International Management Managing Across Borders and Cultures

TEXT AND CASES

Seventh Edition

Helen Deresky

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INTERNATIONAL EDITION

INTERNATIONAL MANAGEMENT

MANAGING ACROSS BORDERS AND CULTURES

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PART

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PART OUTLINE

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Chapter 2
Managing Interdependence: Social Responsibility and Ethics

Assessing the Environment

Political, Economic, Legal, Technological

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OBJECTIVES:

1. To understand the global business environment and how it affects the strategic and operational decisions which managers must make.
2. To critically assess the developments, advantages and disadvantages of globalization.
3. To review the role of technology in international business.
4. To develop an appreciation for the ways in which political, economic, legal and technological factors and changes impact the opportunities that companies face.
5. To discuss the complexities of the international manager's job.

Opening Profile: Economic Crisis Spreads Through Financial Globalization

A perilous global crisis of confidence has revealed both the scale and the limitations of globalimtion.[1]

The 2009 World Economic Forum in Davos, Switzerland, announced its theme—"Shaping the Post-Crisis World." What crisis? What caused the crisis? Some of the developments as they occurred are discussed below, and the effects will no doubt be continuing as you read this book. Discuss updates in your class and how the effects are impacting international business.

In September 2008, fears of a global recession fed a stock market panic as worries about toxic assets (highly leveraged securities mainly linked to risky mortgages taken out in the United States) spread from the financial sector to the credit markets and then to the broader economy.[2]

The American export—the subprime mortgage mess—caused the global economy to hit the brakes. The problem is that Finance has become one of the most international of industries, with banks from around the world doing business across numerous countries. However, regulation of that industry is still only national or local. Because fear gripped depositors around the world concerned that their deposits and savings will disappear, and fear led banks worldwide to cease lending to one another, the entire credit system shut down. Lending to even creditworthy companies dried up in Europe in 2008, causing the International Institute for Labor in Geneva to state:

The financial crisis is hitting the world of work. . .

The financial crisis which developed over the past year and erupted last August represents one of the most significant threats to the world economy in modem history. The credit crunch and collapse of stock markets are starting to affect firms' investment decisions as well as workers' incomes and jobs. Several major developed economies have practically entered into recession and unemployment is on the rise. Economic growth in emerging economies and developing countries has slowed down, in some cases significantly.

INTERNATIONAL INSTITUTE FOR LABOR.'

The United States Treasury Secretary, Henry Paulson, proposed a $700 billion bailout plan for banks, which (then) President Bush signed on October 3, 2008, the beginning of the most expensive government bailout in history, and there was an unprecedented coordination of central banks on three continents to cut interest rates. However, these moves seemed only to generate more fear, and did little to free up credit lines either between banks or to their customers. Stock markets around the world continued their massive losses—estimated at *$6.5* trillion on October 6 and 7, 2008. Iceland came to the brink of bankruptcy because several banks whose assets were greater than the country's economy were experiencing problems.

The failure of banks and other financial institutions prompted governments to attempt to intervene. In the United States, the giant mortgage companies Fannie Mae and Freddie Mac were nationalized, Lehman Brothers and Washington Mutual companies were allowed to fail, but then the government later decided to bail out AIG, the huge global insurer, for fear of the global repercussions. A global problem called for a global solution. However, coordinating policies for Europe's many countries7~fbr example, presents many difficulties. Some of the government rescue actions taken around the world were widely reported, and examples are summarized below as they developed in late 2008 and early 2009.

The International Monetary Fund said it was ready to lend to countries hit by the credit crunch, using an emergency funding mechanism first used in the 1990s Asian financial crisis.

CHINA: China joined the interest rate offensive, cutting rates by 0.27 percentage points.

SOUTH KOREA, HONG KONG, TAIWAN: The central banks of South Korea, Hong Kong, and Taiwan joined the growing number of countries to cut their interest rates.

AUSTRIA and GREECE officially announced a guarantee for all personal bank savings.

BELGIUM and DENMARK'S governments agreed to guarantee bank deposits.

ICELAND: With the country on the brink of bankruptcy, Iceland's parliament passed emergency legislation giving the government wide-ranging powers to dictate banks' operations. Negotiations were under way with Russia for a big loan to support the country's banking system. Moscow has offered more than $5 billion in emergency loans.

IRELAND: Ireland was the first government to come to the rescue of its citizens' savings, promising on 30 September to guarantee all deposits, bonds, and debts in its six main banks for two years. The move initially prompted consternation among some European partners, but several countries have since followed suit.

ARAB STATES: Share prices dropped precipitously, amid fears of weakness in Dubai's property boom and exposure to global markets.

INDIA: The central bank moved to inject 600bn rupees ($12.2bn) into the money markets after sharp falls in Mumbai's stock exchange and the plunge of the rupee to an all- time low.[4]

These moves made it clear that the global ripple effect of Wall Street's woes had debunked the theory of "decoupling," the notion that the rest of the world was robust enough to ride out a U.S. domestic crisis; While attempts to stabilize the global financial system seemed to Stagnate, Britain's Prime Minister Gordon Brown announced a plan to recapitalize its major banks and try to find a broader international solution. The U.S. then followed on October 14, 2008 with a similar plan to buy $250 billion of non-voting preferred stock in major banks and financial institutions—thus also partially nationalizing the U.S. banking system. At that juncture, it became clear that Europe—led by Britain—was leading the way with a financial bailout plan that set the pace for-Washington. However, by the end of 2008, it became clear that "the world's dramatic financial rescue efforts are both unprecedented in scope and creativity—and wholly inadequate."[5]

In spite of the huge amounts of money that governments around the world are spending to attempt to stanch the bleeding, there seems little to prevent the world economy from major downturn, according to the International Monetary Fund. Some encouraging news to combat the global slowdown came as China announced a huge economic stimulus plan on November 9: 2008, aimed at bolstering its weakening economy. The Chinese government topped the world in its rescue package saying it would spend an estimated $586 billion over the next two years—roughly 14 percent of its gross domestic product each year—to construct new railways, subways, and airports. China's banks, at least, remained relatively unscathed.

Not to be outdone in the fight, The United States Federal Reserve and the Treasury announced $800 billion in new lending programs, sending a message that they would print as much money as needed to revive the nation's crippled banking system. That commitment amounted to about $7.8 trillion in direct and indirect financial obligations - equal to about half the size of the nation's entire economy and far greater than the $700 billion that Congress authorized for the Treasury's financial rescue plan.

European countries then mounted a joint approach; the EU commission announced a 200 billion euro rescue plan among the 27 member states. The EU Commissioner urged that all attempts be made to bolster the sagging growth and confidence in the region.

However, at least as of early 2009, although it seemed that the various measures had staved off financial collapse, the world awaited the stimulus that governments were spending billions of their taxpayers' money to gain. Meanwhile, credit was still tight and confidence was low; companies around the world were retrenching, shuttering plants and offices, and laying off thousands of workers. Protectionism and nationalism were increasing, further hampering trade, and the World Bank announced that the global economy is likely to shrink by one or two percent in 2009.

In February 2009, President Obama signed a $787 billion stimulus package (3 percent of GDP). However, while the goal of much of the package was to create jobs in the U-S-, concern about "Buy American" clauses, such as for the steel industry, led to cries of protectionism that aroused fears of retaliation in trade wars.

Increasing awareness of the causes and effects of the financial crisis led many to conclude, as posed in the *New York Times,* that:

> *This crisis has shown the Achilles' heel of a globalized financial system to be lack of high-quality, and consistent, regulation to prevent overconfident bankers from taking irresponsible risks. A year and a half ago, when it appeared to be a subprime mortgage issue for the United States, most countries thought they could glide past it. Bur it turned out that everyone in that globalized system was vulnerable to the collapse that began at the center.*
>
> **WWW.NYTIMES.COM**
> ***February 8,2009.***

In addition, the irony seemed to be that the rapid growth in open economies, as a result of globalization, was coming back to bite them; whereas those with more restricted financial systems appeared more able to weather the storm. Iceland is broke; India was one of the few to expect continuing economic growth.[6]

Another unfortunate result, as noted at the global economic conference in Davos, Switzerland, in February 2009, was the warning that the global recession could sharply reduce lending across borders. Investment of private capital to emerging markets in 2009 was expected to be 82% lower than in

2007. British Prime Minister Gordon Brown said in an interview, "It's the first stage of a financial protectionism that will lead eventually to the kind of trade protectionism that we've seen in the past."[7] Time will tell the long-term consequences around the world, but clearly executives and their companies have been caught in the grip of a storm that will likely revolutionize business.

> *The deepfreeze of capital markets, the implosion of financial groups and the resulting rise in governments' sway over the private sector has called into-question some of the foundations of Anglo-Saxon capitalism.*

In an effort to develop consensus about how to revive a paralyzed global economy, the leaders of the world's largest economies met at the Group of 20 (G20) meeting in London on April 2, 2009. They agreed to bail out developing, countries, stimulate world trade, and regulate financial firms more stringently. Leaders of those countries committed to $1.1 trillion in new funds to be available to the International Monetary Fund with the goal of a revival in trade, which was expected to contract in 2009 for the first time in 30 years. But differences of opinion between Continental Europe and the United States over whether to act now or wait to see whether existing spending measures took effect resulted in what many considered a shortfall of measures needed to stimulate the world economy. Prime Minister Gordon Brown of Britain concluded the conference saying:

> *This is the day the world came together to fight against the global recession. Our message today is clear and certain: we believe that global problems require global solutions.*

As evidenced in the opening profile, managers in the twenty-first century are being challenged to operate in an increasingly complex, interdependent, and dynamic global environment. In a globalized economy, developments such as those described in the opening profile can have repercussions wound the world almost instantaneously. Clearly, those involved in international and global business **have** to adjust their strategies and management styles to those kinds of global developments as well as to those regions of the world in which they want to operate, whether directly or through some form of alliance.

Typical challenges that managers must face involve politics, cultural differences, global competition, terrorism, and technology. In addition, the opportunities and risks of the global marketplace increasingly bring with them the societal obligations of operating in a global community. An example is the dilemma faced by Western drug manufacturers of how to fulfill their responsibilities to stockholders, acquire capital for research, and protect their patents while also being good global citizens by responding to the cry for free or low-cost drugs for AIDS in poor countries. Managers in those companies are struggling to find ways to balance their social responsibilities, their images, and their competitive strategies.

To compete aggressively, firms must make considerable investments overseas—not only capital investment but also investment in well-trained managers with the skills essential to working effectively in a multicultural environment. In any foreign environment, managers need to handle a set of dynamic and fast-changing variables, including the all-pervasive variable of culture that affects every facet of daily management. Added to that "behavioral software" are the challenges of the burgeoning use of technological software and the borderless Internet, which are rapidly changing the dynamics of competition and operations.

International management, then, is the process of developing strategies, designing and operating systems, and working with people around the world to ensure sustained competitive advantage. Those management functions are shaped by the prevailing conditions and ongoing developments in the world, as outlined in the following sections.

THE GLOBAL BUSINESS ENVIRONMENT

Following is a summary of some of the global situations and trends that managers need to monitor and incorporate in their strategic and operational planning.

