(pp. 36-0)

The World Marketplace: Business Without Borders: Chapter Objectives

LEARNING OBJECTIVES

After studying this chapter, you will be able to…

LO1 Discuss business opportunities in the world economy

LO2 Explain the key reasons for international trade

LO3 Describe the tools for measuring international trade
LO4 Analyze strategies for reaching global markets
LO5 Discuss barriers to international trade and strategies to surmount them
LO6 Describe the free-trade movement and discuss key benefits and criticisms

LO1 An Unprecedented Opportunity

As access to technology skyrockets and barriers to trade continue to fall, individual economies around the world have become more interdependent than ever before. The result is a tightly woven global economy marked by intense competition and huge, shifting opportunities. The long-term potential for U.S. business is enormous. Although the global economic crisis caused the world GDP to contract in 2009 for the first time since World War II, compared with average increases of about 3.5% per year since 1946, world GDP growth turned positive again in 2010, expanding +4.6% led by lower-income countries, which averaged +6.3% growth, versus higher-income countries, which averaged just +2.8% growth. See Exhibit 3.1 for a sampling of some specific higher-and lower-growth countries.

A quick look at population trends validates the global business opportunity, especially in developing nations. With more than 300 million people, the United States accounts for less than 4.6% of the world's total population. More than 6.4 billion people live beyond our borders, representing more than 95% of potential customers for U.S. firms. But even though the growth rates in many high-population countries are strong, most of these nations remain behind the United States in terms of development and prosperity, posing considerable challenges for foreign firms. (In other words, most of their populations may not have the resources to buy even basic goods and services.) The issue is likely to become even more severe in the wake of the global economic crisis. Exhibit 3.1, a comparison of population, GDP growth rate, and per capita GDP for the world's six largest nations, highlights some of the discrepancies. Note that even though U.S. consumers clearly have money, China and India represent a much bigger opportunity in terms of both sheer size and economic growth.

The growing number of people with cell phones offers an interesting indicator of economic growth. Several
**EXHIBIT 3.1 Selected Population and GDP Figures**

<table>
<thead>
<tr>
<th>NATION</th>
<th>POPULATION*</th>
<th>PER CAPITA GDP (U.S. DOLLARS)**</th>
<th>GDP GROWTH RATE***</th>
</tr>
</thead>
<tbody>
<tr>
<td>CHINA</td>
<td>1,330,141,295</td>
<td>$7,400</td>
<td>+10.3%</td>
</tr>
<tr>
<td>INDIA</td>
<td>1,173,108,618</td>
<td>$3,400</td>
<td>+8.3%</td>
</tr>
<tr>
<td>EUROPEAN UNION</td>
<td>492,387,344</td>
<td>$32,900</td>
<td>+1.7%</td>
</tr>
<tr>
<td>UNITED STATES</td>
<td>310,232,863</td>
<td>$47,400</td>
<td>+2.8%</td>
</tr>
<tr>
<td>INDONESIA</td>
<td>240,271,522</td>
<td>$4,300</td>
<td>+6.0%</td>
</tr>
<tr>
<td>BRAZIL</td>
<td>198,739,269</td>
<td>$10,700</td>
<td>+7.5%</td>
</tr>
</tbody>
</table>


Recent studies have found that if a country increases cell phone penetration by 10 percentage points, GDP will likely increase by anywhere from +.5% to +1.2%. That may seem small, but it equates to somewhere between $49 and $118 billion for an...
economy the size of China. In other words, when the percentage of the population with cell phones goes up, the entire economy benefits.

Not surprisingly, cell phone penetration in India and China is skyrocketing. China currently boasts the world’s largest base of cell phone users—about 766 million—and the growth will likely continue. India’s current subscriber base is more than 584 million; it has grown explosively over the last five years and seems likely to follow suit in the next decade. The growth may well continue until China and India hit the 100%+ cell phone penetration rates that characterize a number of developed nations such as Taiwan, Hong Kong, Germany, and Argentina, which have more than one phone per person. In the United States, Europe, and Japan, cell phones followed landlines, but large swaths of developing nations aren’t bothering to build conventional phone service. Rather, they’re moving directly to cell phone networks. This trend is particularly marked across Africa, where cell phone penetration rates in 2009 were approximately 21% versus 9% for land lines.

The developing world boasts nearly double the cell phone subscriptions in advanced economies.

— THE WASHINGTON POST

In Zimbabwe, for instance, cell phone penetration grew from 4% in 2008 to about 30% in 2009. David Knapp, general director of Motorola Vietnam, points out that many developing nations “can leapfrog technology.” And Vietnamese micro-entrepreneur Nguyen Huu Truc says, “It’s no longer something that only the rich can afford. Now, it’s a basic means of communication.” As more people get the chance to get connected, better communication will likely feed economic growth. The upshot is that millions of people worldwide will have a higher standard of living.²

Unimpressive Scores

Every three years, the Organization for Economic Cooperation and Development tests 15-year-olds in thirty-four countries. Test results in 2010 showed unequivocally that American students must improve in order to compete effectively in a global economy. U.S. students ranked twenty-fifth among peers from thirty-four countries on a math test and scored in the middle in science and reading. China, Singapore, and South Korea led the pack, outpacing American students by a significant margin. U.S. Education Secretary of Education, Arne Duncan commented “This should be a massive wake-up call to the entire country.” But even some of the high-scoring countries face problems with their students. A recent survey of 1,500 South Korean public-school students, for instance, found that 29.3% of them exhibited signs of video game addiction. In response to this growing problem, the South Korean government set a curfew for online play in 2010 and mandated an automated blackout period after midnight for underage players. China has also experienced issues with compulsive gaming among young people. And the United States isn’t immune to these issues, either. A global study published in early 2011 found that across cultures, somewhere around 7–11% of gamers are addicted to the point of damaging other areas of their lives (e.g., school, families, social interactions). Specifically, the findings showed addiction levels at: Singapore (9.0%), the United States (8.5%), China (10.3%), Australia (8.0%), Germany (11.9%) and Taiwan (7.5%). Regardless of gaming issues, American students clearly need to up their academic game in order to score successful futures in a fiercely competitive, increasingly globalized world market.³
LO2 Key Reasons for International Trade

Companies engage in global trade for a range of reasons beyond the obvious opportunity to tap into huge and growing new markets. The benefits include better access to factors of production, reduced risk, and an inflow of new ideas.

