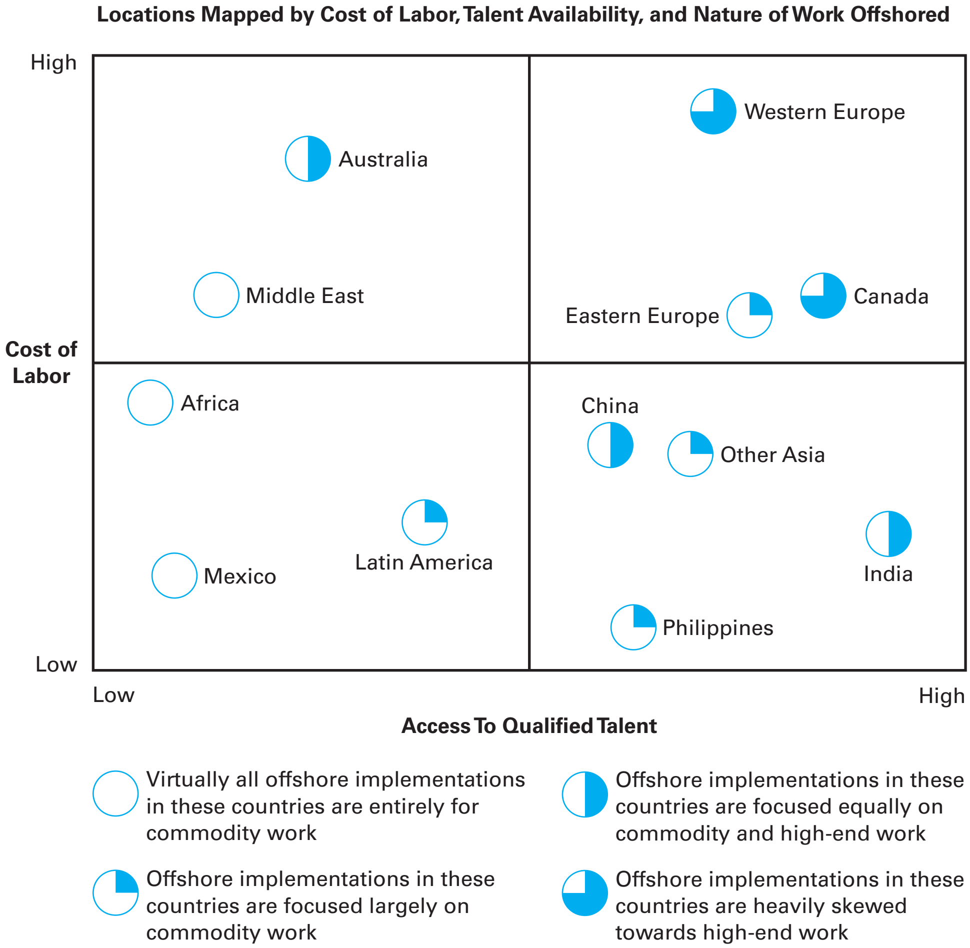
Though politically controversial, outsourcing can save companies significant costs and is very profitable for firms that specialize in providing these services on a contract basis. U.S.-based firms such as EDS, IBM, and Deloitte have developed specific competencies in global production and HR coordination, including managing the HR functions that must support it. These firms combine low labor costs, specialized technical capabilities, and coordination expertise.

Outsourcing can also create quality control problems for some companies, as demonstrated in Dell's decision to repatriate some of its call-center staff from India to Texas because of quality control problems. Because Dell is a company that has little on-site service, the call-center capability is core to Dell's competitive position. "We felt a little noise and angst from our customers, and we decided to make some changes," said Gary Cotshott, vice president of Dell's services division. "Sometimes, we move a little too far, too fast."[20] In addition, Indian companies are beginning to develop their own approaches to outsourcing, including investing in U.S. call centers and business-processing outsourcers. The Indians "are looking to build a global model quickly," said a partner with WestBridge Capital Partners, a Silicon Valley venture-capital firm that invests in outsourcing companies.[21]

Despite these limitations, offshore subcontracting will remain an important tool for managing and deploying international human resources. If anything, the trend is accelerating. Forrester Research recently estimated that U.S. companies would send 3.4 million service jobs offshore by 2015.[22] Although subcontracting provides important flexibility in the human resource practices of MNCs operating globally, it also requires skilled international managers to coordinate and oversee the complex relationships that arise from it.

This is especially true as offshoring begins a new generation. In a survey by Duke University's Offshoring Research Network, significant differences were found in the perspectives of home (source) and host (destination) countries. Specifically, individuals in home countries were often worried about losing jobs to host countries, exacerbated by the fact that higher-end jobs are now being shipped overseas.[23] This is not the case from the organizations' point of view. It is becoming increasingly difficult for managers to find the appropriate talent. More and more, companies are looking overseas in areas such as R&D and procurement to supplement the lack of experts in the home country. This does not take jobs away from home countries; it simply opens jobs globally as managers attempt to fit the skills of the worker to the job itself.[24] Furthermore, companies are very specific about which country they search when looking to fill particular job functions. Figure 14–2 provides a graphical depiction of this reality. Overall, offshoring is a trend that does not appear to be on its way out, but instead is evolving through alternative motivators and continuing to innovatively help the company grow.

Figure 14–2
Skills MNCs Seek within Countries



Note: Shading of circles indicates degree to which high skilled work is currently offshored to the specific country.

Source: Next Generation Offshoring: The Globalization of Innovation by Arie Y. Lewin and Vinay Couto; *2006 Survey Report,* Booz Allen Hamilton/Duke University Offshoring Research Network 2006 Survey. Reprinted with permission.

Selection Criteria for International Assignments

Making an effective selection decision for an overseas assignment can prove to be a major problem. Typically, this decision is based on **international selection criteria,** which are factors used to choose international managers. These selections are influenced by the MNC's experience and often are culturally based. Sometimes as many as a dozen criteria are used, although most MNCs give serious consideration to only five or six.[25] Table 14–2 reports the importance of some of these criteria as ranked by Australian, expatriate, and Asian managers from 60 leading Australian, New Zealand, British, and U.S. MNCs with operations in South Asia.[26]

international selection criteria
Factors used to choose personnel for international assignments.

General Criteria

Some selection criteria are given a great deal of weight; others receive, at best, only lip service. A company sending people overseas for the first time often will have a much longer list of criteria than will an experienced MNC that has developed a "short list."

Typically, both technical and human criteria are considered. Firms that fail to consider both often find that their rate of failure is quite high. For example, Peterson, Napier, and Shul-Shim investigated the primary criteria that MNCs use when choosing personnel

Table 14–2
Rank of Criteria in Expatriate Selection

	Australian Managers (n = 47)	Expatriate Managers* (n = 52)	Asian Managers (n = 15)
1. Ability to adapt	1	1	2
2. Technical competence	2	3	1
3. Spouse and family adaptability	3	2	4
4. Human relations skill	4	4	3
5. Desire to serve overseas	5	5	5
6. Previous overseas experience	6	7	7
7. Understanding of host-country culture	7	6	6
8. Academic qualifications	8	8	8
9. Knowledge of language of country	9	9	9
10. Understanding of home-country culture	10	10	10

*U.S., British, Canadian, French, New Zealand, or Australian managers working for an MNC outside their home countries.

Source: From Raymond J. Stone, "Expatriate Selection and Failure." Reprinted with permission from *Human Resource Planning,* Vol. 14, Issue 1, 1991, by The Human Resource Planning Society, 317 Madison Avenue, Suite 12509, New York, NY 10017.

for overseas assignments and found that the Japanese and American MNCs in their survey ranked both technical expertise and interpersonal skills as very important.[27] The following sections examine some of the most commonly used selection criteria for overseas assignments in more depth.

Adaptability to Cultural Change

Overseas managers must be able to adapt to change. They also need a degree of cultural toughness. Research shows that many managers are exhilarated at the beginning of their overseas assignment. After a few months, however, a form of culture shock creeps in, and they begin to encounter frustration and feel confused in their new environment. This may be a good sign because it shows that the expatriate manager is becoming involved in the new culture and not just isolating himself or herself from the environment.

As this initial and trying period comes to an end, expatriates tend to identify more with the host-country culture, which only increases as managers become more adept at the position. As seen in Figure 14–3, upon first arrival, the expatriates identify almost wholly with the home country. Over time, they become more familiar with their surroundings and become more of an integral part of the environment. This integration can lead to a higher sense of satisfaction with the job and a lessening of stress and alienation.[28]

Organizations examine a number of characteristics to determine whether an individual is sufficiently adaptable. Examples include work experiences with cultures other than one's own, previous overseas travel, knowledge of foreign languages (fluency generally is not necessary), and recent immigration background or heritage. Others include (1) the ability to integrate with different people, cultures, and types of business organizations; (2) the ability to sense developments in the host country and accurately evaluate them; (3) the ability to solve problems within different frameworks and from different perspectives; (4) sensitivity to the fine print of differences of culture, politics, religion, and ethics, in addition to individual differences; and (5) flexibility in managing operations on a continuous basis despite lack of assistance and gaps in information.

In research conducted among expatriates in China, Selmar found that those who were best able to deal with their new situation had developed coping strategies characterized by socio-cultural and psychological adjustments including (1) feeling comfortable that their work challenges can be met; (2) being able to adjust to their new living

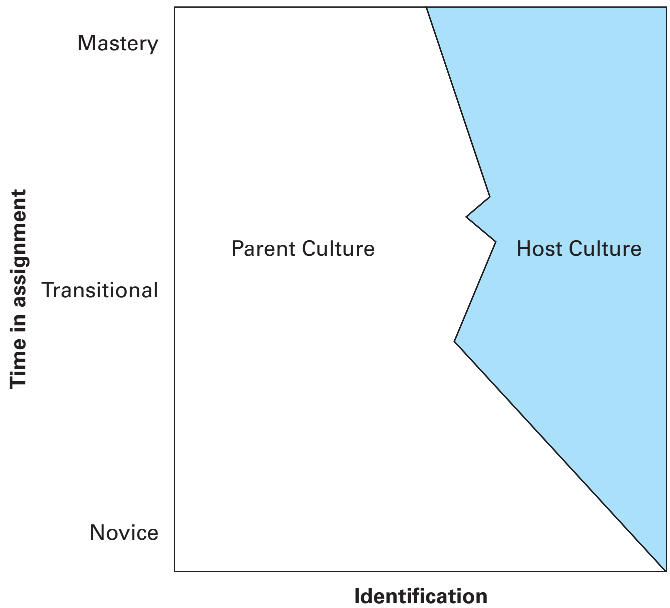


Figure 14–3

Evolution of Parent and Host Culture Identification

Source: Juan Sanchez, Paul Spector, and Cary Cooper, "Adapting to a Boundaryless World: A Developmental Expatriate Model," *Academy of Management Executive* 14, no. 2 (2000), p. 100.

conditions; (3) learning how to interact well with host-country nationals outside of work; and (4) feeling reasonably happy and being able to enjoy day-to-day activities.[29] And Caligiuri, after examining how host nationals help expatriates adjust, reported that certain types of personality characteristics are important in this process. In particular, her findings suggest that greater contact with host nationals helps with cross-cultural adjustment when the person also possesses the personality trait of openness. She also found that sociability was directly related to effective adjustment.[30]

Physical and Emotional Health

Most organizations require that their overseas managers have good physical and emotional health. Some examples are fairly obvious. An employee with a heart condition or a nervous disorder would not be considered. The psychological ability of individuals to withstand culture shock, if this could be discerned, would be an issue, as would the current marital status as it affected an individual's ability to cope in a foreign environment. For example, one U.S. oil company operating in the Middle East considers middle-aged men with grown children to be the best able to cope with culture shock, and for some locations in the desert, considers people from Texas or southern California to be a better fit than those from New England.

Age, Experience, and Education

Most MNCs strive for a balance between age and experience. There is evidence that younger managers are more eager for international assignments. These managers tend to be more "worldly" and have a greater appreciation of other cultures than older managers do. By the same token, young people often are the least developed in management experience and technical skills; they lack real-world experience. To gain the desired balance, many firms send both young and seasoned personnel to the same overseas post. Many companies consider an academic degree, preferably a graduate degree, to be of critical importance to an international executive; however, universal agreement regarding the ideal type of degree is nonexistent. MNCs, of course, use formal education only as a point of departure for their own training and development efforts. For example, Siemens of Germany gives members of its international management team specific training designed to help them deal more effectively with the types of problems they will face on the job.

Language Training

The ability to speak the language of the country in which a manager is doing business can be extremely valuable. One recognized weakness of many MNCs is that they do not give sufficient attention to the importance of language training. English is the primary language of international business, and most expatriates from all countries can converse in English. Those who can speak only English are at a distinct disadvantage when doing business in non-English-speaking countries, however. In other words, language can be a very critical factor.

Traditionally, U.S. managers have done very poorly in the language area. For example, a survey of 1,500 top managers worldwide faulted U.S. expatriates for minimizing the value of learning foreign languages. Executives in Japan, Western Europe, and South America placed a high priority on speaking more than one language. The report concludes that "these results provide a poignant indication of national differences that promise to influence profoundly the success of American corporations."[31]

Motivation for a Foreign Assignment

Although individuals being sent overseas should have a desire to work abroad, this usually is not sufficient motivation. International management experts contend that the candidate also must believe in the importance of the job and even have something of an element of idealism or a sense of mission. Applicants who are unhappy with their current situation at home and are looking to get away seldom make effective overseas managers.

Some experts believe that a desire for adventure or a pioneering spirit is an acceptable reason for wanting to go overseas. Other motivators that often are cited include the desire to increase one's chances for promotion and the opportunity to improve one's economic status. For example, many U.S. MNCs regard international experience as being critical for promotion to the upper ranks. In addition, thanks to the supplemental wage and benefit package, U.S. managers sometimes find that they can make, and especially save, more money than if they remained stateside.

And while many may romanticize the expatriate life, it is clear that the travel mystique continues to motivate professionals to desire and seek an assignment abroad. A recent survey found that at least 40 percent of Britons say that they would like to work or retire abroad. And according to a report in the British *Daily Telegraph:*

> And it's not just about the sunshine. Becoming an expatriate is an adventure, a new beginning, a fresh start, and it is in human nature to want to explore. Global mobility is as old as humankind itself. The ancient migration routes of our earliest ancestors are well documented and the distances travelled by primitive man still continue to amaze. There were even expatriates in the Bible—consider the exodus from Egypt for example. Indeed, the forced expatriation of Adam and Eve from the garden of Eden is the starting point for the entire Biblical narrative. Was Eve the very first "trailing spouse"? In more recent times entire civilizations have been influenced by explorers such as Marco Polo, Christopher Columbus, Captain Cook and the Pilgrim Fathers. So moving across continents is nothing new but its continued rise has been underpinned by the drive towards globalisation aided by the revolution in communication throughout the 20th century. Technologies have allowed companies to globalise in ways which were simply unimaginable in earlier times. Indeed such is the commitment to globalisation, that many major companies now structure their reporting lines along global delivery lines rather than local geographic control.[32]

Spouses and Dependents or Work-Family Issues

Spouses and dependents are another important consideration when a person is to be chosen for an overseas assignment. If the family is not happy, the manager often performs poorly and may either be terminated or simply decide to leave the organization. Shaffer and her associates recently collected multisource data from 324 expatriates in 46 countries and found that the amount of organizational support that an expatriate feels he or she is receiving and the interplay between the person's work and family domains have a direct and unique influence on the individual's intentions regarding staying with or leaving the enterprise.[33] For this reason, some firms interview both the spouse and the manager before deciding whether to approve the assignment. This can be a very important decision for the firm because it focuses on the importance of family as a critical issue to a successful assignment. One popular approach in appraising the family's suitability for an overseas assignment is called **adaptability screening.** This process evaluates how well the family is likely to stand up to the rigors and stress of overseas life. The company will look for a number of things in this screening, including how closely knit the family is, how well it can withstand stress, and how well it can adjust to a new culture and climate. The reason this family criterion receives so much attention is that MNCs have learned that an unhappy executive will be unproductive on the job and the individual will want to transfer home long before the tour of duty is complete. These findings were affirmed and extended by Borstorff and her associates, who examined the factors associated with employee willingness to work overseas and concluded that:

adaptability screening
The process of evaluating how well a family is likely to stand up to the stress of overseas life.

1. Unmarried employees are more willing than any other group to accept expat assignments.
2. Married couples without children at home or those with non-teenage children are probably the most willing to move.
3. Prior international experience appears associated with willingness to work as an expatriate.
4. Individuals most committed to their professional careers and to their employing organizations are prone to be more willing to work as expatriates.
5. Careers and attitudes of spouses will likely have a significant impact on employee willingness to move overseas.
6. Employee and spouse perceptions of organizational support for expatriates are critical to employee willingness to work overseas.[34]

These findings indicate that organizations cannot afford to overlook the role of the spouse in the expat selection decision process. What, in particular, can be done to address their concerns?[35] Table 14–3 provides some insights into this answer. Additionally, the table adds a factor often overlooked in this process—situations in which the wife is being assigned overseas and the husband is the "other" spouse. Although many of the concerns of the male spouse are similar to those of spouses in general, a close look at Table 14–3 shows that some of the concerns of the males are different in their rank ordering.

Leadership Ability

The ability to influence people to act in a particular way—leadership—is another important criterion in selecting managers for an international assignment. Determining whether a person who is an effective leader in the home country will be equally effective in an overseas environment can be difficult, however. When determining whether an applicant has the desired leadership ability, many firms look for specific characteristics, such as maturity, emotional stability, the ability to communicate well, independence, initiative, creativity, and good health. If these characteristics are present and the person has been an effective leader in the home country, MNCs assume that the individual also will do well overseas.

Other Considerations

Applicants also can take certain steps to prepare themselves better for international assignments. Tu and Sullivan suggest the applicant can carry out a number of different phases of preparation.[36] In phase one, they suggest focusing on self-evaluation and general awareness. This includes answering the question, Is an international assignment

Table 14–3
Activities That Are Important for Expatriate Spouses
(scale: 1–5, 5 = Very important)

Mean Score	Activity
Average from All Respondents	
4.33	Company help in obtaining necessary paperwork (permits, etc.) for spouse
4.28	Adequate notice of relocation
4.24	Predeparture training for spouse and children
4.23	Counseling for spouse regarding work/activity opportunities in foreign location
4.05	Employment networks coordinated with other international networks
3.97	Help with spouse's reentry into home country
3.93	Financial support for education
3.76	Compensation for spouse's lost wages and/or benefits
3.71	Creation of a job for spouse
3.58	Development of support groups for spouses
3.24	Administrative support (office space, secretarial services, etc.) for spouse
3.11	Financial support for research
3.01	Financial support for volunteer activities
2.90	Financial support for creative activities
Average from Male Spouses	
4.86	Employment networks coordinated with other international organizations
4.71	Help with spouse's reentry into home country
4.71	Administrative support (office space, secretarial services, etc.) for spouse
4.57	Compensation for spouse's lost wages and/or benefits
4.29	Adequate notice of relocation
4.29	Counseling for spouse regarding work/activity opportunities in foreign location
3.86	Predeparture training for spouse and children
3.71	Creation of a job for spouse
3.71	Financial support for volunteer activities
3.43	Financial support for education
3.14	Financial support for research
3.14	Financial support for creative activities
3.00	Development of support groups for spouses

Source: Adapted from Betty Jane Punnett, "Towards Effective Management of Expatriate Spouses," *Journal of World Business* 33, no. 3 (1997), p. 249.

really for me? Other questions in the first phase include finding out if one's spouse and family support the decision to go international and collecting general information on the available job opportunities.

Phase two is characterized by a concentration on activities that should be completed before a person is selected. Some of these include (1) conducting a technical skills match to ensure that one's skills are in line with those that are required for the job; (2) starting to learn the language, customs, and etiquette of the region where one will be posted; (3) developing an awareness of the culture and value systems of this geographic area; and (4) making one's superior aware of this interest in an international assignment.

The third phase consists of activities to be completed after being selected for an overseas assignment. Some of these include (1) attending training sessions provided by the company; (2) conferring with colleagues who have had experience in the assigned region; (3) speaking with expatriates and foreign nationals about the assigned country; and (4) if possible, visiting the host country with one's spouse before the formally scheduled departure.

Economic Pressures and Trends in Expat Assignments

Despite the economic recession of 2008–2010, most MNCs continue to make overseas assignments. A survey in 2009 found that 95 percent of MNCs responding to GMAC Global Relocation Services' 13th annual Global Relocation Trends Survey said they are optimistic about their global business outlook and plan to send more employees on overseas assignments in the future. The survey of 154 multinational companies, with a total worldwide employee population of 4.3 million, found that 68 percent of the corporations are ramping up their employee assignment efforts. Apparently, this optimism was driven in part by assessments of the growth of emerging markets, especially China as well as the continued integration of the European Union, allowing continued consolidation and integration of European operations. "The survey identified three significant challenges facing corporations: finding suitable candidates for assignments, helping employees—and their families—complete their assignments, and retaining these employees once their assignments end," said Rick Schwartz, president and chief executive officer of GMAC Global Relocation Services in Woodridge, Illinois.

Not surprisingly, family concerns were cited as the most common reason for assignment refusal, with 89 percent of those surveyed identifying families as the primarily reason employees turn down an assignment. This was followed by spousal career concerns, indicated by 62 percent. Family-related concerns also were important in the duration of international assignments and were the main driver of early returns from assignments. "Not surprisingly, children's education, family adjustment, partner resistance and difficult locations were identified as *the* top four critical family challenges in this year's survey," Schwartz said. "That's underscored by the fact that 61 percent of respondents noted that the impact of family issues on early returns from assignment was very critical or of high importance."

The lack of relevance of assignments to one's career progress was also identified as a major issue. In addition, the general inconveniences caused by assignments were also identified as not fully appreciated by their companies. Moreover, some employees lack opportunities to leverage their international experiences into better positions within their companies. Finally, the annual turnover rate for expatriates on assignment is 25 percent. In addition, it's 27 percent for expatriates within one year of completing assignments, compared to 13 percent average annual turnover for all employees. Other findings from the survey included:

- 19 percent of expatriates were women; the historical average was 15 percent.
- 50 percent of expatriates were 20 to 39 years old.
- 60 percent of expatriates were married, less than the 66 percent historical average. The percentage of married men, 51 percent, was the lowest in the report's history.
- 51 percent of expatriates had children accompanying them, matching the previous all-time low in the 2003–2004 report; the historical average was 57 percent.
- Spouses and partners accompanied 83 percent of expatriates, compared to the historical average of 85 percent.
- 54 percent of spouses were employed before an assignment but not during it; 12 percent were employed during an assignment but not before; 20 percent were employed both before and during the assignment.
- 56 percent of expatriates were relocated to or from the headquarters country, below the historical average of 65 percent.
- The United States, China, and United Kingdom were the most frequently cited locations for expatriate assignments.
- China, India, and Russia were the primary emerging destinations.
- China, India, and Russia also were cited as the most challenging locations for administrators overseeing employee relocations.[37]

International Human Resource Selection Procedures

MNCs use a number of selection procedures. The two most common are tests and interviews. Some international firms use one; a smaller percentage employ both. Theoretical models containing the variables that are important for adjusting to an overseas assignment have been developed. These adjustment models can help contribute to more effective selection of expatriates. The following sections examine traditional testing and interviewing procedures and then present an adjustment model.

Testing and Interviewing Procedures

Some evidence suggests that although some firms use testing, it is not extremely popular. For example, an early study found that almost 80 percent of the 127 foreign operations managers who were surveyed reported that their companies used no tests in the selection process.[38] This contrasts with the more widespread testing that these firms use when selecting domestic managers. Many MNCs report that the costs, questionable accuracy, and poor predictive record make testing of limited value.

Many firms do use interviews to screen people for overseas assignments. One expert notes: "It is generally agreed that extensive interviews of candidates (and their spouses) by senior executives still ultimately provide the best method of selection."[39] Tung's research supports these comments. For example, 52 percent of the U.S. MNCs she surveyed reported that in the case of managerial candidates, MNCs conducted interviews with both the manager and his or her spouse, and 47 percent conducted interviews with the candidate alone. Concerning these findings, Tung concluded:

> These figures suggest that in management-type positions which involve more extensive contact with the local community, as compared to technically oriented positions, the adaptability of the spouse to living in a foreign environment was perceived as important for successful performance abroad. However, even for technically oriented positions, a sizable proportion of the firms did conduct interviews with both candidate and spouse. This lends support to the contention of other researchers that MNCs are becoming increasingly cognizant of the importance of this factor to effective performance abroad.[40]

The Adjustment Process

In recent years, international human resource management specialists have developed models that help to explain the factors involved in effectively adjusting to overseas assignments.[41] These adjustment models help to identify the underpinnings of the effective selection of expatriates.

There are two major types of adjustments that an expatriate must make when going on an overseas assignment: anticipatory and in-country adjustment. Anticipatory adjustment is carried out before the expat leaves for the assignment and is influenced by a number of important factors. One factor is the pre-departure training that is provided. This often takes the form of cross-cultural seminars or workshops, and it is designed to acquaint expats with the culture and work life of the country to which they will be posted. Another factor affecting anticipatory adjustment is the previous experience the expat may have had with the assigned country or with countries with similar cultures. The organizational input into anticipatory adjustment is most directly related and concerned with the selection process. Traditionally, MNCs relied on only one important selection criterion for overseas assignments: technical competence. Obviously, technical competence is important, but it is only one of a number of skills that will be needed. If the MNC concentrates only on technical competence as a selection criterion, then it is not properly preparing the expatriate managers for successful adjustment in overseas assignments. As a result, expats are going to go abroad believing that they are prepared to deal with the challenges awaiting them, and they will be wrong.

In-country adjustment takes place once the expatriate is on site, and a number of factors will influence his or her ability to adjust effectively. One factor is the expat's ability to maintain a positive outlook in the face of a high-pressure situation, to interact well with host nationals, and to perceive and evaluate the host country's cultural values and norms correctly.

A second factor is the job itself, as reflected by the clarity of the role the expat plays in the host management team, the authority the expat has to make decisions, the newness of the work-related challenges, and the amount of role conflict that exists. A third factor is the organizational culture and how easily the expat can adjust to it. A fourth is nonwork matters, such as the toughness with which the expatriate faces a whole new cultural experience and how well his or her family can adjust to the rigors of the new assignment. A fifth and final factor identified in the adjustment model is the expat's ability to develop effective socialization tactics and to understand "what's what" and "who's who" in the host organization.