Globalization

The World Is Flat

T FRIEDMAN[10]

The forces and effects of globalization seem to be inescapably evident in our daily lives:

> *An estimated 2 billion people witness Live Earth, a series of concerts held in 11 locations around the world to raise environmental awareness. Chinese manufacturers decorate toys with paint containing lead, and children around the world have to give up their Batmans and Barbie dolls. Mortgage lenders in the United States face a liquidity crunch, and global stock markets go berserk.*"

Business competitiveness has now evolved to a level of sophistication commonly called globalization—global competition characterized by networks of international linkages that bind countries, institutions, and people in an interdependent global economy. Economic integration results from the lessening of trade barriers and the increased flow of goods and services, capital, labor, and technology around the world. The invisible hand of global competition is being propelled by the phenomenon of an increasingly borderless world, by technological advancements, and by the rise of developing economies such as China and India—a process that Thomas Friedman refers to as "leveling the playing field" among countries—or the "flattening of the world."[12]

Whereas the general concept of globalization has been that business expanded from developed to emerging economies, now it is just as likely to refer to business flowing from and among developing economies. Sirkin et al. use the term "globality" stating that business these days is all about "competing with everyone from everywhere for everything." On a more strategic level, Ghemawat argues, rather, that the business world is in a state of "semi-globalization," and will remain so for decades to come. He bases this conviction on his analysis that "most types of economic activity that can be conducted either within or across borders are still quite localized by country."[14]

Globality and Emerging Markets

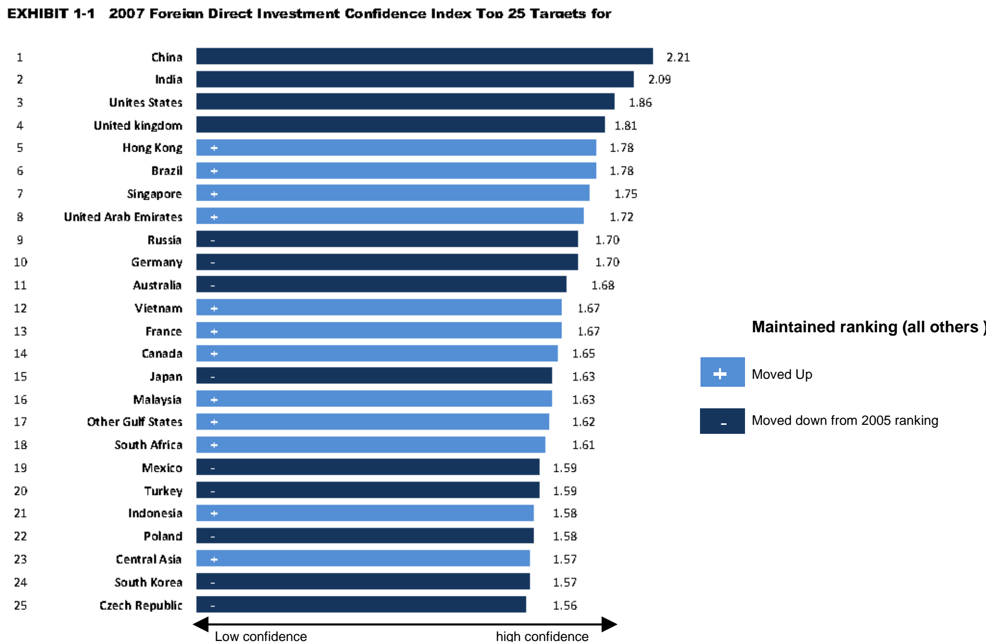
It is clear, however, that globalization—in the broader sense—has led to the narrowing of differences in regional output growth rates as economic activity increased, driven largely by increases led by China, India, and Russia. In spite of the recent slowdown, world trade continues to grow — it has grown by 133 percent in the last 15 years and is over $54 trillion. Importantly, global trade is increasingly including the developing nations. Exhibit 1-1 shows the results from research by the A.T. Kearney Company of the Foreign Direct Investment (FDI) intentions and preferences of the leaders of top companies in 17 industry sectors spanning six continents. The exhibit shows the top 25 countries in which those executives have confidence for their investment opportunities- Their results show that China and India continue to rank at the top of the FDI Confidence Index and that six of the top 10 countries are emerging markets.[15] This phenomenon, says Fareed Zakaria, is something much broader than the much-ballyhooed rise of China or even Asia. Rather, he says:

> *It is the rise of the rest—the rest of the world.*
>
> PARKED ZAKARIA, THE POST-AMERICAN WORLD, 2008.[16]

"The rest," he says, include countries such as Brazil, Mexico, South Korea, Taiwan, India, China and Russia. He states that, as traditional industries in the United States continue to decline. "The rest" are picking up those opportunities. Even so, the United States remains dominant in many "new age" industries such as nanotechnology and biotechnology, and is ranked as the globe's most competitive economy by the World Economic Forum. It is clear, also, that as emerging markets continue to grow their countries' economies, they will provide growth markets far the products and services of developed economies.

Evidence of the growing number of companies from emerging markets can be seen in the Fortune 500 rankings of the world's biggest firms. It now stands at 62, mostly from the so-called BRIC economies of Brazil, Russia, India and China, up from 31 in 2003.[17] Further evidence that "globalization" is no longer just another word for "Americanisation," is the increase in the number of emerging-market companies acquiring established large businesses and brands from the so-called "developed" countries. For example, in 2008 Budweiser, America's favourite beer, was bought by a Belgian-Brazilian conglomerate, and "several of America's leading financial institutions avoided bankruptcy only by going cap in hand to the

EXHIBIT 1-1 2007 Foreign Direct Investment Confidence Index Top 25 Targets for FDI



Source: A. T. Kearney, September 12, 2008. Copyright AT. Kearney, Inc., 2007. All rights reserved. Reprinted with permission.

The main types of FDI are acquisition of a subsidiary or production facility, joint ventures, licensing, investing in new facilities on expansion of facilities.

sovereign-wealth funds (state-owned investment funds) of various Arab kingdoms and the Chinese government."[18] Clearly companies in emerging markets are providing many opportunities for investment and alliances around the world, as well as establishing themselves as competitors to reckon with.

However, there are important aspects of globalization other than economic factors, though these aspects are intertwined. Exhibit 1-2 shows the top 20 countries as measured by four comprehensive factors— economic integration, technological connectivity, personal contact, and political engagement; the details for those categories are given below the chart. As you can see, although the United States leads the world in technology, it falls behind a number of countries on the other three factors.

As we consider the many facets of globalization and how they intertwine, we observe how

Maintained ranking (all others
Q Moved up H *Moved* down from
2005 *ranking*

economic power and shifting opinions and ideals about politics and religion, for example, result in

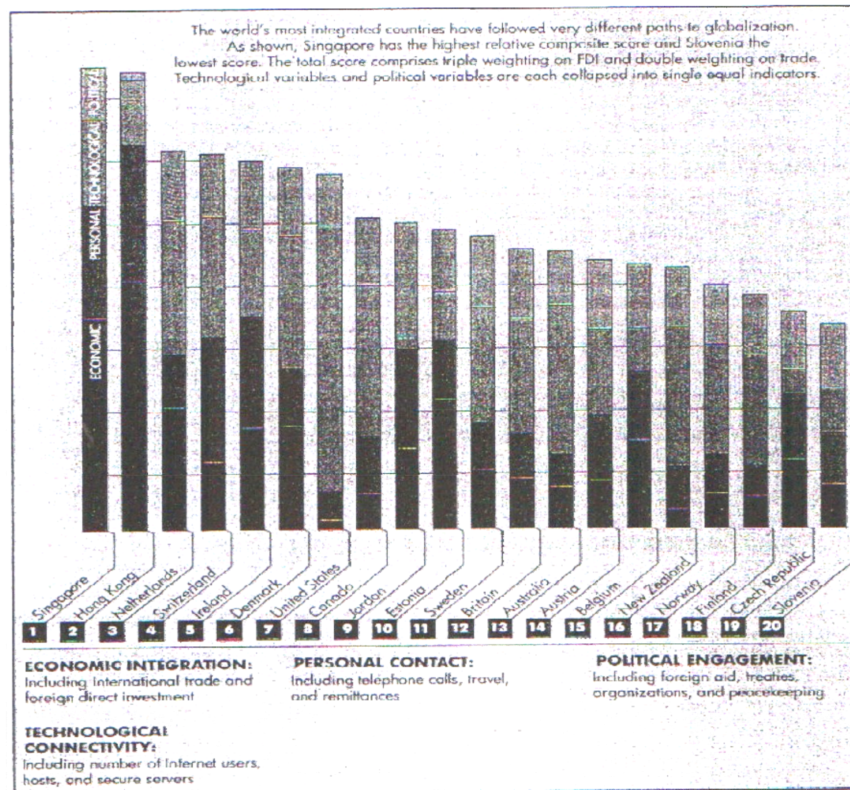
Low confidence **High confidence**

an increasing backlash against globalization and a rekindling of nationalism. Globalization has been propelled by capitalism and open markets, most notably by Western companies. Now,

> *. . . economic power is shifting fast to the emerging nations of the south. China and India are replacing the U.S. as the engines of world economic growth.*
>
> FINANCIAL TIMES, *March 3, 2006.*[19]

The rising nationalist tendencies are evident as emerging and developing nations—wielding their economic power in attempted takeovers and inroads around the world—encounter protectionism. There is hostility to takeovers such as the Indian company Mittal Steel's bid for Europe's largest steel company, Arcelor. At times Europe seems to be closing its borders; and even the United States reacted to an attempted takeover of the British P&O by Dubai Ports World early in 2006. In particular, as the demand on energy resources burgeons with heightened industrial activity in China, we see increased protectionism of those resources around the world as Russia, Venezuela, and Bolivia have privatized their energy resources.

EXHIBIT 1-2 Measuring Globalization



Source: Global Retail Development Index, Copyright A. T. Kearney, 2008. All rights reserved. Reprinted with permission.

Recently, there has been increasing backlash against globalization coming *from* those who feel that it benefits advanced industrial countries at the expense of many other countries and people within them who are not sharing in those benefits. Joseph Stiglitz, for example, argues that such an economic system has been pressed upon many developing countries at the expense of their sovereignty, their well-being, and their environment. Critics point to the growing numbers of people around the world living in poverty.[20] Recently, globalization has also become increasingly unpopular with many in the United States as growth in emerging markets has raised prices for energy and commodities, as their jobs are being lost overseas, driving down wages, and as the weak dollar makes companies in the United States vulnerable to foreign buyers.[21]

While the debate about the effects of globalization continues, it is clear that economic globalization will be advanced by corporations looking to maximize their profits with global efficiencies, by politicians and leaders wishing to advance their countries' economies, and by technological and transportation advances which make their production and supply networks more efficient. However, pressure by parties against those trends, as well as the resurgence in nationalism and protectionism, may serve to pull back those advances to a more regional scope in some areas, or bilateral pacts. This was made clear by the breakdown in the Doha round of talks; unfortunately,

> *In pursuit of the perfect—an international trade deal agreed upon by some 150 countries with vastly different goals—negotiators wound up with nothing. The way forward is likely to be via bilateral and regional agreements. A global deal, if one can be reached, may be a package of smaller agreements between subsets of the full body.*

In addition, while competition to provide the best and cheapest products to consumers exerts pressure on corporations to maximize efficiencies around the world, there is also increasing pressure and publicity for them to consider the social responsibility of their activities (discussed further in Chapter 2).

Effects of Institutions on Global Trade[23]

Two major groups of institutions (supranational and national) play a differing role in globalization. Supranational institutions such as the World Trade Organization (WTO) and the International Labor Organization (ILO) promote the convergence of how international activities should be conducted. For example, the WTO promotes the lowering of tariffs and a common set of trade rules among its member countries. Similarly, the ILO promotes common standards of how workers should be treated. While many supranational institutions frequently promote rules or laws favorable to foreign firms (e.g., requiring intellectual property rights protections in China), others have been criticized for infringing on national sovereignty (e.g., challenges to certain environmental laws in the United States).

National institutions, in contrast, play a role in creating favorable conditions for domestic firms and may make it more difficult for foreign firms to compete in those countries. For example, the stringent drug testing rules required by the U.S. Food and Drug Administration (FDA) and the anti-dumping rules enforced by the U.S. Department of Commerce's International Trade Administration act as entry barriers for foreign firms (see Chapter 6 for a more detailed discussion of these).