- **Access to factors of production**: International trade offers a valuable opportunity for individual firms to capitalize on factors of production that simply aren't present in the right amount for the right price in each individual country. India, China, and the Philippines, for example, attract multibillion-dollar investments because of their large cohort of technically skilled university graduates who work for about one-fifth the pay of comparable American workers. Russia and the OPEC nations offer a rich supply of oil, and Canada, like other forested nations, boasts an abundant supply of timber. The United States offers plentiful capital, which is less available in other parts of the world. International trade helps even out some of the resource imbalances among nations.

- **Reduced risk**: Global trade reduces dependence on one economy, lowering the economic risk for multinational firms. When the Japanese economy entered a deep, sustained slump in the 1990s, for instance, Sony and Toyota thrived through their focus on other, healthier markets around the world. But a word of caution is key: as national economies continue to integrate, an economic meltdown in one part of the world can have far-reaching impact. Major foreign banks, for example, were badly burned by the U.S. subprime market mess, due to heavy investments in U.S. mortgage markets.

- **Inflow of innovation**: International trade can also offer companies an invaluable source of new ideas. Japan, for instance, is far ahead of the curve regarding cell phone service. Japanese cell phone “extras,” including games, ringtones, videos, and stylish new accessories, set the standard for cell service around the world. In Europe, meanwhile, consumers are seeking to bring a top-quality pub experience into their homes with professional-quality home beer taps. Companies with a presence in foreign markets experience budding trends like these firsthand, giving them a jump in other markets around the world.⁴

**Competitive Advantage**

Beyond individual companies, industries tend to succeed on a worldwide basis in countries that enjoy a competitive advantage. But to understand competitive advantage, you need to first understand how opportunity cost relates to international trade. When a country produces more of one good, it must produce less of another good (assuming that resources are finite). The value of the second-best choice—the value of the production that a country gives up in order to produce the first product—represents the opportunity cost of producing the first product.

A country has an absolute advantage when it can produce more of a good than other nations, using the same amount of resources. China, for example, has an absolute advantage in terms of clothing production, relative to the United States. But having an absolute advantage isn't always enough. Unless they face major trade barriers, the industries in any country tend to produce products for which they have a comparative advantage—meaning that they tend to turn out those goods that have the lowest opportunity cost compared to other countries. The United States, for instance, boasts a comparative...
advantage versus most countries in movie and television program production; Germany has a comparative advantage in the
production of high-performance cars; and South Korea enjoys a comparative advantage in electronics.

But keep in mind that comparative advantage seldom remains static. As technology changes and the workforce evolves
(through factors such as education and experience), nations may gain or lose comparative advantage in various industries.
China and India, for example, are both seeking to build a comparative advantage versus other nations in technology
production by investing in their infrastructure and their institutions of higher education.

**LO3 Global Trade: Taking Measure**

After a decade of robust growth, global trade began slowing in 2007, due largely to turbulence in the worldwide financial
markets. In 2008, the rate of growth in world trade slid below 5%, as the global recession tightened its grip. In 2009, global
trade plummeted nearly 25% in U.S. dollar terms, and 12% in terms of overall volume from 2008’s level, the largest single-year
drop since World War II. Global gross fixed investment fell about 4% year-over-year, or by roughly $800 billion. The global
trade recovery began in 2010, with a projected +9.5% growth rate, although persistent low employment in the global
economy may dampen the recovery over the longer term. Global gross fixed investment stabilized in 2010 at about 23% of
global world product. Measuring the impact of international trade on individual nations requires a clear understanding of
balance of trade, balance of payments, and exchange rates.  

**Balance of Trade**

The *balance of trade* is a basic measure of the difference between a nation's exports and imports. If the total value of
exports is higher than the total value of imports, the country has a *trade surplus*. If the total value of imports is higher than
the total value of exports, the country has a *trade deficit*. Balance of trade includes the value of both goods and services,
and it incorporates trade with all foreign nations. Although a trade deficit signals the wealth of an economy that can afford
to buy huge amounts of foreign products, a large deficit can be destabilizing. It indicates, after all, that as goods and
services flow into a nation, money flows out—a challenge with regard to long-term economic health. The United States has
had an overall trade deficit since 1976, and as the American appetite for foreign goods has grown, the trade deficit has
bullooed. But that growth may slow over the next few years if demand remains sluggish in response to the global economic
crisis.

**Balance of Payments**

*Balance of payments* is a measure of the total flow of money into or out of a country. Clearly, the balance of trade plays a
central role in determining the balance of payments. But the balance of payments also includes other financial flows such as
foreign borrowing and lending, foreign aid payments and receipts, and foreign investments. A *balance of payments surplus*
means that more money

<table>
<thead>
<tr>
<th>STRONG DOLLAR VERSUS EURO: WHO BENEFITS? (EXAMPLE: $1.00 • 1.20 EUROS)</th>
<th>WEAK DOLLAR VERSUS EURO: WHO BENEFITS? (EXAMPLE: $1.00 • .60 EUROS)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>U.S. travelers to Europe:</strong> Their dollars can buy more European goods and services.</td>
<td><strong>European travelers to the United States:</strong> Their dollars buy more American goods and services.</td>
</tr>
<tr>
<td><strong>American firms with European operations:</strong> Operating costs—from buying products to paying workers—are lower.</td>
<td><strong>European firms with American operations:</strong> Operating costs—from buying products to paying workers—are lower.</td>
</tr>
<tr>
<td><strong>European exporters:</strong> Their products are less expensive in the United States, so Europe exports more, and we import more.</td>
<td><strong>American exporters:</strong> Their products are less expensive in Europe, so we export more, and Europe imports more.</td>
</tr>
</tbody>
</table>

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flows in than out, while a **balance of payments deficit** means that more money flows out than in. Keep in mind that the
balance of payments typically corresponds to the balance of trade, since trade is, in general, the largest component.