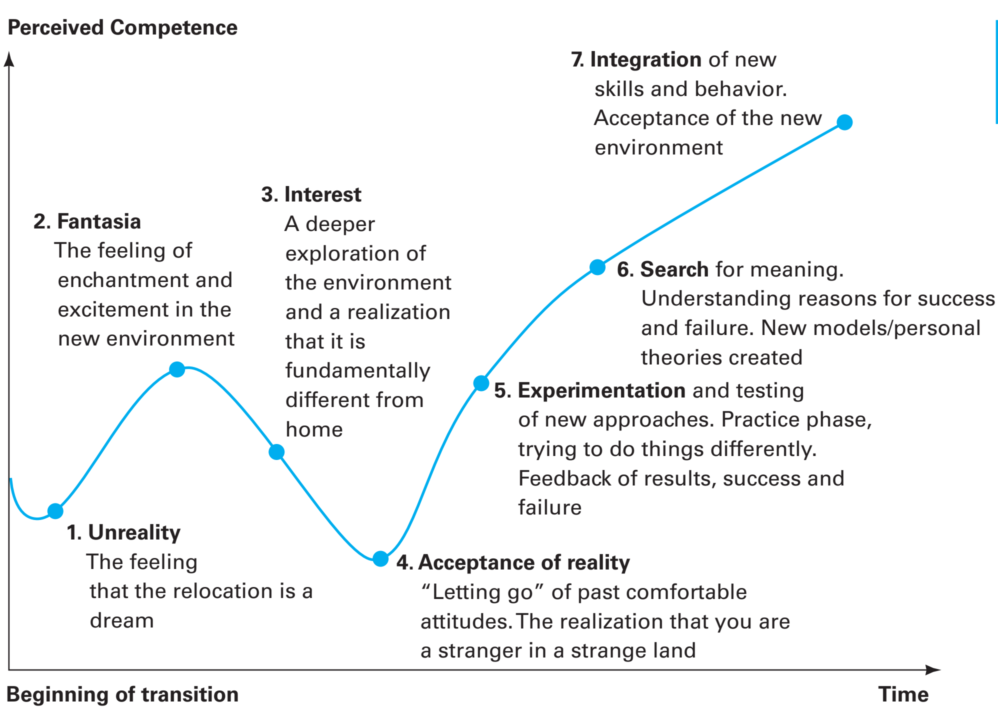
Another model of expatriate adjustment emphasized the formation of network ties in the host country to obtain critical informational and emotional support resources, proposing a five-stage process model that delineates how expatriates form adjustment facilitating support ties in a culturally unfamiliar context. These include

- Stage 1: Factors influencing expatriates' motivation to seek support from actors in the host country.
- Stage 2: Factors influencing expatriates' selection of and support seeking toward actors.
- Stage 3: Factors influencing contacted actors' ability and willingness to provide support.
- Stage 4: Factors influencing expatriates' utilization of received support.
- Stage 5: Factors influencing expatriates' addition of actors to network.[42]

These anticipatory and in-country factors will influence the expatriate's mode and degree of adjustment to an overseas assignment. They can help to explain why effective selection of expatriates is multifaceted and can be very difficult and challenging. But if all works out well, the individual can become a very important part of the organization's overseas operations. McCormick and Chapman illustrated this by showing the changes that an expat goes through as he or she seeks to adjust to the new assignment.[43] As seen in Figure 14–4, early enthusiasm often gives way to cold reality, and the expat typically ends up in a search to balance personal and work demands with the new environment.

Figure 14–4

The Relocation Transition Curve



Source: Adapted from Iain McCormick and Tony Chapman, "Executive Relocation: Personal and Organizational Tactics," in *Managing Across Cultures: Issues and Perspectives,* ed. Pat Joynt and Malcolm Warner (London: International Thomson Business Press, 1996), p. 368.

In many cases, fortunately, everything works out well. Additionally, one of the ways in which MNCs often try to put potential expats at ease about their new assignment is by presenting an attractive compensation package.

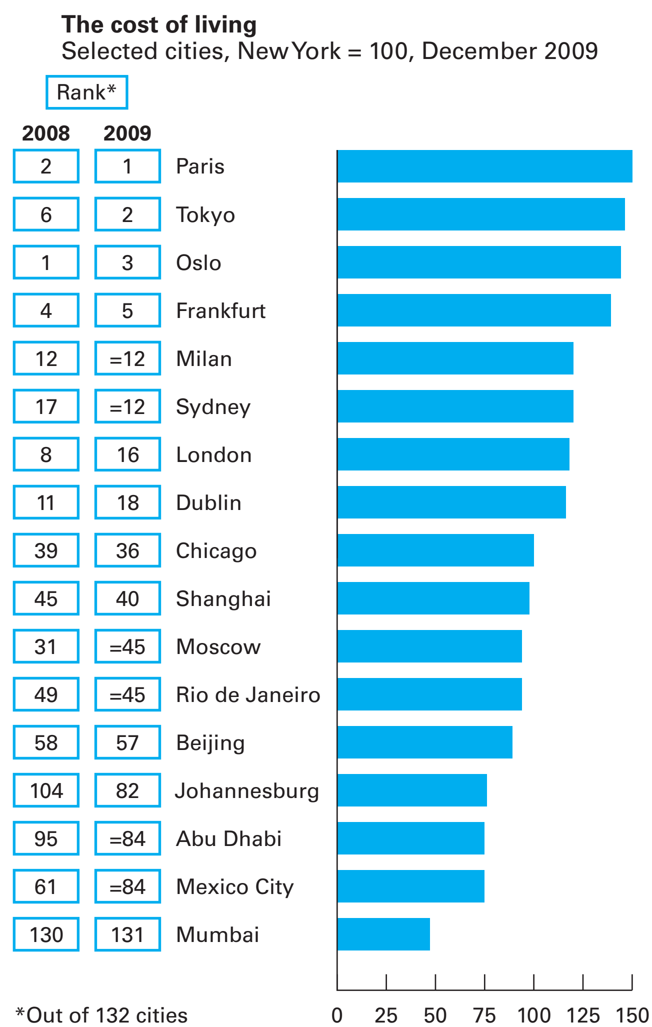
Compensation

One of the reasons there has been a decline in the number of expats in recent years is that MNCs have found that the expense can be prohibitive. Reynolds estimated that, on average, "expats cost employers two to five times as much as home-country counterparts and frequently ten or more times as much as local nationals in the country to which they are assigned."[44] As seen in Figure 14–5, the cost of living in some of the major cities is extremely high, and these expenses must be included somewhere in the compensation package.

The recession of the late 2000s placed additional pressure on firms to control costs associated with expatriate assignments. Mercer reported in 2009 that nearly 40 percent of MNCs were planning on revising their current international assignment policy in the face of declining corporate growth and profitability, as well as an uncertain economic environment. The increasing trend toward localization reflects companies' efforts to either tap into the local talents or to offer less generous packages to locally hired foreign workers. This localization approach was quite consistent among regions and countries around the world, including for companies operating in emerging markets (such as China,

Figure 14–5

Relative Cost of Living in Selected Cities



Source: Economist Intelligence Unit, 2000.

India, and Vietnam), where the local compensation and benefits packages are less generous than home-country plans. In terms of expatriate benefits and allowances, the elements that are least likely to be eliminated for localized employees are housing allowances and education benefits. Mercer did find that localization is practiced in Europe and in North America more than in Latin America and Asia Pacific. In recent years, however, localization has picked up in the Asia Pacific region, particularly as companies want to tap into the regional talent pool and contain costs.[45]

Common Elements of Compensation Packages

The overall compensation package often varies from country to country. As Bailey noted:

> Compensation programs implemented in a global organization will not mirror an organization's domestic plan because of differences in legally mandated benefits, tax laws, cultures, and employee expectation based on local practices. The additional challenge in compensation design is the requirement that excessive costs be avoided and at the same time employee morale be maintained at high levels.[46]

There are five common elements in the typical expatriate compensation package: base salary, benefits, allowances, incentives, and taxes.

Base Salary Base salary is the amount of money that an expatriate normally receives in the home country. In the United States this has often been in the range of \$200,000–\$300,000 for upper-middle managers in recent years, and this rate is similar to that paid to managers in both Japan and Germany. The exchange rates, of course, also affect the real wages.

Expatriate salaries typically are set according to the base pay of the home countries. Therefore, a German manager working for a U.S. MNC and assigned to Spain would have a base salary that reflects the salary structure in Germany. U.S. expatriates have salaries tied to U.S. levels. The salaries usually are paid in home currency, local currency, or a combination of the two. The base pay also serves as the benchmark against which bonuses and benefits are calculated.

Benefits Approximately one-third of compensation for regular employees is benefits. These benefits compose a similar, or even larger, portion of expat compensation. A number of thorny issues surround compensation for expatriates, however. These include:

1. Whether MNCs should maintain expatriates in home-country benefit programs, particularly if these programs are not tax-deductible.
2. Whether MNCs have the option of enrolling expatriates in host-country benefit programs or making up any difference in coverage.
3. Whether host-country legislation regarding termination of employment affects employee benefits entitlements.
4. Whether the home or host country is responsible for the expatriates' social security benefits.
5. Whether benefits should be subject to the requirements of the home or host country.
6. Which country should pay for the benefits.
7. Whether other benefits should be used to offset any shortfall in coverage.
8. Whether home-country benefits programs should be available to local nationals.

Most U.S.-based MNCs include expatriate managers in their home-office benefits program at no additional cost to the expats. If the host country requires expats to contribute to their social security program, the MNC typically picks up the tab. Fortunately, several international agreements between countries recently have eliminated such dual coverage and expenses.

Additionally, MNCs often provide expatriates with extra vacation and with special leaves. The MNC typically will pay the airfare for expats and their families to make an annual visit home, for emergency leave, and for expenses when a relative in the home country is ill or dies.

Allowances Allowances are an expensive feature of expatriate compensation packages. One of the most common parts is a cost-of-living allowance—a payment for differences between the home country and the overseas assignment. This allowance is designed to provide the expat with the same standard of living that he or she enjoyed in the home country, and it may cover a variety of expenses, including relocation, housing, education, and hardship.

Relocation expenses typically involve moving, shipping, and storage charges that are associated with personal furniture, clothing, and other items that the expatriate and his or her family are (or are not) taking to the new assignment. Related expenses also may include cars and club memberships in the host country, although these perks commonly are provided only to senior-level expats.

Housing allowances cover a wide range. Some firms provide the expat with a residence during the assignment and pay all associated expenses. Others give a predetermined housing allotment each month and let expats choose their own residence. Additionally, some MNCs help those going on assignment with the sale or lease of the house they are leaving behind; if the house is sold, the company usually pays closing costs and other associated expenses.

Education allowances for the expat's children are another integral part of the compensation package. These expenses cover costs such as tuition, enrollment fees, books, supplies, transportation, room, board, and school uniforms. In some cases, expenses to attend postsecondary schools also are covered.

Hardship allowances are designed to induce expats to work in hazardous areas or in an area with a poor quality of life. Those who are assigned to Eastern Europe, China, and some Middle Eastern countries sometimes are granted a hardship premium. These payments may be in the form of a lump sum ($10,000 to $50,000) or a percentage (15 to 50 percent) of the expat's base compensation.

Incentives In recent years some MNCs have also been designing special incentive programs for keeping expats motivated. In the process, a growing number of firms have dropped the ongoing premium for overseas assignments and replaced it with a one-time, lump-sum premium. For example, in the early 1990s over 60 percent of MNCs gave ongoing premiums to their expats. Today that percentage is under 50 percent and continuing to decline. Peterson and his colleagues, for example, examined the human resource policies of 24 U.S., British, German, and Japanese subsidiaries and found that in only 10 of the cases did the multinational have a policy of paying expatriates higher compensation than they would have received if they had stayed in their home country.[47]

The lump-sum payment has a number of benefits. One is that expats realize that they will be given this payment just once—when they move to the international locale. So the payment tends to retain its value as an incentive. A second is that the costs to the company are less because there is only one payment and no future financial commitment. A third is that because it is a separate payment, distinguishable from regular pay, it is more readily available for saving or spending.

The specific incentive program that is used will vary, and expats like this. Researchers, for example, have found that some of the factors that influence the type and amount of incentive include whether the person is moving within or between continents and where the person is being stationed. Table 14–4 provides some of the latest survey information related to worldwide employer incentive practices.

Finally, it is important to recognize that growing numbers of MNCs are beginning to phase out incentive premiums. Instead, they are focusing on creating a cadre of expats who are motivated by nonfinancial incentives.

Table 14–4
Employer Incentive Practices Around the World

Percent of MNCs Paying for Moves Within Continents				
Type of Premium	**Asia**	**Europe**	**North America**	**Total**
Ongoing	62%	46%	29%	42%
Lump sum	21	20	25	23
None	16	27	42	32

Percent of MNCs Paying for Moves Between Continents				
Type of Premium	**Asia**	**Europe**	**North America**	**Total**
Ongoing	63%	54%	39%	49%
Lump sum	24	18	30	26
None	13	21	27	22

Source: Derived from Geoffrey W. Latta, "Expatriate Incentives: Beyond Tradition," *HR Focus,* March 1998, p. S4.

Taxes Another major component of expatriate compensation is tax equalization. For example, an expat may have two tax bills, one from the host country and one from the U.S. Internal Revenue Service, for the same pay. IRS Code Section 911 permits a deduction of up to $80,000 on foreign-earned income. Top-level expats often earn far more than this, however; thus, they may pay two tax bills for the amount by which their pay exceeds $80,000.

Usually, MNCs pay the extra tax burden. The most common way is by determining the base salary and other extras (e.g., bonuses) that the expat would make if based in the home country. Taxes on this income then are computed and compared with the taxes due on the expat's income. Any taxes that exceed what would have been imposed in the home country are paid by the MNC, and any windfall is kept by the expat as a reward for taking the assignment.

Tailoring the Package

Working within the five common elements just described, MNCs will tailor compensation packages to fit the specific situation. For example, senior-level managers in Japan are paid only around four times as much as junior staff members. This is in sharp contrast to the United States, where the multiple is much higher. A similar situation exists in Europe, where many senior-level managers make far less than their U.S. counterparts and stockholders, politicians, and the general public oppose U.S.-style affluence. Can a senior-level U.S. expat be paid a salary that is significantly higher than local senior-level managers in the overseas subsidiary, or would the disparity create morale problems? This is a difficult question to answer and must be given careful consideration. One solution is to link pay and performance to attract and retain outstanding personnel.

In formulating the compensation package, a number of approaches can be used. The most common is the **balance-sheet approach,** which involves ensuring that the expat is "made whole" and does not lose money by taking the assignment. A second and often complementary approach is negotiation, which involves working out a special, ad hoc arrangement that is acceptable to both the company and the expat. A third approach, **localization,** involves paying the expat a salary that is comparable to the salaries of local nationals. This approach most commonly is used with individuals early in their careers who are being given a long-term overseas assignment. A fourth approach is the **lump-sum method,** which involves giving the expat a predetermined amount of money and letting the individual make his or her own decisions regarding how to spend it. A fifth

balance-sheet approach
An approach to developing an expatriate compensation package that ensures the expat is "made whole" and does not lose money by taking the assignment.

localization
An approach to developing an expatriate compensation package that involves paying the expat a salary comparable to that of local nationals.

lump-sum method
An approach to developing an expatriate compensation package that involves giving the expat a predetermined amount of money and letting the individual make his or her own decisions regarding how to spend it.

cafeteria approach
An approach to developing an expatriate compensation package that entails giving the individual a series of options and letting the person decide how to spend the available funds.

regional system
An approach to developing an expatriate compensation package that involves setting a compensation system for all expats who are assigned to a particular region and paying everyone in accord with that system.

is the **cafeteria approach,** which entails giving expats a series of options and letting them decide how to spend the available funds. For example, expats who have children may opt for private schooling; expats who have no children may choose a chauffeur-driven car or an upscale apartment. A sixth method is the **regional system,** under which the MNC sets a compensation system for all expats who are assigned to a particular region, so that (for example) everyone going to Europe falls under one particular system and everyone being assigned to South America is covered by a different system.[48] The most important thing to remember about global compensation is that the package must be cost-effective and fair. If it meets these two criteria, it likely will be acceptable to all parties.

As a result of the 2008–2010 recession, many companies are making changes to their expatriate staffing and compensation practices. While many companies have developed short-term assignment and business-travel policies to more efficiently fill their staffing needs, more comprehensive measures, such as shifting home country employees working in foreign locations from expatriate to "local plus" packages, are becoming more common.[49] Participants in two surveys by HR consultancy ORC Worldwide—Survey on Local-Plus Packages in Hong Kong and Singapore and Survey on Local-Plus Packages for Expatriates in China—report a growing trend toward expatriate "light" or "local-plus" packages. "These alternative packages often base the assignee's salary on host country pay structures," says Phil Stanley, managing director of ORC Worldwide's Asia-Pacific region, "but then tack on a few expatriate type benefits, such as some form of housing assistance and possibly an allowance to partially cover children's education."[50]

Individual and Host-Country Viewpoints

Until now, we have examined the selection process mostly from the standpoint of the MNC: What will be best for the company? However, two additional perspectives for selection warrant consideration: (1) that of the individual who is being selected and (2) that of the country to which the candidate will be sent. Research shows that each has specific desires and motivations regarding the expatriate selection process.

Candidate Motivations

Why do individuals accept foreign assignments? One answer is a greater demand for their talents abroad than at home. For example, a growing number of senior U.S. managers have moved to Mexico because of Mexico's growing need for experienced executives. The findings of one early study grouped the participating countries into clusters: Anglo (Australia, Austria, Canada, India, New Zealand, South Africa, Switzerland, United Kingdom, and United States); Northern European (Denmark, Finland, Norway); French (Belgium and France); Northern South American (Colombia, Mexico, and Peru); Southern South American (Argentina and Chile); and Independent (Brazil, Germany, Israel, Japan, Sweden, and Venezuela).[51] Within these groupings, researchers were able to identify major motivational differences. Some of their findings included:

1. The Anglo cluster was more interested in individual achievement and less interested in the desire for security than any other cluster.
2. The French cluster was similar to the Anglo cluster, except that less importance was given to individual achievement and more to security.
3. Countries in the Northern European cluster were more oriented to job accomplishment and less to getting ahead; considerable importance was assigned to jobs not interfering with personal lives.
4. In South American clusters, individual achievement goals were less important than in most other clusters. Fringe benefits were particularly important to South American groups.
5. Germans were similar to those in the South American clusters, except that they placed a greater emphasis on advancement and earnings.

6. The Japanese were unique in their mix of desires. They placed high value on earnings opportunities but low value on advancement. They were high on challenge but low on autonomy. At the same time, they placed strong emphasis on working in a friendly, efficient department and having good physical working conditions.

Another interesting focus of attention has been on those countries that expatriates like best. A study conducted by Ingemar Torbiorn found that the 1,100 Swedish expatriates surveyed were at least fairly well satisfied with their host country and in some cases were very satisfied. Five of the countries that they liked very much were Switzerland, Belgium, England, the United States, and Portugal.[52] These countries are still popular today, which makes sense since they are included in the top tier of countries with the highest quality of life. The criteria include such things as family life, economic life, unemployment rates, political stability, and so forth to determine how safe or attractive the country is.

Host-Country Desires

Although many MNCs try to choose people who fit in well, little attention has been paid to the host country's point of view. Whom would it like to see put in managerial positions? One study that compared U.S., Indonesian, and Mexican managers found that behaviors can distinguish them from one another and that host countries would prefer a managerial style similar to that of their country.[53] For example, positive managerial behaviors, such as honesty and follow-through with employees, distinguish Indonesian and U.S. managers from Mexican managers. As seen in Chapter 4, this could partially be due to the power distance suggested by Hofstede. Furthermore, negative managerial behaviors, such as public criticism and discipline toward employees, also distinguish Indonesian and U.S. managers from Mexican managers. It has been suggested that the dynamic in the workplace has to do with the familial structure, namely that Mexican workers place a higher value on family over work than do the U.S. or Indonesian counterparts. This can be a factor in how the positive and negative behaviors are expressed in each country, as outlined in Table 14–5. Overall, it is important for managers to take the host-country perspectives into consideration, or it could result in an ineffectual endeavor.

Table 14–5
Comparative Positive and Negative Managerial Behavior by Country

Positive Behaviors	Negative Behaviors
Indonesia	
Is honest with employees	Engages in unfair discrimination
Provides clear work expectations	Disciplines and criticizes in public
Shows confidence in employee	Flaunts power
Provides regular feedback	
Mexico	
Shows respect for employees	Practices favoritism
Shows confidence in employees	Does not understand employee values and traditions
Is flexible to individual employee needs	
Provides clear work expectations	
United States	
Is honest with employees	Disciplines and criticizes in public
Shows loyalty to employees	Flaunts power
Shows respect for employees	
Shows confidence in employees	

Source: From Charles M. Vance and Yongsun Paik, "One Size Fits All in Expatriate Pre-departure Training?" *Journal of Management Development* 21, No. 7/8, 2002, p. 566. Reprinted with permission of Emerald Insight.

Repatriation of Expatriates

repatriation
The return to one's home country from an overseas management assignment.

For most overseas managers, **repatriation,** the return to one's home country, occurs within five years of the time they leave. Few expatriates remain overseas for the duration of their stay with the firm.[54] When they return, these expatriates often find themselves facing readjustment problems, and some MNCs are trying to deal with these problems through use of transition strategies.

Reasons for Returning

The most common reason that expatriates return home from overseas assignments is that their formally agreed-on tour of duty is over. Before they left, they were told that they would be posted overseas for a predetermined period, often two to three years, and they are returning as planned. A second common reason is that expatriates want their children educated in a home-country school, and the longer they are away, the less likely it is that this will happen.[55]

A third reason expatriates return is that they are not happy in their overseas assignment. Sometimes unhappiness is a result of poor organizational support by the home office, which leaves the manager feeling that the assignment is not a good one and it would be best to return as soon as possible. Kraimer, Wayne, and Jaworski found that lack of this kind of support has a negative effect on the expat's ability to adjust to the assignment.[56] At other times an expat will want to return home early because the spouse or children do not want to stay. Because the company feels that the loss in managerial productivity is too great to be offset by short-term personal unhappiness, the individual is allowed to come back even though typically the cost is quite high.[57] A fourth reason that people return is failure to do a good job. Such failure often spells trouble for the manager and may even result in demotion or termination.

Readjustment Problems

Many companies that say that they want their people to have international experience often seem unsure of what to do with these managers when they return. One recent survey of midsize and large firms found that 80 percent of these companies send people abroad and more than half of them intend to increase the number they have on assignment overseas. However, responses from returning expats point to problems. Three-quarters of the respondents said that they felt their permanent position upon returning home was a demotion. Over 60 percent said that they lacked the opportunities to put their foreign experience to work, and 60 percent said that their company had not communicated clearly about what would happen to them when they returned. Perhaps worst of all, within a year of returning, 25 percent of the managers had left the company.[58] These statistics are not surprising to those who have been studying repatriation problems. In fact, one researcher reported the following expatriate comments about their experiences:

> My colleagues react indifferently to my international assignment. . . . They view me as doing a job I did in the past; they don't see me as having gained anything while overseas.
>
> I had no specific reentry job to return to. I wanted to leave international and return to domestic. Working abroad magnifies problems while isolating effects. You deal with more problems, but the home office doesn't know the details of the good or bad effects. Managerially, I'm out of touch.
>
> I'm bored at work. . . . I run upstairs to see what [another returning colleague] is doing. He says, "Nothing." Me, too.[59]

Other readjustment problems are more personal in nature. Many expatriates find that the salary and fringe benefits to which they have become accustomed in the foreign assignment now are lost, and adjusting to this lower standard of living is difficult. In addition, those who sold their houses and now must buy new ones find that the monthly cost often is much higher than when they left. The children often are placed in public schools, where classes are much larger than in the overseas private schools. Many also miss the cultural lifestyles, as in the case of an executive who is transferred from Paris, France, to a medium-sized city in the United States, or from any developed country to an underdeveloped country. Additionally, many returning expatriates have learned that their international experiences are not viewed as important. Many Japanese expatriates, for example, report that when they return, their experiences should be downplayed if they want to "fit in" with the organization. In fact, reports one recent *New York Times* article, a substantial number of Japanese expatriates "are happier overseas than they are back home."[60]

Other research supports the findings noted here and offers operative recommendations for action. Based on questionnaires completed by 174 respondents who had been repatriated from four large U.S. MNCs, Black found the following:

1. With few exceptions, individuals whose expectations were met had the most positive levels of repatriation adjustment and job performance.
2. In the case of high-level managers in particular, expatriates whose job demands were greater, rather than less, than expected reported high levels of repatriation adjustment and job performance. Those having greater job demands may have put in more effort and had better adjustment and performance.
3. Job performance and repatriation adjustment were greater for individuals whose job constraint expectations were undermet than for those individuals whose expectations were overmet. In other words, job constraints were viewed as an undesirable aspect of the job, and having them turn out to be less than expected was a pleasant surprise that helped adjustment and performance.
4. When living and housing conditions turned out to be better than expected, general repatriation adjustment and job performance were better.
5. Individuals whose general expectations were met or overmet had job evaluations that placed them 10 percent higher than those whose general expectations were unmet.[61]

Transition Strategies

To help smooth the adjustment from an overseas to a stateside assignment, some MNCs have developed **transition strategies,** which can take a number of different forms. One is the use of **repatriation agreements,** whereby the firm tells an individual how long she or he will be posted overseas and promises to give the individual, on return, a job that is mutually acceptable. This agreement typically does not promise a specific position or salary, but the agreement may state that the person will be given a job that is equal to, if not better than, the one held before leaving.[62]

transition strategies
Strategies used to help smooth the adjustment from an overseas to a stateside assignment.

repatriation agreements
Agreements whereby the firm tells an individual how long she or he will be posted overseas and promises to give the individual, on return, a job that is mutually acceptable.

Some firms also rent or otherwise maintain expatriates' homes until they return. The Aluminum Company of America and Union Carbide both have such plans for managers going overseas. This plan helps reduce the financial shock that often accompanies home shopping by returning expatriates. A third strategy is to use senior executives as sponsors of managers abroad.

Still another approach is to keep expatriate managers apprised of what is going on at corporate headquarters and to plug these managers into projects at the home office whenever they are on leave in the home country. This helps maintain the person's visibility and ensures the individual is looked on as a regular member of the management staff.

One study surveyed 99 employees and managers with international experience in 21 corporations.[63] The findings reveal that cultural reentry, financial implications, and the nature of job assignments are three major areas of expatriate concern. In particular, some of the main problems of repatriation identified in this study include (1) adjusting to life back home; (2) facing a financial package that is not as good as that overseas; (3) having less autonomy in the stateside job than in the overseas position; and (4) not receiving any career counseling from the company. To the extent that the MNC can address these types of problems, the transition will be smooth, and the expatriate's performance effectiveness once home will increase quickly. Some additional steps suggested by experts in this area include:

1. Arrange an event to welcome and recognize the employee and family, either formally or informally.
2. Establish support to facilitate family reintegration.
3. Offer repatriation counseling or workshops to ease the adjustment.
4. Assist the spouse with job counseling, résumé writing, and interviewing techniques.
5. Provide educational counseling for the children.
6. Provide the employee with a thorough debriefing by a facilitator to identify new knowledge, insights, and skills and to provide a forum to showcase new competencies.
7. Offer international outplacement to the employee and reentry counseling to the entire family if no positions are possible.
8. Arrange a postassignment interview with the expatriate and spouse to review their view of the assignment and address any repatriation issues.[64]

Hammer and his associates echo these types of recommendations. Based on research that they conducted in two multinational corporations among expats and their spouses, they concluded:

> The findings from the present study suggest that one of the key transitional activities for returning expatriates and their spouses from a corporate context should involve targeted communication from the home environment concerning the expectations of the home office toward the return of the repatriate executive and his/her family (role relationships). Further, reentry training should focus primarily on helping the repatriate manager and spouse align their expectations with the actual situation that will be encountered upon arrival in the home culture both within the organizational context as well as more broadly within the social milieu. To the degree that corporate communication and reentry training activities help the returning executive and spouse in expectation alignment, the executive's level of reentry satisfaction should be higher and the degree of reentry difficulties less.[65]

Additionally, in recent years many MNCs have begun using inpatriates to supplement their home-office staff and some of the same issues discussed here with repatriation come into play.

