Chapter 10. Business in Global Environment

World is small now

Nike – Adidas – Iphone – Samsung – Mercedes – Ford – Justin Bieber – K-Pop – Sony – Sushi – Kebab – Yogurt – RayBan –and Domino's - Coca- Cola and etc.

If someone knows and/or uses brands' products/services above, then he/she is a global business customer. These brands manufacture most of their products overseas. The globalization of business is bound to affect you. Not only will you buy products manufactured overseas, but it's highly likely that you'll meet and work with individuals from various countries and cultures as customers, suppliers, colleagues, employees, or employers. The bottom line is that the globalization of World commerce has an impact on all of us. Therefore, it makes sense to learn more about how globalization works.

This chapter examines the business world of the global marketplace. It focuses on the processes of taking a business global, such as licensing agreements and franchisees; the challenges that are encountered; and the regulatory systems governing the world market of the 21st century. Today, global revolutions are under way in many areas of our lives: management, politics, communications, and technology. The word global has assumed a new meaning, referring to a boundless mobility and competition in social, business, and intellectual arenas. The purpose of this chapter is to explain how global trade is conducted. We also discuss the barriers to international trade and the organizations that foster global trade. The chapter concludes with trends in the global marketplace.

Why Do Nations Trade?

Why does the Turkey or any other country import automobiles, steel, digital phones, and other products/services from other countries? Why don't we just make them ourselves? Why do other countries buy wheat, chemicals, machinery, and consulting services from us? The answer is simple, because no national economy produces all the goods and services that its people need. Countries are importers when they buy goods and services from other countries; when they sell products to other nations, they're *exporters*.

To understand why certain countries import or export certain products, you need to realize that every country (or region) can't produce the same products. The cost of labor, the availability of natural resources, and the level of know-how vary greatly around the world. Most economists use the concepts of absolute advantage and comparative advantage to explain why countries import some products and export others.

Absolute Advantage

A nation has an absolute advantage if it's the only source of a particular product or it can make more of a product using the same amount of or fewer resources than other countries. Because of climate and soil conditions, for example, Brazil has an absolute advantage in coffee beans and France has an absolute advantage in wine production. Unless, however, an absolute advantage is based on some limited natural resource, it seldom lasts. That's why there are few examples of absolute advantage in the world today. Even France's dominance of worldwide wine production, for example, is being challenged by growing wine industries in Italy, Spain, and the United States. For instance, hazelnut is the absolute advantage for Turkey. Turkey can get more hazelnut production than any another country's production with the same circumstances. For example, Germany couldn't get same production volume with the same hazelnut fields due to climate and workers' experience. Let's take the example of two countries (Country 1 and Country 2), which are in the manufacturing of cars. Assuming County 1 produces 3 cars per hour with 10 employees and Country 2 produces 5 cars with 10 employees.

Countries	Production of Cars/Day	No of Employees
Germany	1000	1000
France	800	1000

Fort his case, Germany has an absolute advantage over France in production size per day with the same employees.

Comparative Advantage

How can we predict, for any given country, which products will be made and sold at home, which will be imported, and which will be exported? This question can be answered by looking at the concept of comparative advantage. Comparative Advantage refers to the country's capability of producing the specific good at lower marginal cost and opportunity cost in comparison to other countries. In absolute advantage where the emphasis is only on marginal cost, comparative advantage takes into account both marginal and opportunity cost.

Let's take an example Japan and China. Japan can produce either 20 computers or 10 cars whereas China can 30 computers or 22 cars with available resources.

Products	Japan	China
Computers	20	30
Cars	10	22

To expand this table by calculating opportunity costs for each product.

Products	Japan	China
1 unit of computer	0,5 unit of car	0.73 unit of car
1 unit of car	2 units of computer	1.36 unit of computer

The opportunity cost of producing 1 unit of the computer is higher for China (0,73) than Japan (0,5) and opportunity cost for producing 1 unit of a car is higher for Japan (2) than a China (1,36).

According to the concept of comparative advantage, Japan should produce computers and China should produce cars to optimize their cost.