Some supranational institutions represent the interests of a smaller group of countries. For example, the European Commission acts in the interest of the 27 EU members as a whole rather than the interest of individual member countries. The European Commission is the executive arm of the EU and is responsible for implementing the decisions of the European Parliament and the European Council. Of relevance to international business, the European Commission speaks for the EU at the World Trade Organization, and is responsible for negotiation trade agreements on behalf of the EU.[24]

Effects of Globalization on Corporations

In returning to our discussion at the corporate level, we can see that almost all firms around the world are affected to some extent by globalization. Firms from any country now compete with your firm both at home and abroad, and your domestic competitors are competing on price by outsourcing or offshoring resources and services anywhere in the world. Often it is difficult to tell which competing products or services are of domestic or foreign origin. While Ford, for example, is pushing its Mustang with the slogan "buy American," only about 65 percent of the car content comes from the United States or Canada—the rest is purchased abroad. In contrast, Japan's Toyota Sienna model is far more American, with 90 percent local components being assembled in Indiana.[25] This didn't happen overnight. Toyota has been investing in North America for 20 years in plants, suppliers, and dealerships, as well as design, testing, and research centers. Toyota became the largest auto-manufacturer in the world in sales in 2009. In fact, on June 1, 2009, General Motors (GM) filed for Chapter 11 bankruptcy, pushed into a temporary partial nationalization by the U.S. government in order to save the company in a drastically downsized form.[26]

Clearly, competition is borderless, with most global companies producing and selling more of their global brands and services abroad than domestically. Avon, for example, estimates it employs 5 million sales representatives globally, and believes a large share of future revenues will come from China, where it hired an additional 399,000 sales representatives in 2006.[27] Nestle' has 50 percent of its sales outside of its home market, Coca-Cola has 80 percent, and Procter & Gamble has 65 percent. The Tata Group, a conglomerate originating in India, has operations in 85 countries and has made a number of acquisitions of large firms around the world.

Investment by global companies around the world means that this aspect of globalization benefits developing economies—through the transfer of financial, technological, and managerial resources, as well as through the development of local allies that later become self-sufficient and have other operations. Global companies are becoming less tied to specific

locations, and their operations and allies are spread around the world as they source and coordinate resources and activities in the most suitable areas, and as technology facilitates faster and more flexible interactions and greater efficiencies.

It is essential, therefore, for managers to look beyond their domestic market. If they do not, they will be even further behind the majority of managers who have already recognized that they must have a global vision for their firms, beginning with preparing themselves with the skills and tools of managing in a global environment. Companies that desire to remain globally competitive and to expand their operations to other countries will have to develop a cadre of top management with experience operating abroad and an understanding of what it takes to do business in other countries and to work with people of other cultures. Many large firms around the world are getting to the stage of evolution known as the stateless multinational, where work is sourced wherever it is most efficient; the result of this stage of development is that

> *for business leaders, building a firm that is seamlessly integrated across time zones and cultures presents daunting obstacles. Rather than huddling together in a headquarters building in Armonk or Millbank, senior managers will increasingly be spread around the world, which will require them to learn some new tricks.*[28]
>
> THE ECONOMIST,
> *September 20, 2008.*

Small and medium-sized companies (SMEs) are also affected by, and in turn affect, globalization. They play a vital role in contributing to their national economies—through employment, new job creation, development of new products and services, and international operations, typically exporting. The vast majority (about 98 percent) of businesses in developed economies are small and medium-sized enterprises (SMEs), which are typically referred to as those companies having fewer than 500 employees. Small businesses are rapidly discovering foreign markets. Although many small businesses are affected by globalism only to the extent that they face competing products from abroad, an increasing number of entrepreneurs are being approached by potential offshore customers, thanks to the burgeoning number of trade shows, federal and state export initiatives, and the growing use of Web sites, with the ease of making contact and placing orders online.[29]

There has never been a better time for SMEs to go global; the Internet is as valid a tool for small companies to find customers and suppliers around the world as it is for large companies. By using the Internet, email, and web-conferencing, small companies can inexpensively contact customers and set up their global businesses. One example of a very small global business (two people) is that of Gayle Warwick Fine Linen—a multinational player based in London. It high-end, handmade bed and table linens are woven in Europe, embroidered in Vietnam, and sold in Britain and the United States. Sales are soaring, and its full-time staff recently doubled—to two: Gayle Warwick and the assistant she recently hired. As she expanded, Ms. Warwick hired a French freight forwarder, SDV International Logistics, to handle her far-flung business by shipping unfinished and finished fabrics within Europe and to Vietnam, then delivering the embroidered linens to London and the United States. (Freight forwarders can also mange payments, a potential godsend for small exporters dealing with partners scattered around the globe.)[30]

Regional Trading Blocs

> *The dominance of the United States is already over. What is emerging is a world economy of blocs represented by the North American Free Trade Agreement (NAFTA), the EU, and the Association of Southeast Asian Nations (ASEAN). There's no one center in this world economy.*
>
> (The late) Peter Drucker[31]

Much of today's world trade takes place within three regional free-trade blocs (Western Europe; Asia, and the Americas) grouped around the three dominant currencies (the euro, the yen, and the dollar). These trade blocs are continually expanding their borders to include neighboring countries, either directly or with separate agreements.

MAP 1.1 EU Member States and Candidate Countries

Source: http://en.wikipedia.org

THE EUROPEAN UNION The European Union (EU) now comprises a 27-nation unified market of over 400 million people, as shown in the map (Map l-l). This "borderless" market now includes ten Central and Eastern Europe (CEE) countries—the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia.—as well as Malta and Cyprus. They joined the EU in May 2004, having met the EU accession requirements, including privatizing state-run businesses, improving the infrastructure, and revamping their finance and banking systems.[32] Bulgaria and Romania joined in January 2007. Turkey, Croatia, and the Republic of Macedonia are official candidates but must meet the requirements before 2015.

Since the euro became a legally tradable currency, Europe's business environment has been transformed. The vast majority of legislative measures have been adopted to create an internal market with free movement of goods and people among the EU countries. The elimination of internal tariffs and customs, as well as financial and commercial barriers, has not eliminated national pride. Although most people in Europe are thought of simply as Europeans, they still think of themselves first as British, French, Danish, Italian, etc., and are wary of giving too much power to centralized institutions or of giving up their national culture. The continuing enlargement of the EU to include many less prosperous countries has also promoted divisions among the "older" members.[33]

Global managers face two major tasks. One is strategic (dealt with more fully in Chapter 6): How firms outside of Europe can deal with the implications of the EU and of what some have called a "Fortress Europe"—that is, a market giving preference to insiders. The other task is cultural: How to deal effectively with multiple sets of national cultures, traditions, and customs within Europe, such as differing attitudes about how much time should be spent on work versus leisure activities.

ASIA

> it *would be difficult to overstate the power of the fundamental drivers of Asian growth. First, Asian economies have been enjoying a remarkable period of "productivity catch-up," adopting modern technologies, industrial practices, and ways of organizing—in some cases leapfrogging Western competitors.*
>
> HARVARD BUSINESS REVIEW, *July/August 2009.*

Manufacturing accounted for approximately 30 percent of GDP in Asia's emerging markets in 2009, thus helping to fuel the demand for materials and supplies from the developed world and lending hope for a quick global economic recovery.[35] Japan and the Four Tigers—Singapore, Hong Kong, Taiwan, and South Korea, each of which has abundant natural resources and labor—have provided most of the capital and expertise for Asia's developing countries. Now the focus is on China's role in driving closer integration in the region through its rapidly growing exports. Japan continues to negotiate trade agreements with its neighbors; China is negotiating with the entire thirteen-member Association of Southeast Asian Nations (ASEAN), while ASEAN is negotiating for earlier development of its own free trade area, Asean Free Trade Area (AFTA).

> *The Chinese market offers big opportunities for foreign investment, but you must learn to tolerate ambiguity and find a godfather to look after your political connections.*
>
> FINANCIAL TIMES[36]

China has enjoyed success as an export powerhouse, a status built on its strengths of low costs and a constant flow of capital. Its growth phenomenon is further discussed in the accompanying feature "Comparative Management in Focus—China's Economy Keeps on Chugging."

India: While China is known as the world's factory, India is becoming known as the world's services supplier, providing highly skilled and educated workers to foreign companies. India is the world's leader for outsourced back-office services, and increasingly for high-tech services, with outsourcing firms like Infosys becoming global giants themselves. India is the fastest-growing free market democracy, yet its biggest hindrance to growth, in particular for the manufacturing sector, remains its poor infrastructure, with both local and foreign companies experiencing traffic gridlocks and power outages. Nevertheless, with growth around 8.5 percent in recent years, second only to China, optimism abounds about the country's prospects.

Trade liberalization started in 1991; India's Foreign Direct Investment (FDI) rules are more open, and the refining sector is now open to outside investors. While there is talk of reduced tariffs, there is serious political concern for protecting India's small to medium size enterprises, comprising 35% of exports. But with a middle class growing at 100 million people per year, improvements in customs processes, and 30% annual growth in tax revenues, trade is looking steady.[42]

After the Indian economy began opening up to the outside world, there has been a surge based on strong industry and agriculture and rising Indian and foreign investment. The expanding middle class of almost 300 million is fuelling demand-led growth. Increasing deregulation is allowing whole sectors to be competitive. Here too there is considerable diversity in markets, incomes and economies; there are fifteen major languages and over 1,600 dialects.

A common comparison between China and India goes that China's economy grows because of its government, while India's economy grows in spite of it. However, with its one billion people, many are still mired in poverty, with per capita GDP below $1,000, although the poverty rate is half that of twenty years ago. While India's large upcoming youth bulge, compared with China, will bring a wave of workers for the economy, it also brings many more mouths to feed. However, in many areas the economic transformation is startling, with growth fed by firms like the Tata Group—a global conglomerate producing everything from cars and steel to software and consulting systems. In August, 2008, India joined a free-trade agreement with the ten fast-growing countries in the Association of South-East Asian Nations (ASEAN)—making it clear that a regional deal was preferable to a compromise to protect its farmers by saying "no" to the multilateral trading system in the Doha trade talks.[43]

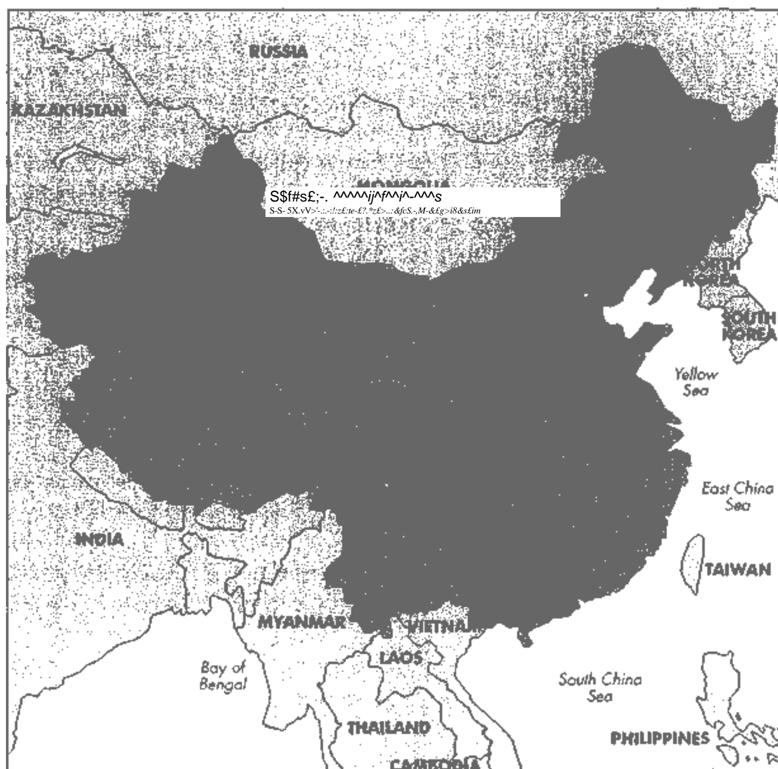
In South Asia, an agreement was signed to form the South Asia Association of Regional Cooperation (SAARC), a free trade pact among seven South Asian nations: Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka, effective January 1, 2006. The agreement will lower tariffs to 25 percent within three to five years and eliminate them within seven years. The member nations comprise 1.5 billion people, with an estimated one-third of them living in poverty. Trade in South Asia is estimated at $14 billion, though the majority of that trade will be

COMPARATIVE MANAGEMENT IN FOCUS China's Economy Keeps on Chugging

China's gross domestic product (GDP) growth rate—over 9 percent a year for thirty years—has been the fastest in the world.[37] Its economy has doubled every eight years for thirty years and the income of its people has increased sevenfold. Even in 2009, with most of the world in a global recession, China's economy quickly snapped back, growing at 8 percent by mid-year, because of the aggressive approach to the slowdown by committing $586 billion—9 percent of GDP—to infrastructure projects, and because its banking system remained relatively unscathed compared with others around the world. Indeed, China surpassed Germany in 2009 as the world's largest exporter.[38] Continuing its aggressive long-term approach, China stepped up to the plate in early 2009 to take advantage of the economic downturn by going on a major shopping spree, investing in energy and other natural resources that could give it an economic advantage it has never had before. Examples were lending the Brazilian oil giant Petrobras $10 billion in exchange for a long-term commitment to send oil to China; and similar deals with Russia and Venezuela, bringing Beijing's total oil investments for February 2009 alone to $41 billion; as well as deals such as a $19.5 billion investment in Rio Tinto, an Australian mining company. Such moves put China in an advantageous position of increased access to oil and other commodities at a better price than it would likely be as the world pulls out of the recession. In fact, PetroChina passed Exxon Mobil as the world's most valuable company in May 2009.[39]

However, faced with a possible global recession and weakening demand for Chinese exports, there was concern in China and the rest of the world that the Chinese government would not be able to prevent the financial crisis from derailing the country's economic miracle; continued Chinese growth is vital to the global economy as the United States and Europe face severe downturns. The United States, for example, had imported $321 billion worth of goods in 2007, but that demand reduced substantially because of the recession in the U.S., and also because of reduced imports of some tainted products such as toys. The precipitous decline of the housing industry in the United States, for example, which sources 70 percent of its furniture from China, indicates the interdependence of the two economies. However, as mentioned earlier, as of mid-2009, China's resurgence promised to provide leadership for the world's economic rebound, in particular as the Chinese government provided incentives to its people so as to stoke a consumer-driven economy. Indeed,

MAP 1.2 China



China has becotae a battleground for companies wanting a piece of the action in this rapidly growing and opening economy. In fact, over 400 of the Fortune 500 Global companies are operating there. China's rapid rise—and the burgeoning opportunities for foreign businesses—is partly attributable to its membership in the World Trade Organization (WTO) and its actions for structural reforms and opening of many of its industries to foreign investment. China is now a market-driven economy—driven by competition, capital and entrepreneurship.