**Exchange Rates**
Exchange rates measure the value of one nation’s currency relative to the currency of other nations. While the exchange rate does not directly measure global commerce, it certainly has a powerful influence on how global trade affects individual nations and their trading partners. The exchange rate of a given currency must be expressed in terms of another currency. Here are some examples of how the exchange rate can influence the economy, using the dollar and the euro.

Countertrade

A complete evaluation of global trade must also consider exchanges that don’t actually involve money. A surprisingly large chunk of international commerce—possibly as much as 25%—involves the barter of products for products rather than for currency. Companies typically engage in countertrade to meet the needs of customers that don’t have access to hard currency or credit, usually in developing countries. Individual countertrade agreements range from simple barter to a complex web of exchanges that end up meeting the needs of multiple parties. Done poorly, countertrading can be a confusing nightmare for everyone involved. But done well, countertrading is a powerful tool for gaining customers and products that would not otherwise be available.6

LO4 Seizing the Opportunity: Strategies for Reaching Global Markets

There is no one “right way” to seize the opportunity in global markets. In fact, the opportunity may not even make sense for every firm. While international trade can offer new profit streams and lower costs, it also introduces a higher level of risk and complexity to running a business. Being ready to take on the challenge can mean the difference between success and failure.

Firms ready to tap the opportunity have a number of options for how to move forward. One way is to seek foreign suppliers through outsourcing and importing. Another possibility is to seek foreign customers through exporting, licensing, franchising, and direct investment. These market development options fall in a spectrum from low cost–low control to high cost–high control, as shown in Exhibit 3.2. In other words, companies that choose to export products to a foreign country spend less to enter that market than companies that choose to build their own factories. But companies that build their own factories have a lot more control than exporters over how their business unfolds. Keep in mind that profit opportunity and risk—which vary along with cost and control—also play a critical role in how firms approach international markets.

Smaller firms tend to begin with exporting and move along the spectrum as the business develops. But larger firms may jump straight to the strategies that give them more control over their operations. Large firms are also likely to use a number of different approaches in different countries, depending on the goals of the firm and the structure of the foreign market. Regardless of the specific strategy, most large companies—such as General Electric, Nike, and Disney—both outsource with foreign suppliers and sell their products to foreign markets.

Foreign Outsourcing and Importing

Foreign outsourcing means contracting with foreign suppliers to produce products, usually at a fraction of the cost of domestic production. Gap, for instance, relies on a network of manufacturers in fifty different countries, mostly in less-developed parts of the world, from Asia, to Africa, to Central America. Apple depends on firms in China and Taiwan to produce the iPhone. And countless small companies contract with foreign manufacturers as well. The key benefit, of course, is dramatically lower wages, which drive down the cost of production.
But while foreign outsourcing lowers costs, it also involves significant risk. Quality control typically requires very detailed specifications to ensure that a company gets what it actually needs. Another key risk of foreign outsourcing involves social responsibility. A firm that contracts with foreign producers has an obligation to ensure that those factories adhere to ethical standards. Deciding what those standards should be is often quite tricky, given different cultures, expectations, and laws in different countries. And policing the factories on an ongoing basis can be even harder than determining the standards. But companies that don't get it right face the threat of significant consumer backlash in the United States and Europe. This has been a particular issue with products produced in China. In the recent past, for instance, product defects forced U.S. firms to recall a host of Chinese-produced toys, including Thomas the Tank Engine trains that were coated with toxic lead paint, ghoulish fake eyeballs that were filled with kerosene, and Polly Pocket dolls that posed a swallowing hazard.\(^7\)

Many Americans have become personally familiar with the quality/cost tradeoff as a growing number of companies have outsourced customer service to foreign call centers. Research suggests that the approximate cost of offering a live, American-based, customer service agent averages about $7.50 per call, while outsourcing those calls to live agents in another country drops the average cost down to about $3.25 per call. But customers end up paying the difference in terms of satisfaction, reporting high levels of misunderstanding, frustration, and inefficiency. A number of firms – such as JetBlue – have enjoyed the best of both worlds by outsourcing customer service calls to U.S. agents who work from their own homes.\(^8\)

**Importing** means buying products from overseas that have already been produced, rather than contracting with overseas manufacturers to produce special orders. Imported products, of course, don't carry the brand name of the importer, but they also don't carry as much risk. Pier 1 Imports, a large retail chain, has built a powerful brand around the importing concept, creating stores that give the customer the sense of a global shopping trip without the cost or hassle of actually leaving the country.

**Exporting** is the most basic level of international market development. It simply means producing products domestically and selling them abroad. Exporting represents an especially strong opportunity for small and mid-sized companies. Ernest Joshua, for instance, developed a thriving Arkansas-based hair care company that specializes in products for African Americans. Recognizing opportunity abroad, his firm now exports products to Africa and the Caribbean.\(^9\)

**Foreign Licensing and Foreign Franchising**

Foreign licensing and foreign franchising, the next level of commitment to international markets, are quite similar. **Foreign licensing** involves a domestic firm granting a foreign firm the rights to produce and market its product or to use its
Foreign franchising is a specialized type of licensing. A firm that expands through foreign franchising, called a franchisor, offers other businesses, or franchisees, the right to produce and market its products if the franchisee agrees to specific operating requirements—a complete package of how to do business. Franchisors also often offer their franchisees management guidance, marketing support, and even financing. In return, franchisees pay both a start-up fee and an ongoing percentage of sales to the franchisor. One key difference between franchising and licensing is that franchisees assume the identity of the franchisor. A McDonald's franchise in Paris, for instance, is clearly a McDonald's, not, say, a Pierre's Baguette outlet that also carries McDonald's products.