Training in International Management

training
The process of altering employee behavior and attitudes in a way that increases the probability of goal attainment.

Training is the process of altering employee behavior and attitudes in a way that increases the probability of goal attainment. Training is particularly important in preparing employees for overseas assignments because it helps ensure that their full potential will be tapped.[66] One of the things that training can do is to help expat managers better understand the customs, cultures, and work habits of the local culture. The simplest training, in terms of preparation time, is to place a cultural integrator in each foreign operation. This individual is responsible for ensuring that the operation's business systems are in accord with those of the local culture. The integrator advises, guides, and recommends actions needed to ensure this synchronization.[67]

Unfortunately, although using an integrator can help, it is seldom sufficient. Recent experience clearly reveals that in creating an effective global team, the MNC must assemble individuals who collectively understand the local language, have grown up in diverse cultures or neighborhoods, have open, flexible minds, and will be able to deal with high degrees of stress.[68] In those cases where potential candidates do not yet possess all these requisite skills or abilities, MNCs need a well-designed training program that is administered before the individuals leave for their overseas assignment (and, in some cases, also on-site) and then evaluated later to determine its overall effectiveness. One review of 228 MNCs found that cross-cultural training, which can take many forms, is becoming increasingly popular. Some of these findings included the following:

1. Of organizations with cultural programs, 58 percent offer training only to some expatriates, and 42 percent offer it to all of them.
2. Ninety-one percent offer cultural orientation programs to spouses, and 75 percent offer them to dependent children.
3. The average duration of the cultural training programs is three days.
4. Cultural training is continued after arrival in the assignment location 32 percent of the time.
5. Thirty percent offer formal cultural training programs.
6. Of those without formal cultural programs, 37 percent plan to add such training.[69]

The most common topics covered in cultural training are social etiquette, customs, economics, history, politics, and business etiquette. However, the MNC's overall philosophy of international management and the demands of the specific cultural situation are the starting point. This is because countries tend to have distinctive human resource management (HRM) practices that differentiate them from other countries. For example, the HRM practices that are prevalent in the United States are quite different from those in France and Argentina. This was clearly illustrated by Sparrow and Budhwar, who compared data from 13 different countries on the basis of HRM factors. Five of these factors were the following:

1. Structural empowerment that is characterized by flat organization designs, wide spans of control, the use of flexible cross-functional teams, and the rewarding of individuals for productivity gains.
2. Accelerated resource development that is characterized by the early identification of high-potential employees, the establishment of both multiple and parallel career paths, the rewarding of personnel for enhancing their skills and knowledge, and the offering of continuous training and development education.
3. Employee welfare emphasis that is characterized by firms offering personal family assistance, encouraging and rewarding external volunteer activities, and promoting organizational cultures that emphasize equality in the workplace.
4. An efficiency emphasis in which employees are encouraged to monitor their own work and to continually improve their performance.
5. Long-termism, which stresses long-term results such as innovation and creativity rather than weekly and monthly short-term productivity.[70]

When Sparrow and Budhwar used these HRM approaches on a comparative country-by-country basis, they found that there were worldwide differences in human resource management practices. Table 14–6 shows the comparative results after each of the 13 countries was categorized as being either high or low on the respective factors. These findings reveal that countries are unique in their approach to human resource management. What works well in the United States may have limited value in France. In fact, a close analysis of Table 14–6 shows that none of the 13 countries had the same profile; each was different. This was true even in the case of Anglo nations such as the United States, Canada, Australia, and the United Kingdom, where differences in employee welfare emphasis, accelerated resource development, efficiency emphasis orientation, and long-termism resulted in unique HRM profiles for each. Similarly, Japan and Korea differed on two of the factors, as did Germany and France; and India, which many people might feel would be more similar to an Anglo culture, because of the British influence,

Table 14–6
Human Resource Management Practices in Select Countries

	Structural Empowerment		Accelerated Resource Development		Employee Welfare Emphasis		Efficiency Emphasis		Long-Termism	
	High	Low	High	Low	High	Low	High	Low	High	Low
United States	X			X	X		X			X
Canada	X			X	X			X		X
United Kingdom	X			X		X		X		X
Italy		X		X		X		X		X
Japan		X		X	X		X		X	
India		X		X	X			X	X	
Australia	X		X			X	X		X	
Brazil	X		X		X			X	X	
Mexico	X		X		X			X		X
Argentina		X	X		X			X		X
Germany		X	X			X		X	X	
Korea		X	X			X	X		X	
France		X	X			X	X			X

Source: Adapted from Paul R. Sparrow and Pawan S. Budhwar, "Competition and Change: Mapping the Indian HRM Recipe Against Worldwide Patterns," *Journal of World Business* 32, no. 3 (1997), p. 233.

than to an Asian one, differed on two factors with Canada, on three factors with both the United States and the United Kingdom, and on four factors with Australia.

These findings point to the fact that MNCs will have to focus increasingly on HRM programs designed to meet the needs of local personnel. A good example is provided in the former communist countries of Europe, where international managers are discovering that in order to effectively recruit college graduates, their firms must provide training programs that give these new employees opportunities to work with a variety of tasks and to help them specialize in their particular fields of interest. At the same time the MNCs are discovering that these recruits are looking for companies that offer a good social working environment. A recent survey of over 1,000 business and engineering students from Poland, the Czech Republic, and Hungary found that almost two-thirds of the respondents said that they wanted their boss to be receptive to their ideas; 37 percent wanted to work for managers who had strong industry experience; and 34 percent wanted a boss who was a good rational decision maker. These findings indicate that multinational human resource management is now becoming much more of a two-way street: Both employees and managers need to continually adjust to emerging demands.[71]

The Impact of Overall Management Philosophy on Training

The type of training that is required of expatriates is influenced by the firm's overall philosophy of international management. For example, some companies prefer to send their own people to staff an overseas operation; others prefer to use locals whenever possible.[72] Briefly, four basic philosophical positions of multinational corporations can influence the training program:

ethnocentric MNC
An MNC that stresses nationalism and often puts home-office people in charge of key international management positions.

1. An **ethnocentric MNC** puts home-office people in charge of key international management positions. The MNC headquarters group and the affiliated world company managers all have the same basic experiences, attitudes, and beliefs about how to manage operations. Many Japanese firms follow this practice.

2. A **polycentric MNC** places local nationals in key positions and allows these managers to appoint and develop their own people. MNC headquarters gives the subsidiary managers authority to manage their operations just as long as these operations are sufficiently profitable. Some MNCs use this approach in East Asia, Australia, and other markets that are deemed too expensive to staff with expatriates.
3. A **regiocentric MNC** relies on local managers from a particular geographic region to handle operations in and around that area. For example, production facilities in France would be used to produce goods for all EU countries. Similarly, advertising managers from subsidiaries in Italy, Germany, France, and Spain would come together and formulate a "European" advertising campaign for the company's products. A regiocentric approach often relies on regional group cooperation of local managers. The Gillette MNC uses a regiocentric approach.
4. A **geocentric MNC** seeks to integrate diverse regions of the world through a global approach to decision making. Assignments are based on qualifications, and all subsidiary managers throughout the structure are regarded as equal to those at headquarters. IBM is an excellent example of an MNC that attempts to use a geocentric approach.

polycentric MNC
An MNC that places local nationals in key positions and allows these managers to appoint and develop their own people.

regiocentric MNC
An MNC that relies on local managers from a particular geographic region to handle operations in and around that area.

geocentric MNC
An MNC that seeks to integrate diverse regions of the world through a global approach to decision making.

All four of these philosophical positions can be found in the multinational arena, and each puts a different type of training demand on the MNC.[73] For example, ethnocentric MNCs will do all training at headquarters, but polycentric MNCs will rely on local managers to assume responsibility for seeing that the training function is carried out.

The Impact of Different Learning Styles on Training and Development

Another important area of consideration for development is learning styles. **Learning** is the acquisition of skills, knowledge, and abilities that result in a relatively permanent change in behavior.[74] Over the last decade, growing numbers of multinationals have tried to become "learning organizations," continually focused on activities such as training and development. In the new millennium, this learning focus applied to human resource development may go beyond learning organizations to "teaching organizations." For example, Tichy and Cohen, after conducting an analysis of world-class companies such as General Electric, PepsiCo, AlliedSignal, and Coca-Cola, found that teaching organizations are even more relevant than learning organizations because they go beyond the belief that everyone must continually acquire new knowledge and skills and focus on ensuring that everyone in the organization, especially the top management personnel, passes the learning on to others. Here are their conclusions:

learning
The acquisition of skills, knowledge, and abilities that result in a relatively permanent change in behavior.

> In teaching organizations, leaders see it as their responsibility to teach. They do that because they understand that it's the best, if not only, way to develop throughout a company people who can come up with and carry out smart ideas about the business. Because people in teaching organizations see teaching as critical to the success of their business, they find ways to do it every day. Teaching every day about critical business issues avoids the fuzzy focus that has plagued some learning organization efforts, which have sometimes become a throwback to the 1960s and 1970s style of self-exportation and human relations training.[75]

Of course, the way in which training takes place can be extremely important. A great deal of research has been conducted on the various types and theories of learning. However, the application of these ideas in an international context often can be quite challenging because cultural differences can affect the learning and teaching. Prud'homme van Reine and Trompenaars, commenting on the development of expats, noted that national cultural differences typically affect the way MNCs train and develop their people. For example, Americans like an experiential learning style, while Germans prefer a theoretical-analytical learning approach.[76] Moreover, there can be sharp learning preferences between groups that are quite similar in terms of culture. Hayes and Allinson, after studying cultural differences in the learning styles of managers, reported, "Two groups can be very similar in ecology and climate and, for example, through a common legacy of colonialism, have a similar language and legal, educational and governmental infrastructure, but may be markedly different in terms of beliefs, attitudes, and values."[77] Moreover, research shows that people with different learning styles prefer different learning environments, and if there is a mismatch between the preferred learning style and the work environment, dissatisfaction and poor performance can result.

In addition to these conclusions, those responsible for training programs must remember that even if learning does occur, the new behaviors will not be used if they are not reinforced. For example, if the head of a foreign subsidiary is highly ethnocentric and believes that things should be done the way they are in the home country, new managers with intercultural training likely will find little reward or reinforcement for using their ideas. This cultural complexity also extends to the way in which the training is conducted.

Reasons for Training

Training programs are useful in preparing people for overseas assignments for many reasons. These reasons can be put into two general categories: organizational and personal.

ethnocentrism
The belief that one's own way of doing things is superior to that of others.

Organizational Reasons Organizational reasons for training relate to the enterprise at large and its efforts to manage overseas operations more effectively.[78] One primary reason is to help overcome **ethnocentrism,** the belief that one's way of doing things is superior to that of others. Ethnocentrism is common in many large MNCs where managers believe that the home office's approach to doing business can be exported intact to all other countries because this approach is superior to anything at the local level. Training can help home-office managers understand the values and customs of other countries so that when they are transferred overseas, they have a better understanding of how to interact with local personnel. This training also can help managers overcome the common belief among many personnel that expatriates are not as effective as host-country managers. This is particularly important given that an increasing number of managerial positions now are held by foreign managers in U.S. MNCs.[79]

Another organizational reason for training is to improve the flow of communication between the home office and the international subsidiaries and branches. Quite often, overseas managers find that they are not adequately informed regarding what is expected of them although the home office places close controls on their operating authority. This is particularly true when the overseas manager is from the host country. Effective communication can help minimize these problems.

Finally, another organizational reason for training is to increase overall efficiency and profitability. Research shows that organizations that closely tie their training and human resource management strategy to their business strategy tend to outperform those that do not.[80] Stroh and Caligiuri conducted research on 60 of the world's major multinationals and found that effective HRM programs pay dividends in the form of higher profits. Additionally, their data showed that the most successful MNCs recognized the importance of having top managers with a global orientation. One of the ways in which almost all these organizations did this was by giving their managers global assignments that not only filled technical and managerial needs but also provided developmental experiences for the personnel—and this assignment strategy included managers from every geographic region where the firms were doing business. Drawing together the lessons to be learned from this approach, Stroh and Caligiuri noted:

> The development of global leadership skills should not stop with home-country nationals. Global HR should also be involved in developing a global orientation among host-country nationals as well. This means, for example, sending not only home-country managers on global assignments but host national talent to the corporate office and to other divisions around the world. Many of the managers at the successful MNCs talked about how their

companies develop talent in this way. In addition, they described a "desired state" for human resources, including the ability to source talent within the company from around the world. Victor Guerra, an executive at Prudential, commented: *We need to continually recognize that there are bright, articulate people who do not live in the home country. U.S. multinationals are especially guilty of this shortsightedness.* Acknowledging that talent exists and using the talent appropriately are two different issues—one idealist, the other strategic.[81]

Personal Reasons The primary reason for training overseas managers is to improve their ability to interact effectively with local people in general and with their personnel in particular. Increasing numbers of training programs now address social topics such as how to take a client to dinner, effectively apologize to a customer, appropriately address one's overseas colleagues, communicate formally and politely with others, and learn how to help others "save face."[82] These programs also focus on dispelling myths and stereotypes by replacing them with facts about the culture. For example, in helping expatriates better understand Arab executives, the following guidelines are offered:

1. There is a close relationship between the Arab executive and his environment. The Arab executive is looked on as a community and family leader, and there are numerous social pressures on him because of this role. He is consulted on all types of problems, even those far removed from his position.
2. With regard to decision making, the Arab executive likely will consult with his subordinates, but he will take responsibility for his decision himself rather than arriving at it through consensus.
3. The Arab executive likely will try to avoid conflict. If there is an issue that he favors but that is opposed by his subordinates, he tends to impose his authority. If it is an issue favored by the subordinates but opposed by the executive, he will likely let the matter drop without taking action.
4. The Arab executive's style is very personal. He values loyalty over efficiency. Although some executives find that the open-door tradition consumes a great deal of time, they do not feel that the situation can be changed. Many executives tend to look on their employees as family and will allow them to bypass the hierarchy to meet them.
5. The Arab executive, contrary to popular beliefs, puts considerable value on the use of time. One thing he admires most about Western or expatriate executives is their use of time, and he would like to encourage his own employees to make more productive use of their time.[83]

Another growing problem is the belief that foreign language skills are not really essential to doing business overseas. Effective training programs can help to minimize these personal problems.

A particularly big personal problem that managers have in an overseas assignment is arrogance. This is the so-called Ugly American problem that U.S. expatriates have been known to have. Many expatriate managers find that their power and prestige are much greater than they were in their job in the home country. This often results in improper behavior, especially among managers at the upper and lower positions of overseas subsidiaries. This arrogance takes a number of different forms, including rudeness to personnel and inaccessibility to clients.

Another common problem is expatriate managers' overruling of decisions, often seen at lower levels of the hierarchy. When a decision is made by a superior who is from the host country and the expatriate does not agree with it, the expatriate may appeal to higher authority in the subsidiary. Host-country managers obviously resent this behavior, because it implies that they are incompetent and can be second-guessed by expatriate subordinates.

Still another common problem is the open criticizing by expatriate managers of their own country or the host country. Many expatriates believe that this form of criticism is regarded as constructive and shows them to have an open mind. Experience has found, however, that most host-country personnel view such behavior negatively and feel that the manager should refrain from such unconstructive criticism. It creates bad feelings and lack of loyalty.

In addition to helping deal with these types of personal problems, training can be useful in improving overall management style. Research shows that many host-country nationals would like to see changes in some of the styles of expatriate managers, including their leadership, decision making, communication, and group work. In terms of leadership, the locals would like to see their expatriate managers be more friendly, accessible, receptive to subordinate suggestions, and encouraging to subordinates to make their best efforts. In decision making, they would like to see clearer definition of goals, more involvement in the process by those employees who will be affected by the decision, and greater use of group meetings to help make decisions. In communication, they would like to see more exchange of opinions and ideas between subordinates and managers. In group work, they would like to see more group problem solving and teamwork.

The specific training approach used must reflect both the industrial and the cultural environment. For example, there is some evidence that Japanese students who come to the United States to earn an MBA degree often find this education of no real value back home. One graduate noted that when he tactfully suggested putting to use a skill he had learned during his U.S. MBA program, he got nowhere. An analysis of Japanese getting an outside education concluded:

> Part of the problem is the reason that most Japanese workers are sent to business schools. Whatever ticket the MBA degree promises—or appears to promise—Americans, the diploma has little meaning within most Japanese companies. Rather, companies send students abroad under the life-time employment system to ensure that there will be more English speakers who are familiar with Western business practices. Some managers regard business schools as a kind of high-level English language school, returning students say, or consider the two years as more or less a paid vacation.[84]

However, as the Japanese economy continues to have problems, American-style business education is beginning to receive attention and respect. In the 1980s American managers went to Japan to learn; now Japanese managers are coming to the United States in increasing numbers to see what they can pick up to help them better compete.

Types of Training Programs

There are many different types of multinational management training programs. Some last only a few hours; others last for months. Some are fairly superficial; others are extensive in coverage. Organizations can decide what training program works best by determining the effectiveness of the program, and altering it accordingly. Typically, a combination of standardized and tailor-made training and development approaches are used.

Standardized vs. Tailor-Made

Some management training is standard, or generic. For example, participants often are taught how to use specific decision-making tools, such as quantitative analysis, and regardless of where the managers are sent in the world, the application is the same. These tools do not have to be culturally specific. Research shows that small firms usually rely on standard training programs. Larger MNCs, in contrast, tend to design their own. Some of the larger MNCs are increasingly turning to specially designed video and PowerPoint programs for their training and development needs.

Tailor-made training programs are created for the specific needs of the participants. Input for these offerings usually is obtained from managers who currently are working (or have worked) in the country to which the participants will be sent as well as from local managers and personnel who are citizens of that country. These programs often are designed to provide a new set of skills for a new culture. For example, MNCs are now learning that in managing in China, there is a need to provide directive leadership training because many local managers rely heavily on rules, procedures, and orders from their superiors to guide their behaviors.[85] So training programs must explain how to effectively use this approach. Quite often, the offerings are provided before the individuals leave for their overseas assignment; however, there also are postdeparture training programs that are conducted on-site. These often take the form of systematically familiarizing the individual with the country through steps such as meeting with government officials and other key personnel in the community; becoming acquainted with managers and employees in the organization; learning the host-country nationals' work methods, problems, and expectations; and taking on-site language training.

Training approaches that are successful in one geographic region of the world may need to be heavily modified if they are to be as effective elsewhere. Sergeant and Frenkel conducted interviews with expatriate managers with extensive experience in China in order to identify HRM issues and the ways in which they need to be addressed by MNCs going into China.[86] As seen in Table 14–7, many of the human resource management approaches that are employed are different from those used in the United States or other developed countries because of the nature of Chinese culture and China's economy.

Table 14–7
Human Resources Management Challenges Facing MNCs in China

Human Resource Management Function	Comments/Recommendations
Employee recruitment	The market for skilled manual and white-collar employees is very tight and characterized by rapidly rising wages and high turnover rates. Nepotism and overhiring remain a major problem where Chinese partners strongly influence HR policies; and transferring employees from state enterprises to joint ventures can be difficult because it requires approval from the employee's old work unit.
Reward system	New labor laws allow most companies to set their own wage and salary levels. As a result, there is a wide wage disparity between semiskilled and skilled workers. However, these disparities must be balanced with the negative effect they can have on workers' interpersonal relations.
Employee retention	It can be difficult to retain good employees because of poaching by competitive organizations. In response, many American joint-venture managers are learning to take greater control of compensation programs in order to retain high-performing Chinese managers and skilled workers.
Work performance and employee management	Local managers are not used to taking the initiative and are rarely provided with performance feedback in their Chinese enterprises. As a result, they tend to be risk-averse and are often unwilling to innovate. In turn, the workers are not driven to get things done quickly and they often give little emphasis to the quality of output. At the same time, it is difficult to dismiss people.
Labor relations	Joint-venture regulations give workers the right to establish a trade union to protect employee rights and to organize. These unions are less adversarial than in the West and tend to facilitate operational efficiency. However, there is concern that with the changes taking place in labor laws and the possibility of collective bargaining, unions may become more adversarial in the future.
Expatriate relations	Many firms have provided little cross-training to their people and family, education, and health issues limit the attractiveness of a China assignment. Some of the major repatriation problems include limited continuity in international assignments and difficulties of adjusting to more specialized and less autonomous positions at home, lack of career prospects, and undervaluation of international experience. Management succession and the balancing of local and international staff at Chinese firms are also problematic.

Source: Adapted from Andrew Sergeant and Stephen Frenkel, "Managing People in China: Perceptions of Expatriate Managers," *Journal of World Business* 33, no. 1 (1998), p. 21.

International Management in Action

U.S.-Style Training for Expats and Their Teenagers

One of the major reasons expatriates have trouble with overseas assignments is that their teenage children are unable to adapt to the new culture, and this has an impact on the expat's performance. To deal with this acculturation problem, many U.S. MNCs now are developing special programs for helping teenagers assimilate into new cultures and adjust to new school environments. A good example is provided by General Electric Medical Systems Group (GEMS), a Milwaukee-based firm that has expatriates in France, Japan, and Singapore. As soon as GEMS designates an individual for an overseas assignment, this expat and his or her family are matched up with those who have recently returned from this country. If the family going overseas has teenage children, the company will team them up with a family that had teenagers during its stay abroad. Both groups then discuss the challenges and problems that must be faced. In the case of teenagers, they are able to talk about their concerns with others who already have encountered these issues, and the latter can provide important information regarding how to make friends, learn the language, get around town, and turn the time abroad into a pleasant experience. Coca-Cola uses a similar approach. As soon as someone is designated for an overseas assignment, the company helps initiate cross-cultural discussions with experienced personnel. Coke also provides formal training through use of external cross-cultural consulting firms that are experienced in working with all family members.

A typical concern of teenagers going abroad is that they will have to go away to boarding school. In Saudi Arabia, for example, national law forbids expatriate children's attending school past the ninth grade, so most expatriate families will look for European institutions for these children. GEMS addresses these types of problems with a specially developed education program. Tutors, schools, curricula, home-country requirements, and host-country requirements are examined, and a plan and specific program of study are developed for each school-age child before he or she leaves.

Before the departure of the family, some MNCs will subscribe to local magazines about teen fashions, music, and other sports or social activities in the host country, so that the children know what to expect when they get there. Before the return of the family to the United States, these MNCs provide similar information about what is going on in the United States, so that when the children return for a visit or come back to stay, they are able to quickly fit into their home-country environment once again.

An increasing number of MNCs now give teenagers much of the same cultural training they give their own managers; however, there is one area in which formal assistance often is not as critical for teens as for adults: language training. While most expatriates find it difficult and spend a good deal of time trying to master the local language, many teens find that they can pick it up quite easily. They speak it at school, in their social groups, and out on the street. As a result, they learn not only the formal language but also clichés and slang that help them communicate more easily. In fact, sometimes their accent is so good that they are mistaken for local kids. Simply put: The facility of teens to learn a language often is greatly underrated. A Coca-Cola manager recently drove home this point when he declared: "One girl we sent insisted that, although she would move, she wasn't going to learn the language. Within two months she was practically fluent."

A major educational benefit of this emphasis on teenagers is that it leads to an experienced, bicultural person. So when the young person completes college and begins looking for work, the parent's MNC often is interested in this young adult as a future manager. The person has a working knowledge of the MNC, speaks a second language, and has had overseas experience in a country where the multinational does business. This type of logic is leading some U.S. MNCs to realize that effective cross-cultural training can be of benefit for their workforces of tomorrow as well as today.

Some organizations have extended cross-cultural training to include training for family members, especially children who will be accompanying the parents. International Management in Action, "U.S.-Style Training for Expats and Their Teenagers," explains how this approach to cultural assimilation is carried out.

In addition to training expats and their families, effective MNCs also are developing carefully crafted programs for training personnel from other cultures who are coming into their culture. These programs, among other things, have materials that are specially designed for the target audience. Some of the specific steps that well-designed cultural training programs follow include:

1. Local instructors and a translator, typically someone who is bicultural, observe the pilot training program or examine written training materials.

2. The educational designer then debriefs the observation with the translator, curriculum writer, and local instructors.
3. Together, the group examines the structure and sequence, ice breaker, and other materials that will be used in the training.
4. The group then collectively identifies stories, metaphors, experiences, and examples in the culture that will fit into the new training program.
5. The educational designer and curriculum writer make the necessary changes in the training materials.
6. The local instructors are trained to use the newly developed materials.
7. After the designer, translator, and native-language trainers are satisfied, the materials are printed.
8. The language and content of the training materials are tested with a pilot group.[87]

In developing the instructional materials, culturally specific guidelines are carefully followed so that the training does not lose any of its effectiveness.[88] For example, inappropriate pictures or scenarios that might prove to be offensive to the audience must be screened out. Handouts and other instructional materials that are designed to enhance the learning process are provided for all participants. If the trainees are learning a second language, generous use of visuals and live demonstrations will be employed. Despite all these efforts, however, errors sometimes occur.

Cultural Assimilators

The cultural assimilator has become one of the most effective approaches to cross-cultural training. A **cultural assimilator** is a programmed learning technique that is designed to expose members of one culture to some of the basic concepts, attitudes, role perceptions, customs, and values of another culture. These assimilators are developed for each pair of cultures. For example, if an MNC is going to send three U.S. managers from Chicago to Caracas, a cultural assimilator would be developed to familiarize the three Americans with Venezuelan customs and cultures. If three Venezuelan managers from Caracas were to be transferred to Singapore, another assimilator would be developed to familiarize the managers with Singapore customs and cultures.

cultural assimilator
A programmed learning technique designed to expose members of one culture to some of the basic concepts, attitudes, role perceptions, customs, and values of another culture.

In most cases, these assimilators require the trainee to read a short episode of a cultural encounter and choose an interpretation of what has happened and why. If the trainee's choice is correct, he or she goes on to the next episode. If the response is incorrect, the trainee is asked to reread the episode and choose another response.

Choice of Content of the Assimilators One of the major problems in constructing an effective cultural assimilator is deciding what is important enough to include. Some assimilators use critical incidents that are identified as being important. To be classified as a critical incident, a situation must meet at least one of the following conditions:

1. An expatriate and a host national interact in the situation.
2. The situation is puzzling or likely to be misinterpreted by the expatriate.
3. The situation can be interpreted accurately if sufficient knowledge about the culture is available.
4. The situation is relevant to the expatriate's task or mission requirements.[89]

These incidents typically are obtained by asking expatriates and host nationals with whom they come in contact to describe specific intercultural occurrences or events that made a major difference in their attitudes or behavior toward members of the other culture. These incidents can be pleasant, unpleasant, or simply nonunderstandable occurrences.

validity
The quality of being effective, of producing the desired results. A valid test or selection technique measures what it is intended to measure.

Validation of the Assimilator The term **validity** refers to the quality of being effective, of producing the desired results. It means that an instrument—in this case, the cultural assimilator—measures what it is intended to measure. After the cultural assimilator's critical incidents are constructed and the alternative responses are written, the process is validated. Making sure that the assimilator is valid is the crux of its effectiveness. One way to test an assimilator is to draw a sample from the target culture and ask these people to read the scenarios that have been written, choosing the alternative they feel is most appropriate. If a large percentage of the group agrees that one of the alternatives is preferable, this scenario is used in the assimilator. If more than one of the four alternatives receives strong support, however, either the scenario or the alternatives are revised until there is general agreement or the scenario is dropped.