What accounts for China's rapid rise? China's recent exports in a single day have been more than it exported in all of 1978. With its 1.3 billion people, China benefits greatly from its large and rapidly growing foreign and domestic market size, which provides significant economies of scale. The World Economic Forum assessment of China is that its "macroeconomic stability is a source of competitive advantage, with the government budget moving into surplus, and manageable debt levels, although rising inflation has become an area of concern. Innovation is becoming another competitive advantage, with rising company spending on R&D coupled with strong university-industry research collaboration, and an increasing rate of patenting." Indeed, China has the world's largest foreign-exchange reserves—three times the holdings of the entire EU, for example. As of September 2009, China had accumulated $2 trillion in foreign reserves, mostly in Treasury bonds and other dollar-denominated assets.[40]

China's vast population of low-wage workers and massive consumer market potential has attracted offshoring of manufacturing from companies around the world. In fact there are 49,000 U.S. companies alone operating in China. It is estimated that China has over 160 cities with populations of over 1 million:

> *One town manufactures most of the eyeglass frames in the world, while the town next door produces most of the portable cigarette lighters in the world, and the next one is doing most of the computer screens for Dell, and another is specializing in mobile phones.*
>
> THOMAS FRIEDMAN, 2OO5.[41]

It is this low-cost manufacturing base that contributes greatly to its exports and growth—as a major factor in China's uniqueness—according to Fareed Zakaria in his book "The Post American WorId'"—making the world's largest manufacturer, second-largest consumer, largest server and probably the second-largest military spender. China has the world's largest shipped goods port capacity. For these reasons China would seem well positioned to expand globally as long as global demand for its products and manufacturing continues. In addition, with its substantial foreign exchange reserves from trade surpluses and heavy foreign investment in China, it could acquire discounted stakes in Western banks and industrial companies. The government is aware that it must stoke consumer spending among its own people in order to stave off unemployment. There are still over 500 million people living on less than $2 a day, and average per capita income is under $2,000. The Boston Consulting Group estimates that, in 2009, some sixty million households are considered middle class.

There are considerable differences among the country's regions, making for quite varied markets. The great diversity is indicated by China's eight major languages, several dialects, and several other minority languages. Mandarin is the main language in the north; Cantonese in the south, in particular in Hong Kong. Each language reflects its own history and culture, and therefore markets and economies. Generally speaking, it is clear that China is aggressively opening its doors. The fact remains, however, that, in virtually all industrial sectors, state firms play a significant or dominant role. Sixteen State-owned enterprises make up about half of GDP.

In addition, central, regional, and local political influences create unpredictability for businesses, as do the arbitrary legal systems, suspect data, and underdeveloped infrastructure. However, in addition to foreign investment, China continues to enjoy significant inflows of money from the ethnic Chinese outside of China, often called the "Bamboo Network" or the "Chinese Commonwealth" network. Using their contacts *(guanxi)* and their familiarity with the culture, language and how to navigate layers of government, Chinese business people around the world—though primarily in Asia—invest large amounts in China.

One of the many challenges for international managers is how to negotiate with the Chinese business people and government representatives. This is the subject of the Comparative Management section in Chapter 5.

between India and Pakistan, the two largest countries in the region.[44] Officials in those countries hope to follow the success of the other Asian regional bloc, the ASEAN.

Australia—while not regarded as part of Southeast Asia, but of the region called Oceania that includes also New Zealand and neighboring islands in the Pacific Ocean—did sign an ASEAN friendship treaty with Southeast Asia. Australia is one of the richest countries in the world, and over 50 percent of her exports go to East Asia, with more transported through the region to markets around the world.

THE AMERICAS

> *Mexico's exports have exploded under NAFTA, quintupling to $292 billion in 2008, but Mexico is still exporting people too, almost half a million each year, seeking opportunities in the United States that they do not have at home.*[45]

NAFTA: The goal of the North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico was to bring faster growth, more jobs, better working conditions, and a cleaner environment for all as a result of increased exports and trade. This trading bloc— "one America"—has 421 million consumers. Now, many years since the 1993 agreement, the debate continues about the extent to which those goals have been accomplished. That perspective varies, of course, among the three NAFTA countries and also varies according to how it has affected individual business firms and employees in various parts of those countries. The Canada-United States trade is the largest bilateral flow between two countries. In addition, the vast majority—around 84 percent—of both Canadian and Mexican exports goes to the United States. From Mexico's perspective, the country's exports have exploded under NAFTA, quintupling to $292 billion in 2008, but Mexico is still exporting people too, almost half a million each year, seeking opportunities in the United States that they do not have at home, in particular because MNCs displaced farming. However, Mexico's dependence on the United States for its exports—NAFTA's greatest success—has become a liability, as Mexico feels the full brunt of declining consumption in the United States. The auto industry, for example, which has flourished under NAFTA, ground to a virtual standstill early 2009. Mexican auto exports fell more than 50 percent in the first two months of 2009 compared with 2008, and production dropped almost 45 percent. In addition, since NAFTA attracted so many multinationals, which, in turn sourced parts from its own suppliers, Mexico's domestic industries were severely curtailed. Overall, many feel that attracting MNCs was short-sighted for an overall strategy—in particular because their low wages have perpetuated poverty and therefore also low purchasing power, thus weakening the economy. "Economic growth has averaged about 3 percent a year since NAFTA took effect, far below what is needed to create jobs for the million young people who enter the work force each year and the millions more who barely scrape by."[46]

However, some changes for Mexico in those years are not debatable, whether or not they all are attributable to the NAFTA. Mexican trade policy is among the most open in the world, and Mexico has become an important exporting and importing power. While the Mexican economic cycles are very dependent on American economic behavior, she has signed 12 trade agreements with 43 nations, putting 90 percent of its trade under free trade regulations; the latest agreement was made with Japan in 2005.[47]

The trade agreements have resulted in an increase in GDP from $403 billion in 1993 to $893.4 billion in 2007, with exports of $213.4 billion.[48] Mexico's 3.3 percent GDP growth in 2007 also included an increase in remittances by migrants—those contributions made by Mexicans living abroad both legally and illegally, mostly in the United States, to their families at home in Mexico; they comprised $18 billion in 2005, up from $2.4 billion in 1994.[49] Recent competition from China for offshored jobs from foreign firms has put downward pressure on opportunities for Mexico, as manufacturing facilities and some service facilities migrate from Mexico to China in a race for the lowest cost operations.[50]

CAFTA: Modeled after the NAFTA agreement, the goal of the U.S.-Central America Free Trade Agreement (CAFTA) was to promote trade liberalization between the United States and five Central American countries: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. In 2004, the Dominican Republic joined the negotiations, and the agreement was renamed DR-CAFTA. The treaty must be approved by the U.S. Congress and by National

Assemblies in the Central American countries before it becomes law. CAFTA is considered to be a stepping-stone to the larger Free Trade Area of the Americas (FTAA) that would encompass 34 economies, but which has met with considerable resistance.[51]

MERCOSUR is the fourth largest trading bloc after the EU, NAFTA and ASEAN. Established in 1991, it comprises the original parties—Brazil, Argentina, Paraguay, and Uruguay; Venezuela is an applicant country awaiting ratification. This regional trading bloc comprises 250 million people and accounts for 75 percent of South America's GDP.

Other Regions in the World

Sweeping political, economic, and social changes around the world present new challenges to global managers. The worldwide move away from communism, together with the trend toward privatization, has had an enormous influence on the world economy. Economic freedom is a critical factor in the relative wealth of nations.

One of the most striking changes today is that almost all nations have suddenly begun to develop decentralized, free market systems in order to manage a global economy of intense competition, the complexity of high-tech industrialization, and an awakening hunger for freedom.

The Russian Federation Foreign investment in Russia, as well as its consumers' climbing confidence and affluence, bode well for the economy. In the first quarter of 2009, for example, FDI into the Russian economy was about $8.4 billion.[52] However, corruption and government interference persist:

> *The writing has been on the wall for years. The Kremlin won't stop until it has recouped control of all the energy assets that were sold off at bargain prices when the Iron Curtain fell—and it will use any means necessary to achieve that goal.*
>
> INTERNATIONAL HERALD TRIBUNE,
> *March20, 2008*[53]

Until recently, Russia has been regarded as more politically stable. New land, legal and labor codes, as well as the now-convertible ruble have encouraged foreign firms to take advantage of opportunities in that immense area, in particular the vast natural resources and the well-educated population of 145 million. Moscow, in particular, is teeming with new construction sites, high-end cars, and new restaurants. Growth has been steady, but the real GDP growth for Russia is considered to be controlled by the so-called business "oligarchs"—a small group of businesspeople with political influence who capitalized on the privatization of Russia's economy and who limit competitive opportunities for small businesses. However, foreign investors became very wary after the break up of the Yukos oil group, including jailing its head Mikhail Khodorkovsky with an eight-year sentence; this made foreign investors reluctant to propose new deals that would require political approval. About two dozen Russian companies have come under the control of the Kremlin in the last few years, including newspapers and banks.[54] As an example, in September 2008, British Petroleum had to make deep concessions to its Russian partner in its TNK-BP oil joint venture. in order to avoid a forced sale of its assets there to a state company. BP had to agree to dismiss the American chief executive of its joint venture and give up some board seats to its Russian partners[55].

The Middle East. The United Arab Emirates is the most competitive economy in the Arab world among the countries at the third and most advanced stage of development according to The Arab World Competitiveness Report 2007 by the World Economic Forum. It is followed by Qatar and Kuwait. Among countries at the second stage of development, Tunisia and Oman are the best performing Arab economies while Egypt is the regional best performer in the third group of countries. The Forum predicted there will be prosperity with challenges for the Middle East

> *Oil and gas revenues provide unique investment opportunities, but the region's greatest challenges are likely to be in managing expectations, lowering trade and investment barriers and educating the next generation to handle the wealth that is now being produced. Education is the biggest challenge.*

Developing Economies are characterized by change that has come about more slowly as they struggle with low gross national product (GNP) and low per capita income, as well as the burdens of large, relatively unskilled populations and high international debt. Their economic situation and the often-unacceptable level of government intervention discourage the foreign investment they

need. Many countries in Central and South America, the Middle East, and Africa desperately hope to attract foreign investment to stimulate economic growth.

The African Union (AU): The AU comprises the 53 African countries and was formed from the original Organization of African Unity (OAU) primarily to deal with political issues. However, that union is not able to provide a vehicle for integration of trade and economic growth because of the many major problems in the region. Unfortunately, Africa has been virtually ignored by most of the world's investors, although it receives increasing investment from companies in South Africa, which has the region's biggest economy.