Exports and Imports

The developed nations (those with mature communication, financial, educational, and distribution systems) are the major players in international trade. They account for about 70 percent of the world's exports and imports. Exports are goods and services made in one country and sold to others. Imports are goods and services that are bought from other countries. The United States is both the largest exporter and the largest importer in the world.

Each year the United States exports more food, animal feed, and beverages than the year before. A third of U.S. farm acreage is devoted to crops for export. The United States is also a major exporter of engineering products and other high-tech goods, such as computers and telecommunications equipment. For more than 60,000 U.S. companies (the majority of them small), international trade offers exciting and profitable opportunities. Among the largest U.S. exporters are Apple, General Motors Corp., Ford Motor Co., Procter & Gamble, and Cisco Systems.

Despite our impressive list of resources and great variety of products, imports to the United States are also growing. Some of these imports are raw materials that we lack, such as manganese, cobalt, and bauxite, which are used to make airplane parts, exotic metals, and military hardware. More modern factories and lower labor costs in other countries make it cheaper to import industrial supplies (such as steel) and production equipment than to produce them at home. Most of Americans' favorite hot beverages—coffee, tea, and cocoa—are imported. Lower manufacturing costs have resulted in huge increases in imports from China.

Balance of Trade

The difference between the value of a country's exports and the value of its imports during a specific time is the country's balance of trade. A country that exports more than it imports is said to have a favorable balance of trade, called a *trade surplus.* A country that imports more than it exports is said to have an unfavorable balance of trade, or a *trade deficit.* When imports exceed exports, more money from trade flows out of the country than flows into it.

The Changing Value of Currencies

The exchange rate is the price of one country's currency in terms of another country's currency. If a country's currency appreciates, less of that country's currency is needed to buy another country's currency. If a country's currency depreciates, more of that currency will be needed to buy another country's currency. How do appreciation and depreciation affect the prices of a country's goods? If, say, the U.S. dollar depreciates relative to the Japanese yen, U.S. residents have to pay more dollars to buy Japanese goods. To illustrate, suppose the dollar price of a yen is $0.012 and that a Toyota is priced at 2 million yen. At this exchange rate, a U.S. resident pays $24,000 for a Toyota ($0.012 × 2 million yen = $24,000). If the dollar depreciates to $0.018 to one yen, then the U.S. resident will have to pay $36,000 for a Toyota. As the dollar depreciates, the prices of Japanese goods rise for U.S. residents, so they buy fewer Japanese goods—thus, U.S. imports decline. At the same time, as the dollar depreciates relative to the yen, the yen appreciates relative to the dollar. This means prices of U.S. goods fall for the Japanese, so they buy more U.S. goods—and U.S. exports rise.

Licensing and Franchising

A company that wants to get into an international market quickly while taking only limited financial and legal risks might consider licensing agreements with foreign companies. An international licensing agreement9 allows a foreign company (the licensee) to sell the products of a producer (the licensor) or to use its intellectual property (such as patents, trademarks, copyrights) in exchange for royalty fees. Here's how it works:

You own a company in the United States that sells coffeeflavored popcorn. You're sure that your product would be a big hit in Japan, but you don't have the resources to set up a factory or sales office in that country. You can't make the popcorn here and ship it to Japan because it would get stale. So you enter into a licensing agreement with a Japanese company that allows your licensee to manufacture coffee-flavored popcorn using your special process and to sell it in Japan under your brand name. In exchange, the Japanese licensee would pay you a royalty fee.

Another popular way to expand overseas is to sell franchises. Under an international franchise10 agreement, a company (the franchiser) grants a foreign company (the franchisee) the right to use its brand name and to sell its products or services. The franchisee is responsible for all operations but agrees to operate according to a business model established by the franchiser. In turn, the franchiser usually provides advertising, training, and new-product assistance. Franchising is a natural form of global expansion for companies that operate domestically according to a franchise model, including restaurant chains, such as McDonald's and Kentucky Fried Chicken, and hotel chains, such as Holiday Inn and Best Western.