Foreign Direct Investment

Direct investment in foreign production and marketing facilities represents the deepest level of global involvement. The cost is high, but companies with direct investments have more control over how their business operates in a given country. The high-dollar commitment also represents significant risk if the business doesn't go well. Most direct investment takes the form of either acquiring foreign firms or developing new facilities from the ground up. Another increasingly popular approach is strategic alliances or partnerships that allow multiple firms to share risks and resources for mutual benefit.

Foreign acquisitions enable companies to gain a foothold quickly in new markets. In 2009, for example,

![Image](https://via.placeholder.com/150)

© Mystic Arabia/Alamy

Italian carmaker Fiat took over struggling U.S. auto giant Chrysler, with plans to more fully exploit the American market in the wake of the Great Recession. A number of other global giants, such as Microsoft, General Electric, and Nestlé, tend to follow a foreign acquisition strategy.¹⁰

Developing new facilities from scratch—or “offshoring”—is the most costly form of direct investment. It also involves significant risk. But the benefits include complete control over how the facility develops and the potential for high profits, which makes the approach attractive for corporations that can afford it. Intel, for instance, plans to build a $2.5 billion specialized computer chip manufacturing plant in northeastern China. And foreign car companies, from German Daimler-Benz, to Korean Hyundai, to Japanese Toyota, have built factories in the southern United States.¹¹

Joint ventures involve two or more companies joining forces—sharing resources, risks, and profits, but not merging companies—to pursue specific opportunities. A formal, long-term agreement is usually called a partnership, while a less formal, less encompassing agreement is usually called a strategic alliance. Joint ventures are a popular, though controversial, means of entering foreign markets. Often a foreign company connects with a local firm to ease its way into the market. In fact, some countries, such as Malaysia, require that foreign investors have local partners. But research from Harvard finance professor Mihir Desai finds that joint ventures between multinational firms and
domestic partners can be more costly and less rewarding than they initially appear. He and his team suggest that they make sense only in countries that require local political and cultural knowledge as a core element of doing business. \(^{12}\)

**LO5 Barriers to International Trade**

Every business faces challenges, but international firms face more hurdles than domestic firms. Understanding and surmounting those hurdles is the key to success in global markets. Most barriers to trade fall into the following categories: sociocultural differences, economic differences, and legal/political differences. As you think about these barriers, keep in mind that each country has a different mix of barriers. Often countries with the highest barriers have the least competition, which can be a real opportunity for the first international firms to break through.

**Sociocultural Differences**

Sociocultural differences include differences among countries in language, attitudes, and values. Some specific, and perhaps surprising, elements that affect business include nonverbal communication, forms of address, attitudes toward punctuality, religious celebrations and customs, business practices, and expectations regarding meals and gifts.

Understanding and responding to sociocultural factors are vital for firms that operate in multiple countries. But since the differences often operate at a subtle level, they can undermine relationships before anyone is aware that it's happening. The best way to jump over sociocultural barriers is to conduct thorough consumer research, cultivate firsthand knowledge, and practice extreme sensitivity. The payoff can be a sharp competitive edge. Hyundai, for instance, enjoys a whopping 17% share of the passenger car market in India. It beat the competition with custom features that reflect Indian culture, such as elevated rooflines to provide more headroom for turban-wearing motorists. \(^{13}\)

**Economic Differences**

Before entering a foreign market, it's critical to understand and evaluate the local economic conditions. Key factors to consider include population, per capita income, economic growth rate, currency exchange rate, and stage of economic development. But keep in mind that low scores for any of these measures don't necessarily equal a lack of opportunity. In fact, some of today's biggest opportunities are in countries with low per capita income. For example, the Indian division of global giant Unilever gets 50% of its sales from rural India by selling products to individual consumers in tiny quantities, such as two-cent sachets of shampoo. The rural Indian market has been growing so dramatically that in 2010,
To Spend or Not to Spend

Both common sense and basic economics suggest that spending more than you earn is a bad idea both for individuals and for countries. In the U.S., we see the results of this reckless policy in a multi-trillion-dollar federal debt that threatens to overwhelm future generations. And over a million Americans file personal bankruptcy each year. China, however, may need to encourage its citizens to save less and spend more. Healthy consumer spending is crucial for long-term economic health; when consumer spending falters, economic growth eventually staggers as well. In line with traditional Confucian thinking, many Chinese save a full third of after-tax income (compared to a personal savings rate of around 5% in the U.S. in 2010), planning for old age, storing up reserves for emergencies, and creating their own social “safety nets.” Another factor dampening consumption is that Chinese financial markets for household borrowing – mortgage debt, personal loans, and credit cards are underdeveloped. One startling example is that General Motors reports that 90% of Buicks – a bestseller in China – are purchased with stacks and stacks of cold hard cash, virtually unheard of in the United States, where checks, credit cards, and financing are the norm. Looking forward, China seems likely to encourage greater consumption to maintain its blistering pace of economic growth. One positive result for the U.S. should be a reduction in the huge trade deficit with China, which will bolster the American economy.  

Foreign markets can differ dramatically in terms of infrastructure development. © Mao Siqian/Xinhua/Xinhua Press/Corbis

the Chairman on Hindustan Unilever declared, “What we have done in the last 25 years we want to do it in the next two years,” scaling up the reach of its consumer products from about 250,000 rural retail outlets to about 750,000. And Hewlett-Packard has recently joined forces with Unilever to give microdistributors in rural India the ability to check prices and place orders online from “what are now distinctively offline villages and regions.” Also capitalizing on the rapid growth and increased demand, Samsung has introduced Guru, a mobile phone that can be charged with solar power, to rural India.
Effectively serving less-developed markets requires innovation and efficiency. Emerging consumers often need different product features, and they almost always need lower costs. C. K. Prahalad, an influential business scholar, believed that forward-thinking companies can make a profit in developing countries if they make advanced technology affordable. Many markets are simply so large that high-volume sales can make up for low-profit margins.

Overall, the profit potential is clear and growing. And as consumers in developing countries continue to gain income—although at a much slower pace in the wake of the economic crisis—companies that established their brands early will have a critical edge over firms that enter the market after them.