After the final incidents are chosen, they are sequenced in the assimilator booklet and can be put online to be taken electronically. Similar cultural concepts are placed together and presented, beginning with simple situations and progressing to more complex ones. Most cultural assimilator programs start out with 150 to 200 incidents, of which 75 to 100 eventually are included in the final product.

The Cost-Benefit Analysis of Assimilators The assimilator approach to training can be quite expensive. A typical 75- to 100-incident program often requires approximately 800 hours to develop. Assuming that a training specialist is costing the company $50 an hour including benefits, the cost is around $40,000 per assimilator. This cost can be spread over many trainees, and the program may not need to be changed every year. An MNC that sends 40 people a year to a foreign country for which an assimilator has been constructed is paying only $200 per person for this programmed training. In the long run, the costs often are more than justified. In addition, the concept can be applied to nearly all cultures. Many different assimilators have been constructed, including Arab, Thai, Honduran, and Greek, to name but four. Most importantly, research shows that these assimilators improve the effectiveness and satisfaction of individuals being trained as compared with other training methods.

Positive Organizational Behavior

We discussed in Chapter 13 how leaders can increase motivation and morale if they focus on the positives, or strengths, of individuals. The positive internal traits of the leader, along with the other factors, tend to lead to consistent positive behaviors. Luthans has done extensive research on **positive organizational behavior (POB).** He defines it as:

> The study and application of positively oriented human resource strengths and psychological capacities that can be measured, developed, and effectively managed for performance improvement in today's workplace.[90]

positive organizational behavior (POB)
The study and application of positively oriented human resource strengths and psychological capacities that can be measured, developed, and effectively managed for performance improvement in today's workplace.

Positivity in the workplace has been connected to employee satisfaction. The positive environment, however, consists of many layers. Luthans and Youssef postulated that in order for an organization to be the most efficient and innovative, it must have positive traits, states, and systems in order to promote positive behavior. The positive traits were covered in Chapter 13 and consist of conscientiousness, emotional stability, extroversion, agreeableness, openness to experience, core self-evaluations, and positive psychological traits. A positive state is domain-specific, and reactions and behaviors may change depending on the environment. Research has shown that other "states" are self-efficacy, hope, optimism, resiliency, and psychological capital.[91]

Finally, positive organizations focus on the selection, development, and management of human resources. This positive approach attempts to match employee skills and talents with organizational goals and expectations. When employees are treated well, they will be motivated to give back to the institution. Therefore, when these individual traits, internal and external states, and organizations all focus on the positive, the resulting organizational citizenship behavior (OCB) will also be positive. Furthermore, altruism, conscientiousness, and courtesy will be inadvertently emphasized.[92]

As with most examples, the description above is culturally specific. That is, what seems to be positive internal or external factors in one country may not be the same in another. However, human resources are essential to an organization no matter its location, and MNCs should do all they can to focus on the power of human capital to drive organizational success.

Future Trends

The coming decades will be important and transformational ones for international human resources. A recent report from Brookfield Global Relocation Services concludes that several issues will emerge as critical for managing a global workforce. At the top of the list, according to Brookfield, will be linking talent management and employee mobility. As the nature of temporary assignments evolves, companies and employees will be more closely scrutinizing the costs and benefits of the assignments.

Some companies are questioning the basic decision of supporting expensive international assignments. Employees are also questioning the personal and professional value of an overseas assignment, especially if such assignments have little influence in helping them to advance in their careers. The Brookfield survey found that 38 percent of employees leave their company within just one year of repatriation, in line with industry estimates that range between 25 percent and 45 percent. "This is a key issue for global organizations, since this is a population of employees that they have invested so heavily in," Sullivan said. "Losing these employees represents a significant loss of experience and talent. Many of the companies we surveyed are beginning to see the integration of talent management and international assignment mobility as a strategy to turn this loss into a competitive gain."

Another trend is the emergence of "cross-border" commuters, employees who regularly move back and forth between countries. Commuter assignments, as an alternative to short-term (and even long-term) assignments, have begun to take a larger role, especially in Europe, given the deepening integration of the European Union and the resultant cross-border employee mobility. The report suggests this trend is likely to continue and accelerate.[93]

One of the most profound trends, first explored in Chapter 1 of this book, is the dramatic rise and growth of emerging markets. Brookfield's survey notes that emerging locations run the spectrum of countries from those that are long-time assignment destinations to those that are just this year appearing as locations for expatriate assignments. To some degree, this trend may offset the effects of the other trends, suggesting that although the particular structure and duration may evolve, expatriate assignments are likely to continue as part of the arsenal of MNCs seeking to leverage talent for global success.

The World of International Management—Revisited

The World of International Management that opened this chapter illustrated how the desire to source and retain talent has become a global phenomenon, affecting most major markets, including India. In a time of increased globalization, firms must be able to source talent from a range of locations. Given the increasing presence of foreign MNCs in India—and the dramatic growth of India's domestic offshore outsourcing sector—employee retention has become a critical issue. One interesting observation is that employees are motivated by intrinsic rewards that go beyond financial compensation. Attracting and retaining talent turns out be a complex process in which both financial and nonfinancial issues come into play.

As outlined in this chapter, MNCs are realizing the intense challenges associated with the selection, development, and training of international human resources. MNCs have a range of options when selecting employees for overseas assignments, and

Lessons in Global Leadership Development: The PWC Ulysses Program

PricewaterhouseCoopers (PwC), one of the "Final 4" global accounting firms, has for several years sent top midcareer talent to the developing world for eight-week service projects under its "Ulysses" Program. After the merger of Price Waterhouse and Coopers Lybrand in 1998, the combined firm decided it needed a new model for a global professional services organization. Executives recognized that global problems were not increasing or decreasing, but changing and reshaping, the way business is done. In response, the firm created "Project Ulysses" in 2001, which sends a number of emerging leaders each year to a developing nation for two and a half months to work on service projects and programs. The purpose is not only to aid those in need, but to develop leadership skills on an individual level by taking executives out of their comfort zone, on a team level by pairing two to three partners together from different nations, and on the organizational level by creating stakeholder networks on a much broader level. For a relatively modest investment—about $15,000 per person, plus salaries—Ulysses both tests the talent and expands the world view of the accounting firm's future leaders. Since the company started the program in 2000, it has attracted the attention of Johnson & Johnson, Cisco Systems, and other big companies considering their own programs.

The projects, which range from helping an ecotourism collective in Belize to AIDS work in Namibia and organic farming in Zambia, take the participants out of their comfort zone and force them to build upon their leadership skills in a new and challenging environment. The benefit of pairing partners from three different places is that they draw on their own cultures to make decisions. As one participant noted, "You realize that perhaps the way you see things isn't necessarily the best way." In 2003, PwC partner Tahir Ayub was assigned a consulting gig unlike anything he had done before. His job was helping village leaders in the Namibian outback grapple with their community's growing AIDS crisis. Faced with language barriers, cultural differences, and scant access to electricity, Ayub, 39, and two colleagues had to scrap their PowerPoint presentations in favor of a more low-tech approach: face-to-face discussion. The village chiefs learned that they needed to garner community support for programs to combat the disease, and Ayub learned an important lesson as well: Technology isn't always the answer. "You better put your beliefs and biases to one side and figure out new ways to look at things," he said.

Although traditional business education and training has historically focused on helping firms improve financial performance, increasingly, B-schools and training programs are adding social responsibility to their curriculum. Further, graduates are increasingly signaling they want to work for firms with a positive reputation for social responsibility and service. According to a *Wall Street Journal* article, top corporate executives are now pairing with MBA programs across the country to help students gain a better understanding of responsible global leadership. In fact, a recent study showed that 75 percent of Americans consider a company's commitment to social issues when deciding where to work, and that 6 out of 10 employees wish their companies did more to help globally. According to Liz Maw, executive director of Net Impact, a corporate nonprofit dedicated to social responsibility, "The companies most involved in corporate social responsibility are the ones that have already seen their bottom line and brand awareness increase."

While results are hard to quantify, PwC is convinced that the program works. All two dozen of the initial graduates are still working at the company. Half of them have been promoted, and most have new responsibilities. Just as important, all 24 people say they have a stronger commitment to PwC—in part because of the commitment the firm made to them and in part because of their new vision of the firm's values. Says global managing partner Willem Bröcker: "We get better partners from this exercise." The Ulysses Program is PwC's answer to one of the biggest challenges confronting professional services companies: identifying and training up-and-coming leaders who can find unconventional answers to intractable problems. By tradition and necessity, new PwC leaders are nurtured from within. With 8,000 partners, identifying those with the necessary business savvy and relationship-building skills isn't easy. But just as the program gives partners a new view of PwC, it also gives PwC a new view of them, particularly their ability to hold up under pressure.

PwC says the program, now in its third cycle, gives participants a broad, international perspective that's crucial for a company that does business around the world. Traditional executive education programs turn out men and women who have specific job skills but little familiarity with issues outside their narrow specialty, according to Douglas Ready, director of the International Consortium for Executive Development Research. PwC says Ulysses helps prepare participants for challenges that go beyond the strict confines of accounting or consulting and instills values such as community involvement that are essential to success in any field.

Ulysses has also given PwC a very positive name in the accounting and broader professional services community. The project has taught the partners to understand risks more holistically, to consider all stakeholders that are involved, and to realize that doing business is not about one goal, but many.

increasing numbers of tools and resources are available to help develop, train, and deploy those individuals. Human resource selection and development across cultures cannot be taken lightly. Firms that do not invest in their human resource processes will face additional costs related to poor labor relations, quality control, and other issues. Now that you have read the chapter and reflected back on the chapter's opening World of International Management about employee retention in India, answer the following questions: (1) What are the costs and benefits of hiring home-, host-, and third-country nationals for overseas assignments? (2) What skill sets are important for international assignments, and how can employees be prepared for such assignments? (3) What are the implications of offshore outsourcing for the management of human resources globally and in India in particular?

SUMMARY OF KEY POINTS

1. MNCs can use four basic sources for filling overseas positions: home-country nationals (expatriates), host-country nationals, third-country nationals, and inpatriates. The most common reason for using home-country nationals, or expatriates, is to get the overseas operation under way. Once this is done, many MNCs turn the top management job over to a host-country national who is familiar with the culture and language and who often commands a lower salary than the home-country national. The primary reason for using third-country nationals is that these people have the necessary expertise for the job. The use of inpatriates (a host-country or third-country national assigned to the home office) recognizes the need for diversity at the home office. This movement builds a transnational core competency for MNCs. In addition, MNCs can subcontract or outsource to take advantage of lower human resource costs and increase flexibility.
2. Many criteria are used in selecting managers for overseas assignments. Some of these include adaptability, independence, self-reliance, physical and emotional health, age, experience, education, knowledge of the local language, motivation, the support of spouse and children, and leadership.
3. Individuals who meet selection criteria are given some form of screening. Some firms use psychological testing, but this approach has lost popularity in recent years. More commonly, candidates are given interviews. Theoretical models that identify important anticipatory and in-country dimensions of adjustment offer help in effective selection.
4. Compensating expatriates can be a difficult problem, because there are many variables to consider. However, most compensation packages are designed around five common elements: base salary, benefits, allowances, incentives, and taxes. Working within these elements, the MNC will tailor the package to fit the specific situation. In doing so, there are five different approaches that can be used: balance-sheet approach, localization, lump-sum method, cafeteria approach, and regional method. Whichever one (or combination) is used, the package must be both cost-effective and fair.
5. A manager might be willing to take an international assignment for a number of reasons: increased pay, promotion potential, the opportunity for greater responsibility, the chance to travel, and the ability to use his or her talents and skills. Research shows that most home countries prefer that the individual who is selected to head the affiliate or subsidiary be a local manager, even though this often does not occur.
6. At some time, most expatriates return home, usually when their predetermined tour is over. Sometimes, managers return because they want to leave early; at other times, they return because of poor performance on their part. In any event, readjustment problems can arise back home, and the longer a manager has been gone, the bigger the problems usually are. Some firms are developing transition strategies to help expatriates adjust to their new environments.
7. Training is the process of altering employee behavior and attitudes to increase the probability of goal attainment. Many expatriates need training before (as well as during) their overseas stay. A number of factors will influence a company's approach to training. One is the basic type of MNC: ethnocentric, polycentric, regiocentric, or geocentric. Another factor is the learning style of the trainees.
8. There are two primary reasons for training: organizational and personal. Organizational reasons include overcoming ethnocentrism, improving communication, and validating the effectiveness of training programs. Personal reasons include improving the ability of expatriates to interact locally and

increasing the effectiveness of leadership styles. There are two types of training programs: standard and tailor-made. Research shows that small firms usually rely on standard programs and larger MNCs tailor their training. Common approaches to training include elements such as cultural orientation, cultural assimilators, language training, sensitivity training, and field experience.

9. A cultural assimilator is a programmed learning approach that is designed to expose members of one culture to some of the basic concepts, attitudes, role perceptions, customs, and values of another. Assimilators have been developed for many different cultures. Their validity has resulted in the improved effectiveness and satisfaction of those being trained as compared with other training methods.

KEY TERMS

adaptability screening, *507*
balance-sheet approach, *515*
cafeteria approach, *516*
cultural assimilator, *529*
ethnocentric MNC, *522*
ethnocentrism, *524*
expatriates, *498*
geocentric MNC, *523*
home-country nationals, *498*
host-country nationals, *498*
inpatriates, *500*
international selection criteria, *503*
learning, *523*
localization, *515*
lump-sum method, *515*
polycentric MNC, *523*
positive organizational behavior (POB), *530*
regiocentric MNC, *523*
regional system, *516*
repatriation, *518*
repatriation agreements, *519*
third-country nationals (TCNs), *499*
training, *520*
transition strategies, *519*
validity, *529*

REVIEW AND DISCUSSION QUESTIONS

1. A New York–based MNC is in the process of staffing a subsidiary in New Delhi, India. Why would it consider using expatriate managers in the unit? Local managers? Third-country managers?
2. What selection criteria are most important in choosing people for an overseas assignment? Identify and describe the four that you judge to be of most universal importance, and defend your choice.
3. What are the major common elements in an expat's compensation package? Besides base pay, which would be most important to you? Why?
4. Why are individuals motivated to accept international assignments? Which of these motivations would you rank as positive reasons? Which would you regard as negative reasons?
5. Why do expatriates return early? What can MNCs do to prevent this from happening? Identify and discuss three steps they can take.
6. What kinds of problems do expatriates face when returning home? Identify and describe four of the most important. What can MNCs do to deal with these repatriation problems effectively?
7. How do the following types of MNCs differ: ethnocentric, polycentric, regiocentric, and geocentric? Which type is most likely to provide international management training to its people? Which is least likely to provide international management training to its people?
8. IBM is planning on sending three managers to its Zurich office, two to Madrid, and two to Tokyo. None of these individuals has any international experience. Would you expect the company to use a standard training program or a tailor-made program for each group?
9. Zygen Inc., a medium-sized manufacturing firm, is planning to enter into a joint venture in China. Would training be of any value to those managers who will be part of this venture? If so, what types of training would you recommend?
10. Hofstadt & Hoerr, a German-based insurance firm, is planning on expanding out of the EU and opening offices in Chicago and Buenos Aires. How would a cultural assimilator be of value in training the MNC's expatriates? Is the assimilator a valid training tool?

11. Ford is in the process of training managers for overseas assignments. Would a global leadership program be a useful approach? Why or why not?
12. Microsoft is weighing setting up an R&D facility in India to develop new software applications. Should it staff the new facility with Microsoft employees? Indian employees? Or should it subcontract with an Indian firm? Explain your answer and some of the potential challenges in implementing it.

INTERNET EXERCISE: GOING INTERNATIONAL WITH COKE

As seen in this chapter, the recruiting and selecting of managers is critical to effective international management. This is particularly true in the case of firms that are expanding their international operations or currently do business in a large number of countries. These MNCs are continually having to replace managers who are retiring or moving to other companies. Coca-Cola is an excellent example. Go to the company's Web site at www.coke.com and look at the career opportunities that it offers overseas. In particular, pay close attention to current opportunities in Europe, Africa, and Asia. Read what the company has to say, and then contact one of the individuals whose e-mail address is provided. Ask this company representative about the opportunities and challenges of working in that country or geographic area. Then using this information, coupled with the chapter material, answer these questions: (1) From what you have learned from the Coca-Cola inquiry, what types of education or experience would you need to be hired by the company? (2) What kinds of international career opportunities does Coke offer? (3) If you were hired by Coke, what type of financial package could you expect? (4) In what areas of the world is Coke focusing more of its attention? (5) What kinds of management and leadership training programs does Coke offer?

In the International Spotlight

Russia

Russia is by far the largest of the former Soviet republics. Russia stretches from Eastern Europe across northern Asia to the Pacific Ocean. The 139 million people in Russia consist of 79.8 percent Russians, 4.8 percent Tartars, and a scattering of various others. The largest city and capital is Moscow, with about 10 million people. At present, there is continuing social and economic turmoil in Russia. Although prices are no longer controlled and privatization is well under way, the value of the ruble has been deteriorating. At the same time, there are many pockets of prosperity in the country, and under former President Vladimir Putin positive efforts were made to bolster the economy with some tangible results.

By 2010, Russia's GDP had reached $2.1 trillion, which is a lot more than the $1.75 trillion of 2006. Russia's privatization and liberalization program has attracted substantial foreign investment. One MNC that has been extremely interested in the country is Earth, Inc. (EI), a farm-implement company headquartered in Birmingham, Alabama. EI recently entered into an agreement with the government of Russia to set up operations near Moscow in a factory that was operating at about one-half of capacity. The factory will produce farm implements for the newly emerging Eastern European market. EI will supply the technical know-how and product design as well as assume responsibility for marketing the products. The Russian plant will build the equipment and package it for shipping.

The management of the plant operation will be handled on a joint basis. EI will send a team of five management and technical personnel from the United States to the Russian factory site for a period of 12 to 18 months. After this time, EI hopes to send three of them home, and the two who remain will continue to provide ongoing assistance. At the same time, EI intends to hire four middle-level managers and eight first-level supervisors from Italy and Germany, because the operation will need Europeans who are more familiar with doing manufacturing in this part of the world. Very few locals have inspired EI with confidence that they can get the job done. However, over a two-year period, EI intends to replace the third-country nationals with trained local managers. "We need to staff the management ranks with knowledgeable, experienced people," the CEO explained, "at least until we get the operation up and running successfully with our own people. Then we can turn more and more of the operation over to local management, and run the plant with just a handful of headquarters people on-site."

This arrangement has been agreed to by the Russian government, and EI currently is identifying and recruiting managers both in the United States and in Europe. Initially, the firm thought that this would be a fairly simple process, but screening and selecting are taking much longer than anticipated. Nevertheless, EI hopes to have the plant operating within 12 months.

Questions

1. What are some current issues facing Russia? What is the climate for doing business in Russia today?
2. What are some of the benefits of using home-country nationals in overseas operations? What are some of the benefits of using host-country nationals?
3. Why would a multinational such as EI be interested in bringing in third-country nationals?
4. What criteria should EI use in selecting personnel for the overseas assignment in Russia?

A Selection Decision

The Star Corporation is a California-based manufacturing firm that is going to do business in mainland China. The company's contract with the Chinese government calls for it to supply technical know-how and machinery for producing consumer electronics. These products are not state-of-the-art, but they will be more than adequate for the needs of the Chinese consumers. Star has agreed to sell the Chinese its U.S. plant, which was being closed because it no longer was competitive.

The Chinese will pay to move all the machinery and equipment to the mainland and install it in a factory that currently is being modified for this purpose. The two then will become partners in the venture. Star will provide the management and technical expertise to run the plant, and the Chinese government will provide the workers and be responsible for paying for all output. Star will receive an annual fee of $1 million and 5 percent of all sales.

The Star management is very pleased with the arrangement. Although they are of Chinese descent, they have lived in the United States all their lives and know relatively little about doing business either with or in mainland China. To provide Star with the necessary information and assistance, a native of Beijing, educated there but having lived in California for the past five years, was brought in. The individual told the company the following facts about mainland China:

- Chinese managers do not plan. They usually are told what to do, and they do it. Planning is handled by others and simply passed on to them.
- Chinese managers are not concerned with profit or loss. They simply do their jobs and let the government worry about whether the operation is making money.
- No rewards are given to workers who perform well; everyone is treated the same. If there is no work, the workers are still paid, although they may not be required to come to the factory.
- There is a basic aversion to individual decision making; most decisions are collective efforts.
- The current government of China would like its managers to learn how to run a profit-oriented operation and eventually eliminate the need for foreign managerial assistance.
- When outsiders tell the Chinese how to do things, they have to be careful not to insult or offend the Chinese, who often are sensitive about the way they are treated.

Questions

1. What selection criteria would you recommend to Star when deciding whom to send to mainland China?
2. What procedures should the company use in making the final selection?
3. What type of repatriation agreement would you recommend the firm use? Be specific regarding some things you would suggest be contained in the agreement.

Brief Integrative Case 4.1

A Copy Shop Goes Global

After weeks of demonstrations, the Berlin Wall came crashing down on November 9, 1989. The end of Communist rule in Eastern Europe was clearly in sight. At about the same time, Washington, D.C., entrepreneur Paul Panitz was completing his three-year contractual obligation to the purchasers of his typesetting company. After nearly 20 years of running and working in the business he had started, Panitz had no concrete plans for the future.

Paul had two heroes that he looked to for inspiration. One was Duke Snyder of the old Brooklyn Dodgers; the other was Alexander Dubcek, first secretary of the Communist Party of Czechoslovakia from January 5, 1968, until his ouster by Soviet tanks in August of the same year. During his short tenure, known as the "Prague Spring," Dubcek introduced reforms that presaged the "Velvet Revolution," which occurred about 20 years later.

Thinking of his heroes and having both time and money, Panitz wanted to do what he could for the newly freed people of Central and Eastern Europe. He believed in freedom of the press. He also believed that the way to help people was by creating businesses that created jobs. Paul wanted to do something that would advance both beliefs. His first venture was a loan/equity deal to help a Polish daily newspaper modernize its composition department. But this was a passive investment, and he was left with plenty of time to consider his next opportunity.

On a trip to Budapest, Paul visited a government-run copy center, one of the few copy centers available in Hungary. In fact, copiers that members of the public could use were extremely rare—perhaps not surprisingly: In Communist countries the last thing the government had wanted was for ordinary people to have access to a means of sharing information. The opportunity in postcommunist Hungary was obvious to Paul, and on a return visit home, he contacted me [Ken Chaletzky] and Dirck Holscher, college friends of Paul's who operated a successful chain of copy centers in Washington, D.C., called Copy General. Paul asked us if we would like to help him open a copy center in Budapest. We were a little skeptical about the concept, but we signed on.

Copy General in Budapest: The Beginning

It was now early 1990, and the search for a first store location in Budapest was under way. In a major U.S. city, we would have contacted a commercial real estate agent and asked him or her to show us what was available. Not possible in Budapest in 1990. There was no organized real estate market. Nearly all retail space—what there was of it—was owned and controlled by the government. Even if you found vacant space, it was never clear with whom you needed to talk. So we spent most of 1990 and early 1991 being led down one blind alley after another. Every time we thought we had a deal, a new complication would arise. Frequently, potential landlords wanted an equity position in the business. At other times, space we thought would be ours alone was supposed to be shared with the current occupant. On one occasion, we drank a celebratory toast with a government official signifying agreement—only to have that official lose his position the next day. It was very stressful.

In mid-1990, we hired our Hungarian country manager, although at the time we didn't know he was going to be the country manager. Paul and Dirck Holscher were looking at a street map on a Budapest tramcar. They seemed to be in need of assistance, and a young man came over and asked in nearly flawless English if he could help. Erno Duda was barely in his 20s. His parents, both well-traveled physicians, had spent a few years in Canada, where he learned English. Erno spent the afternoon showing Paul and Dirck around and shortly thereafter was hired as translator and aide.

Erno was a natural-born wheeler-dealer. If we needed something, he knew whom to see or where to go. In the early days of 1990s Hungarian capitalism, he was a very useful person to have on our team. As our first country manager, he helped lead us through rapid growth during our first five years. After leaving Copy General, Erno went on to become a successful investment banker and later formed his own biotechnology company. He says he owes much of his success to what he learned working with Paul Panitz and Copy General.

Erno Duda's Recollections

"I met Paul when I was traveling on the subway. I noticed two Americans who were arguing about where to get off. They couldn't figure out from the Hungarian signs which stop was Heroes' Square. I went up to them and helped them out, and we started talking; and when we got off the subway, the guy with the baseball hat asked me if I wanted to have a beer with them. So we drank a few beers and talked about all kinds of things. He mentioned the idea of starting a copy center in Hungary. I immediately told him that in my opinion it was a lousy idea because they do photocopying on every corner so he should think of something else. Frankly, I thought he didn't have much business sense whatsoever. I changed my mind later. We ended up exchanging phone numbers and had drinks on a few other occasions. He called me up once because his interpreter didn't show up, and he asked me if I was willing to do fill in. Since he was satisfied with me, from then on he used me as his interpreter/translator. He had a market survey done for him by some consulting company. He paid 5,000 bucks for it, and it had maybe five companies listed. I offered to help and got a few friends to go through literally every street in downtown Budapest. We gave him a database of 53 companies (and a lot more detail), and it cost him less than a hundred dollars. I got more and more involved, and after a while it was me who went and figured out things for him and negotiated because every time an American showed up the prices suddenly quadrupled.

"When we were trying to find a bank for Copy General, most banks immediately refused us because they didn't want to deal with companies with only one million forints as base capital, which they thought was not enough. Finally we found a surprisingly flexible bank called Budapest Bank. The shock came when the lady said that she would be really willing to help and the one-million-forint base capital was not a problem, but the bank was full. We just stood there with Paul and stared. Then finally Paul asked me to translate the following sentence: 'If your bank is really full, we've just recently rented a large basement in Lonyai utca, so if you can't store any more money in your bank, we would be willing to help.' It turned out that it was not a matter of where to put the money; the bank had no more space for files (they were installing a computer system and were recording everything twice, on the computer and then on paper). It was interesting to see how the banking system changed in two or three years after this scenario. By the way, in the end we did become a customer of Budapest Bank."

Challenges of Operating in a Postsocialist World

Early in 1991, Paul took charge of the location search and found a small store in the basement of a 19th-century apartment building near the Budapest University of Economic Sciences. Renovations began while we looked for suppliers. We thought that finding them would be easy, but it was not. We contacted Xerox, our main supplier in the United States, to arrange for copiers for our new store. Xerox told us they would be pleased to provide us with equipment as long as we were willing to pay 100 percent cash up front. Of course, the latest models were not available in Budapest, so we would have to accept older models. No new equipment and no equipment leases—not what we were used to.

Then we contacted Kodak, which was then still a major competitor of Xerox in the copier business. At the time it had almost no presence in Hungary and wanted one. Kodak offered to lease equipment to us on very favorable terms. It offered us ramp-up pricing, which meant that the equipment payments would start out very low and then grow as the business grew. Additionally, it asked if it could use our store to showcase its equipment because it didn't have an office in Budapest.

One weakness of the Kodak offer was that it had no service technicians based in Budapest. Service would have to come from Vienna, which meant the next day or so. To compensate, Kodak would provide us with extra equipment at no cost. Another part of our early arrangement with Kodak was that Copy General, which would be open 24 hours a day, would act as backup for machines that Kodak would install at government offices. If a Kodak copier went down at a government office, we would run the copies free for the customer and send the bill to Kodak. This arrangement provided Kodak with a guarantee that its competition couldn't match, and it provided us with extra business and contacts with government agencies. This symbiotic relationship continued for several years.