Contract Manufacturing and Outsourcing

Because of high domestic labor costs, many U.S. companies manufacture their products in countries where labor costs are lower. This arrangement is called international contract manufacturing11 or outsourcing. A U.S. company might contract with a local company in a foreign country to manufacture one of its products. It will, however, retain control of product design and development and put its own label on the finished product. Contract manufacturing is quite common in the U.S. apparel business, with most American brands being made in Asia (China and Malaysia) and Latin America (Mexico and the Dominican Republic).

Thanks to twenty-first-century information technology, nonmanufacturing functions can also be outsourced to nations with lower labor costs. U.S. companies increasingly draw on a vast supply of relatively inexpensive skilled labor to perform various business services, such as software development, accounting, and claims processing. For years, American insurance companies have processed much of their claims-related paperwork in Ireland. With a large, well-educated population, India has become a center for software development and customer-call centers for American companies. In the case of India, as you can see in Table "Selected Hourly Wages, United States and India", the attraction is not only a large pool of knowledge workers, but also significantly lower wages.

Table. Selected Hourly Wages, United States and India

Occupation	**U.S. Wage**	**Indian Wage**
Telephone operator	*$12.57*	*Under $1.00*
Health-record technical worker/Medical transcriber	*$13.17*	*$1.50–$2.00*
Payroll clerk	*$15.17*	*$1.50–$2.00*
Legal assistant/paralegal	*$17.86*	*$6.00–$8.00*
Accountant	*$23.35*	*$6.00–$15.00*
Financial researcher/analyst	*$33.00–$35.00*	*$6.00–$15.00*

Strategic Alliances and Joint Ventures

What if a company wants to do business in a foreign country but lacks the expertise or resources? Or what if the target nation's government doesn't allow foreign companies to operate within its borders unless it has a local partner? In these cases, a firm might enter into a strategic alliance with a local company or even with the government itself. A strategic alliance13 is an agreement between two companies (or a company and a nation) to pool resources in order to achieve business goals that benefit both partners. For example, Viacom (a leading global media company) has a strategic alliance with Beijing Television to produce Chinese-language music and entertainment programming.

An alliance can serve a number of purposes:

- Enhancing marketing efforts
- Building sales and market share
- Improving products
- Reducing production and distribution costs
- Sharing technology

Alliances range in scope from informal cooperative agreements to joint ventures—alliances in which the partners fund a separate entity (perhaps a partnership or a corporation) to manage their joint operation. Magazine Publisher Hearst, for example, has joint ventures with companies in several countries. So, young women in Israel can read Cosmo Israel in Hebrew, and Russian women can pick up a Russian-language version of Cosmo that meets their needs. The U.S. edition serves as a starting point to which nationally appropriate material is added in each different nation.

Foreign Direct Investment and Subsidiaries

Many of the approaches to global expansion that we've discussed so far allow companies to participate in international markets without investing in foreign plants and facilities. As markets expand, however, a firm might decide to enhance its competitive advantage by making a direct investment in operations conducted in another country. Foreign direct investment (FDI) refers to the formal establishment of business operations on foreign soil—the building of factories, sales offices, and distribution networks to serve local markets in a nation other than the company's home country.

FDI is generally the most expensive commitment that a firm can make to an overseas market, and it's typically driven by the size and attractiveness of the target market. For example, German and Japanese automakers, such as BMW, Mercedes, Toyota, and Honda, have made serious commitments to the U.S. market: most of the cars and trucks that they build in plants in the South and Midwest are destined for sale in the United States.

A common form of FDI is the foreign subsidiary: an independent company owned by a foreign firm (called the parent). This approach to going international not only gives the parent company full access to local markets but also exempts it from any laws or regulations that may hamper the activities of foreign firms. The parent company has tight control over the operations of a subsidiary, but while senior managers from the parent company often oversee operations, many managers and employees are citizens of the host country. Not surprisingly, most very large firms have foreign subsidiaries. IBM and Coca-Cola, for example, have both had success in the Japanese market through their foreign subsidiaries (IBM-Japan and CocaCola–Japan). FDI goes in the other direction, too, and many companies operating in the United States are in fact subsidiaries of foreign firms. Gerber Products, for example, is a subsidiary of the Swiss company Novartis, while Stop & Shop and Giant Food Stores belong to the Dutch company Royal Ahold.