**Infrastructure** should be another key economic consideration when entering a foreign market. Infrastructure refers to a country's physical facilities that support economic activity. It includes basic systems in each of the following areas:

- Transportation (e.g., roads, airports, railroads, and ports)
- Communication (e.g., TV, radio, Internet, and cell phone coverage)
- Energy (e.g., utilities and power plants)
- Finance (e.g., banking, checking, and credit)

The level of infrastructure can vary dramatically among countries. In Africa, for instance, only 11% of the population has Internet access, compared to 77% in North America. In

**Veggie Surprise, Anyone?**

![Veggie Surprise, Anyone?](https://example.com/veggie-surprise-image.jpg)

Travel around the world, and you're likely to see American fast-food franchisees in virtually every city. Although you'll surely recognize the names of these fast-food behemoths, you may not be as familiar with the food that they serve, since many of the dishes have been completely changed in response to local culture.

Some favorites from the Domino's international menus:

- Japan: squid pizza
- England: tuna and sweet corn pizza
- South Korea: broccoli and potato pizza
- Netherlands: grilled lamb pizza

**Pizza Hut:**

- Japan: crust stuffed with shrimp nuggets and injected with mayonnaise
- South Korea: crust filled with sweet potato mousse

**McDonald's:**

- India: Paneer Salsa Wrap (cottage cheese with Mexican-Cajun coating)
- Australia: Bacon and Egg Roll (“Rashers of quality bacon and fried egg”)
- Kuwait: Veggie Surprise Burger (no detailed description...yikes!)
Vietnam and Thailand, many consumers buy products directly from vendors in small boats, compared to firmly grounded stores in Europe. While credit card purchases are still relatively low in much of the world, particularly in Asia, recent growth has been explosive and will probably continue for the next few years.  

Political and Legal Differences

Political regimes obviously differ around the world, and their policies have a dramatic impact on business. The specific laws and regulations that governments create around business are often less obvious, yet they can still represent a significant barrier to international trade. To compete effectively—and to reduce risk—managers must carefully evaluate these factors and make plans to respond to them both now and as they change.

Laws and Regulations

International businesses must comply with international legal standards, the laws of their own countries, and the laws of their host countries. This can be a real challenge, since many developing countries change business regulations with little notice and less publicity. The justice system can pose another key challenge, particularly with regard to legal enforcement of ownership and contract rights. Since 2003, The World Bank has published a “Doing Business” report that ranks the ease of doing business for small and medium-sized companies in 183 different countries. The 2011 “Doing Business” report presented the encouraging news that in the past five years, about 85% of the world's economies have made it easier for local entrepreneurs to operate, through 1,511 improvements to business regulation. For the fifth year running, Singapore leads in the ease of doing business, followed by Hong Kong SAR China, New Zealand, the United Kingdom, and the United States. China and India are among the top 40 most-improved economies. The “Doing Business” project examines the ease of doing business from nine different angles, including the ease of dealing with construction permits to paying taxes to enforcing contracts. The key benefit of an effective legal system is that it reduces risk for both domestic and foreign businesses.

Bribery, the payment of money for favorable treatment, and corruption, the solicitation of money for favorable treatment, are also major issues throughout the world. While bribery and corruption are technically illegal in virtually every major country, they are often accepted as a standard way of doing business. Regardless, U.S. corporations and American citizens are subject to prosecution by U.S. authorities for offering bribes in any nation. See Chapter 4 for more details.

Global Greening: The Ultimate Group Project

Global greening can only happen if every major nation does its share in making it happen. But like any group project, no one will make the grade unless every country participates as significantly as possible. The good news is that global greening seems to be on a roll. According to a 2010 report from the nonprofit Pew Environment Group, overall global investment in clean energy grew 230 percent from 2005 to 2009. And in 2009, in the face of the worldwide economic downturn, investments in clean energy declined only 6.6 percent from 2008. Demonstrating its staying power, the clean energy sector outperformed the oil and gas industry, which experienced investment declines of 19 percent in 2009. The United States leads the world in terms of renewable energy capacity, followed by China, Germany, Spain, and India. In a positive sign for the future, many governments prioritized clean energy within economic recovery funding, devoting more than $184 billion of public stimulus investments to the sector. The bulk of the funds will likely reach innovators, businesses and installers in 2010 and 2011. Looking further forward, students can probably expect that the clean energy sector will offer job opportunities for a number of decades to come as the nations of the world continue to work together to achieve global greening.

Political Climate

The political climate of any country deeply influences whether that nation is attractive to foreign business. Stability is crucial. A country subject to strife from civil war, riots, or other violence creates huge additional risk for foreign business. Yet, figuring out how to operate in an unstable environment such as Russia, Bolivia, or the Middle East, can give early movers a real advantage. Grant Winterton, Coca-Cola's regional manager for Russia, commented to Time magazine that “the politics do concern us.” But having snagged 50% of the $1.9 billion carbonated-soft-drink market, he concludes that “the
opportunity far outweighs the risk.” Poor enforcement of intellectual property rights across international borders is another tough issue for business. Fortunately, there has been some progress. The Business Software Alliance piracy-tracking study found that worldwide piracy rates increased two percentage points to 43% in 2009 (vs. 2008), which was lower than expected given the economic pressure of the Great Recession; in fact, the rate of PC software piracy dropped in 49% of the 111 economies studied. The highest-piracy countries are Georgia, Zimbabwe, Bangladesh, Moldava, Armenia, and Yemin, all over 90%.20

**International Trade Restrictions**

National governments also have the power to erect barriers to international business through a variety of international trade restrictions. The arguments for and against trade restrictions—also called protectionism—are summarized below. As you read, note that most economists find the reasons to eliminate trade restrictions much more compelling than the reasons to create them.

Just as trade restrictions have a range of motivations, they can take a number of different forms. The most common trade restrictions are tariffs, quotas, voluntary export restraints, and embargos.