South Africa: The South African economy has been growing continuously since 1998, amid a more stable political environment since the defeat of apartheid. It is the longest economic upswing in the country's history, although, according to Statistics South Africa, GDP had slowed near the end of 2008 to +0.2 percent. In addition, unemployment was 23.2 percent of the population of 48.7 million (as of January, 2009).[57] The rapid growth of consumer demand, along with increasing tourism and foreign business investment, has made the country's outlook very positive. Foreign investment is encouraged through the Strategic Industrial Project, which provides approved companies with substantial tax reductions as well as other incentives. These incentives, along with more political stability, encouraged the return of most of the foreign companies which had left during the apartheid era. In addition, companies in South Africa no doubt realize that they have a competitive edge on the African continent that they do not have in more developed parts of the world.[58]

For firms willing to take the economic and political risks, developing economies offer considerable potential for international business. Assessing the risk-return trade-offs and keeping up with political developments in these developing countries are two of the many demands on international managers. Among proactive managers taking advantage of such opportunities are those at Intel—a corporation that epitomizes the ways in which "globalization" is affecting less-developed countries (LDCs) and developing economies such as Vietnam, as discussed in the accompanying Management Focus.

MANAGEMENT FOCUS

Intel Brings Changes to Vietnam's Economy and Culture[59]

The United States opened trade relations with Vietnam in 2000, opening the way for that country's expansion. Although Vietnam is a communist country, its rapid growth can be attributed to its entrepreneurial traditions and those aspects of globalization that attract corporations such as Intel to take advantage of new markets and lower costs of production. While the debate continues about whether globalization brings overall positive or negative effects to less developed countries, the inevitable march of trade and investment has led Daniel Altman to believe that "the more relevant question today is whether these multinational relationships can be managed in a way that benefits both guests and hosts." Intel's success in this regard started with the awareness of the tight control of the Vietnamese government in all aspects of society and on foreign companies wishing to do business there.

After painstaking and secret negotiations with Vietnamese government officials who were unused to market economics, Intel's general manager, Rick Howath, decided to build its biggest semiconductor manufacturing plant ever along the Hanoi Highway in Vietnam, a nation of 85 million with limited higher education opportunities. This is Intel Corporation's seventh assembly site of its global network. (Other sites include Penang and Kulim, Malaysia; Cavite, Philippines; Chengdu and Shanghai, China; and San Jose, Costa Rica.) Planning to hire 4,000 workers by 2010 to produce chips for the company's extensive global supply chain, Intel has demonstrated how multinationals which are industry leaders can change the economic and cultural dynamics in a developing country by the decision to locate a plant there. However, this was no light decision. Intel's company strategic decision-makers spent years investigating and evaluating the benefits and constraints of locating there and considerable effort in working with the government in Hanoi. The company's investigations were relentless, evaluating school curricula, traffic congestion, the poor infrastructure, and the size of the average adult in order to tailor the factory to them. Their main concern was finding enough qualified engineers.

In the end, the Vietnamese government's desire to attract multinationals, along with the country's proximity to China and its young, low-cost workforce, convinced Intel to invest $1 billion there

for its 115-acre construction site in the new Saigon Hi-Tech Park. The company called the project A-9. (Nine is regarded as a lucky number in Vietnam.) However, this was not until the government-owned Saigon Hi-Tech Park signed a pact with Intel to fight against corruption and improper business conduct. This was the first time a state agency had made such a pact and also a first for Intel, who was concerned about Vietnam's reputation as one of the world's most corrupt countries.

Changes resulting from Intel's investment in Vietnam are already evident. The Vietnamese government is giving Intel's managers unprecedented access to high-ranking officials, and other global giants are showing interest in investing there. The plant will create a higher-end manufacturing base beyond garment assembly lines and create desperately needed professional jobs for its youth. Intel is also bringing its culture to Vietnam. Executives work alongside the workers, with no big offices for the bosses—contrary to Vietnam's hierarchical culture. It also sponsors team-building exercises like karaoke Fridays. Intel's company buses shuttle workers to the plant, passing low-slung shacks, which house so many Vietnamese.

In all, the Vietnamese view the new plant in Ho Chi Minh City with patriotic pride and hope for further economic emergence. For its part, Intel's success is largely attributable to cultivating government officials and to understanding the government's goals and work towards them. These include the desire to increase the use of personal computers and the Internet, and also to get a reputation for Vietnam to export high-tech items. Focusing on local traditions and working with the government's Communist youth group, Intel developed a program under the brand Thanh Giong, a Vietnamese hero, with the goal of beating back the enemy of illiteracy.

Information Technology

Of all the developments propelling global business today, the one that is transforming the international manager's agenda more than any is the rapid advance in information technology (IT). The speed and accuracy of information transmission are changing the nature of the global manager's job by making geographic barriers less relevant. Indeed, the necessity of being able to access IT is being recognized by managers and families around the world, who are giving priority to being "plugged in" over other lifestyle accoutrements.

Information can no longer be totally controlled by governments; political, economic, market, and competitive information is available almost instantaneously to anyone around the world, permitting informed and accurate decision-making. Even cultural barriers are being lowered gradually by the role of information in educating societies about one another. Indeed, as consumers around the world become more aware, through various media, of how people in other countries live, their tastes and preferences begin to converge.

The explosive growth of information technology is both a cause and an effect of globalism. The information revolution is boosting productivity around the world. Denmark is the most networked economy in the world, followed by Sweden and Switzerland, according to the 2008 edition of the *Global Information Technology Report.* Among the top ten, the Republic of Korea (9) and, to a lesser extent, the United States (4) post the most notable improvements.[60]

In addition, use of the Internet is propelling electronic commerce around the world (as discussed later in this chapter). Companies around the world are linked electronically to their employees, customers, distributors, suppliers, and alliance partners in many countries. Technology, in all its forms, gets dispersed around the world by **multinational enterprises** (MNEs) and their alliance partners in many countries. However, some of the information intended for electronic transmission is currently subject to export controls by an EU directive intended to protect private information about its citizens. So, perhaps IT is not yet "borderless" but rather is subject to the same norms, preferences, and regulations as "human" cross-border interactions.

The Globalization of Human Capital

The high cost of fuel is going to radically transform the way people look at the geography of their manufacturing.

BUSINESS WEEK,
June30, 2008[61]

Firms around the world have been **offshoring manufacturing** jobs to low-cost countries for decades—that is, they close down all **or part of a** ***factory,*** **say, in** Detroit and open it back up in

China or Mexico. An increasing number of firms have been producing or assembling parts of their products in many countries and then integrating them into their global supply chains. Although, with the greatly higher cost of fuel recently, greatly increasing shipping rates, some firms were fearful that their cost advantage of producing abroad was being lost. But shipping costs do not affect non-manufacturing jobs, and more and more firms are outsourcing white-collar jobs to India, China, Mexico, and the Philippines: customer support, medical analysis, technical work, computer programming, form filling and claims processing—all these jobs can now move around the globe in the same way that farming and factory jobs could a century ago.[62] We have all experienced talking to someone in India when we call the airlines or a technology support service; now increasingly sophisticated jobs are being outsourced, leaving many people in developed economies to worry about job retention. For example, as of May 2009, General Electric has about 14,500 employees in India, I.B.M. more than 74,000, and Citigroup more than 10,000.[63]

Forrester Research predicted that 3.3 million (U.S.) jobs would be lost in service-sector outsourcing around the world by 2015, and added that "the information technology industry will lead the initial overseas exodus."[64] A programmer in India, for example—well educated, skilled, and English-speaking—earns about $20,000 a year, compared to $80,000 in the United States. In Bangalore, India, MNCs such as Intel, Dell, IBM, Yahoo!, and AOL employ workers in chip design, software, call centers, and tax processing.[65] Dell has four call centers in India, where the bulk of its 10,000 employees work, as well as software development and product testing centers. The annual salary for a call-center agent in India is $2,667, compared to $29,000 in the United States. Moreover, while most call centers serve their own domestic markets, 73 percent of India's call centers serve foreign markets.[66] Overall, the Indian ITES sector (IT-enabled services) has 700,000 people worldwide and comprises 35 percent of the Business Process Outsourcing **market** (BPO).[67] India's software services exports are expected to reach $60 billion by 2010. However, two recent trends in the globalization of IT jobs are changing this scene. One is that **large** Indian IT outsourcing companies such as Infosys technologies Ltd. and the Tata Group are luring their staff in the United States. The other is that the growth in such jobs in India and elsewhere is being threatened by the economic downturn resulting from the financial crisis, which started in the fall of 2008.

India's seemingly unstoppable outsourcing industry is grappling with the woes of the financial firms that make up as much as half of revenues for some players. "How this plays out, who knows?" says Pramod Bhasin, CEO of Genpact, the world's largest business process outsourcing company. Although he's optimistic, he says: "The ability to predict has gone away.

BUSINESS WEEK,[68]
October 13, 2008.

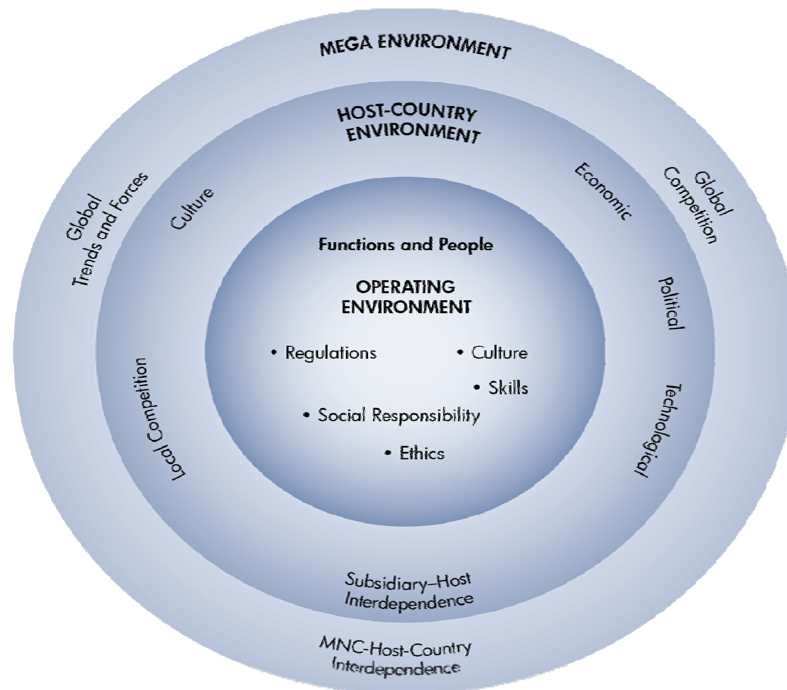
However, Infosys CEO Kris Gopalakrishnan was cautiously optimistic in late 2008 that Infosys and other top Indian tech services firms will fare reasonably well in the downturn, saying that

Companies look for ways to cut costs during a recession, and, in spite of wage inflation among the Indian services outfits, work done there still carries a price advantage. In fact, the 8.4 percent drop in value of the rupee versus the dollar last quarter means Indian labor is become MORE competitive, not less.

BUSINESS WEEK ASIA,
October 10, 2008.