Multinational Corporations

A company that operates in many countries is called a multinational corporation (MNC). Fortune magazine's roster of the top five hundred MNCs speaks for the strong global position of U.S. business: almost 40 percent are headquartered in the United States, and these U.S. companies make up half the top ten: Wal-Mart, Exxon Mobil, General Motors, Ford, and General Electric.

The World's Twenty Largest MNCs

Rank	MNC (country)	Revenues (in $ millions)
1	Wal-Mart Stores (USA)	378,799
2	Exxon Mobil (USA)	372,824
3	Royal Dutch Shell (Netherlands)	355,782
4	BP (Great Britain)	291,438
5	Toyota Motor (Japan)	230,201
6	Chevron (USA)	210,783
7	ING Group (Netherlands)	201,516
8	Total (France)	187,280
9	General Motors (USA)	182,347
10	ConocoPhillips (USA)	178,558
11	Daimler (Germany)	177,167
12	General Electric (USA)	176,656
13	Ford Motor (USA)	172,468
14	Fortis (Belgium)	164,877
15	AXA (France)	162,762
16	Sinopec (China)	159,260
17	Citigroup (USA)	159,229
18	Volkswagen (Germany)	149,054
19	Dexia Group (Belgium)	147,648
20	HSBC Holdings (Britain)	146,500

MNCs often adopt the approach encapsulated in the motto "Think globally, act locally." They often adjust their operations, products, marketing, and distribution to mesh with the environments of the countries in which they operate. Because they understand that a "one-size-fits-all" mentality doesn't make good business sense when they're trying to sell products in different markets, they're willing to accommodate cultural and economic differences. Increasingly, MNCs supplement their mainstream product line with products designed for local markets. Coca-Cola, for example, produces coffee and citrus-juice drinks developed specifically for the Japanese market.

When such companies as Nokia and Motorola design cell phones, they're often geared to local tastes in color, size, and other features. McDonald's provides a vegetarian menu in India, where religious convictions affect the demand for beef and pork.

Likewise, many MNCs have made themselves more sensitive to local market conditions by decentralizing their decision making. While corporate headquarters still maintain a fair amount of control, home-country managers keep a suitable distance by relying on modern telecommunications. Today, fewer managers are dispatched from headquarters; MNCs depend instead on local talent. Not only does decentralized organization speed up and improve decision making, but it also allows an MNC to project the image of a local company. IBM, for instance, has been quite successful in the Japanese market because local customers and suppliers perceive it as a Japanese company. Crucial to this perception is the fact that the vast majority of IBM's Tokyo employees, including top leadership, are Japanese nationals.

The Global Business Environment

The differences between the foreign landscape and the one with which they're familiar are often huge and multifaceted. Some are quite obvious, such as differences in language, currency, and everyday habits (say, using chopsticks instead of silverware). But others are subtle, complex, and sometimes even hidden. Success in international business means understanding a wide range of cultural, economic, legal, and political differences between countries.

The Cultural Environment

Even when two people from the same country communicate, there's always a possibility of misunderstanding. When people from different countries get together, that possibility increases substantially. Differences in communication styles reflect differences in culture: the system of shared beliefs, values, customs, and behaviors that govern the interactions of members of a society. Cultural differences create challenges to successful international business dealings. We explain a few of these challenges in the following sections.

Language

English is the international language of business. The natives of such European countries as France and Spain certainly take pride in their own languages and cultures, but nevertheless English is the business language of the European Community. Whereas only a few educated Europeans have studied Italian or Norwegian, most have studied English. Similarly, on the South Asian subcontinent, where hundreds of local languages and dialects are spoken, English is the official language. In most corners of the world, English-only speakers—such as most Americans—have no problem finding competent translators and interpreters. So why is language an issue for English speakers doing business in the global marketplace?

In many countries, only members of the educated classes speak English. The larger population—which is usually the market you want to tap—speaks the local tongue. Advertising messages and sales appeals must take this fact into account. More than one English translation of an advertising slogan has resulted in a humorous (and perhaps serious) blunder.