During all this time in Budapest, Paul and the Copy General people who visited from the United States needed a place to stay. Most Western businesspeople settled in at the Forum, Hyatt, or Gellert hotels, but that was not Paul's style. He said that it would be difficult to expect our local Hungarian staff to help us build a business if we were staying in $200-a-night hotel rooms while they were living off $200-a-month average wages. This attitude was typical of Paul and signaled the type of corporate culture he wanted to create.

Our initial company flat was located in a working-class district of Budapest a few steps from a Metro station. Later, Copy General rented a new apartment around the corner from the first store. Locating near public transportation was important because company policy discouraged the use of taxis and private vehicles. The public transportation system in Budapest goes everywhere, operates frequently, and is cheap. In the early 1990s, a monthly pass cost about $7. With your photo-ID pass in hand, you had unlimited travel rights. You learned a lot about the locals crammed into a tram on a hot summer afternoon.

In June 1991, our first store opened and was an immediate success. We were the first copy shop anyone had seen that offered self-service copiers. It was quite a sight to see people lined up in front of the store and down the sidewalk waiting their turn to use one of our walk-up machines.

Branching Out: Hungary, Czech Republic, and Poland

Shortly after opening in Budapest, we set our sights on Prague. Steven and Teresa Haas partnered with us and moved to the Czech capital. In keeping with company policy, the Haases rented an apartment in the Pancraz district, which was notorious for a prison that had been used by the secret police and the Gestapo. The company flat was in a dull gray Stalinist-era block across the street from a large state-run bakery.

On their first visit to the small retail store that was part of the bakery, the Haases had difficulty choosing. No one at the counter spoke English, and they spoke no Czech. After a few minutes, one of the clerks went to the back of the store and brought out a young bookkeeper who knew a little English. He helped the Haases with their purchases; then they left. The next evening they were back for their daily purchases. One of the counter people handed them a small folded note, which began, "I am the boy from last night . . .," Roman Petr's way of introducing himself.

Roman became their guide and translator, showing them around Prague. Steve did most of the scouting for new locations. They learned quickly that the best way to find possible retail locations was to knock on the doors of stores in areas in which they were interested. Steve and Roman spent many weeks walking around the center of Prague near Wenceslas Square.

One day they went into an electronics repair shop in Gorky Square. Roman asked a member of the store's staff if he knew of any stores that might be available to rent. He replied, "Yes, this one." Steve and Roman were directed to the government education agency that controlled that building. After much negotiation that store became the first Copy General in Prague. In typical socialist fashion, the store had plywood partitions and two interior levels that disguised the turn-of-the-century architecture. The first step was to gut the store and remove all the "improvements" made by the previous occupants. Uncovered were 15-foot ceilings, curved archways, solid walnut doors and trim, and an intricate tile floor.

Steve and Roman oversaw a major renovation that brought back many long-lost details. The store opened in the late spring of 1992—almost exactly one year after the first Budapest store. It was arguably the most attractive and inviting copy center in Europe, and it was an instant success. Its nonstop hours and friendly, helpful service were a novelty. As you may have guessed, Roman became our country manager, a position he still holds.

With the Czech operation under way successfully, Steve and Roman headed for Warsaw to scout out locations for Copy General in Poland. Again, hard work and shoe leather paid off. A government-run travel agency that needed to downsize offered to share its space in the center of town with us. Our preference was not to share space, but the excellent location made us willing to compromise. Then as time went by and we began our renovations, the travel agency decided it didn't need any of the space, so we had the whole store to ourselves.

For Western businesspeople, the Marriott Hotel was the place to stay. It still is. If a guest at the hotel walks out the front door and continues across the street, he or she will walk right into our front entrance. The airport bus terminal is located in the hotel, which is across the street from the main railway station. At a conference in Washington, [Ken Chaletzky] was talking with the Polish trade minister. He knew Copy General, and he was very curious about how we were able to obtain such an excellent location. It was clear from his tone that he suspected we had bribed someone or had some inside help. Though we had done everything honestly, his comments confirmed what we already knew: There was no better location in Warsaw for our store.

As we opened our first stores in each new country, we continued to expand where we already were. Every bit of profit was reinvested into the business. We kept looking for new opportunities to open Copy General copy centers. By the time we opened our first store in Prague, we had four stores in Budapest. When the Warsaw store opened, there were three stores in the Czech Republic (Slovakia became independent on January 1, 1993).

Russia, China, and Beyond

Copy General now operates eight retail copy centers in Hungary, seven in the Czech Republic, and four in Warsaw, Poland. There are also Copy General locations in Moscow; Riga, Latvia; and Shanghai in the People's Republic of China. In addition to offering in-house facilities management to large corporations, the company has set up on-site facilities for special events. NATO, the World Bank, and the U.S. State Department have all hired Copy General to provide on-site services for their large meetings.

Much of the success of the Copy General in Eastern Europe is due to the vision and persistence of Paul Panitz and the people he chose to join him. Paul seized on an opportunity to "do good" and to make a profit—both among the most noble of American capitalist qualities.

Questions for Review

1. What are some of the general challenges of starting a new business in another country? What specific challenges did Copy General face in Eastern and Central Europe?
2. How important was Paul Panitz's vision to the decision to go into Hungary? How would you characterize his leadership and management style and his commitment to "doing well by doing good"?
3. Compare the recollections of Ken Chaletsky, a U.S. manager with Copy General, and Erno Duda, Copy General's initial country manager in Hungary. How do their perspectives differ, and how do they reflect the cultural values of their respective countries?
4. What lessons (if any) can you derive from Copy General's successful experience in Eastern Europe and beyond?

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Brief Integrative Case 4.2

The Road to Hell

John Baker, chief engineer of the Caribbean Bauxite Company of Barracania in the West Indies, was making his final preparations to leave the island. His promotion to production manager of Keso Mining Corporation near Winnipeg—one of Continental Ore's fast-expanding Canadian enterprises—had been announced a month before, and now everything had been tidied up except the last vital interview with his successor, the able young Barracanian, Matthew Rennalls. It was crucial that this interview be successful and that Rennalls leave his office uplifted and encouraged to face the challenge of a new job. A touch on the bell would have brought Rennalls walking into the room, but Baker delayed the moment and gazed thoughtfully through the window, considering just exactly what he was going to say and, more particularly, how he was going to say it.

John Baker, an English expatriate, was 45 years old and had served 23 years with Continental Ore in East Asia, several African countries, Europe, and for the last two years, the West Indies. He hadn't cared much for his previous assignment in Hamburg and was delighted when the West Indian appointment came through. Climate was not the only attraction. Baker had always preferred working overseas (in what were termed "the developing countries"), because he felt he had an innate knack—better than most other expatriates working for Continental Ore—of knowing just how to get along with the regional staff. After 24 hours in Barracania, however, he realized that he would need all this "innate knack" to deal effectively with the problems that awaited him in this field.

At his first interview with Hutchins, the production manager, the problem of Rennalls and his future was discussed. There and then it was made quite clear to Baker that one of his most important tasks would be "grooming" Rennalls as his successor. Hutchins had pointed out that not only was Rennalls one of the brightest Barracanian prospects on the staff of Caribbean Bauxite—at London University he had taken first-class honors in the BSc engineering degree—but being the son of the minister of finance and economic planning, he also had no small political pull.

The company had been particularly pleased when Rennalls decided to work for it rather than the government in which his father had such a prominent post. The company ascribed his action to the effect of its vigorous and liberal regionalization program, which since World War II had produced 18 Barracanians at mid-management level and given Caribbean Bauxite a good lead in this respect over all other international concerns operating in Barracania. The success of this timely regionalization policy led to excellent relations with the government.

This relationship was given an added importance when Barracania, three years later, became independent—an occasion that encouraged a critical and challenging attitude toward the role that foreign interests would play in the new Barracania. Therefore, Hutchins had little difficulty in convincing Baker that the successful career development of Rennalls was of primary importance.

The interview with Hutchins was now two years old, and Baker, leaning back in his office chair, reviewed his success in grooming Rennalls. What aspects of the latter's character had helped and what had hindered? What about his own personality? How had that helped or hindered? The first item to go on the credit side would, without question, be the ability of Rennalls to master the technical aspects of the job. From the start, he had shown keenness and enthusiasm and often impressed Baker with his ability in tackling new assignments as well as the constructive comments he invariably made in departmental discussions. He was popular with all ranks of Barracanian staff and had an ease of manner that placed him in good stead when dealing with his expatriate seniors. These were all assets, but what about the debit side?

First and foremost, there was his racial consciousness. His four years at London University had accentuated this feeling and made him sensitive to any sign of condescension on the part of expatriates. It may have been to give expression to this sentiment that as soon as he returned from London, he threw himself into politics on behalf of the United Action Party, which later won the preindependence elections and provided the country with its first prime minister.

The ambitions of Rennalls—and he certainly was ambitious—did not lie in politics, because, staunch nationalist that he was, he saw that he could serve himself and his country best—for bauxite was responsible for nearly half the value of Barracania's export trade—by putting his engineering talent to the best use possible. On this account, Hutchins found that he had an unexpectedly easy task in persuading Rennalls to give up his political work before entering the production department as an assistant engineer.

Baker knew that it was Rennalls's well-repressed sense of race consciousness that had prevented their relationship from being as close as it should have been. On the surface, nothing could have seemed more agreeable. Formality between the two men was at a minimum. Baker was delighted to find that his assistant shared his own peculiar "shaggy dog" sense of humor so that jokes were continually being exchanged; they entertained each other at their houses and often played tennis together—and yet the barrier remained invisible, indefinable, but ever present. The existence of this "screen" between them was a constant source of frustration to Baker, because it indicated a weakness that he was loath to accept. If he was successful with all other nationalities, why not with Rennalls?

At least he had managed to "break through" to Rennalls more successfully than any other expatriate. In fact, it was the young Barracanian's attitude—sometimes overbearing, sometimes cynical—toward other company expatriates that had been one of the subjects Baker had raised last year when he discussed Rennalls's staff report with him. He knew, too, that he would have to raise the same subject again in the forthcoming interview, because Jackson, the senior draftsperson, had complained only yesterday about the rudeness of Rennalls. With this thought in mind, Baker leaned forward and spoke into the intercom, "Would you come in, Matt, please? I'd like a word with you." As Rennalls entered the room, Baker said, "Do sit down," and offered a cigarette. He paused while he held out his lighter, then went on.

"As you know, Matt, I'll be off to Canada in a few days' time, and before I go, I thought it would be useful if we could have a final chat together. It is indeed with some deference that I suggest I can be of help. You will shortly be sitting in this chair doing the job I am now doing, but I, on the other hand, am 10 years older, so perhaps you can accept the idea that I may be able to give you the benefit of my longer experience."

Baker saw Rennalls stiffen slightly in his chair as he made this point. Consequently, he added in explanation, "You and I have attended enough company courses to remember those repeated requests by the personnel manager to tell people how they are getting on as often as the convenient moment arises and not just the automatic 'once a year' when, by regulation, staff reports have to be discussed."

Rennalls nodded his agreement, and Baker went on. "I shall always remember the last job performance discussion I had with my previous boss back in Germany. He used what he called the 'plus and minus technique.' His firm belief was that when a senior, by discussion, seeks to improve the work performance of his staff, his prime objective should be to make sure that the latter leaves the interview encouraged and inspired to improve. Any criticism must, therefore, be constructive and helpful. He said that one very good way to encourage a person—and I fully agree with him—is to tell him about his good points—the plus factors—as well as his weak ones—the minus factors. I thought, Matt, it would be a good idea to run our discussion along these lines."

Rennalls offered no comment, so Baker continued. "Let me say, therefore, right away, that, as far as your own work performance is concerned, the plus far outweighs the minus. I have been most impressed, for instance, with the way you have adapted your considerable theoretic knowledge to master the practical techniques of your job—that ingenious method you used to get air down to the fifth-shaft level is a sufficient case in point—and at departmental meetings I have invariably found your comments well-taken and helpful. In fact, you will be interested to know that only last week I reported to Mr. Hutchins that, from the technical point of view, he could not wish for a more able man to succeed to the position of chief engineer."

"That's very good indeed of you, John," cut in Rennalls with a smile of thanks. "My only worry now is how to live up to such a high recommendation."

"Of that I am quite sure," returned Baker, "especially if you can overcome the minus factor which I would like now to discuss with you. It is one that I have talked about before, so I'll come straight to the point. I have noticed that you are more friendly and get on better with your fellow Barracanians than you do with Europeans. In point of fact, I had a complaint only yesterday from Mr. Jackson, who said you had been rude to him—and not for the first time either.

"There is, Matt, I am sure, no need for me to tell you how necessary it will be for you to get on well with expatriates, because until the company has trained sufficient people of your caliber, Europeans are bound to occupy senior positions here in Barracania. All this is vital to your future interests, so can I help you in any way?"

While Baker was speaking on this theme, Rennalls sat tensed in his chair, and it was some seconds before he replied. "It is quite extraordinary, isn't it, how one can convey an impression to others so at variance with what one intends? I can only assure you once again that my disputes with Jackson—and you may remember also, Godson—have had nothing at all to do with the color of their skins. I promise you that if a Barracanian had behaved in an equally peremptory manner, I would have reacted in precisely the same way. And again, if I may say it within these four walls, I am sure I am not the only one who has found Jackson and Godson difficult. I could mention the names of several expatriates who have felt the same. However, I am really sorry to have created this impression of not being able to get along with Europeans—it is an entirely false one—and I quite realize that I must do all I can to correct it as quickly as possible. On your last point, regarding Europeans holding senior positions in the company for some time to come, I quite accept the situation. I know that Caribbean Bauxite—as it has been doing for many years now—will promote Barracanians as soon as their experience warrants it. And, finally, I would like to assure you, John—and my father thinks the same too—that I am very happy in my work here and hope to stay with the company for many years to come."

Rennalls had spoken earnestly. Although not convinced by what he heard, Baker did not think he could pursue the matter further except to say, "All right, Matt, my impression *may* be wrong, but I would like to remind you about the truth of that old saying, 'What is important is not what is true but what is believed.' Let it rest at that."

But suddenly Baker knew he didn't want to "let it rest at that." He was disappointed once again at not being able to break through to Rennalls and having yet again to listen to his bland denial that there was any racial prejudice in his makeup. Baker, who had intended to end the interview at this point, decided to try another tactic.

"To return for a moment to the 'plus and minus technique' I was telling you about just now, there is another plus factor I forgot to mention. I would like to congratulate you not only on the caliber of your work but also on the ability you have shown in overcoming a challenge which I, as a European, have never had to meet. Continental Ore is, as you know, a typical commercial enterprise—admittedly a big one—which is a product of the economic and social environment of the United States and Western Europe. My ancestors have all been brought up in this environment for the past 200 or 300 years, and I have, therefore, been able to live in a world in which commerce (as we know it today) has been part and parcel of my being. It has not been something revolutionary and new that has suddenly entered my life." Baker went on, "In your case, the situation is different, because you and your forebears have had only some 50 or 60 years in this commercial environment. You have had to face the challenge of bridging the gap between 50 and 200 or 300 years. Again, Matt, let me congratulate you—and people like you—once again on having so successfully overcome this particular hurdle. It is for this very reason that I think the outlook for Barracania—and particularly Caribbean Bauxite—is so bright."

There was a pause, and for a moment, Baker thought hopefully that he was about to achieve his long-awaited breakthrough, but Rennalls merely smiled back. The barrier remained unbreached. There remained some five minutes of cheerful conversation about the contrast between the Caribbean and Canadian climate and whether the West Indies had any hope of beating England in the Fifth Test before Baker drew the interview to a close. Although he was as far as ever from knowing the real Rennalls, he nevertheless was glad that the interview had run along in this friendly manner and, particularly, that it had ended on such a cheerful note.

This feeling, however, lasted only until the following morning. Baker had some farewells to make, so he arrived at the office considerably later than usual. He had no sooner sat down at his desk than his secretary walked into the room with a worried frown on her face. Her words came fast, "When I arrived this morning, I found Mr. Rennalls already waiting at my door. He seemed very angry and told me in quite a peremptory manner that he had a vital letter to dictate that must be sent off without any delay. He was so worked up that he couldn't keep still and kept pacing about the room, which is most unlike him. He wouldn't even wait to read what he had dictated. Just signed the page where he thought the letter would end. It has been distributed, and your copy is in your tray."

Puzzled and feeling vaguely uneasy, Baker opened the confidential envelope and read the following letter:

From: Assistant Engineer

To: Chief Engineer,
Caribbean Bauxite Limited

14 August

Assessment of Interview Between Baker and Rennalls

It has always been my practice to respect the advice given me by seniors, so after our interview, I decided to give careful thought, once again, to its main points and so make sure that I had understood all that had been said. As I promised you at the time, I had every intention of putting your advice to the best effect.

It was not, therefore, until I had sat down quietly in my home yesterday evening to consider the interview objectively that its main purport became clear. Only then did the full enormity of what you said dawn on me. The more I thought about it, the more convinced I was that I had hit upon the real truth—and the more furious I became. With a facility in the English language which I, a poor Barracanian, cannot hope to match, you had the audacity to insult me (and through me every Barracanian worth his salt) by claiming that our knowledge of modern living is only a paltry 50 years old whereas yours goes back 200 or 300 years. As if your materialistic commercial environment could possibly be compared with the spiritual values of our culture. I'll have you know that if much of what I saw in London is representative of your most boasted culture, I hope fervently that it will never come to Barracania. By what right do you have the effrontery to condescend to us? At heart, all you Europeans think us barbarians; as you say amongst yourselves, we are "just down from the trees."

Far into the night I discussed this matter with my father, and he is as disgusted as I. He agrees with me that any company whose senior staff think as you do is no place for any Barracanian proud of his culture and race—so much for all the company "clap-trap" and specious propaganda about regionalization and Barracania for the Barracanians.

I feel ashamed and betrayed. Please accept this letter as my resignation, which I wish to become effective immediately.

cc: Production Manager
Managing Director

Questions for Review

1. What mistake did John Baker make? Why did he not realize this mistake when it occurred?
2. What would you recommend that Baker do now? Explain.
3. What does this case illustrate about human resource management in the international environment? Be complete in your answer.

Source: This case was prepared by Gareth Evans and is used with permission.

In-Depth Integrative Case 4.1

HSBC in China

Introduction

After years of negotiations, China finally acceded to the World Trade Organization (WTO) in December 2001 (see Exhibit 1). This development was a significant milestone in China's integration with the global economy. One of the most important and far-reaching consequences was the transformation of China's financial sector. China's banking, insurance, and securities industries were long due for a major overhaul, and the WTO requirements guaranteed that the liberalization of China's economy would extend to the important financial sector. China's banking sector had become a casualty of the state. Banks and other financial institutions haphazardly extended loans to state-owned enterprises (SOEs) based not on sound credit analysis but favoritism and government-directed policy. As a consequence, crippling debt from bad and underperforming loans mounted, with no effective market disciplines to rein it in.

China recognized that opening up the banking sector could bolster its financial system. Foreign management would help overhaul the banking sector and put the focus on returns, instead of promoting a social agenda. This fiscal agenda would ultimately lead to a stronger and more stable economy. Yet after years of direction from the state, Chinese bank managers did not have the necessary skills to transform the banks on their own. Guo Shuqing, shortly after being promoted to chairman of China Construction Bank, admitted that, "more than 90 percent of the bank's risk managers are unqualified."[1]

Immediately upon accession to the WTO, China's banking sector began to open to foreign banks. Initially, foreign banks were allowed to conduct foreign currency business without any market access restrictions and conduct local currency business with foreign-invested enterprises and foreign individuals. In addition, the liberalization of foreign investment rules made Chinese banks attractive targets for foreign financial institutions. Sweeping domestic changes have followed. Strong emphasis has been placed on interest rate liberalization, clearer and more consistent regulation, and a frenzy of IPOs of state owned banks has followed. It was in this context that HSBC rapidly expanded its presence in China.

Exhibit 1 **China's WTO Commitments**

General Cross-Sector Commitments

- Reforms to lower trade barriers in every sector of the economy, opening its markets to foreign companies and their exports from the first day of accession.
- Provide national treatment and improved market access to goods and services from other WTO members.
- Special rules regarding subsidies and the operation of state-owned enterprises, in light of the state's large role in China's economy.
- Undertake important changes to its legal framework, designed to add transparency and predictability to business dealings and improve the process of foreign market entry.
- Agreement to assume the obligations of more than 20 *existing* multilateral WTO agreements, covering all areas of trade.
- Under the acquired rights commitment, agreed that the conditions of ownership, operation, and scope of activities for a foreign company under any existing agreement would not be made more restrictive than they were on the date of China's accession to the WTO.
- Licensing procedures that were streamlined, transparent, and more predictable.

Commitments Specific to the Financial Services Industry

- Allow foreign banks to conduct *foreign currency business* without any market access or national treatment limitations.
- Allow foreign banks to conduct *local currency business* with foreign-invested enterprises and foreign individuals (subject to geographic restrictions).
- Banking services (with a five-year transitional plan) by foreign banks:
  Within two years after accession, foreign banks would be able to conduct *domestic* currency business with Chinese enterprises (subject to geographic restrictions).
  Within five years after accession, foreign banks would be able to conduct domestic currency business with Chinese individuals, and all geographic restrictions will be lifted.
  Foreign banks also would be permitted to provide financial leasing services at the same time that Chinese banks are permitted to do so.

HSBC, known for its international scope and careful, judicious strategy, made a series of key investments between 2001 and 2005 that arguably gave it the most extensive position in China of any foreign financial group. These investments included two separate transactions that resulted in a 19.9 percent stake in Ping An insurance, and, in June 2004, a $1.8 billion successful tender for a 19.9 percent stake in Bank of Communications, the fifth largest bank in China. HSBC had a long history in Asia, and was uniquely positioned to take advantage of China's vast population and mushrooming middle class, high savings rates (in the range of 40 percent), and huge capital investments (US$50 billion FDI in 2005). HSBC recognized that the current banking system was not capitalizing on this vast opportunity, and sought to get in on the ground floor in this new environment. Perhaps, with further liberalization, however, China would allow future investors to establish even greater claims to Chinese banks. Citigroup's successful effort to gain a controlling stake in Guandgong Development Bank appeared to undermine earlier investors who had been limited by China's rule that allowed foreigners to own no more than 19.9 percent of domestic financial institutions. Did the huge potential rewards of being an early mover in China mitigate the promise of uncertainty and risks of doing business in an emerging market? After being burned in Argentina, could HSBC relax its conservative philosophy in its China strategy? If the economy took a turn for the worse, HSBC could face heavy losses. On the other hand, could HSBC afford not to be an early mover in a region where it had a longstanding presence?

Background on HSBC

History

Thomas Sutherland founded the Hongkong and Shanghai Banking Corporation (Hongkong Bank) in 1865 to finance the growing trade between Europe, India, and China.[2] Sutherland, a Scot, was working for the Peninsular and Oriental Steam Navigation Company when he recognized a considerable demand for local banking facilities in Hong Kong and on the China coast. Hongkong Bank opened in Hong Kong in March 1865 and in Shanghai a month later.

The bank rapidly expanded by opening agencies and branches across the globe, reaching as far as Europe and North America, but maintained a distinct focus on China and the Asia-Pacific region. Hongkong Bank helped pioneer modern banking during this time in a number of countries, such as Japan, where it opened a branch in 1866 and advised the government on banking and currency, and Thailand, where it opened the country's first bank in 1888 and printed the country's first banknotes. By the 1880s, the bank issued banknotes and held government funds in Hong Kong, and also helped manage British government accounts in China, Japan, Penang, and Singapore. In 1876, the bank handled China's first public loan, and thereafter issued most of China's public loans. Hongkong Bank had become the foremost financial institution in Asia by the close of the 19th century.[3]

After the First World War, the Hongkong Bank anticipated an expansion in its Asian markets, and took a leading role in stabilizing the Chinese national currency. The tumultuous Second World War, for its part, saw most of the bank's European staff become prisoners of war to the advancing Japanese.

The Postwar Years

In the postwar years, Hongkong Bank turned to dramatic expansion through acquisitions and alliances in order to diversify. The acquisitions began with the British Bank of the Middle East (Persia and the Gulf states) and the Mercantile Bank (India and Malaya) in 1959, and were followed by acquiring a majority interest in Hong Kong's Hang Seng Bank in 1965. The 51 percent controlling interest in Hang Seng Bank was acquired during a local banking crisis for $12.4 million. As of 2002, HSBC's interest in the bank was 62 percent and was over $13 billion. Hang Seng, which retained its name and management, has been a consistently strong performer. The bank made further acquisitions in the United Kingdom and Europe (from 1973), North America (from 1980), and Latin America (from 1997), as well as other Asian markets.

Under Chairman Michael Sandberg, Hongkong Bank entered the North American market with a $314 million, 51 percent acquisition of Marine Midland, a regional bank in upstate New York. In 1987, the bank purchased the remaining 49 percent, doubling Hongkong Bank's investment and providing the bank a significant U.S. presence. As a condition of the acquisition, however, Marine Midland retained its senior management.

Move to London and Acquisitions

In 1991, Hongkong Bank reorganized as HSBC Holdings and moved its headquarters in 1993 to London from Hong Kong. Sandberg's successor, William Purves, led HSBC's purchase of the U.K.'s Midland Bank in 1992. This acquisition fortified HSBC's European presence and doubled its assets. The move also enhanced HSBC's global presence and advanced the bank's reputation as a global financial services company.

Other major acquisitions of the 1990s included Republic Bank and Safra Holdings in the United States, which doubled HSBC's private banking business investments moves in Brazil and Argentina in 1997, and acquisition of Mexico's Bital in 2002. In 2000, HSBC acquired CCF in France. By 2006, HSBC had assets exceeding $1,860 billion, customers numbering close to 100 million, and operations in six continents. In recent years, HSBC has made a major commitment to emerging markets, especially China and Mexico, but also Brazil, India, and smaller developing economies.

Expansion, Acquisition, and Succession

The World's Local Bank

HSBC holding company set up a group policy in 1991 that established 11 quasi-independent banks, each a separate subsidiary with its own balance sheet.[4] The head office provided essential functions, such as strategic planning, human resource management, and legal, administrative, and financial planning and control. This setup promoted prompter decision making at a local level and greater accountability.[5] HSBC portrays itself as "the world's local bank," recognizing the importance of globalization, flexibility, and local responsiveness.

As of 1998, HSBC established distinct customer groups or lines of business that would overlay existing geographic designations. This encouraged maximizing the benefits of its universal scope, such as sharing best practices of product development, management, and marketing. The geographic perspective was melded closely with a customer group perspective, demanding both global and local thinking.