In China—long the world's low-cost manufacturing hub—jobs are on the upswing for back-office support for financial services and for telecom and retail companies in Asia. Such employees communicate to people in Hong Kong and Taiwan in local languages.[70] While backlash from some firms' clients has resulted in them repatriating high-end jobs, white-collar job migration is still on the rise for firms around the world, bringing with it a new phase in economic globalization and competition. For global firms, winning the 'war for talent' is one of the most pressing issues, especially as hot labor markets in emerging markets are causing extremely high turnover rates.[71]

EXHIBIT 1-3 An Open Systems **Model**



The Global Manager's Role

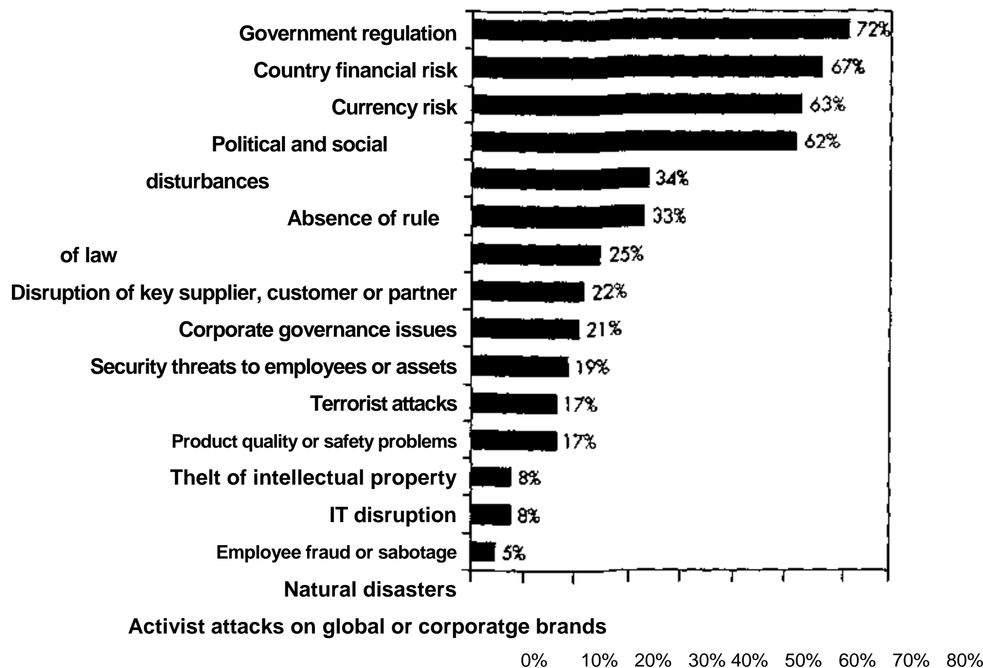
Whatever your level of involvement, it is important to understand the global business environment and its influence on the manager's role. This complex role demands a contingency approach to dynamic environments, each of which has its own unique requirements. Within the larger context of global trends and competition, the rules of the game for the global manager are set by each country (see Exhibit 1-3): its political and economic agenda, its technological status and level of development, its regulatory environment, its comparative and competitive advantages, and its cultural norms. The astute manager will analyze the new environment, anticipate how it may affect the future of the company, and then develop appropriate strategies and operating styles.

THE POLITICAL AND ECONOMIC ENVIRONMENT

Proactive globally-oriented firms maintain an up-to-date profile of the political and economic environment of the countries in which they maintain operations (or have plans for future investment). Surveys of top executives around the world show that Sustainability—economic, political social, and environmental—has become a significant worldwide issue. Executives who recognize that fact are leading their companies to develop new policies and to invest in sustainability projects with the purpose of benefiting the environment as well as profitability. Among the strategic and operational risks reported by global companies are government regulation, country financial risks and currency risk and political and social disturbances. These concerns and other risks, as reported by those companies, are shown in Exhibit 1-4.

An important aspect of the political environment is the phenomenon of ethnicity— a driving force behind political instability around the world. In fact, many uprisings and conflicts that are thought to be political in nature are actually expressions of differences among ethnic groupings. Often, religious disputes lie at the heart of those differences. Uprisings based on religion operate either in conjunction with ethnic differences (as probably was the case in the former Yugoslavia) or as separate from them (as in Northern Ireland). Many terrorist activities

EXHIBIT 1-4 Greatest Risks affecting FDI Decisions, As Reported by Global Companies



Source: www.atkearney.com, September 12, 2008. Copyright A. T. Kearney, Inc., 2007. All rights reserved. Reprinted with permission.

are also based on religious differences, as in the Middle East. Managers must understand the **ethnic and** religious composition of the host country in order to anticipate problems of general **instability,** as well as those of an operational nature, such as effects on the workforce, on **production and** access to raw materials, and on the market. For example, consider the following:

> ***In*** *Pakistan one must understand the differences between Punjabi and Sindi. In Malaysia it is essential to recognize the special economic relationship between Chinese and Malay. In the Philippines it is important to understand the significant and lead financial role played by the Filipino-Chinese.*[73]

Political Risk

As shown in the example below, firms operating in some countries are exposed to political risks that can drastically affect them with little warning:

> *Venezuela will take control of cement plants and offices belonging to Mexico's Cemex as of midnight Monday night (August 18, 2008) after failing to reach an agreement in nationalization talks, the government said. The expropriation is part of a drive by the socialist president, Hugo Chdvez, to place key industries under state control.*
>
> WWW. BUSINESS WEEK.COM,
> *August 19, 2008.*

In another example, Bolivian President Evo Morales' move to nationalize the national gas industry followed that in Venezuela, where Mr. Chavez, in a move against Big Oil, forced major oil companies to accept a minority stake in fields that they had owned, also giving more money for higher taxes and royalties.[75]

The managers of a global firm need to investigate the political risks to which they expose their company in certain countries—and the implications of those risks for the economic success of the firm. **Political risks** are any governmental action or politically motivated event that could adversely affect the long-run profitability or value of a firm. The Middle East, as we have seen, has traditionally been an unstable area where political risk heavily influences business decisions.

Nationalization in unstable areas, multinational corporations weigh the risks of nationalization or expropriation, as in Bolivia and Venezuela in the examples previously cited. **Nationalization** refers to the forced sale of an MNC's assets to local buyers, with some compensation to the firm, perhaps leaving a minority ownership with the MNC. As the fallout from the financial meltdown spread around the world in 2009. government moves to take stakes in

ailing industries was verging on partial or full nationalization—though for the most part not forced. Japan, for example, was taking the cue from the United States in taking majority stakes in major banks, while in Russia, The Kremlin was exploiting the economic crisis to establish more control over industries such as energy that it has long coveted.[76]

In Europe, nationalist impulses gathered storm in 2009, with many politicians arguing—as in the United States—that if the government is going to bail out banks, then taxpayers should get some ownership and some say in how they operate. For instance, few banks expanded more rapidly in Germany over the last decade than Royal Bank of Scotland. "The British financier muscled onto Continental turf with attractive financing packages for German manufacturers. Today, Royal Bank is majority-owned by the British government after losses in 2008 from £7 billion to £8 billion, or $9.2 billion to $10.5 billion."[77]

Expropriation occurs when a local government seizes and provides inadequate compensation for the foreign-owned assets of an MNC; when no compensation is provided, it is confiscation. In countries that have a proven history of stability and consistency, the political risk to a multinational corporation is relatively low. The risk of expropriation is highest in countries that experience continuous political upheaval, violence, and change, as evidenced by actions such as that by Hugo Chavez in his continuing drive to place key industries under state control, as shown in the previous quote when he took control of Mexico's Cemex cement plants in Venezuela.

Although political risk is typically higher in emerging markets, it is also evident in developed economies. Dubai Ports World found this when its bid in 2006 to manage six American ports for the British owner, P&O, met with such opposition in the U.S. Congress that it withdrew its bid. The Chinese National Offshore Oil Company (CNOOC) ran into similar opposition when it tried unsuccessfully to buy Unocal, the American oil company.

An event that affects all foreign firms doing business in a country or region is called a **macropolitical risk event.** In the Middle East, Iraq's invasion of Kuwait in 1990 abruptly halted all international business with and within both of those countries and caught businesses wholly unprepared.

In many regions, **terrorism** poses a severe and random political risk to company personnel and assets and can, obviously, interrupt the conduct of business. According to Micklous, terrorism is "the use, or threat of use, of anxiety-inducing . . . violence for ideological or political purposes."[7] The increasing incidence of terrorism around the world concerns MNCs. In particular, the kidnapping of business executives has become quite common.

An event that affects one industry or company or only a few companies is called a **micropolitical risk event.** Such events have become more common than macropolitical risk events. Such micro action is often called "creeping expropriation," indicating a government's gradual and subtle action against foreign firms. This is a situation when you haven't been expropriated, but it takes ten times longer to do anything. Typically, such continuing problems with an investment present more difficulty for foreign firms than do major events that are insurable by political-risk insurers. The following list describes seven typical political risk events common today (and possible in the future):

1. Expropriation of corporate assets without prompt and adequate compensation
2. Forced sale of equity to host-country nationals, usually at or below depreciated book value
3. Discriminatory treatment against foreign firms in the application of regulations or laws
4. Barriers to **repatriation** of funds (profits or equity)
5. Loss of technology or other intellectual property (such as patents, trademarks, or trade names)
6. Interference in managerial decision making
7. Dishonesty by government officials, including canceling or altering contractual agreements, extortion demands, and so forth.[79]

Political Risk Assessment

International companies must conduct some form of political risk assessment to manage their exposure to risk and to minimize financial losses. Typically, local managers in each country assess potentially destabilizing issues and evaluate their future impact on their company, making suggestions for dealing with possible problems. Corporate advisers then establish guidelines for each local manager to follow in handling these problems. Dow Chemical has a program in which it uses line managers trained in political and economic analysis, as well as executives in foreign subsidiaries, to provide risk analyses of each country.

Risk assessment by multinational corporations usually takes two forms. One uses experts or consultants familiar with the country or region under consideration. Such consultants, advisers, and committees usually monitor important trends that may portend political change, such as the development of opposition or destabilizing political parties. They then assess the likelihood of political change and develop several plausible scenarios to describe possible future political conditions.

A second and increasingly common means of political risk assessment used by MNCs is the development of internal staff and in-house capabilities. This type of assessment may be accomplished by having staff assigned to foreign subsidiaries, by having affiliates monitor local political activities, or by hiring people with expertise in the political and economic conditions in regions critical to the firm's operations. Frequently, all means are used. The focus must be on monitoring political issues before they become headlines; the ability to minimize the negative effects on the firm—or to be the first to take advantage of opportunities—is greatly reduced once a major media source, such as CNN, has put out the news.

No matter how sophisticated the methods of political risk assessment become, nothing can replace timely information from people on the front line. In other words, sophisticated techniques and consultations are useful as an addition to, but not as a substitute for, the line managers in foreign subsidiaries, many of whom are host-country nationals. These managers represent the most important resource for current information on the political environment, and how it might affect their firm, because they are uniquely situated at the meeting point of the firm and the host country. Prudent MNCs, however, weigh the subjectivity of these managers' assessments and also realize that similar events will have different effects from one country to another.

In addition to assessing the political risk facing a firm, alert managers also examine the specific types of impact that such risks may have on the company. For an autonomous inter-actional subsidiary, most of the impact from political risks (nationalization, terrorism) will be at the level of the ownership and control of the firm because its acquisition by the host country would provide the state with a fully operational business. For global firms, the primary risks are likely to be from restrictions (on imports, exports, currency, and so forth), with the impact at the level of the firm's transfers (or exchanges) of money, products, or component parts.

Managing Political Risk

After assessing the potential political risk of investing or maintaining current operations in a country, managers face perplexing decisions on how to manage that risk. On one level, they can decide to suspend their firm's dealings with a certain country at a given point—either by the avoidance of investment or by the withdrawal of current investment (by selling or abandoning plants and assets). On another level, if they decide that the risk is relatively low in a particular country or that a high- risk environment is worth the potential returns, they may choose to start (or maintain) operations there and to accommodate that risk through adaptation to the political regulatory environment. That adaptation can take many forms, each designed to respond to the concerns of a particular local area. Some means of adaptation suggested by Taoka and Beeman are as follows:

1. Equity sharing includes the initiation of joint ventures with nationals (individuals or those in firms, labor unions, or government) to reduce political risks.
2. Participative management requires that the firm actively involve nationals, including those in labor organizations or government, in the management of the subsidiary.
3. Localization of the operation includes the modification of the subsidiary's name, management style, and so forth, to suit local tastes. Localization seeks to transform the subsidiary from a foreign firm to a national firm.
4. Development assistance includes the firm's active involvement in infrastructure development (foreign-exchange generation, local sourcing of materials or parts, management - training, technology transfer, securing external debt, and so forth).[80]

In addition to avoidance and adaptation, two other means of risk reduction available lo managers are dependency and hedging. Some means that managers might use to maintain *dependency*—keeping the subsidiary and the host nation dependent on the parent corporation— are as follows:

1. Input control means that the firm maintains control over key inputs, such as raw materials, components, technology, and know-how.