Lost in Translation

In Belgium, the translation of the slogan of an American auto-body company, "Body by Fisher," came out as "Corpse by Fisher."
Translated into German, the slogan "Come Alive with Pepsi" became "Come out of the Grave with Pepsi."
A U.S. computer company in Indonesia translated "software" as "underwear."
A German chocolate product called "Zit" didn't sell well in the United States.
An English-speaking car-wash company in Francophone Quebec advertised itself as a "*lavement d'auto*" ("car enema") instead of the correct "*lavage d'auto*."
A proposed new soap called "Dainty" in English came out as "aloof" in Flemish (Belgium), "dimwitted" in Farsi (Iran), and "crazy person" in Korea; the product was shelved.
One false word in a Mexican commercial for an American shirt maker changed "When I used this shirt, I felt good" to "Until I used this shirt, I felt good."
In the 1970s, GM's Chevy Nova didn't get on the road in Puerto Rico, in part because *Nova* in Spanish means "It doesn't go."
A U.S. appliance ad fizzled in the Middle East because it showed a well-stocked refrigerator featuring a large ham, thus offending the sensibilities of Muslim consumers, who don't eat pork.

Time and Sociability

Americans take for granted many of the cultural aspects of our business practices. Most of our meetings, for instance, focus on business issues, and we tend to start and end our meetings on schedule. These habits stem from a broader cultural preference: we don't like to waste time. (It was an American, Benjamin Franklin, who coined the phrase "Time is Money.") This preference, however, is by no means universal. The expectation that meetings will start on time and adhere to precise agendas is common in parts of Europe (especially the Germanic countries), as well as in the United States, but elsewhere—say, in Latin America and the Middle East—people are often late to meetings.

High- and Low-Context Cultures

Likewise, don't expect businesspeople from these regions—or businesspeople from most of Mediterranean Europe, for that matter—to "get down to business" as soon as a meeting has started. They'll probably ask about your health and that of your family, inquire whether you're enjoying your visit to their country, suggest local foods, and generally appear to be avoiding serious discussion at all costs. For Americans, such topics are conducive to nothing but idle chitchat, but in certain cultures, getting started this way is a matter of simple politeness and hospitality. If you ever find yourself in such a situation, the best advice is to go with the flow and be receptive to cultural nuances. In high-context cultures, the numerous interlocking (and often unstated) personal and family connections that hold people together have an effect on almost all interactions. Because people's personal lives overlap with their business lives (and vice versa), it's important to get to know your potential business partners as human beings and individuals.

By contrast, in low-context cultures, such as those of the United States, Germany, Switzerland, and the Scandinavian countries, personal and work relationships are more compartmentalized: you don't necessarily need to know much about the personal context of a person's life to deal with him or her in the business arena.

The Economic Environment

If you plan to do business in a foreign country, you need to know its level of economic development. You also should be aware of factors influencing the value of its currency and the impact that changes in that value will have on your profits.

Economic Development

If you don't understand a nation's level of economic development, you'll have trouble answering some basic questions, such as, Will consumers in this country be able to afford the product I want to sell? How many units can I expect to sell? Will it be possible to make a reasonable profit?

A country's level of economic development is related to its standard of living, which can be evaluated using an economic indicator called gross national income (GNI) per capita. To calculate GNI per capita, we divide the value of all goods and services produced in a country (its GNI) by its average population, to arrive at an estimate of each citizen's share of national income.

Currency Valuations and Exchange Rates

If every nation used the same currency, international trade would be a lot easier. Unfortunately, this is not the case. Let's say that your business is importing watches from Switzerland. Because the watchmaker will want to be paid in Swiss francs, you have to figure out how many U.S. dollars you'll need to buy the francs with which to pay the watchmaker. You'd start by finding out the exchange rate between the Swiss franc and the U.S. dollar. The exchange rate tells you how much one currency is worth relative to another currency. So you need to know the value of the Swiss franc relative to the U.S. dollar.