Traditionally, HSBC's culture has embraced caution, thrift, discipline, and risk avoidance. The bank looked at long-term survival and considered markets in 50-year views. Thrift manifested through the company, and even the chairman flew economy class on flights less than three hours.[6] In 2005, incoming Chairman Stephen Green recognized the company's rule "to follow the letter and spirit of regulations" and signaled his intention to protect the bank's reputation as it extends into consumer finance.[7]

Bond's Rein and Move to "HSBC"

Sir John Bond became CEO of HSBC in 1993, and chairman in 1998, bringing with him a hands-on entrepreneurial style and exceptionally ambitious goals.[8] He pursued acquisitions beyond HSBC's traditional core, in pursuit of such attractive financial segments as wealth management, investment banking, online retail financing, and consumer finance. Bond considered shareholder value and economic profit in deciding when acquisition premiums were in order, which was in contrast to his predecessor's "three times book value" rule.[9] By 2001, Bond had authorized investments of over $21 billion on acquisitions and new ventures.[10]

In 1998, Bond adopted the HSBC brand, and preserved "The Hongkong & Shanghai Banking Corp." name only for its bank based in Hong Kong. HSBC branded its subsidiary banks across the world with the parent bank's acronym and greatly expanded marketing efforts in 2000. In March 2002, HSBC's marketing message became "the world's local bank," which would help the brand become one of the world's top 50 most recognizable brands by 2003.[11]

Household Acquisition

In 2003, a $15.5 billion acquisition of Household International,[12] the U.S. consumer lending business, became the basis of HSBC's Consumer Finance customer group. Household utilized a unique system to forecast the likelihood that customers would repay debt, which used a 13-year database of consumer behavior. Household was controversial and yet presented great opportunity. HSBC desired to leverage this new skill in developing countries, yet was unable to find all demographic and credit data that Household normally relies on in the United States. HSBC particularly looked to extend the Household model into China and Mexico. However, the subprime mortgage crisis hit the United States hard in 2007–2008 and had a major impact on Household operations.

Six years after acquiring Household International, HSBC effectively conceded that the deal was a mistake. In March 2009 HSBC made public that it would close all 800 remaining branches of HSBC Finance Corp., the former Household Financial, resulting in 6,100 job cuts nationwide. HSBC had already closed about 600 HFC and Beneficial branches over the past two years.[13] "High levels of delinquency, given rising levels of unemployment, mean that the business model for subprime home equity refinancing is not sustainable," said Niall Booker, HSBC Finance chief executive during one of the media conferences.[14] HSBC Finance said it would retain its credit card business, and HSBC Holdings would keep its New York–based HSBC Bank USA. HSBC officials also said that the bank would continue to help mortgage customers with loan repayments and foreclosure-prevention efforts.

The HSBC Finance (Household) executives pointed out that it was hard to predict in 2003 that global financial crisis and the recession would occur. When the crisis hit hard in 2008, the subprime mortgage market led to more than $1.15 trillion of credit losses and writedowns at financial institutions and government bailouts of companies ranging from Citigroup Inc. to Royal Bank of Scotland Group Plc of Edinburgh as noted by Bloomberg analysts. HSBC was one of the first banks to acknowledge the possibility of upcoming subprime mortgage problems, and set aside about $53 billion to cover bad loans during the past three years.[15]

Economic Crisis and Financial Performance

The consequences of global economic crisis were severe for the world's banking system, prompting thousands of banks to seek financial assistance from their local government. Many banks were burdened with highly overvalued "bad loans" and suffered huge losses. Unlike many global players, HSBC reported a profit for 2008 but it still took a hit: Its pretax profit of $9.3 billion was 62 percent below the $24.2 billion reported for 2007. The bank also cut its dividend for the full year by 29 percent to 64 cents per share. The slide in profits was largely the result of a goodwill impairment charge of $10.6 billion in the United States.[16] In spite of the bitter loss in North America, HSBC performed much better in the other parts of the world. For example, in Europe, pretax profit rose to $10.9 billion from $8.6 billion. Profit from Hong Kong fell to $5.46 billion from $7.34 billion, while earnings from the rest of Asia rose to $6.47 billion from $6.01 billion.[17] HSBC is still considered one of the world's strongest banks by some measures. The bank's market value of $68.2 billion in early 2009 ranked it behind only Industrial & Commercial Bank of China Ltd., China Construction Bank Corp., Bank of China Ltd., and JPMorgan Chase & Co.[18]

To the credit of HSBC management, the bank avoided taking U.K. government "bailout" funding unlike other big banks. Instead, HSBC made plans to raise £12.5 billion ($17.9 billion) in capital to prepare for further deterioration of the global economy.[19] Also, responding to growing public anger over the scale of bonuses paid to many senior bankers, HSBC said no performance share awards would be made for 2008 and that no executive director would receive a cash bonus.[20]

Managing for Growth

HSBC's strategic plan, "Managing for Growth," was launched in the fall of 2003. This strategy builds on HSBC's global, international scope and seeks to grow by focusing on the key customer groups of personal financial services; consumer finance; commercial banking; corporate, investment banking, and markets; and private banking.[21] "Managing for Growth" is intended to be "evolutionary, not revolutionary," and aims to vault HSBC to the world's leading financial services company. HSBC seeks to grow earnings over the long term, using its peers as a benchmark. It also plans to invest in delivery platforms, technology, its people, and brand name to prop up the future value of HSBC's stock market rating and total shareholder return. HSBC retains its core values of communication, long-term focus, ethical relationships, teamwork, prudence, creativity, high standards, ambition, customer-focused marketing, and corporate social responsibility, all with an international outlook.[22]

Strategic Pillars

As part of the growth strategy, HSBC identified eight strategic pillars:

> *Brand:* continue to establish HSBC and its hexagon symbol as one of the top global brands for customer experience and corporate social responsibility.
> *Personal Financial Services:* drive growth in key markets and through appropriate channels; emerging markets are essential markets with a burgeoning demand.
> *Consumer Finance:* offer both a wider product range and penetrate new markets, such as the emerging country markets.
> *Commercial Banking:* leverage HSBC's international reach through effective relationship management and improved product offerings.
> *Corporate, Investment Banking, and Markets:* accelerate growth by enhancing capital markets and advisory capabilities.
> *Private Banking:* a focus on serving the highest value personal clients.
> *People:* draw in, develop and motivate HSBC's people.
> *TSR:* fulfill HSBC's TSR target by achieving strong competitive performances in earnings per share growth and efficiency.[23]

Focus on Emerging Markets

In 2000, HSBC had half of its assets in developing countries.[24] Most earnings, however, stemmed from mature markets, such as Hong Kong and Britain. All but 5 percent of group profits came from five economies, while India and Latin America each added only 1 percent to group profit.[25]

In 2005 incoming Chairman Stephen Green underlined HSBC's focus on the potential of emerging markets: "There is a general rule of thumb that says the emerging markets grow faster than mature markets as economies and the financial services sector grows faster than the real economy in emerging markets because you are starting from very low penetration of financial services in general."[26]

Specifically in consumer finance, Green recognized the importance of importing HSBC's model into markets starved for credit cards and loans, saying, "Any analysis of the demographics of emerging markets tells you that consumer finance is going to be an important part, and a rapidly growing part, of the financial-services spectrum for a long time to come."[27]

The Draw of Emerging Markets

Recognition of the impact of emerging markets is an essential thread running throughout the elements of the "Managing for Growth" strategy. Since 2000, many of HSBC's emerging markets' profits have increased dramatically (see Exhibit 2). Across the board, HSBC's pretax profits in emerging markets have increased from $905 million in 2000 to $3,439 million in 2005. In January 2010, HSBC Global Asset Management reported that despite high volatility throughout 2009, Asian and emerging market equities gained around 100 percent. The Brazilian equity market was the best performer with a return of over 140 percent in 2009. In contrast, major markets such as the U.S., Europe, and Japan were all up between 39 and 82 percent for the same period. Meanwhile, HSBC Global Asset Management expects the pace of economic growth in global emerging markets to be faster than that of developed markets over the medium to long term.[28]

Liberalization of China's Banking Sector

China's Banking Sector Pre-WTO

Before the WTO accession negotiations, China's banking industry operated as a cog in China's centrally planned economy. The state commercial banks performed a social function, during China's post-Mao drive to industrialize,

Exhibit 2 **HSBC Emerging Markets**

Pretax Profits 2005 vs. 2004, 2000

Country	2000 (US$ mil)	2004 (US$ mil)	2005 (US$ mil)	% Change 2004–2005
Argentina	112	154	244	58
Brazil	208	281	406	44
China	−26	32	334	944
India	87	178	212	19
Indonesia	70	76	113	49
Malaysia	116	214	236	10
Mexico	9	774	923	19
Saudi Arabia	30	122	236	93
South Korea	65	89	94	6
Taiwan	45	107	68	−36
Turkey	59	142	265	87
UAE	130	192	308	60
Total	**905**	**2,361**	**3,439**	**+46**
Total profit before tax (all countries)		18,943	20,966	+10.7

Pretax Profits 2005 vs. 2006

Country	2006 (US$ mil)	% Change (2006 over 2005)
Argentina	157	−36
Brazil	526	30
China	708	112
India	393	85
Indonesia	71	−37
Malaysia	274	16
Mexico	1,009	9
Saudi Arabia	181	41
South Korea	48	−13
Taiwan	(23)	NA
Turkey	217	−18
Middle East	730	25
Other	166	−15
Total	**4,533**	**19**
Total profit before tax (all countries)	22,086	5

instead of operating for economic return. Consequently, the banks adhered to directed lending practices from the government and in turn created some of China's most successful enterprises, but also supported thousands of other inefficient and unprofitable state-owned enterprises. This practice left state commercial banks with massive amounts of debt that were largely unrecoverable and hordes of nonperforming loans.

In addition to widespread losses, instability ensued in the banking system overall. To make matters worse, corruption and mismanagement ran rampant throughout the sector, sapping away consumer and investor confidence.

WTO Accession

Following 15 years of negotiation and two decades of economic reform in China, December 11, 2001, marked China's accession to the World Trade Organization. The main objective of the WTO agreement was to open China's market up to foreign competition. The deadline for complete implementation was December 11, 2006.

China made a number of implementations immediately. To begin with, foreign banks were allowed to conduct foreign currency business without any market access restrictions. Also, foreign banks were allowed to conduct local currency business with foreign-invested enterprises and foreign individuals (with geographic restrictions). Within two years of accession, China agreed to allow foreign banks to conduct domestic currency business with Chinese enterprises (geographic restrictions). Within five years, foreign banks could conduct domestic currency business with Chinese individuals (no geographic restrictions); and foreign banks were able to provide financial leasing services at the same time as Chinese banks. Under the WTO investment provisions, China agreed to allow foreign ownership of Chinese banks (up to 25 percent), with no single foreign investor permitted to own more than 20 percent.

"Bank reform has become the most crucial task for the government in pushing forward economic reforms," said Yi Xianrong, an economist at the Chinese Academy of Social Sciences in Beijing.[29] Indeed, bank reform is critical to stabilizing and advancing the Chinese economy.

Domestic Reform

China has undertaken a number of domestic reforms in order to overhaul the banking industry. China has engaged in interest rate liberalization by removing certain interest rate and price controls. Instead of being pegged to the U.S. dollar, as it once was, China's currency exchange rate is now pegged to within 0.3 percent of a basket of currencies, dominated by a group including the U.S. dollar, euro, Japanese yen, South Korean won, British pound, Thai baht, and Russian ruble. The yuan was revalued by 2.1 percent against the dollar in July 2005, but analysts estimate that it remains 10–30 percent undervalued.

Regulation has long been a concern in the Chinese banking industry. China has made major progress by creating regulatory agencies. In 2003, China created a central regulator, the China Banking Regulatory Commission (CBRC), out of the central bank. The regulator's 20,000 staff members endeavor to shift the banks' focus from senseless loans and grow mind-sets to a goal of preserving capital and generating returns. Lenders not meeting a capital ratio of 8 percent of risk-weighted assets (as decreed by Basel I, a global standard) by 2007 may face sanctions, which could include the removal of senior management. Still, the CBRC faces an uphill battle. Han Mingzhi, as head of the CBRC's international department, admitted in 2004 that "we lack people who understand commercial banking and microeconomics. It is a headache for the CBRC."[30]

Concurrently, China is striving to make regulatory and reporting requirements more clear, because they have often proved confusing barriers to foreign investment. Since 1998, China has intensified accounting, prudential, and regulatory standards. Prior to 1998, the banks booked interest income for up to three years even if it was not being paid. Now, the banks can do so for only 90 days, which is the international norm. Still, it has been all too common for Chinese banks to ignore regulations and not monitor loans. As a result of poor accounting, the banks themselves are sometimes unsure of their bad loans. Lai Xiaomin, head of the CBRC's Beijing office, admits that "when our banks disclose information, they don't always do so in a totally honest manner."[31] Indeed, the lack of reliable accounting can hamper investment. As one Hong Kong investor put it, "When you take a state-owned enterprise that has had weak internal controls, it can be enormously labor-intensive to come up with financials we can work with."[32]

In 2006, regulators overhauled the system in which almost one-third of a company's shares were "nontradable." Fixing this problem has helped energize the market and welcome in individual investors.[33]

Recent Regulatory Moves

New regulations, it is hoped, will address China's history of dishonesty and embezzlement. With the tight connection of Chinese banks with local governments, corruption has choked the Chinese banking system. Some common practices have historically encouraged corruption, such as allowing the same person to make and approve a loan. Former bank Chairman Zhang Enzhao himself was arrested in June 2005 for allegedly taking bribes. At the China Construction Bank alone, there were more than 100 cases of theft and embezzlement between 2002 and 2004.[34] These old habits have to be rooted out.

China is working hard to transition its traditional banks into "universal" banks. Most of China's 128 commercial banks have introduced better governance, shareholding, and incentive structures, while also adding independent directors to their boards.[35] Foreign management and knowledge are intended to flush the Chinese banking system with managerial talent. To help encourage foreign banks, China is relaxing some foreign bank restrictions. The Chinese government has also taken steps to eliminate bad loans by bailing out banks.

IPO Explosion

China has aggressively pursued IPOs of state-owned banks, a policy which has been met with a strong response from investors eager to tap into the populous country and seize first-mover advantages (see Exhibit 3). HSBC's

Exhibit 3 **Foreign Bank Investments in China**

PRC Bank	Foreign Partner	% Stake	Price	Date
Bank of Shanghai	HSBC	8.00	$62.6 m	12/2001
	IFC	7.00	$25.0 m	
	Shanghai Commercial Bank (HK)	3.00	$15.7 m	
Shanghai Pudong Dev Bank	Citigroup	4.62	$72.0 m	12/2003
Fujian Asian Bank	HSBC	50	Less than $20 m[1]	12/2003
Bank of Communications	HSBC	19.90	$1.75 b	6/2004
Xian CCB	Scotia Bank	12.4	$3.2 m	10/2004
Jinan City CCB	Commonwealth Bank of Australia	11.0	$17 m[2]	11/2004
Shenzhen Dev. Bank	Newbridge Capital	17.9	$1.23 b	12/2004
Minsheng Bank	Temasek	4.9		1/2005
Hangzhou CCB	Commonwealth Bank of Australia	19.90	$78.0 m	4/2005
China Construction Bank	Bank of America	9.00	$3.0 b	6/2005
	Temasek	5.1	$1.5 m[3]	
Bank of China	Royal Bank of Scotland	5.00	$3.1 b	8/2005
	UBS	1.6	$500 m[4]	9/2005
	Temasek	10.00	$3.1 b[5]	9/2005
Industrial Commercial BOC	Goldman, Allianz, AmEx			8/2005
Nanjing CCB	BNP Paribas	19.20	$27.0 m	10/2005
Hua Xia Bank	Deutsche Bank	9.9	$329 m[6]	10/2005
	Sal. Oppenheim Jr.	4.1		10/2005
Bank of Beijing	ING	19.90	$214 m	3/2005

[1]HSBC Press Article, accessed October 3, 2006, www.hsbc.com.cn/cn/aboutus/press/content/03dec29a.htm.
[2]Guonan Ma, "Sharing China's Bank Restructuring," *China and World Economy* 14, no. 3 (2006), p. 8.
[3]David Lague and Donald Greenlees, "China's Troubled Banks Lure Investors," *International Herald Tribune,* www.iht.com/articles/2005/09/21/business/bank.php, accessed on October 4, 2006.
[4]"UBS to Invest $500 million in Bank of China," CBS News, www.cbsnews.com/stories/2005/09/27/ap/business/main D8CSHPLO0.shtml, assessed October 4, 2006.
[5]Luo Jun and Xiao Yu, "Temasek to Buy 10% of China Bank," *International Herald Tribune,* www.iht.com/articles/2005/09/01/bloomberg/sxboc.php, accessed on October 4, 2006.
[6]"Deutsche Bank Seals Chinese Deal," BBC News, news.bbc.co.uk/2/hi/business/4348560.stm, accessed October 4, 2006.

purchase of a 19.9 percent stake in Bank of Communications (BoCOM) in June 2004 was the pioneering, substantial foreign bank investment in China. HSBC had previously made large investments in Fujian Asian Bank (50 percent) and Bank of Shanghai (8 percent). In 2005, foreign banks invested $18 billion in several of China's largest banks. The October 2005 listing of China Construction Bank (CCB), China's largest at the time, raised $8 billion from foreign investors for 12 percent of its shares. CCB further obtained an additional $4 billion ahead of its float by selling stakes of 9 percent to Bank of America and 5.1 percent to Temasek, Singapore's investment agency. In the following months, the Royal Bank of Scotland put $3.1 billion into Bank of China, Temasek another $3.1 billion, and Switzerland's UBS $500 million.

In May 2006, Bank of China, the country's second-largest lender, raised $11.2 billion in a Hong Kong stock sale, which was the fifth-largest initial public offering in history. In July 2006, the Chinese government announced approval for an even larger IPO of the country's largest bank, Industrial & Commercial Bank of China, to raise $18 billion or more in one of the largest stock offerings ever.[36] The central bank expects foreigners to bring much needed improvements to the state banks' risk-management and internal control systems, including credit-risk assessment and more transparent reporting. With capital allocated more efficiently, a more stable financial system will follow, and the economy will become more open to foreign competition.

Two Steps Forward

Pulling back from some of its commitments, China indirectly delayed the implementation of its WTO commitments. On February 1, 2002, the People's Bank of China (PBOC) issued regulations and implementation rules governing foreign-funded banks. While these measures met the commitments of the WTO agreement, the PBOC was taking a *very* conservative approach in opening up the banking sector. For example, foreign-funded banks could open only one branch every 12 months.

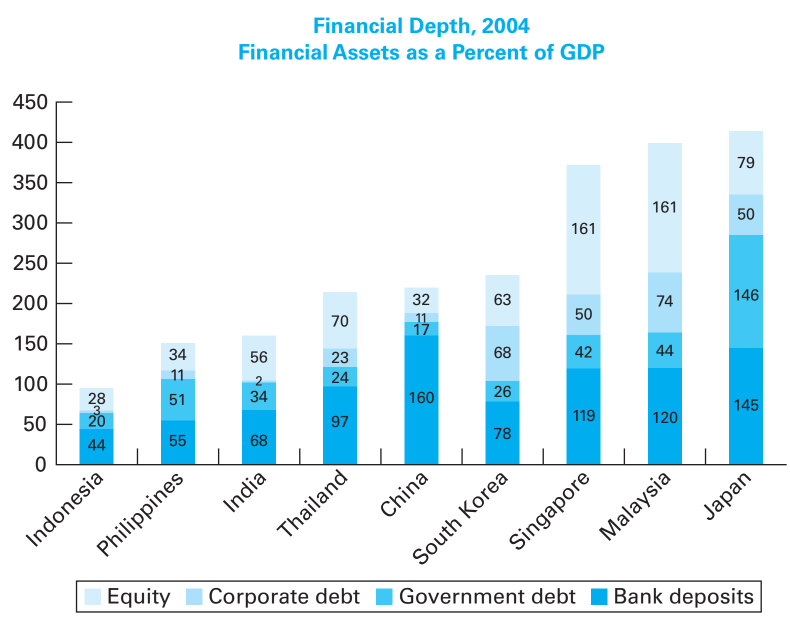
In the wake of these early obstacles, there have been positive changes. Capital requirements were reduced, additional cities were opened up to foreign banking, and the "one branch every 12 months" restriction was lifted. Central bank officials have indicated willingness to eventually elevate the foreign ownership limit above the current 25 percent, but experts doubt it will ever go beyond 50 percent.[37]

A 2006 study by McKinsey found that underperforming loans with merely negligible returns are also very damaging to the Chinese economy. McKinsey estimates that reforming China's financial system could boost GDP by $321 billion annually.[38]

China's banking sector plays an excessive role in the overall financial system. The share of bank deposits in the financial system ranges from less than 20 percent in developed economies to around half in emerging markets. China, however, has a share of bank deposits at a sky-high 75 percent of the capital in the economy, which practically doubles any other Asian nation (see Exhibit 4).[39]

Capital is still mostly allocated to state-owned enterprises even though private companies have been China's growth engine. Private companies produce 52 percent of GDP in China, but only account for 27 percent of outstanding loans.[40] By sinking money into state-owned

Exhibit 4 **Financial Depth in Major Market**



Source: McKinsey.

enterprises, China's banks are dragging the economy. China's banks had difficulty lending to private companies in the past, because of challenges related to gathering and processing the necessary information on them. As a response, China launched its first national credit bureau in early 2006. China's banks have been satisfying a social role, but now must allocate capital efficiently in order to generate positive economic return.

Investments in Ping An and BoCOM

With its longstanding presence in China, HSBC was among the best positioned financial institutions to take advantage of China's market opening.

Ping An Investments

In October of 2002, HSBC announced that it had taken a 10 percent stake in Ping An Insurance, China's second largest insurer, for $600 million. U.S. investment banks Goldman Sachs and Morgan Stanley already had a combined 14 percent stake in Ping An. Chairman Sir John Bond indicated that HSBC was particularly attracted to the long-term prospects in the insurance and asset management sectors.

In May 2005, HSBC indicated it was investing an additional HK$8.1 billion ($1.04 billion) for an additional 9.91 percent stake in Ping An, doubling its holding in the number-two life insurer. HSBC paid HK$13.20 a share for the stakes held by investment banks Goldman Sachs and Morgan Stanley, lifting HSBC's holding to 19.9 percent, the maximum stake allowed by a single foreign investor.

"This is good news for Ping An," said Kenneth Lee, an analyst at Daiwa Institute of Research. "HSBC is buying at a premium and is replacing Goldman Sachs and Morgan Stanley, which are venture capital investors. HSBC is a long-term investor and will help Ping An to develop its insurance platform," he said.

The company's market share of more than 15 percent of the Chinese market puts it behind domestic competitor China Life Insurance Co., which underwrites about half of all Chinese life insurance premiums. In 2005, HSBC Chairman John Bond commented, "We are optimistic about the long-term prospects of the insurance industry in mainland China and believe Ping An is well-positioned to benefit from the sector's development."[41]

In addition to holding a stake in Ping An Insurance, HSBC has applied for its own life insurance license in China. Foreign firms account for only 5 percent of the life insurance market in China, while three domestic firms (China Life Insurance, Ping An Insurance, and China Pacific Insurance) hold 76 percent of the market share. The bank hopes to start operations in 2008, and says it will maintain its relationship with Ping An.[42]

The BoCOM Deal

HSBC invested $1.8 billion for a 19.9 percent stake in BoCOM in June 2004. HSBC's chairman at the time, Sir John Bond, commented on the company's long-term perspective: "[I]t is inevitable that China will become a superpower. And indeed, desirable. And we are positioning our business for the decades ahead accordingly."[43] HSBC wanted a piece of the alluring Chinese market, which Goldman Sachs predicts will overtake the United States as the number-one economy in the world by 2040, and wanted to deepen its international scope in line with the "Managing for Growth" strategy.

Speaking one month after HSBC's big move, then-CEO and future Chairman Stephen Green expounded upon China: "[T]he potential in China's domestic market is the largest in history." China is the "world's manufacturer," and as the population continues to urbanize and industrialize, it increasingly has more disposable income, the workers become greater consumers, and the middle class expands.[44] China has one of the world's highest savings rates, at around 40 percent, and already has around one-third of the $1.2 trillion of central bank foreign exchange reserves sitting in Asia. Further, access to capital is not a problem, as FDI floods the country. The challenge facing China is to recycle and invest its pool of savings efficiently.

HSBC recognized the huge potential in the market for banking services, as well as credit cards. As part of its emerging market strategy, HSBC wanted to feed the demand for credit cards in these markets. Green commented: "[O]ur joint venture with Bank of Communications for credit cards is one which we think has a lot of exciting prospects. Bank of Communications has over 30 million debit cards in issue. Over time, a proportion of those is going to convert to credit cards. And we are issuing co-branded credit cards with the Bank of Communications."[45] HSBC saw an opportunity to shepherd millions of new people into the banking system.

HSBC's Green acquiesced that emerging markets do carry risk. This risk was starkly evident during the HSBC debacle in Argentina during the country's economic crisis. China's epic turnaround could conceivably flop, and heavily invested banks could pay dearly. The banking system in China was and is very fragile. Would China's banks be able to break away from state-directed lending and its lasting effects? The banks further rely on the continued acceleration of the economy, and many rely on volatile real estate loans.[46] HSBC recognized other challenges for China, including the need to strengthen regulations, build social security, stem corruption, and fortify the financial system.[47]

Margaret Leung, general manager and global co-head of commercial banking for the HSBC Group, commented, "[W]e believe we have a unique advantage [in China]. A lot of analysts . . . have been saying that if any foreign bank is going to succeed in China, that would be HSBC."[48] BoCOM's net profit soared from Rmb1.604bn (US$200m) in 2004 to Rmb9.249bn in 2005, and a BoCOM-HSBC credit card has successfully been issued to over 650,000 people.[49] However, with the passing of the WTO deadline, BoCOM now faces greater competition from foreign banks, which are now better able to compete under the new Regulation on Administration of Foreign-Funded Banks (adopted in late 2006). Under these new regulations, foreign banks are allowed to issue local currency loans and are no longer limited in the size and scope of their business.

Recent Developments and Future Competitive Conditions

Current Strategies in China

Foreign banks that operate in China have different strategies. Some of them have purchased smaller stakes of Chinese financial institutions, while some prefer to buy a bigger stake of a small bank. Nevertheless, they all want to be in China. The best strategy, in theory, has turned out to be with a local partner. Bob Edgar, senior managing director at Australia and New Zealand Banking Group Ltd., said that "it would be very difficult to go into a market like that and undertake the cost of establishing a branch network, getting a customer base of hundreds of thousands if not millions of customers. That already exists, so why would we want to set it up again?"[50]

Many foreign banks, however, experience difficulties when working with a local partner. The credit standards are not as strict as they should be, and there is still endemic corruption at different levels. In addition, the partners gain influence in the foreign bank. This is the reason why HSBC has decided to invest "outside the Big Four": so it would have bigger control in operations. Peter Wong, executive director of HSBC's Hong Kong and Mainland China operations, has commented: "[T]he state-owned banks would be too big." So only the future will tell what is the best strategy.[51]

Recent Developments

One significant development in the bank sector in China was the IPO of Industrial and Commercial Bank of China. As expected, it was the world's biggest IPO. ICBS raised $19.1 billion, exceeding investors' predictions, valuing the bank at more than $108 billion. The previous IPO record was $18.4 billion and was held by NTT DoCoMo Inc., a Japanese mobile company.[52] The bank has announced that the money will be used to fund its expansion.

The competition in China's banking industry is continuing to grow. Recently, Morgan Stanley announced its expansion into China, given the company's desire to tap into the growing Chinese market and become competitive there. The company chief executive commented, "[T]his platform will allow us to provide a wider array of new product capabilities that are currently offered only by commercial banks with a presence within China."[53]

Another important development was the deal in which a consortium led by Citigroup took control over the Guangdong Development Bank (GDB). The agreement was reached on November 16, 2006, after a year of negotiations. Citigroup and its investors' partners have agreed to pay about $3.1 billon for 85.6 percent of Guangdong Development Bank.[54] The deal is significant since this is the first time that a foreign investor has been able to gain control in a Chinese bank. It is expected that Citigroup alone would purchase only 20 percent of Guangdong Development Bank; however, its partners would split the remaining 65.6 percent. The China Life Insurance Co. and State Grid Corporation each own 20 percent, followed by Citic Trust & Investment Co. with 12.9 percent and Yangpu Puhua Investment and Development Co. with 8 percent. Interestingly, IBM also has a stake at GDB, owning 4.74 percent of Guangdong Development Bank.