- **Tariffs** are taxes levied against imports. Governments tend to use protective tariffs either to shelter fledgling industries that couldn't compete without help, or to shelter industries that are crucial to the domestic economy. In 2002, for instance, the United States imposed tariffs of 8% to 30% on a variety of imported steel products for a period of three years, in order to give some relief to the large, but ailing, U.S. steel industry.

- **Quotas** are limitations on the amount of specific products that may be imported from certain countries during a given time period. Russia, for instance, has specific quotas for U.S. meat imports.

- **Voluntary Export Restraints (VERs)** are limitations on the amount of specific products that one nation will export to another nation. Although the government of the exporting country typically imposes VERs, they usually do so out of fear that the importing country would impose even more onerous restrictions. As a result, VERs often aren't as “voluntary” as the name suggests. The United States, for instance, insisted on VERs with Japanese auto exports in the early 1980s (which many economists believe ultimately precipitated the decline of the U.S. auto industry).

- **An embargo** is a total ban on the international trade of a certain item, or a total halt in trade with a particular nation. The intention of most embargoes is to pressure the targeted country to change political policies or to protect national security. The U.S. embargo against trade with Cuba offers a high-profile example.

Quotas, VERs, and embargoes are relatively rare compared to tariffs, and tariffs are falling to new lows. But as tariffs decrease, some nations are seeking to control imports through nontariff barriers such as:

- Requiring red-tape-intensive import licenses for certain categories
- Establishing nonstandard packaging requirements for certain products
- Offering less-favorable exchange rates to certain importers
- Establishing standards on how certain products are produced or grown
- Promoting a “buy national” consumer attitude among local people

Nontariff barriers tend to be fairly effective because complaints about them can be hard to prove and easy to counter.21

**LO6 Free Trade: The Movement Gains Momentum**

Perhaps the most dramatic change in the world economy has been the global move toward free trade—the unrestricted movement of goods and services across international borders. Even though complete free trade is not a reality, the emergence of regional trading blocks, common markets, and international trade agreements has moved the world economy much closer to that goal.

**GATT and the World Trade Organization**

The General Agreement on Tariffs and Trade (GATT) is an international trade accord designed to encourage worldwide trade among its members. Established in 1948 by 23 nations, GATT has undergone a number of revisions. The most significant changes stemmed from the 1986–1994 Uruguay Round of negotiations, which took bold steps to slash average tariffs by about 30%
and to reduce other trade barriers among the 125 nations that signed.

The Uruguay Round also created the World Trade Organization (WTO), a permanent global institution to promote international trade and to settle international trade disputes. The WTO monitors provisions of the GATT agreements, promotes further reduction of trade barriers, and mediates disputes among members. The decisions of the WTO are binding, which means that all parties involved in disputes must comply to maintain good standing in the organization. Ministers of the WTO meet every two years to address current world trade issues. As the world economy has shifted toward services rather than goods, the emphasis of WTO meetings has followed suit. Controlling rampant piracy of intellectual property is a key concern for developed countries. For less-developed countries, one central issue is U.S. and European agricultural subsidies, which may unfairly distort agricultural prices worldwide.

In fact, both the broader agenda and the individual decisions of the WTO have become increasingly controversial over the past ten years. Advocates for less-developed nations are deeply concerned that free trade

World peace through international trade and commerce.

— Hilton Hotel’s Corporate Motto

clears the path for major multinational corporations to push local businesses into economic failure. A local food stand, for instance, probably won’t have the resources to compete with a global giant such as McDonald’s. If the food stand closes, the community has gained inexpensive hamburgers, but the entrepreneur has lost his livelihood, and the community has lost the local flavor that contributes to its unique culture. Other opponents of the WTO worry that the acceleration of global trade encourages developing countries to fight laws that protect the environment and workers’ rights, for fear of losing their low-cost advantage on the world market. The concerns have sparked significant protests during the past few meetings of the WTO ministers, and the outcry may well grow louder as developing nations gain economic clout.

The World Bank

Established in the aftermath of World War II, the World Bank is an international cooperative of 187 member countries, working together to reduce poverty in the developing world. The World Bank influences the global economy by providing financial and technical advice to the governments of developing countries for projects in a range of areas including infrastructure, communications, health, and education. The financial assistance usually comes in the form of low-interest loans. But to secure a loan, the borrowing nation must often agree to conditions that can involve rather arduous economic reform.

The International Monetary Fund

Like the World Bank, the International Monetary Fund (IMF) is an international organization accountable to the governments of its 187 member nations. The basic mission of the IMF is to promote international economic cooperation and

<table>
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<tr>
<th>REASONS TO CREATE TRADE RESTRICTIONS</th>
<th>REASONS TO ELIMINATE TRADE RESTRICTIONS</th>
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<tbody>
<tr>
<td>Protect domestic industry (e.g., the U.S. steel industry)</td>
<td>Reduce prices and increase choices for consumers by encouraging competition from around the world</td>
</tr>
<tr>
<td>Protect domestic jobs in key industries (but perhaps at the cost of domestic jobs in other industries)</td>
<td>Increase domestic jobs in industries with a comparative advantage versus other countries</td>
</tr>
<tr>
<td>Protect national security interests</td>
<td>Increase jobs—both at home and abroad—from foreign companies</td>
</tr>
<tr>
<td>Retaliate against countries who have engaged in unfair trade practices</td>
<td>Build exporting opportunities through better relationships with other countries</td>
</tr>
<tr>
<td>Pressure other countries to change their policies and practices</td>
<td>Use resources more efficiently on a worldwide basis</td>
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stable growth. Funding comes from the member nations, with the United States contributing more than twice as much as any other country. To achieve these goals, the IMF:

- Supports stable exchange rates
- Facilitates a smooth system of international payments
- Encourages member nations to adopt sound economic policies
- Promotes international trade
- Lends money to member nations to address economic problems.

Over the past 40 years, life expectancy in developing countries has risen by 20 years—about as much as was achieved in all of human history prior to the mid-twentieth century.