2. Market control requires that the firm keep control of the means of distribution (for instance, by only manufacturing components for the parent firm or legally blocking sales outside the host country).
3. Position control involves keeping certain key subsidiary management positions in the hands of expatriate or home-office managers.
4. Staged contribution strategies mean that the firm plans to increase, in each successive year, the subsidiary's contributions to the host nation (in the form of tax revenues, jobs, infrastructure development, hard-currency generation, and so forth). For this strategy to be most effective, the firm must inform the host nation of these projected contributions as an incentive.[81]

Finally, even if the company cannot diminish or change political risks, it can minimize the losses associated with these events by hedging. Some means of hedging are as follows:

1. Political risk insurance is offered by most industrialized countries. In the United States, the Overseas Private Investment Corporation (OPIC) provides coverage for new investments in projects in friendly, less developed countries. Insurance minimizes losses arising from specific risks—such as the inability to repatriate profits, expropriation, nationalization, or confiscation—and from damage as a result of war, terrorism, and so forth.[82] The Foreign Credit Insurance Association (FCIA) also covers political risks caused by war, revolution, currency inconvertibility, and the cancellation of import or export licenses. However, political risk insurance covers only the loss of a firm's assets, not the loss of revenue resulting from expropriation.[83]
2. Local debt financing (money borrowed in the host country), where available, helps a firm hedge against being forced out of operation without adequate compensation. In such instances, the firm withholds debt repayment in lieu of sufficient compensation for its business losses.

Multinational corporations also manage political risk through their global strategic choices. Many large companies diversify their operations both by investing in many commies and by operating through joint ventures with a local firm or government or through local licensees. By involving local people, companies, and agencies, firms minimize me risk negative outcomes due to political events. (See Chapters 6 and 7 for further discussion of these and other global strategies.)

Managing Terrorism Risk

No longer is the risk of terrorism for global businesses focused only on certain areas such as south America or the Middle East. That risk now has to be considered in countries such as the United States, which had previously been regarded as safe. Eighty countries lost Citizens in the World Trade Center attack on September 11, 2001. Many companies from Asia and Europe had office branches in the towers of the World Trade Center; most of those offices, along with the employees from those countries, were destroyed in the attack. Thousands of lives and billions of dollars were lost, not only by those immediately affected by the attack but also by countless small and large businesses impacted by the ripple effect; global airlines and financial markets were devastated.

As incidents of terrorism accelerate around the world, many companies are increasingly aware of the need to manage the risk of terrorism. In high-risk countries, both IBM and Exxon try to develop a benevolent image through charitable contributions to the local community. They also try to maintain low profiles and minimize publicity in the host countries by using, for example, discreet corporate signs at company sites.[84]

Some companies have put together teams to monitor the patterns of terrorism around the world. Kidnappings are common in Latin America (as a means of raising money for political activities). In the Middle East, airplane hijackings, kidnapping of foreigners, and blackmail (for the release of political prisoners) are common. In Western Europe, terrorists typically aim bombs at U.S.-owned banks and computer companies. Almost all MNCs have stepped up their security measures abroad, hiring consultants in counterterrorism (to train employees to cope with the threat of terrorism) and advising their employees to avoid U.S. airlines when flying overseas. For many firms, however, the opportunities outweigh the threats, even in high-risk areas

Economic Risk

Closely connected to a country's political stability is its economic environment—and the relative risk that it may pose to foreign companies. A country's level of economic development generally determines its economic stability and, therefore, its relative risk to a foreign firm. Most industrialized nations pose little risk of economic instability; less developed nations pose more risk. However, going into 2009, the global economic risks started by the financial woes in the United States threatened all.

A country's ability or intention to meet its financial obligations determines its economic risk. The economic risk incurred by a foreign corporation usually falls into one of two main categories. Its subsidiary (or other investment) in a specific country may become unprofitable if (1) the government abruptly changes its domestic monetary or fiscal policies or (2) the government decides to modify its foreign-investment policies. The latter situation would threaten the company's ability to repatriate its earnings and would create a financial or interest-rate risk. Furthermore, the risk of exchange-rate volatility results in currency translation exposure to the firm when the balance sheet of the entire corporation is consolidated, and may cause a negative cash flow from the foreign subsidiary. Currency translation exposure occurs when the value of one country's currency changes relative to that of another. For a U.S. company operating in Mexico, the recent peso devaluation meant that the company's assets in that country were worth less when translated into dollars on the financial statements, but the firm's liabilities in Mexico were also less.

When exchange-rate changes are radical, repercussions are felt around the world. For example, when the Russian ruble was devalued in 1998, it was unfortunate for the Russian people because their money bought much less and for Russian firms because they did not have enough buying power to purchase products from overseas, which meant that the sales of foreign companies declined. On the other hand, foreign companies suddenly had more purchasing power in Russia to outsource raw materials, labor, and so on.

Because every MNC operating overseas exposes itself to some level of economic risk, often affecting its everyday operational profitability, managers constantly reassess the level of risk their companies may face in any specific country or region of the world. Four methods of analyzing economic risk, or a country's creditworthiness, are recommended by John Mathis, a professor of international economics who has also served as senior financial policy analyst for the World Bank. These methods are (1) the quantitative approach, (2) the qualitative approach, (3) a combination of both of these approaches, and (4) the checklist approach.

The **quantitative approach,** says Mathis, "attempts to measure statistically a country's ability to honor its debt obligation."[85] This measure is arrived at by assigning different weights to economic variables in order to produce a composite index used to monitor the country's creditworthiness over time and to make comparisons with other countries. A drawback of this approach is that it does not take into account different stages of development among the countries it compares.

The **qualitative approach** evaluates a country's economic risk by assessing the competence of its leaders and analyzing the types of policies they are likely to implement. This approach entails a subjective assessment by the researcher in the process of interviewing those leaders and projecting the future direction of the economy.

The **checklist approach** relies on a few easily measurable and timely criteria believed to reflect or indicate changes in the creditworthiness of the country. Researchers develop various vulnerability indicators that categorize countries in terms of their ability to withstand economic volatility.

Most corporations recognize that no single approach can provide a comprehensive economic risk profile of a country. Therefore, they try to use a combination of approaches.

THE LEGAL ENVIRONMENT

The prudent global manager consults with legal services, both locally and at headquarters, to comply with host-country regulations and to maintain cooperative long-term relationships in the local area. If the manager waits until a problem arises, little legal recourse may be available outside of local interpretation and enforcement. Indeed, this has been the experience of many foreign managers in China, where financial and legal systems remain limited in spite of attempts to show the world a capitalist face. Managers there often simply ignore their debts to foreign

companies as they did under the old socialist system. The lesson for many foreign companies in China is that they are losing millions because Beijing often does not stand behind the commitments of its state-owned enterprises. David Ji, a Chinese-American electronics entrepreneur, experienced this painful lesson:

> *A year after the Chinese police apprehended him in his hotel room during a business trip, Mr. Ji remains in China as a pawn—his colleagues say a hostage—in a commercial dispute that pits Changhong, China's largest television manufacturer, against Apex Digital, Mr. Ji's electronics trading company based in Los Angeles.*
>
> NEW YORK TIMES,
> *November 1, 2005.*[86]

Changhong claimed that Apex owed it $470 million, but Mr. Ji claimed the amount is less than $150 million. Mr. Ji, after two months in custody, had no recourse under China's judicial system, which fiercely protects its powerful companies like Changhong. There is heavy pressure from foreign companies for Beijing to embrace global legal norms with the same determination that it has pursued foreign trade.[87]

Although no guarantee is possible, the risk of massive losses may be minimized, among other ways, by making sure you get approval from related government offices (national, provincial, and local), seeing that you are not going to run amok of long-term government goals, and getting loan guarantees from the headquarters of one of Beijing's main banks. Some of the contributing factors in cases like Mr. Ji's are often the personal connections—*guanxi*—involved and the fact that some courts offer their services to the business community for profit. In addition, many judges get their jobs through nepotism rather than by virtue of a law degree.

Although the regulatory environment for international managers consists of the many local laws and the court systems in those countries in which they operate, certain other legal issues are covered by international law, which governs relationships between sovereign countries, the basic units in the world political system. One such agreement, which regulates international business by spelling out the rights and obligations of the seller and the buyer, is the United Nations Convention on Contracts for the International Sale of Goods (CISC). This applies to contracts for the sale of goods between countries that have adopted the convention.

Generally speaking, the manager of the foreign subsidiary or foreign operating division will comply with the host country's legal system. Such systems, derived from common law, civil law, or Muslim law, are a reflection of the country's culture, religion, and traditions. Under common law, used in the United States and 26 other countries of English origin or influence, past court decisions act as precedents to the interpretation of the law and to common custom. Civil law is based on a comprehensive set of laws organized into a code. Interpretation of these laws is based on reference to codes and statutes. About 70 countries, predominantly in Europe (e.g., France and Germany), are ruled by civil law, as is Japan. In Islamic countries, such as Saudi Arabia, the dominant legal system is Islamic law; based on religious beliefs, it dominates all aspects of life. Islamic law is followed in approximately 27 countries and combines, in varying degrees, civil, common, and indigenous law.

Contract Law

A contract is an agreement by the parties concerned to establish a set of rules to govern a business transaction. Contract law plays a major role in international business transactions because of the complexities arising from the differences in the legal systems of participating countries and because the host government in many developing and communist countries is often a third party in the contract. Both common law and civil law countries enforce contracts, although their means of resolving disputes differ. Under civil law, it is assumed that a contract reflects promises that will be enforced without specifying the details in the contract; under common law, the details of promises must be written into the contract to be enforced. Astute international managers recognize that they will have to draft contracts in legal contexts different from their own, and they prepare themselves accordingly by consulting with experts in international law before going overseas.

In some countries, "The risk is, you could have a contract torn up or changed. We're just going to have to adjust to that in the West," says Robert Broadfoot, who heads the Political &

Economic Risk Consultancy in Hong Kong. He says that Western companies think they can avoid political risk by spelling out every detail in a contract, but "in Asia, there is no shortcut for managing the relationship."[88] In other words, the contract is in the relationship, not on the paper, and the way to ensure the reliability of the agreement is to nurture the relationship.

Even a deal that has been implemented for some time may start to get watered down at a time when you cannot do anything about it. A Japanese-led consortium experienced this problem after it built an expressway in Bangkok. The Thai government later lowered the toll that it had agreed could be charged for use of the road. This is a subtle form of expropriation, since a company cannot simply pack up a road and leave.[89] Neglect regarding contract law may leave a firm burdened with an agent who does not perform the expected functions, or a firm may be faced with laws that prevent management from laying off employees (often the case in Belgium, the Netherlands, Germany, Sweden, and elsewhere).

Other Regulatory Issues

Differences in laws and regulations from country to country are numerous and complex. These and other issues in the regulatory environment that concern multinational firms are briefly discussed here.

Countries often impose protectionist policies, such as tariffs, quotas, and other trade restrictions, to give preference to their own products and industries. The Japanese have come under much criticism for protectionism, which they use to limit imports of foreign goods while they continue exporting consumer goods (e.g., cars and electronics) on a large scale. The U.S. auto industry continues to ask the U.S. government for protection from Japanese car imports. Calls to "Buy American," however, are thwarted by the difficulty of identifying cars that are truly U.S.-made; the intricate web of car-manufacturing alliances between Japanese and American companies often makes it difficult to distinguish the maker.

A country's tax system influences the attractiveness of investing in that country and affects the relative level of profitability for an MNC. Foreign tax credits, holidays, exemptions, depreciation allowances, and taxation of corporate profits are additional considerations the foreign investor must examine before acting. Many countries have signed tax treaties (or conventions) that define such terms as "income," "source," and "residency" and spell out what constitutes taxable activities.

The level of government involvement in the economic and regulatory environment varies a great deal among countries and has a varying impact on management practices. In Canada, the government has a significant involvement in the economy. It has a powerful role in many industries, including transportation, petrochemicals, fishing, steel, textiles, and building materials— forming partly owned or wholly owned enterprises. Wholly owned businesses are called Crown Corporations (Petro Canada, Ontario Hydro, Saskatchewan Telecommunications, and so forth), many of which are as large as major private companies. The government's role in the Canadian economy, then, is one of both control and competition. Government policies, subsidies, and regulations directly affect the manager's planning process, as do other major factors in the Canadian legal environment, such as the high proportion of unionized workers (30 percent). In Quebec, the law requiring official bilingualism imposes considerable operating constraints and expenses. For a foreign subsidiary, this regulation forces managers to speak both French and English and to incur the costs of language training for employees, translators, the administration of bilingual paperwork, and so on.