Trade Controls

The debate about the extent to which countries should control the flow of foreign goods and investments across their borders is as old as international trade itself. Governments continue to control trade. To better understand how and why, let's examine a hypothetical case. Suppose you're in charge of a small country in which people do two things—grow food and make clothes. Because the quality of both products is high and the prices are reasonable, your consumers are happy to buy locally made food and clothes. But one day, a farmer from a nearby country crosses your border with several wagonloads of wheat to sell. On the same day, a foreign clothes maker arrives with a large shipment of clothes. These two entrepreneurs want to sell food and clothes in your country at prices below those that local consumers now pay for domestically made food and clothes. At first, this seems like a good deal for your consumers: they won't have to pay as much for food and clothes. But then you remember all the people in your country who grow food and make clothes. If no one buys their goods (because the imported goods are cheaper), what will happen to their livelihoods? Will everybody be out of work? And if everyone's unemployed, what will happen to your national economy?

That's when you decide to protect your farmers and clothes makers by setting up trade rules. Maybe you'll increase the prices of imported goods by adding a tax to them; you might even make the tax so high that they're more expensive than your homemade goods. Or perhaps you'll help your farmers grow food more cheaply by giving them financial help to defray their costs. The government payments that you give to the farmers to help offset some of their costs of production are called subsidies. These subsidies will allow the farmers to lower the price of their goods to a point below that of imported competitors' goods. What's even better is that the lower costs will allow the farmers to export their own goods at attractive, competitive prices.

Whether they push up the price of imports or push down the price of local goods, such initiatives will help locally produced goods compete more favorably with foreign goods. Both strategies are forms of trade controls—policies that restrict free trade. Because they protect domestic industries by reducing foreign competition, the use of such controls is often called protectionism. Though there's considerable debate over the pros and cons of this practice, all countries engage in it to some extent. Before debating the issue, however, let's learn about the more common types of trade restrictions: tariffs, quotas, and, embargoes.

Tariffs

Tariffs are taxes on imports. Because they raise the price of the foreign-made goods, they make them less competitive. The United States, for example, protects domestic makers of synthetic knitted shirts by imposing a stiff tariff of 32.5 percent on imports. Tariffs are also used to raise revenue for a government. Shoe imports are worth $1.63 billion annually to the federal government.

Quotas

A quota imposes limits on the quantity of a good that can be imported over a period of time. Quotas are used to protect specific industries, usually new industries or those facing strong competitive pressure from foreign firms. U.S. import quotas take two forms. An *absolute quota* fixes an upper limit on the amount of a good that can be imported during the given period. A *tariff-rate quota* permits the import of a specified quantity and then adds a high import tax once the limit is reached.

Dumping

A common political rationale for establishing tariffs and quotas is the need to combat dumping: the practice of selling exported goods below the price that producers would normally charge in their home markets (and often below the cost of producing the goods).

Usually, nations resort to this practice to gain entry and market share in foreign markets, but it can also be used to sell off surplus or obsolete goods. Dumping creates unfair competition for domestic industries, and governments are justifiably concerned when they suspect foreign countries of dumping products on their markets. They often retaliate by imposing punitive tariffs that drive up the price of the imported goods.

The Pros and Cons of Trade Controls

Opinions vary on government involvement in international trade. Some experts believe that governments should support free trade and refrain from imposing regulations that restrict the free flow of goods and services between nations. Others argue that governments should impose some level of trade regulations on imported goods and services.

Proponents of controls contend that there are a number of legitimate reasons why countries engage in protectionism. Sometimes they restrict trade to protect specific industries and their workers from foreign competition—agriculture, for example, or steel making. At other times, they restrict imports to give new or struggling industries a chance to get established. Finally, some countries use protectionism to shield industries that are vital to their national defense, such as shipbuilding and military hardware.

Despite valid arguments made by supporters of trade controls, most experts believe that such restrictions as tariffs and quotas—as well as practices that don't promote level playing fields, such as subsidies and dumping—are detrimental to the World economy. Without impediments to trade, countries can compete freely. Each nation can focus on what it does best and bring its goods to a fair and open world market. When this happens, the world will prosper. Or so the argument goes. International trade hasn't achieved global prosperity, but it's certainly heading in the direction of unrestricted markets.