—World Bank FAQs

Although all of its functions are important, the IMF is best known as a lender of last resort to nations in financial trouble. This policy has come under fire in the past few years. Critics accuse the IMF of encouraging poor countries to borrow more money than they can ever hope to repay, which actually cripples their economies over the long term, creating even deeper poverty.

At the end of 2005, the IMF responded to its critics by implementing a historic debt relief program for poor countries. Under this program, which has since been expanded to include other agencies, the IMF and its partners have extended 100% debt forgiveness to 40 poor countries, erasing about $75 billion in debt. The managing director of the IMF pointed out that the canceled debt will allow these countries to increase spending in priority areas to reduce poverty and promote growth (although some experts worry that debt cancellation sets a troubling precedent for future lending). The result should be a higher standard of living for some of the poorest people in the world.  

Trading Blocs and Common Markets

Another major development in the last decade is the emergence of regional trading blocs, or groups of countries that have reduced or even eliminated all tariffs, allowing the free flow of goods among the member nations. A common market goes even further than a trading bloc by attempting to harmonize all trading rules. The United States, Mexico, and Canada have formed the largest trading bloc in the world, and the 27 countries of the European Union have formed the largest common market.

NAFTA
The **North American Free Trade Agreement (NAFTA)** is the treaty that created the free-trading zone among the United States, Mexico, and Canada. The agreement took effect in 1994, gradually eliminating trade barriers and investment restrictions over a 15-year period. Despite dire predictions of American jobs flowing to Mexico, the U.S. economy has grown significantly since the implementation of NAFTA. The Canadian and Mexican economies have thrived as well (although all three economies have slowed significantly during the global economic crisis).

But NAFTA critics point out that the U.S. trade deficit with both Mexico and Canada has skyrocketed. While exports to both nations have increased, imports have grown far faster; both countries are among the top ten contributors to the total U.S. trade deficit, threatening the long-term health of the American economy. Other criticisms of NAFTA include increased pollution and worker abuse. Companies that move their factories to Mexico to capitalize on lower costs also take advantage of looser environmental and worker-protection laws, creating major ethical concerns. But the full impact of NAFTA—for better or for worse—is tough to evaluate, since so many other variables affect all three economies.23

**European Union**

Composed of 27 nations and nearly half a billion people, and boasting a combined GDP of nearly $15 trillion, the **European Union (EU)** is the world's largest common market. Exhibit 3.3 shows a map of the 2011 EU countries plus the three countries that have applied to join.24 The overarching goal of the EU is to bolster Europe's trade position and to increase its international political and economic power. To help make this happen, the EU has removed all trade restrictions among member nations and unified internal trade rules, allowing goods and people to move freely among EU countries. The EU has also created standardized policies for import and export between EU countries and the rest of the world, giving the member nations more clout as a bloc than each would have had on its own. Perhaps the EU's most economically significant move was the introduction of a single currency, the euro, in 2002. Of the 15 EU members at the time, 12 adopted the euro (exceptions were the United Kingdom, Sweden, and Denmark). Most economists anticipate that the holdouts plus the 12 newest members of the EU will eventually adopt the euro, creating an even bolder presence on the world market. The EU also affects the global economy with its leading-edge approach to environmental protection, quality production, and human rights.
JUST BECAUSE THEY CAN...

With 400 million people under the age of 18 and an explosively growing economy, the market for higher education in India has boomed. Since public universities can't keep up with the swelling demand, private colleges have jumped at the chance to fill in the gap, creating opportunities for American institutions to plant their flags in India via joint ventures with Indian colleges and universities (the only option according to Indian law).

... DOESN'T MEAN THEY SHOULD.

A number of top American universities—including Northwestern, Ohio State, Wharton Business School, and Virginia Tech—rushed at the opportunity, eager to boost their enrollment, pump up their bottom line, and enhance their global prestige. But unfortunately, building quality programs has been more of a challenge. Only a small portion of private institutions are accredited in India, which means that their graduates are not qualified to take government jobs or pursue most graduate degrees. According to Rahul Choudaha, an associate director at World Education Services, “Across the whole landscape of Indian higher education, at the institutional level, the concept of quality is considered an add-on, not a necessity.”

What do YOU think?

- Should top-notch American higher education institutions continue to seek partnerships with Indian institutions?
- Do any differences in quality undermine their brands? Do they have an obligation to inform their other stakeholders (e.g., students, alumni) about any differences in quality?
- What other issues should both parties consider?

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The Big Picture

The last decade has been marked by extraordinary changes in the world economy. The boundaries between individual countries have fallen lower than ever before, creating a new level of economic connectedness. The growing integration has created huge opportunities for visionary companies of every size.
integration also means risk. The dangers became clear in 2008, when the economic crisis in the United States rapidly reverberated around the globe, fueling a deep, worldwide recession. To succeed abroad—especially in tough economic times—individual firms must make the right choices about how to structure their operations, surmount barriers to trade, meet diverse customer needs, manage a global workforce, and handle complex logistics. Human rights and environmental protection continue to be especially critical for international businesses. Both are vital components of social responsibility and will only gain importance as advocates raise awareness around the world. In the face of economic, political, and social flux, effective global business leaders must master both strategy and implementation at a deeper level than ever before.

**Careers in World Markets**

Given the global aspects of the Web, virtually every business job has some international dimensions. Even if you don't work in a foreign country, chances are strong that a least some portion of your customers, competitors, or suppliers are from abroad. In fact, a growing number of major corporations, such as Coca-Cola and Google, consider international experience a “must-have” for senior management positions. So as you complete your business education—regardless of your area of specialization—you should seriously consider pursuing opportunities to study abroad if possible, and to learn another language and culture.

**What else?**

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**LO1 Discuss business opportunities in the world economy**

Advancing technology and falling trade barriers have created unprecedented international business opportunities. Despite the global economic crisis that began in 2008, high-population developing countries—such as China, India, Indonesia, and Brazil—continue to offer the most potential due to both their size and their relatively strong economic growth rates.