Another issue that makes the deal special is the fact that in January 2007, China opened its financial sector to foreign investors, which was one of its last WTO membership commitments. Under the new rules, foreign banks in China finally have the opportunity to offer services in the local currency—yuan—which was previously prohibited.[55] In a statement issued after the deal was announced, William R. Rhodes, the chairman and chief executive of Citibank, said, "The continued emergence of China's economy represents a tremendous opportunity for Citigroup."[56]

Although Citigroup has gained more market opportunities since the deal was approved, analysts say that there are certain risks involved. It is publicly known that the Guangdong Development Bank has been struggling financially, and there is speculation about the amount of bad loans that have not been put on the books. Bad loans have been an issue for the Chinese banks. However, it seems that the experience in banking and asset management that Citigroup possesses, in addition to the IT support offered by IBM, would make this investment beneficial to Guangdong Development Bank and could turn the bank around.[57] In June 2007, the Guangdong Development Bank issued an outline of its five-year plan. The bank aims to reach the average levels of its Chinese bank peers for all major operational indicators in the next two to three years and become a leader among midsized Chinese banks within three to five years.[58]

Other recent developments include the Ping An and China Life Insurance initial public offerings in China. Ping An raised 38.9 billion yuan ($5 billion) with its February 2007 IPO and plans to use those funds to finance operations. In January 2007, its main competitor, China Life Insurance Co., was also listed on the Shanghai Stock Exchange, making an IPO of $3.6 billion.

On September 11, 2006, HSBC opened a new sub-branch in Beijing. With the opening of its fourth branch in Beijing, HSBC became the foreign bank with the most branches in Beijing. Richard Yorke, chief executive officer China at the Hongkong and Shanghai Banking Corporation Limited, commented: "[We] are delighted to be able to further expand our service network in Beijing. It is part of our overall network expansion in China where HSBC has a long-term commitment. Beijing is a key retail market for HSBC in the Mainland and we shall provide diversified products to meet our customers' growing needs for world-class banking services."[59]

In addition, HSBC continues to invest in fast-growing emerging markets, including Asia, Latin America, and the Middle East. Malaysia is one country where HSBC's expansion is quite noticeable. It operated 40 branches there as of June 2010.[60] HSBC also has plans to extend its insurance business to other countries.[61]

HSBC Plans to Expand in Vietnam, Laos, and Cambodia

In the beginning of 2009 HSBC Holdings PLC announced plans to increase its branches in Vietnam and to set up operations in Laos and Cambodia. HSBC's moves were part of its broader expansion in developing Asian markets. Solid financial results from this region have helped outweigh losses at the bank's U.S. business. "It's something that we keep an eye on. We visit there [Laos and Cambodia] regularly, and we're in close contact with the customers and the regulators. We see tremendous potential in both those countries. So for sure, within the next five years, we'll keep an eye on it," said HSBC Vietnam President and Chief Executive Thomas Tobin.[62]

In March 2008, HSBC won approval from the Vietnamese government to become the first foreign bank to set up a locally incorporated entity. New laws that have helped open Vietnam's banking sector to foreign companies were introduced as part of the communist country's inclusion in the World Trade Organization. The change in legal status in Vietnam has made it easier for HSBC's local operations to set up branches across the country. That year, HSBC hired more than 400 additional staff in Vietnam in anticipation of its expansion. This has brought the number of staff numbers there to more than 1,000. In Vietnam, HSBC also owns 10 percent of Bao Viet Holdings, an insurance company, and 20 percent of Vietnam Technological & Commercial Joint Stock Bank, or Techcombank.[63]

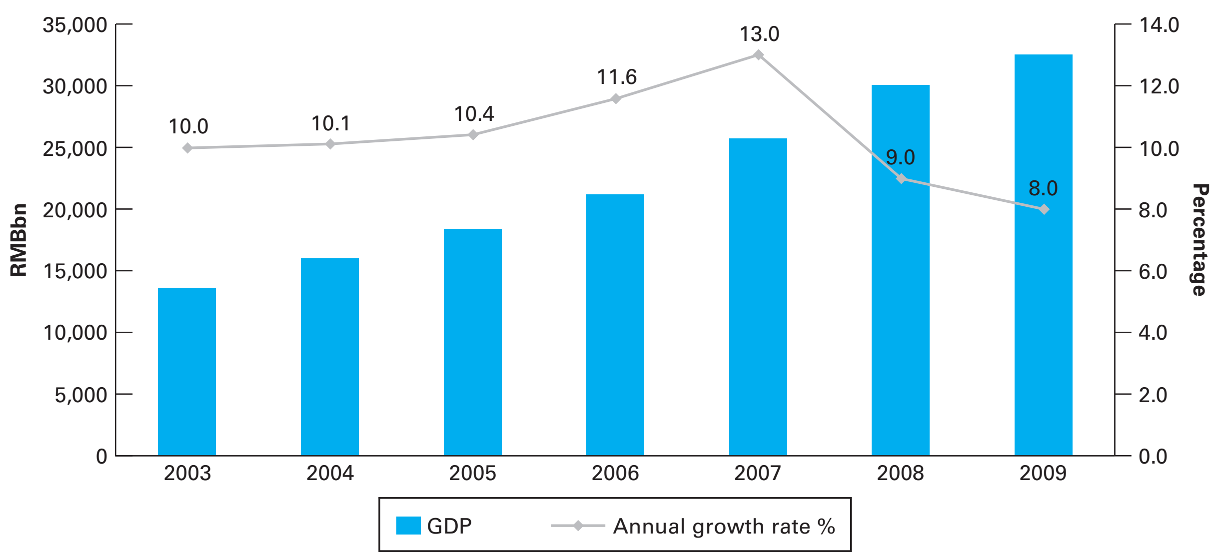
Future Competitive Conditions

Despite the economic crisis, there were several geographical regions that did not fall into economic recession in the 2008–2010 period. China, foremost, experienced strong economic growth throughout this period.

China's gross domestic product expanded 10.7 percent in the fourth quarter of 2009, bringing full-year growth to 8.7 percent. That came in above the government's targeted 8 percent growth and well above many economists' estimates. China officially surpassed Japan as the world's second-largest economy in mid 2010. The growth numbers demonstrate that Beijing's stimulus program—a response to the global economic slowdown that focused on massive bank lending and public investments in infrastructure—helped avert an economic slowdown. But now that China is growing so rapidly, in part thanks to a real-estate boom fueled by government lending, some economists warned that it was time for Beijing to adjust its policies to better manage growth.[64]

China has the highest foreign direct investment (FDI) in Asia; however, as of 2010, FDI was beginning to slow. China had long been preferred as an attractive FDI

China: continued growth



Note: The Chinese govenment targets GDP growth for 2009 at about 8%

Source: HSBC, "China Strategy," May 26, 2009.

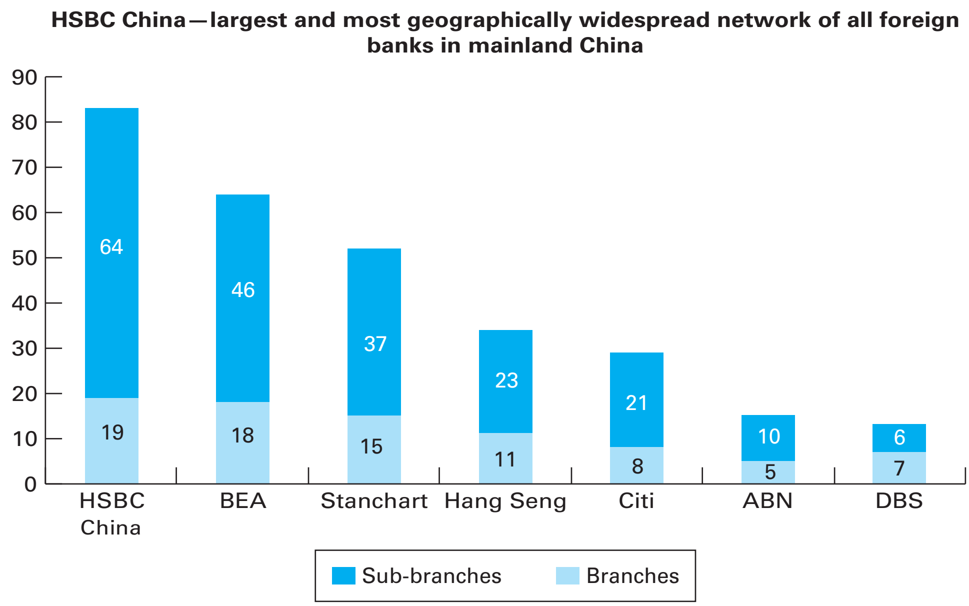
destination due to its low labor costs and land rental fees. But such advantages are now diminishing and the nation is facing stiff competition from other Asian nations like Vietnam and India. In 2009, China's FDI decreased by 2.6 percent to $90.03 billion.[65] In response, the government relaxed rules to lure investors amid a sustained economic expansion. As a result, total FDI for the first four months of 2010 was $30.8 billion, up 11.3 percent from a year earlier.[66]

HSBC's future development will depend heavily on two things. First, the competition will play a major role in HSBC's strategy. HSBC competitors are aggressively seeking opportunities in China, and HSBC has to constantly work to maintain and expand its market position. Second, HSBC's success will depend on the opportunities that the company sees in the other emerging markets of the world.

HSBC Current China Strategy

HSBC's strategy in China is carried out by its 100 percent subsidiary HSBC Bank (China) Company Limited. As of

Locally incorporated foreign banks by network



Note: As of end-April 2009 (excluding representative offices, administrative offices, etc.)

HSBC's investments in China

HSBC in China (US$m)	% Ownership	Outlets
HSBC Bank (China) Company Limited	100%	83
HSBC Jintrust	49.0%	1
Beijing HSBC Insurance Broker	24.9%	1
HSBC Rural Bank	100%	5
Hang Seng Bank (China) Limited	62.14%	34
Bank of Communications	19%	2,600+
Ping An Insurance	16.8%	356,000 agents
Bank of Shanghai	8.0%	200+
Industrial Bank	12.78% (via Hang Seng Bank)	400+

Source: HSBC, "China Strategy," May 26, 2009.

PwC Report 2008—Foreign banks in China

	First	Second	Third
Corporate lending	HSBC ➡	Standard Chartered	Citibank
Retail banking	HSBC ➡	Citibank	Standard Chartered
Private wealth management*	HSBC	UBS	Citibank
Foreign exchange and Treasury	HSBC ⬈	Citibank	Standard Chartered
Trade finance	HSBC ➡	Standard Chartered	Citibank
Credit cards	HSBC ⬈	Citibank	Standard Chartered
Brand awareness*	HSBC	Citibank	Standard Chartered
	First	**Second**	**Third**
Derivatives	Citibank	HSBC ➡	Deutsche Bank
Corporate finance	Goldman Sachs	HSBC ⬈	Standard Chartered
Cash management*	Citibank	HSBC	Standard Chartered
Debt capital markets*	Citibank	HSBC	Deutsche Bank
	First	**Second**	**Third**
Project financing	Citibank	Standard Chartered	HSBC ⬊
Asset management	JPMorgan Chase	Fortis	HSBC ⬊
	First	**Second**	**Third**
Mergers and acquisitions	Goldman Sachs	Morgan Stanley	UBS
Equity capital markets	Goldman Sachs	Morgan Stanley	UBS
Investment banking	Goldman Sachs	Morgan Stanley	UBS

**New category in 2008*

Source: HSBC, "China Strategy," May 26, 2009.

April of 2009 HSBC Bank (China) was a network of 83 bank outlets (19 branches and 64 sub-branches) with 5,376 employees and registered capital of RMB 8 billion. At this time HSBC had the largest and most geographically widespread network of banks in mainland China compared to other foreign banks operating in China. Moody's has rated HSBC Bank (China) as A1 (long-term), which was the highest rating for a locally incorporated bank in China.[67]

Among the list of foreign banks in China, HSBC identifies itself as the largest and it provides a greater number of bank services than other foreign banks (UBS, Citibank, Goldman Sachs Standard Chartered, JPMorgan Chase, etc.).

In its attempt to mitigate the negative impact of economic crisis and strengthen its competitive position, HSBC took several measures to redefine and clarify its strategies for the nearest future. In May 26, 2009, new China strategy was outlined by Richard Yorke, chief executive of HSBC Bank (China) Co. in London.[68] China was identified to be the center of the Group's emerging markets strategy.

Two elements of this strategy were:

1. *Organic growth*—organic business growth via own branch network.
2. *Strategic investments*—creating value and synergies from HSBC's investment in strategic partners.

The 2009 strategy focused on further expansion in Bohai Rim, Yangtze River, Pearl River Delta, and western regions.[69]

Later in July of 2009, HSBC opened a branch in Jinan, the capital of the eastern Shandong Province. It became the first foreign bank operating in that area. HSBC Bank (China) Co. confirmed its plans to further expand its presence in China's Bohai Rim region and said it is strengthening its network in inland cities. The Bohai Rim region, which includes Jinan, offers great potential and is one of its key areas for business development. HSBC has also obtained approval to establish a branch in Taiyuan, the capital of the northwest Shanxi Province.[70]

Organic strategy—expand network

- 83 service outlets
- Regional focus: Bohai Rim, Yangtze River Delta, Pearl River Delta, and western region

Source: HSBC, "China Strategy," May 26, 2009.

HSBC Group Strategy for 2010

HSBC continued to track its performance and global expansion in emerging markets compared to the developed markets. At the end of 2009, it conducted another assessment of its performance in various markets and noted that emerging markets, especially the Asian region, were taking the lead. Based on the first half of 2009, HSBC reported the following results:[71]

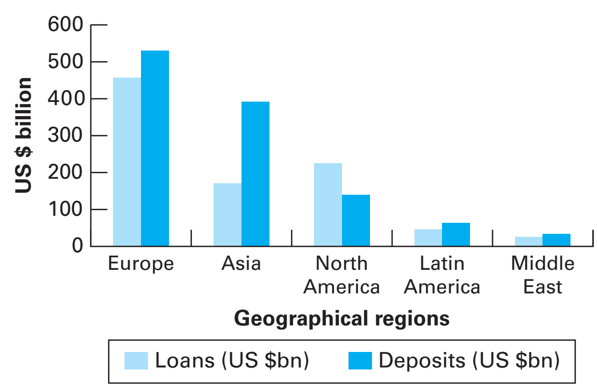
North America
- In the U.S. consumer finance run-off portfolio, loan impairment allowances declined in Q3 2009, first quarterly fall since start of 2006.
- Did not require any capital support from Group in Q3 2009.

Asia
- Continued to perform strongly.
- Lending growing as regional economies move out of recession.
- Loan impairment charges moderated in Q3 2009.

Latin America and Middle East
- Positive contribution; revenue held up well.
- In Latin America loan impairment charges declined in Q3 2009.
- In Middle East lending portfolios continued to reduce though loan impairment charges were higher than Q2 2009. Credit conditions remained difficult.

Europe
- UK mortgage lending continued to perform well, with our market share increasing to 9.9%.
- Overdraft utilization by our Commercial Banking customers remained stable at under 50%.

HSBC Loans vs. Deposits, by region (based on 1H09 results)



Source: HSBC, "Strategy Reconfirmed in a Period of Regulatory Change," December 2, 2009.

The key points of HSBC Group's current strategy are based on three world trends:

Group strategy
Aligned with key trends

Key trends	Strategy
Developing markets are growing faster than mature economies	Combine emerging markets leadership with global network
World trade expanding at a greater rate than gross domestic product	
Life expectancy increasing around the world	Build on international connectivity and scale

In a December 2, 2009 report, HSBC management identified the following three key opportunities in Asia region:[72]

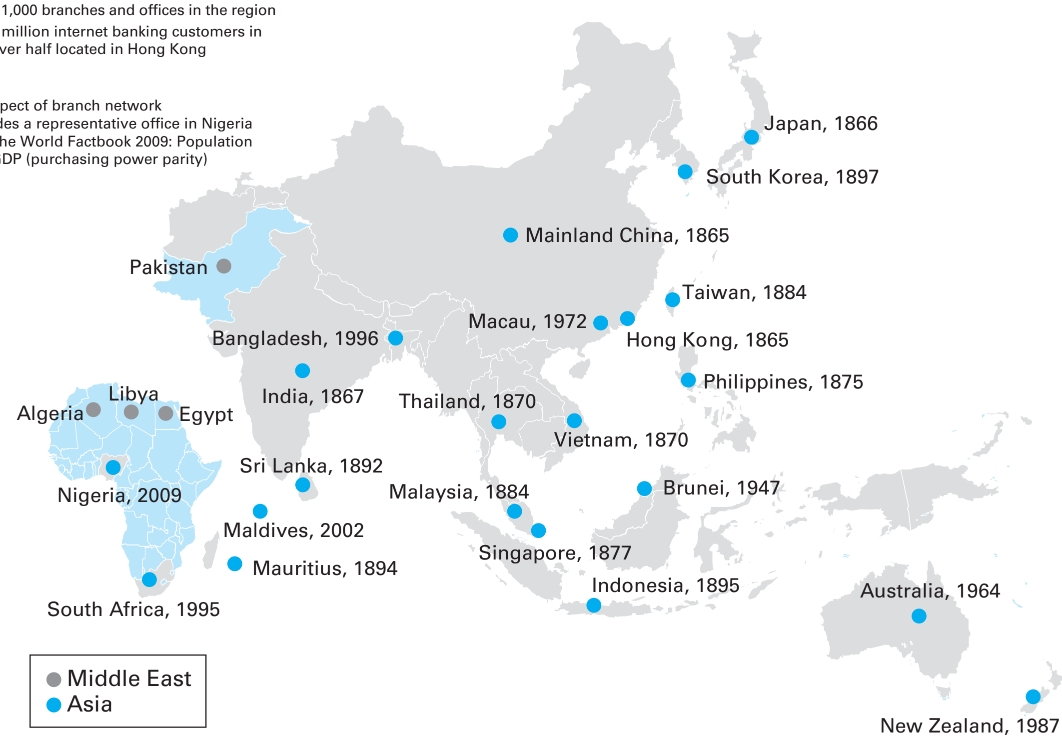
1. Asia to contribute largest share of global GDP, surpassing EU and U.S. by 2016.
2. Asian consumers to become biggest incremental spenders, overtaking U.S. and European consumers by 2013.
3. Asian intra-regional trade growing significantly faster than world trade overall.

Presence
Largest foreign bank[1] in mainland China, Hong Kong, Indonesia, and Malaysia

Footprint in Asia

- History in Asia spans nearly 150 years
- Presence in 22 countries and territories[2]
- Access to half of the world's population with combined GDP of US$21.3trn, the size of the combined GDP of the US, UK, Germany, and France[3]
- Nearly 1,000 branches and offices in the region
- Over 3 million internet banking customers in Asia, over half located in Hong Kong

Notes:
(1) In respect of branch network
(2) Includes a representative office in Nigeria
(3) CIA The World Factbook 2009: Population and GDP (purchasing power parity)



Source: HSBC, "Strategy Reconfirmed in a Period of Regulatory Change," December 2, 2009.

HSBC management has re-affirmed that the core of its strategy for 2010 will be to continue positioning the Group for long-term growth and attractive returns. Within this framework, HSBC management outlined the following four tasks:[73]

1. Continue to strengthen HSBC's position as the world's leading international bank.
2. Concentrate more on emerging markets and faster growing businesses.
3. Move Group CEO's principal office to Hong Kong.
4. Focus on organic growth, but position for inorganic if aligned with strategy, risks fully understood, and regulatory changes allow.

2010 Forecasts

HSBC's Global Asset Management division issued a statement in January 2010 saying that emerging markets will sustain high momentum to lead the global recovery in 2010, particularly countries with favorable demographics and solid fundamentals, like China and India. The bank's optimism toward emerging markets was in stark contrast with its conservative viewpoint toward developed economies.[74]

"We expect that global economic growth is likely to be moderate in 2010, hindered by unsolved structural problems, particularly in developed markets with personal wealth and balance sheets to be rebuilt," said Leon Goldfeld, Chief Investment Officer of HSBC Global Asset Management (Hong Kong) in a press conference on its 2010 investment outlook on January 11, 2010. As governments were expected to begin winding down their stimulus programs by the second half of the year, Goldfeld said unless consumption and business investment picked up, the momentum of global growth will slow down in the latter part of this year.[75]

Goldfeld said the collapse over the past 18 months brought the level of economic activity to a very low base, which provides an easy comparison when the economy springs back. "Our concern is that due to the structural constraints of excessive household debt as well as the conservative stances by banks in terms of new lending, the private sector will struggle to deliver sufficient growth," said Goldfeld.[76] Goldfeld also predicted that official interest rates across the world would be tightened very gradually from the middle of the year, noting that bonds should provide a good opportunity against cash. Emerging markets, on the other hand, are in a better position, with more to sustain their growth story and outperform developed markets.[77]

2010 China Strategy in Motion

In April of 2010 HSBC Holdings PLC re-affirmed that it is capitalizing on China's fast-growing economy and a government-led campaign aimed at expanding rural financial services to ramp up its business in the country. HSBC reported that it now has 99 outlets across 23 cities in mainland China, a sharp increase from fewer than 30 in mid-2006, a year before China fully opened its banking industry to overseas competition. In 2010, the U.K. lender planned to add around 20 outlets in China.[78]

"We are focused on leveraging opportunities as quickly as we are able to," Richard Yorke, chief executive of HSBC Bank (China) Co., said on the sidelines of the annual Boao Forum, a gathering of government and business leaders on the southern Chinese island of Hainan. "Last year we opened 19 new outlets, including three new branches. We expect this year to be able to open at least that number." For HSBC, the largest foreign bank in China, extending its presence to more cities in the country will allow it to not only capitalize on China's rapid economic growth, but also assist Chinese multinational companies looking to expand overseas, Mr. Yorke said.[79]

In addition, HSBC has been strengthening its presence in China's rural areas, targeting the two-thirds of the nation's 1.3 billion population, who lack easy access to funding sources. Providing financial services to people who don't live in China's large cities has become a concern for Beijing's leadership in recent years, as China's rural population continues to miss out on the strong economic growth and rising living standards in the country's urban areas.[80]

The bank announced it had set up seven standalone rural-banking branches in China since August 2007, and hoped to maintain the growth rate to expand HSBC's rural-banking business in the coming years. "The rural banking sector is under-banked, so we are seeing strong demand for the right product and for the right services. There is strong untapped demand in that market," said HSBC Bank (China) CEO Yorke. HSBC's oldest rural bank is just over two years old, he said, adding that the rural outlets will likely start breaking even at the three-year mark.[81]

The bank is also working toward being one of mainland China's first foreign-listed companies to tap into the country's liquidity and to raise its overall profile there. In addition, HSBC is seeking regulatory approval to set up a credit-card joint venture with Bank of Communications and is seeking licenses to access China's securities business. Foreign banks have been allowed to issue credit cards in China since 2004 in conjunction with their local partners. Since then HSBC and Bank of Communications have issued over 20 million co-branded credit cards in China.[82]

HSBC's China experience has been one of steady and consistent expansion and success. While there have been some setbacks, its overall approach, emphasizing close collaboration with the Chinese government and local partners, reliance on local staff and talent, and its overall shift in global strategy from developed to emerging markets, has served it well.

Questions for Review

1. How has HSBC adapted its global strategy to operate in China, both before and after China's WTO accession?
2. Discuss HSBC's strategy for entering and operating in other emerging markets. Where has it found success, and where has it faced setbacks? Why?
3. What are the pros and cons of HSBC's "Managing for Growth" strategy?
4. How did HSBC withstand the world economic crisis? Was HSBC's position weakened or strengthened as result of the crisis? What were the results of HSBC group strategy in 2009? What regions were identified as new global opportunities?
5. What is the core of HSBC's current "Organic Growth Strategy" in China? Why did HSBC decide to expand its financial services in China's rural areas? What are the pros and cons of the rural expansion?

Exercise

HSBC is considering asking the government of China (China Banking Regulatory Commission—CBRC) to allow it to increase its stake in BoCom above the limit currently in place (25% total foreign ownership; 20% for an individual foreign investor). Break into four groups:

1. HSBC
2. BoCom
3. Citibank
4. CBRC

Groups 1–3 should prepare a 5-minute presentation on whether the government of China should grant the request and, if so, what the ownership limit should be (30%? 50%?) and whether it should be extended to other foreign financial institutions (e.g., Citibank). Then, Group 4 should discuss the question and report its decision.

Source: This case was prepared by Jonathan Doh of Villanova University as the basis for class discussion. Research assistance was provided by Courtney Asher, Elizabeth Stewart, and Tetyana Azarova. It is not intended to illustrate effective or ineffective managerial capability or administrative responsibility.

In-Depth Integrative Case 4.2

Chiquita's Global Turnaround

On January 12, 2004, Chiquita named Fernando Aguirre as the company's new president and CEO, replacing Cyrus Freidhem, who had held the position since the company's emergence from bankruptcy in March 2002. In his 23 years with Cincinnati-based Procter & Gamble (P&G), Aguirre served in a variety of positions, including president of P&G Brazil and president of P&G Mexico. In his first remarks to Chiquita employees and investors, Aguirre reiterated the importance of corporate responsibility: "In terms of managing businesses and people, while I am profit-conscious, I make decisions first and foremost based on values and principles. In that respect, I'm proud to be joining a company with Core Values that guide day-to-day operations and one where corporate responsibility is an important part of our company culture."[1]

Over the past several years, social responsibility has become the watchword of this traditional company with midwestern roots but a checkered history. In 2004, Chiquita scarcely resembled the company that once held a reputation as cold, uncaring, and indifferent, frustrated with mediocre returns, a lack of innovation, and a demoralized workforce. Throughout the 20th century, hostile relationships with its labor unions and employees and a reputation for immorality solidified by the actions of its predecessor company, United Fruit, helped to slow Chiquita's growth. In addition, by the late 1990s, consumption of bananas had declined in major markets, and Chiquita's position in Europe had been compromised by the European Union's preferential import relationships with its members' former colonies in the Caribbean, Africa, and the Pacific. These factors helped push Chiquita to seek Chapter 11 bankruptcy protection in November 2001.

Through a serious and dedicated internal analysis, a thorough reevaluation of its core mission and business principles, and a concerted effort to reach out to some of its primary stakeholders—such as employees—who had become disenchanted and alienated, by early 2003, Chiquita had engineered the beginnings of a turnaround. One of the most impressive aspects of this recovery was Chiquita's success in redirecting and redefining its reputation through a more open and transparent approach to its global operations and to the various stakeholder groups with which it interacted. In addition, Chiquita had substantially reformed its labor practices and relations and initiated a set of projects in sustainable development and community action in its various locations around the world. Both labor unions and nongovernmental organizations (NGOs) lauded these steps.

Yet despite Chiquita's apparent turnaround, lingering problems remained in financial performance, organizational efficiency, and a strategy for the future. How could Chiquita sustain the positive momentum from its turnaround in reputation and employee relations to deliver improved and sustainable business performance in a global industry environment plagued by low margins and intense competition?