**LO2 Explain the key reasons for international trade**

The benefits of international trade for individual firms include access to factors of production, reduced risk, and an inflow of new ideas from foreign markets. Overall, Industries tend to succeed on a global basis in countries that enjoy a competitive
advantage. A country has an absolute advantage in a given industry when it can produce more of a good than other nations, using the same amount of resources, and a country has a comparative advantage when it can make products at a lower opportunity cost than other nations. Unless they face major trade barriers, the industries in any country tend to produce products for which they have a comparative advantage.

LO3 Describe the tools for measuring international trade

Measuring the impact of international trade on individual nations requires a clear understanding of balance of trade, balance of payments, and exchange rates.

- **Balance of trade**: A basic measure of the difference between a nation's exports and imports.
- **Balance of payments**: A measure of the total flow of money into or out of a country, including the balance of trade, plus other financial flows, such as foreign loans, foreign aid, and foreign investments.
- **Exchange rates**: A measure of the value of one nation's currency relative to the currency of other nations. The exchange rate has a powerful influence on the way global trade affects both individual nations and their trading partners.

LO4 Analyze strategies for reaching global markets

Firms can enter global markets by developing foreign suppliers, foreign customers, or both. Two strategies for acquiring foreign suppliers are outsourcing and importing. Key strategies for developing foreign markets include exporting, licensing, franchising, and direct investment. Exporting is relatively low cost and low risk, but it offers little control over the way the business unfolds. Direct investment, at the other end of the spectrum, tends to be high cost and high risk, but it offers more control and higher potential profits.

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LO5 Discuss barriers to international trade and strategies to surmount them

Most barriers to trade fall into the following categories: sociocultural differences, economic differences, and legal/political differences. Each country has a different mix of barriers. Often countries with the highest barriers have the least competition, which can be a real opportunity for the first international firms to break through. The best way to surmount trade barriers is to cultivate a deep understanding of a country before beginning business. And since conditions change rapidly in many nations, learning and responding are continual processes.

**opportunity cost** The opportunity of giving up the second-best choice when making a decision.

**absolute advantage** The benefit a country has in a given industry when it can produce more of a product than other nations using the same amount of resources.

**comparative advantage** The benefit a country has in a given industry if it can make products at a lower opportunity cost than other countries.

**balance of trade** A basic measure of the difference in value between a nation's exports and imports, including both goods and services.

**trade surplus** Overage that occurs when the total value of a nation's exports is higher than the total value of its imports.

**trade deficit** Shortfall that occurs when the total value of a nation's imports is higher than the total value of its exports.
balance of payments A measure of the total flow of money into or out of a country.

balance of payments surplus Overage that occurs when more money flows into a nation than out of that nation.

balance of payments deficit Shortfall that occurs when more money flows out of a nation than into that nation.

exchange rates A measurement of the value of one nation's currency relative to the currency of other nations.

counter trade International trade that involves the barter of products for products rather than for currency.

foreign outsourcing (also contract manufacturing) Contracting with foreign suppliers to produce products, usually at a fraction of the cost of domestic production.

importing Buying products domestically that have been produced or grown in foreign nations.

exporting Selling products in foreign nations that have been produced or grown domestically.

foreign licensing Authority granted by a domestic firm to a foreign firm for the rights to produce and market its product or to use its trademark/patent rights in a defined geographical area.

foreign franchising A specialized type of foreign licensing in which a firm expands by offering businesses in other countries the right to produce and market its products according to specific operating requirements.

direct investment (or foreign direct investment) When firms either acquire foreign firms or develop new facilities from the ground up in foreign countries.

joint ventures When two or more companies join forces—sharing resources, risks, and profits, but not actually merging companies—to pursue specific opportunities.

partnership A voluntary agreement under which two or more people act as co-owners of a business for profit.

strategic alliance An agreement between two or more firms to jointly pursue a specific opportunity without actually merging their businesses. Strategic alliances typically involve less formal, less encompassing agreements than partnerships.

sociocultural differences Differences among cultures in language, attitudes, and values.

infrastructure A country's physical facilities that support economic activity.

protectionism National policies designed to restrict international trade, usually with the goal of protecting domestic businesses.

tariffs Taxes levied against imports.

quotas Limitations on the amount of specific products that may be imported from certain countries during a given time period.

voluntary export restraints (VERs) Limitations on the amount of specific products that one nation will export to another nation.

embargo A complete ban on international trade of a certain item, or a total halt in trade with a particular nation.

free trade The unrestricted movement of goods and services across international borders.

General Agreement on Tariffs and Trade (GATT) An international trade treaty designed to encourage worldwide trade among its members.

World Trade Organization (WTO) A permanent global institution to promote international trade and to settle international trade disputes.

World Bank An international cooperative of 187 member countries, working together to reduce poverty in the developing
world.

**International Monetary Fund (IMF)** An international organization of 187 member nations that promote international economic cooperation and stable growth.

**trading bloc** A group of countries that has reduced or even eliminated tariffs, allowing for the free flow of goods among the member nations.

**common market** A group of countries that have eliminated tariffs and harmonized trading rules to facilitate the free flow of goods among the member nations.

**North American Free Trade Agreement (NAFTA)** The treaty among the United States, Mexico, and Canada that eliminated trade barriers and investment restrictions over a 15-year period starting in 1994.

**European Union (EU)** The world’s largest common market, composed of twenty-seven European nations.

**LO6 Describe the free trade movement and discuss key benefits and criticisms**

Over the past two decades, the emergence of regional trading blocs, common markets, and international trade agreements has moved the world economy much closer to complete free trade. Key players include:

- **GATT and the WTO**
- **The World Bank**
- **The International Monetary Fund (IMF)**
- **The North American Free Trade Agreement (NAFTA)**
- **The European Union (EU)**

The free trade movement has raised the global standard of living, lowered prices, and expanded choices for millions of people, but critics are troubled by the growing economic gap between the haves and the have-nots, worker abuse, large-scale pollution, and cultural homogenization.


15. Rural Market India Brand Equity Foundation, Updated December 10, 2010, IBEF website,


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