Chiquita's Background

Chiquita Brands International Inc. is a multinational producer, distributor, and marketer of bananas and other fresh produce. The company also distributes and markets fresh-cut fruit and other branded, value-added fruit products. Approximately 60 percent of its 2003 revenues of $2.6 billion came from bananas.[2] Since adding new products and acquiring Fresh Express, the U.S. market leader in fresh salads, in 2005, bananas totaled 43 percent of Chiquita's net sales.[3] In 2003, the banana division consisted of 19,000 employees, mainly working on more than 100 banana farms in countries throughout Latin America, including Guatemala, Honduras, Nicaragua, Ecuador, Costa Rica, Panama, and Colombia. Approximately 45 percent of all bananas sold by Chiquita are from Chiquita-owned farms; independent suppliers in Latin America produce the remainder. Chiquita is one of the global market leaders in banana supply and production (see Table 1). Since Chiquita's exports are often a substantial part of the foreign trade of the Latin American countries in which the company operates, relationships with suppliers, workers' unions, and communities are critical elements for success.

Chiquita sources bananas from many developing Latin American countries, countries that historically have struggled with poverty, literacy, access to affordable health care, and limited infrastructure. The image of the banana industry has long been tarnished by its historical support

Table 1 **Banana World Market Share Leaders, 1999, 2002, and 2005**

	2005	2002	1999
Chiquita	25%	23%	25%
Dole	25	25	25
Del Monte	15	16	15
Fyfess	8	8	8
Noboa	11	11	11

Source: Banana Link.

of the failed U.S. invasion of Cuba in 1961, child labor, unsafe working conditions, sexual discrimination, low wages, and accusations of serious brutality against unionizing workers.[4] Chiquita's reputation was damaged by past events, notably those associated with its predecessor company, United Fruit. These included allegations of the company's participation in labor rights suppression in Colombia in the 1920s, the use of company ships in the U.S. government–backed overthrow of the Guatemalan government in 1954, and involvement in a bribery scandal in Honduras in 1975.[5] In the 1980s and 1990s, Chiquita clearly projected a defensive and protective culture, conveying a closed-door impression of its policies and practices.

Because bananas are produced all year long, local communities are closely tied together by the performance of farms. Many employees live in houses owned by the company, most of which are located on the farms themselves. In many areas, Chiquita provides electricity, potable water, medical facilities, and other basic services.[6] However, labor relations remained strained throughout the 1980s and 1990s.

Chiquita's Downward Spiral

Although Chiquita improved its environmental procedures throughout the 1990s, many human rights groups, including Banana Link and US/Labor Education in the Americas, organized an outspoken campaign against all banana companies to improve social conditions on their plantations. One morning in early 1998, executives at Chiquita were devastated to see their company splashed all over the newspapers after an undercover investigation into "dangerous and illegal business practices" throughout Chiquita's Latin American operations. This was a watershed moment for the company.

The *Cincinnati Enquirer,* a paper based in the same town as Chiquita's corporate headquarters, printed an exposé contending that Chiquita was guilty of "labor, human rights, environmental and political violations in Central America."[7] Although the newspaper was later forced to retract the series after it was discovered that a reporter had illegally penetrated Chiquita's voice-mail system, the damage was done. Corporate image was further damaged when the firm emphasized the violation of its privacy instead of addressing the possible validity of the claims made. According to Jeff Zalla, current corporate responsibility officer at Chiquita, the strategy backfired. "It left some people with an unsavory impression of our company," he said.[8]

Damaging media coverage and a renewed desire to evaluate its own ethics performance and gain support for a common set of values and standards for environmental and social performance served as catalysts for the institution of corporate social responsibility policies at Chiquita. After recognizing the need for a complete corporate makeover, Chiquita's then CEO, Steve Warshaw, declared his commitment to leading in the area of corporate responsibility and pledged that the company would do much more than just repair previous damage. Four years later, despite changes in the executive management group, Chiquita's corporate social responsibility programs were a positive example of leading responsibility change in today's multinational business environment.

In January 2001, Chiquita announced that it could no longer pay the interest on its $862 million debt. The fiercely competitive banana industry, downward trends in prices due to excess supply, EU restrictive trade quotas, poor labor-union relations, and the market view of bananas as a low-margin commodity all contributed to Chiquita's bankruptcy filing. Chiquita attributed much of the responsibility to the European Union. In 1993, the EU imposed quotas that gave preferential treatment to banana imports from ACP (Africa, Caribbean, and Pacific) countries that were former European colonies, ostensibly to help these former European colonies boost their international trade and commerce. Before the 1993 act, 70 percent of the bananas sold in Europe came from Latin America, and Chiquita had a 22 percent share of the world's banana market.[9] After the quotas were imposed, Chiquita claimed that its European market share was cut in half, costing $200 million a year in lost earnings.

Although many of its difficulties were intensified by the EU policy, Chiquita's problems had begun to develop before the 1993 decision. Most important, miscalculations of increases in European demand in the 1990s resulted in an oversupply, leading to depressed banana prices worldwide. Although prices recovered somewhat (see Table 2),

Table 2 **Banana Prices: Regional Year-over-Year Percentage Change, 2003 vs. 2002**

Region	Q1, 03	Q2, 03	Q3, 03	Q4, 03	Year
North America	3%	−4%	1%	−2%	−1%
European core markets—US$	11	12	5	18	12
European core markets—local currency	−9	−10	−9	0	−7
Central & E. Europe/Mediterranean—US$	4	−3	4	2	−2
Central & E. Europe/Mediterranean—local currency	−15	−22	−10	−14	−19
Asia—US$	−7	0	3	12	0
Asia—local currency	−18	−7	3	6	−5

Source: Company reports.

Table 3 Key Developments in Chiquita's History

1899:	United Fruit Company is created through a merger of fruit companies.
1903:	The company is listed on the New York Stock Exchange; it builds refrigerated ships.
1918:	Thirteen banana ships are lost after being commissioned by Allied forces in World War I.
1941:	Allied forces in World War II commission company ships, and the banana industry nearly shuts down.
1945:	Twenty-seven ships and 275 men on company ships are lost serving Allied forces.
1950:	The company starts massive postwar banana-planting projects.
1961:	Company ships provide support for failed U.S. invasion of Cuba.
1964:	The company begins a large-scale branding program for produce and starts using banana stickers bearing the Chiquita name.
1970:	United Fruit merges with AMK Corp. and becomes United Brands Company.
1975:	United Brands is involved in Honduran bribery scandal, which leads to enactment of U.S. Foreign Corrupt Practices Act. Company stocks plunge, and CEO Eli Black commits suicide.
1990:	United Brands changes name to Chiquita Brands International.
1993:	EU banana regulations cut Chiquita's market share by more than 50 percent. Chiquita begins working with Rainforest Alliance and Better Banana Project.
1994:	Start of the "banana wars" between the EU and WTO. Follows complaints by Chiquita that EU favors Caribbean banana suppliers over Latin American importers.
1998:	Chiquita becomes largest U.S. private-label fruit canner. Becomes first large company to meet with COLSIBA, an affiliation of Latin American banana unions.
1999:	Faces possible auction proposed by large shareholder American Financial Group.
2000:	Adopts expanded code of conduct. All 115 Chiquita-owned farms achieve Better Banana certification.
2001:	Restructures debt after stopping payments on $862 million loan, cites prejudiced trade pacts by EU.
2001:	Files for Chapter 11 bankruptcy protection.
2001:	Issues first (2000) corporate responsibility report.
2002:	Chiquita shareholders and bondholders support reorganization plan.
2002:	Issues 2001 corporate responsibility report.
2003:	Chiquita reports positive net income under reorganized company.
2003:	SustainableBusiness.com names Chiquita one of the top 20 sustainable stock picks for the second year in a row.
2004:	Maintained market leadership in the growing EU.
2005:	Chiquita acquires Fresh Express, U.S. market leader in fresh salads.
2006:	Awarded the Contribution to the Community Award by the American–Costa Rican Chamber of Commerce for its Nature & Community Project in Costa Rica.
2007:	Chiquita faces a $25 million fine from the U.S. Department of Justice for payments made to Colombian paramilitary groups for the protection of its employees.

CEO Keith Linder blamed $284 million in losses in 2001 on a "decline in product quality resulting from an extraordinary outbreak of disease and unusual weather patterns."[10] At the end of 2006, Chiquita still faced financial difficulties as a result of a "perfect storm" of higher tariffs, increased competition in the EU banana market, U.S. consumer concerns about the safety of fresh spinach (another Chiquita product), and higher industry costs overall. While the company expressed dissatisfaction with 2006 results, it also stated that "we firmly believe our 2006 results are not indicative of the underlying strengths of Chiquita's business or our long-term potential."[11] Table 3 provides a comprehensive summary of key developments in Chiquita's history.

Dispute over Access to European Banana Markets

Chiquita has long claimed that its recent struggles are a direct result of the 1993 EU decision to put restrictive quotas on imports from Latin American suppliers. Immediately after the decision by the EU in 1993 to extend preferential quotas to its former Caribbean and African colonies, Chiquita took the issue to the U.S. trade representative, suggesting violations of free trade. In 1994, a General Agreement on Tariffs and Trade (GATT) panel ruled that the new regime violates GATT obligations, but the EU blocked adoption of the ruling by the full GATT. In 1996, the United States, along with Ecuador, Guatemala, Honduras, and Mexico, challenged the new regime under the new World Trade Organization (WTO) dispute-settlement mechanism, which came into force after the Uruguay Round of GATT negotiations.

In May 1997, a WTO panel ruled that the EU's banana import regime violated WTO obligations under the General Agreement on Trade in Services and the Agreement on Import Licensing Procedures. In September 1997, the WTO Appellate Body upheld the panel ruling, granting the EU 15 months, until January 1, 1999, to comply with the ruling. In January 1999, the deadline for EU compliance expired, and the United States sought WTO authorization to impose retaliatory tariffs. In April 1999, the WTO Dispute Settlement Body authorized U.S. retaliatory tariffs amounting to $191.4 million a year—the level of damage to U.S. companies calculated by arbitrators—and the

United States immediately began steps to withhold liquidation of European imports, the first step in the imposition of the tariffs.[12]

In April 2001, the United States and the European Commission announced that they had reached agreement resolving their dispute. The agreement took effect on July 1, 2001, at which time the United States suspended the retaliatory sanctions imposed on EU imports in 1999. Import volumes of bananas were returned to levels comparable to those prior to 1993, and the EU committed to moving to a tariff-only system in 2006 as part of its overall WTO obligations.

The dispute has taken its toll on the banana trade by creating uncertainty for smaller producers reliant on EU markets under the quota system and for large producers such as Chiquita that were forced to expend considerable financial and other resources in the course of the dispute. High tariffs in the EU continue to be a financial burden for Chiquita.

Corporate Responsibility

Chiquita had begun to initiate corporate responsibility projects in 1992 when it adopted Better Banana Project standards designed to improve environmental and worker conditions on its farms. Then after the 1998 exposé in the *Cincinnati Enquirer,* Chiquita management began to conduct a series of broader companywide reviews of its conduct, policies, and internal and external operations and relationships, all designed to integrate corporate responsibility throughout the company's operations.

In 1998, Chiquita initiated several projects aimed at implementing its corporate responsibility efforts worldwide. Two internal groups were formed: the Senior Management Group and the Corporate Responsibility Steering Committee. The former consists of eight top managers of Chiquita's global businesses, including the president/CEO and COO of banana operations. The Senior Management Group is ultimately responsible for providing strategic vision and leadership for corporate responsibility. The Steering Committee, also consisting of eight members, was constructed to help streamline corporate social responsibility policies throughout each operational area of the firm.

In August 1999, Chiquita adopted the four key values that now guide all strategic business decision making worldwide. After a year of discussions, interviews, and debates on the merits of an internal corporate social responsibility policy, Chiquita defined the following four core values:

> *Integrity:* We live by our Core Values. We communicate in an open, honest and straightforward manner. We conduct our business ethically and lawfully.
>
> *Respect:* We treat people fairly and respectfully. We recognize the importance of family in the lives of our employees. We value and benefit from individual and cultural differences. We foster individual expression, open dialogue and a sense of belonging.
>
> *Opportunity:* We believe the continuous growth and development of our employees is key to our success. We encourage teamwork. We recognize employees for their contributions to the company's success.
>
> *Responsibility:* We take pride in our work, in our products and in satisfying our customers. We act responsibly in the communities and environments in which we live and work. We are accountable for the careful use of all resources entrusted to us and for providing appropriate returns to our shareholders.[13]

In support of the four core values, Chiquita undertook reforms to link its corporate governance and corporate responsibility policies. These reforms included expanding the role of the board's Audit Committee to oversee the firm's corporate responsibility (CR) mission and to evaluate whether the firm had the right people, policies, and programs in place to properly advance the CR agenda.[14] In addition, in May 2000, Chiquita appointed a full-time vice president and CR officer responsible for all aspects of corporate social responsibility. According to Chiquita, the four core values, supported by the senior management group and CR committee, have helped drive responsible change throughout the entire organization. Each business decision must be evaluated through the lens of CR policies.

Chiquita also began to realize that a corporate social responsibility platform could mean a competitive advantage in the banana market. Dennis Christou, vice president of marketing–Europe, explained: "Bananas are, by definition, a commodity and U.K. consumers do not generally see fruit as branded. Chiquita is trying to change this. We have a brand because we own certain values and a relationship with consumers. And we communicate with them. They have expectations about Chiquita."[15] In particular, environmental and social performance is of keen interest to some leading European customers. In 2002, 56 percent of Chiquita's sales in northern European markets were to customers who had either inspected farms or formally asked questions about environmental and social performance. This was a 5 percent increase—about 13,000 forty-pound boxes per week—over the prior year.

Chiquita also strengthened its commitment to the Better Bananas Project. Under this program, external auditors audit all Chiquita farms annually. Chiquita has made an important partnership with Rainforest Alliance, which has been integral in assessing Chiquita's environmental practices, especially related to deforestation. The Rainforest Alliance, which claims that the world's rainforests are being deforested at a rate of 1 percent per year (or two U.S. football fields every second),[16] has annually accredited every Chiquita farm since 2000. Chiquita also encourages its independent producers, which supply Chiquita with about 50 percent of its bananas, to achieve Rainforest Alliance certification. In 2002, the volume of

Table 4 Better Banana Project Principles

1. **Ecosystem Conservation.** Protect existing ecosystems; recovery of damaged ecosystems in plantation area.
2. **Wildlife Conservation.** Protect biodiversity, especially endangered species.
3. **Fair Treatment and Good Conditions for Workers.** Comply with local and international labor laws/norms; maintain policy of nondiscrimination; support freedom of association.
4. **Community Relations.** Be a "good neighbor," contributing to the social and economic development of local communities.
5. **Integrated Pest Management.** Reduction in use of pesticides; training for workers in pesticide use/management/risks.
6. **Integrated Waste Management.** Reduction of the production of wastes that contaminate the environment and harm human health; institute recycling.
7. **Conservation of Water Resources.** Reduce and reuse the water used in production; establish buffer zones of vegetation around waterways; protect water from contamination.
8. **Soil Conservation.** Control erosion; promote soil conservation and replenishment.
9. **Planning and Monitoring.** Plan and monitor banana cultivation activities according to environmental, social, and economic measures.

Source: Adapted from Rainforest Alliance, *Normas Generales Para la Certificación del Cultivo de Banano,* May 2002, www.rainforest-alliance.org/programs/cap/socios/banana-s.pdf.

bananas purchased from certified farms rose from 33 to 46 percent, and farms certified through June 2003 brought the total to 65 percent. In 2006, the percent of Chiquita's independent producers that were Rainforest Alliance–certified reached 84 percent.[17] Table 4 presents the nine principles of the Better Banana Project. According to insiders, the adoption of third-party standards has helped Chiquita drive a stronger internal commitment to achieving excellence[18]—and to cut costs. In 2003, the Rainforest Alliance estimated that Chiquita reduced production spending by $100 million as a result of a $20 million investment to reduce agrochemical use.[19]

Chiquita is receiving increasing recognition for its efforts. In 2005, SustainableBusiness.com, publisher of *The Progressive Investor* newsletter, named Chiquita to its list of the world's top 20 sustainable stock picks, known as the SB20, for the fourth year in a row. SustainableBusiness.com identifies its picks by asking leading investment advisers to recommend companies that stand out as world leaders in both sustainability and financial strength. In April 2004, the Trust for the Americas, a division of the Organization of Americas, selected Chiquita Brands as the winner of the 2004 Corporate Citizen of the Americas Award for Chiquita's Nuevo San Juan Home-Ownership Project in Honduras.[20] Also in 2004, Chiquita earned the Ethic Award from the AGEPE Editorial Group and KPMG in Italy for its initiatives in the field of ethics, environmental protection, and workplace improvements.[21]

One recent setback for Chiquita's corporate responsibility profile involved its banana-producing subsidiary in Colombia. After a 2003 probe into the company's finances, Chiquita self-reported to the U.S. Department of Justice (DOJ) that it had made payments to left- and right-wing paramilitary groups in Colombia such as the AUC, ELN, and FARC. These payments, beginning in 1997, were made in order to protect the lives of its employees. Colombia has one of the highest kidnapping rates in the world and a murder rate 11 times that of the United States.[22] "It's certainly a common understanding that in order to do business in Colombia, payments have to be made for at best security, or at worst extortion," explained Ron Oswald, general secretary of the International Union of Foodworkers, which represents Chiquita workers in Latin America (including many in Colombia).[23]

The U.S. 1996 Anti-Terrorism Act makes it illegal to support any organizations identified as a terrorist threat. As of September 2001, the list of terrorist threats included the Colombian paramilitary groups. In a company press release, Chiquita chairman and CEO, Fernando Aguirre, explained, "The payments . . . were always motivated by our good faith concern for the safety of our employees. Nevertheless, we recognized—and acted upon—our legal obligation to inform the DOJ of this admittedly difficult situation."[24] Officially announced in 2007, Chiquita faced a $25 million fine for the payments it made in Colombia. In anticipation of the decision, the company set aside funds in 2006 to pay the fine. Chiquita does not believe the fines will hurt its operations.[25] Perhaps as a result of the pending DOJ investigation and decision, Chiquita sold its Colombian subsidiary in 2004.

Global Codes of Conduct, Standards, and Labor Practices

In late 2001, Ron Oswald, general secretary of the International Union of Food Workers, was asked if he had seen improvements in Chiquita's internal and external corporate policies. He responded, "Yes. It is a company that is totally unrecognizable from five years ago."[26] Clearly Chiquita had come a long way.

Traditionally, relations between Chiquita and labor unions in Latin America were mired in conflict and mistrust. In 1998, after recognizing the need for change in the way it deals with its line, Chiquita began striving to adhere to SA8000, the widely accepted international labor rights standard. Management struggled with the decision of whether to adopt an outside standard or to develop an internal measurement gauge for corporate responsibility. After much deliberation, management concluded that adopting the SA8000 standard would yield the most credibility with external stakeholders, because SA8000 gives detailed requirements for adequacy of management systems for implementation. Having an external standard forces Chiquita to push CR change down through each organizational level so that the firm is able to meet third-party requirements.

In May 2000 Chiquita expanded its code of conduct to include SA8000. Standards now included areas such as food safety, labor standards, employee health and safety, environmental protection, and legal compliance.[27] Recognizing the importance of labor support and its resounding effect on corporate image, Chiquita began an open dialogue with the International Union of Food Workers and the Coalition of Latin American Banana Workers' Unions (COLSIBA). By June 2001, the firm had reached an agreement with both organizations, pledging to respect worker rights as elaborated in ILO conventions, address long-standing health and safety concerns for workers, and ensure that its independent suppliers did likewise. This made Chiquita the first multinational corporation in the agricultural sector to sign a worker rights agreement.[28] Management credits this agreement as having helped to build a positive image, improving relations with both internal and external stakeholders. In mid-2001, Chiquita published its first corporate responsibility report detailing the firm's future CR strategies and goals. Both stakeholders and media outlets have been impressed with the complete turnaround in the transparency of Chiquita's corporate agenda, which has led to a much more favorable impression of the company.

In order to adhere to the organization's own core values and to the SA8000 labor standard, Chiquita routinely performs internal audits in all of its Latin American operations. NGOs also conduct external audits. After the audits are completed, each local management team plans corrective actions using the firm's code of conduct and core values as decision-making guides. At year-end 2003, independent auditors certified Chiquita's operations in Costa Rica, Colombia, and Panama to the SA8000 standard. Chiquita's operations were the first ever to earn SA8000 certification in each of these countries. In its 2006 corporate responsibility report, Chiquita announced that it has maintained 100 percent certification of its banana farms in Latin America in accordance with the Rainforest Alliance, Social Accountability 8000, and EurepGAP standards (environmental, labor, and human rights and food safety standards, respectively).

Marketing the Message

Although it would seem advantageous for Chiquita to communicate and leverage the great strides it has made through its corporate responsibility effort, management seems reluctant to promote its achievements through the typical mass communication vehicles. Indeed, when Chiquita attempted to advertise its certification process with commercials in Denmark that equated its Central American banana farms with a "glorious rainforest," the ads were met with skepticism and thought to be unrealistic.[29]

Instead of mass advertising, the firm has opted for a longer-term marketing strategy based on educating leading opinion makers and critics alike. According to Dennis Christou, vice president of marketing–Europe, there is a natural suspicion among consumers about commercially driven messages. He believes that customers feel more trust in the message if it's delivered by an external body rather than by the company or by a paid advocate of the business.[30] That is a main reason why the firm is relying on viral marketing tactics and third-party testimonials as the means of spreading its message. Retailers are treated differently: They must be exposed to improvements at Chiquita because they determine which exclusive brand to carry on an annual basis. However, Christou believes that creating brand recognition with consumers is possible through nonobtrusive, reputable means.

Defining and conveying a brand's differences in a commodities marketplace is difficult. Nevertheless, Chiquita believes it can carve out its own niche by distinguishing itself as a leader in corporate responsibility. Instead of positioning itself solely on the basis of price, Chiquita is hoping that its distinctive competency in CR will help it stand out from the pack. The company got a boost in this regard in April 2003, when Chiquita, along with Ben and Jerry's, received the first Award for Outstanding Sustainability Reporting presented by the Coalition for Environmentally Responsible Economies (CERES) and the Association of Chartered Certified Accountants.[31] In 2006, Chiquita won Costa Rica's Contribution to the Community Award for its Nature and Community Project, which preserves biodiversity and promotes nature conservation awareness.[32]

Recent Performance and Future Path

Chiquita has drastically shifted its strategic decision-making models and broader corporate operating principles. During its reorganization, debt repayments and other reorganization costs resulted in significant losses. Chiquita made great strides in improving its financial performance by cutting costs and streamlining its local and global operations. In 2003, the year after it filed for bankruptcy, Chiquita's net sales were $2.6 billion, up from $1.6 billion the year before. In 2006, net sales reached a record $4.5 billion (due in part to the acquisition of Fresh Express). Since its emergence from bankruptcy in early 2002, Chiquita has been profitable (see Tables 5 and 6).

Chiquita's future financial stability depends, in part, on external market factors such as steady or rising international banana prices and consumer demand. Internally, the company's performance will result from the effectiveness of financial controls on the cost side, and successful

Table 5 **Chiquita Brands Balance Sheet as of December 31, 2005, 2003, 2002, 2001, 2000 (in thousands)**

	2005	2003	2002	2001	2000
Assets					
Cash and equivalents	89,020	—	—	—	26,715
Other current assets	31,388	951	810	732	42,375
Total current assets	900,075	951	810	732	69,090
Investments in and accounts with subsidiaries	—	1,035,915	908,404	1,424,961	1,399,708
Other assets	165,558	5,607	5,429	15,328	29,872
Total assets	2,833,099	1,042,473	914,643	1,441,021	1,498,625
Liabilities and Shareholders' Equity					
Accounts payable and accrued liabilities	569,648	17,182	16,541	10,735	86,930
Total current liabilities	600,857	17,182	16,451	10,735	125,833
Long-term debt	475,000	250,000	250,000	—	772,380
Total liabilities	1,839,598	285,127	285,354	992,427	916,082
Shareholders' equity	993,501	757,346	629,289	448,594	582,543
Total liabilities and shareholders' equity	2,833,099	1,042,473	914,643	1,441,021	1,498,625

Source: Company reports.

Table 6 **Chiquita Brands International Income Statement, 2001–2005 (in thousands)**

	Predecessor Company			Reorganized Company	
	Year Ended 12/31/2005	Year Ended 12/31/2003	9 Months Ended 12/31/2002	Three Months Ended 3/31/2002	Year Ended 12/31/2001
Net sales	3,904,361	—	—	—	—
Cost of sales	3,268,128	—	—	—	—
SG&A	(384,184)	(38,500)	(30,443)	(6,545)	(31,188)
Equity in earnings of subsidiaries (loss)		170,398	68,822	(368,899)	32,674
Operating income (loss)	187,633	131,898	38,379	(375,444)	1,486
Interest income	10,255	—	—	—	783
Interest expense	(60,294)	(27,392)	(20,384)	(1,250)	(81,633)
Financial restructuring items	—	—	—	124,394	(33,604)
Income before income taxes and accounting change	134,540	104,506	17,995	(252,300)	(112,968)
Income taxes	(3,100)	(5,300)	(4,800)	(1,000)	(5,800)
Income (loss) before accounting change		99,206	13,195	(253,300)	(118,768)
Cumulative effect of accounting change		—	—	(144,523)	—
Net income (loss)	134,440	99,206	13,195	(397,823)	(118,768)

Source: Company reports.

marketing, emphasizing differentiation and value-added production, on the revenue side. Although Chiquita has gone to impressive lengths to turn around its reputation and performance, it continues to face a challenging and competitive international business environment and must make continuous progress in its management and operations in order to achieve a healthy and sustainable financial future.

Questions for Review

1. How would you characterize Chiquita's historical approach to global management?
2. Describe Chiquita's approach to human resource management in its global supply chain. What particular human resource challenges does Chiquita face as the purchaser, producer, and supplier of a commodity?
3. Does Chiquita's global corporate responsibility (CR) program create a conflict between shareholders and other stakeholders? Who are Chiquita's main stakeholders in the United States and around the world, and how are they affected by Chiquita's CR program?
4. How would you characterize Chiquita's past and present leadership? How does leadership affect a company's overall reputation?
5. Do you believe Chiquita would have changed its policies without the presence of damaging stories in the media? If not, what does this say about Chiquita's old management style?
6. What challenges does Chiquita's new CEO face in continuing to turn the company around and balance the interests of competing stakeholders?

Exercise

At its annual stakeholder/shareholder meeting, management, represented by Chiquita's CEO, is considering input from various groups about its strategic direction and continued reorganization. Your group represents one of the following interests:

1. Shareholders of the previous company who lost most of the value of the shares after the company declared bankruptcy.
2. Shareholders in the newly reorganized company.
3. Employees and union representatives of North American operations.
4. Employees and union representatives of South American operations.
5. Representatives of the nongovernmental organization Rainforest Action Network.

Spend five minutes preparing two or three requests to the management team about your group's interests and priorities for the company. Then conduct an open forum in which you discuss these requests among the different groups.

Source: © McGraw-Hill Irwin. This case was prepared by Professor Jonathan Doh and Research Associate Erik Holt of Villanova University as the basis for class discussion. Research assistance was provided by Courtney Asher. It is not intended to illustrate either effective or ineffective managerial capability or administrative responsibility. We appreciate assistance from Sherrie Terry and Michael Mitchell of Chiquita International. Any errors remain those of the authors.