THE TECHNOLOGICAL ENVIRONMENT

The effects of technology around the world are pervasive—both in business and in private lives. In many parts of the world, whole generations of technological development are being skipped over. For example, many people will go straight to a digital phone without ever having had their houses wired under the analog system. In Entasopia, Kenya, its 4,000 inhabitants have no bank, no post office, and scant infrastructure of any kind. Yet it was there that three young engineers, with financial backing from Google, installed a small satellite dish powered by a solar panel, to hook up a handful of computers in the community center to the rest of the world. Google is paying the monthly fees for bandwidth connection. Locals can now send information instantly instead of having to physically travel to deliver it.• on

Advances in information technology are bringing about increased productivity—for employees, for companies, and for countries. As noted by Thomas Friedman, technology, as well as other factors that are opening up borders—"the opening of the Berlin Wall, Netscape, work flow, outsourcing, offshoring, open-sourcing, insourcing, supply-chaining, in-forming"—have converged to create a more level playing field. The result of this convergence was

> *The creation of a global, Web-enabled playing field that allows for multiple forms of collaboration—the sharing of knowledge and work—in real time, without regard to geography, distance, or, in the near future, even language.*
>
> THOMAS FRIEDMAN,
> *The World Is Flat, 2005.*[91]

Now that we are in a global information society, it is clear that corporations must incorporate into their strategic planning and their everyday operations the accelerating macro-environmental phenomenon of technoglobalism—in which the rapid developments in information and communication technologies (ICTs) are propelling globalization and vice versa. Investment-led globalization is leading to global production networks, which results in global diffusion of technology to link parts of the value-added chain in different countries. That chain may comprise parts of the same firm, or it may comprise suppliers and customers, or technology-partnering alliances among two or more firms. Either way, technological developments are facilitating, indeed necessitating, the network firm structure that allows flexibility and rapid response to local needs.

Clearly, the effects of technology on global trade and business transactions cannot be ignored; in addition, the Internet is propelling electronic commerce around the world. The ease of use and pervasiveness of the Internet raise difficult questions about ownership of intellectual property, consumer protection, residence location, taxation, and other issues.

New technology specific to a firm's products represents a key competitive advantage to firms and challenges international businesses to manage the transfer and diffusion of proprietary technology, with its attendant risks. Whether it is a product, a process, or a management technology, an MNC's major concern is the appropriability of technology—that is, the ability of the innovating firm to profit from its own technology by protecting it from competitors.

An MNC can enjoy many technological benefits from its global operations. Advances resulting from cooperative research and development (R&D) can be transferred among affiliates around the world, and specialized management knowledge can be integrated and shared. However, the risks of technology transfer and pirating are considerable and costly. Although firms face few restrictions on the creation and dissemination of technology in developed countries, less developed countries often impose restrictions on licensing agreements, royalties, and so forth, as well as on patent protection.

In most countries, governments use their laws to some extent to control the flow of technology. These controls may be in place for reasons of national security. Other countries, LDCs in particular, use their investment laws to acquire needed technology (usually labor-intensive technology to create jobs), increase exports, use local technology, and train local people.

The most common methods of protecting proprietary technology are the use of patents, trademarks, trade names, copyrights, and trade secrets. Various international conventions afford some protection in participating countries; more than 80 countries adhere to the International Convention for the Protection of Industrial Property, often referred to as the Paris Union, for the protection of patents. However, restrictions and differences in the rules in some countries not signatory to the Paris Union, as well as industrial espionage, pose continuing problems for firms trying to protect their technology.

One risk to a firm's intellectual property is the inappropriate use of the technology by joint-venture partners, franchisees, licensees, and employees (especially those who move to other companies). Some countries rigorously enforce employee secrecy agreements.

Another major consideration for global managers is the need to evaluate the appropriateness of technology for the local environment—especially in less developed countries. Studying the possible cultural consequences of the transfer of technology, managers must assess whether the local people are ready and willing to change their values, expectations, and behaviors on the job to use new technological methods, whether applied to production, research,

marketing, finance, or some other aspect of business. Often, a decision regarding the level of technology transfer is dominated by the host government's regulations or requirements. In some instances, the host country may require that foreign investors import only their most modern machinery and methods so that the local area may benefit from new technology. In other cases, the host country may insist that foreign companies use only labor-intensive processes, which can help to reduce high unemployment in an area.

When the choice is left to international managers, experts in economic development recommend that managers make informed choices about appropriate technology. The choice of technology may be capital intensive, labor intensive, or intermediate, but the key is that it should suit the level of development in the area and the needs and expectations of the people who will use it.

Global E-Business

Without doubt, the Internet has had a considerable impact on how companies buy and sell goods around the world—mostly raw materials and services going to manufacturers. Internet-based electronic trading and data exchange are changing the way companies do business, while breaking down global barriers of time, space, logistics, and culture. However, the Internet is not totally open; governments still make sure that their laws are obeyed in cyberspace. This was evidenced when France forced Yahoo! to stop displaying Nazi trinkets for sale where French people could view them.[92] The reality is that

> *Different nations, and different peoples, may want a different kind of Internet—one whose language, content and norms conform more closely to their own.*
>
> FINANCIAL TIMES, *May 17, 2006.*[93]

There is no doubt, however, that the Internet has introduced a new level of global competition by providing efficiencies through reducing numbers of suppliers and slashing administration costs throughout the value chain. **E-business** is "the integration of systems, processes, organizations, value chains, and entire markets using Internet-based and related technologies and concepts."[94] **E-commerce** refers directly to the marketing and sales process via the Internet. Firms use e-business to help build new relationships between businesses and customers.[95] The Internet and e-business provide a number of uses and advantages in global business, including the following:

1. Convenience in conducting business worldwide; facilitating communication across borders contributes to the shift toward globalization and a global market.
2. An electronic meeting and trading place, which adds efficiency in conducting business sales.
3. A corporate Intranet service, merging internal and external information for enterprises worldwide.
4. Power to consumers as they gain access to limitless options and price differentials.
5. A link and efficiency in distribution.[96]

Although most early attention was on e-commerce, experts now believe the real opportunities are in business-to-business **(B2B)** transactions. In addition, while the scope, complexity, and sheer speed of the B2B phenomenon, including e-marketplaces, have global executives scrambling to assess the impact and their own competitive roles, estimates for growth in the e-business marketplace may have been overzealous because of the global economic slowdown and its resultant dampening of corporate IT spending. While we hear mostly about large companies embracing B2B, it is noteworthy that a large proportion of current and projected B2B use is by small and medium-sized firms, for three common purposes: supply chain, procurement, and distribution channel.

A successful Internet strategy—especially on a global scale—is, of course, not easy to create. Potential problems abound, as experienced by the European and U.S. companies surveyed by Forrester Research. Such problems include internal obstacles and politics, difficulties in regional coordination and in balancing global versus local e-commerce, and cultural differences. Such a large-scale change in organizing business clearly calls for absolute commitment from the top, empowered employees with a willingness to experiment, and good internal communications. Barriers to the adoption and progression of e-business around the world include lack of

readiness of partners in the value chain, such as suppliers. If companies want to have an effective marketplace, they usually must invest in increasing their trading partners' readiness and their customers' capabilities. Other barriers are cultural. In Europe, for example, "Europe's e-commerce excursion has been hindered by a laundry list of cultural and regulatory obstacles, like widely varying tax systems, language hurdles, and currency issues."[98]

In other areas of the world, barriers to creating global e-businesses include differences in physical, information, and payment infrastructure systems. In such countries, innovation is required to use local systems for implementing a Web strategy. In Japan, for example, very few transactions are conducted using credit cards. Typically, bank transfers and COD are used to pay for purchases. Also, many Japanese use convenience stores, such as 7-Eleven Japan, to pay for their online purchases by choosing that option online."

For these reasons, B2B e-business is likely to expand globally faster than B2C (business-to-consumer) transactions. In addition, consumer e-commerce depends on each country's level of access to computers and the Internet, as well as the relative efficiency of home delivery. Clearly, companies who want to go global through e-commerce must localize to globalize, which means much more than just presenting online content in local languages.

> *Localizing . . . also means recognizing and conforming to the nuances, subtleties and tastes of multiple local cultures, as well as supporting transactions based on each country's currency, local connection speeds, payment preferences, laws, taxes and tariffs.*[100]

In spite of various problems, use of the Internet to facilitate and improve global competitiveness continues to be explored and discovered. In the public sector in Europe, for example, the European Commission advertises tender invitations online in order to transform the way public sector contracts are awarded, using the Internet to build a truly single market.

It is clear that e-business is not only a new Web site on the Internet but also a source of significant strategic advantage. Hoping to capture this strategic advantage, the European Airbus venture—a public and private sector combination—joined a global aerospace B2B exchange for aircraft parts. The exchange illustrates two major trends in global competition: (1) those of cooperative global alliances, even among competitors, to achieve synergies and (2) the use of technology to enable those connections and synergies.

CONCLUSION

A skillful global manager cannot develop a suitable strategic plan or consider an investment abroad without first assessing the environment—political, economic, legal, and technological— in which the company will operate. This assessment should result not so much in a comparison of countries as in a comparison of (1) the relative risk and (2) the projected return on investments among these countries. Similarly, for ongoing operations, both the subsidiary manager and headquarters management must continually monitor the environment for potentially unsettling events or undesirable changes that may require the redirection of certain subsidiaries or the entire company. Some of the critical factors affecting the global manager's environment (and therefore requiring monitoring) are listed in Exhibit 1-5.

Environmental risk, as discussed in this chapter, has become the new frontier in global business. The skills of companies and the measures taken to manage their exposure to environmental risk on a world scale will soon largely replace their ability to develop, produce, and market global brands as the key element in global competitive advantage.

The pervasive role of culture in international management will be discussed fully in Part II, with a focus on how the managerial functions and the daily operations of a firm are also affected by a subtle, but powerful, environmental factor in the host country—that of societal culture.

Chapter 2 presents some more subtle, but critical, factors in the global environment—those of social responsibility and ethical behavior. We will consider a variety of questions: What is the role of the firm in the future of other societies and their people? What stakeholders must managers consider in their strategic and operational decisions in other countries? How do the expectations of firm behavior vary around the world, and should those expectations influence the international manager's decisions? What role does long-term global economic interdependence play in the firm's actions in other countries?

EXHIBIT 1-5 The Environment of the Global Manager

Political Environment	Economic Environment
• Form of Government. • Political Stability • Foreign policy • State companies • Role of military • Level of terrorism • Restrictions on imports/exports	• Economic system • State of development • Economic stability • GNP • International financial standing • Monetary/fiscal policies • Foreign investment
Regulatory Environment	**Technological Environment**
• Legal system • Prevailing international laws • Protectionist laws • Tax laws • Role of contracts • Protection for proprietary property • Environmental protection	• Level of technology • Availability of local technical skills • Technical requirements of country • Appropriability • Transfer of technology • Infrastructure.
Cultural Environment (see Part II)	

Summary of Key Points

1. Competing in the twenty-first century requires firms to invest in the increasingly refined managerial skills needed to perform effectively in a multicultural environment. Managers need a global orientation to meet the challenges of world markets and rapid, fundamental changes in a world of increasing economic interdependence.
2. Global management is the process of developing strategies, designing and operating systems, and working with people around the world to ensure sustained competitive advantage.
3. One major direction in world trade is the rise of rapidly developing economies, such as China, India, Brazil, and Russia (often called the BRIC countries).
4. Drastic worldwide changes present dynamic challenges to global managers, including the political and economic trend toward the privatization of businesses, rapid advances in information technology, and the management of offshore human capital. In 2009, global economic woes were causing a resurgence of protectionism and nationalism around the world.
5. Global managers must be aware of political risks around the world that can adversely affect the long-run profitability or value of a firm. International managers must evaluate various means to either avoid or minimize the effects of political risk.
6. The risk of terrorist activity represents an increasing risk around the world. Managers have to decide how to incorporate that risk factor in their strategic and operational plans.
7. Economic risk refers to a country's ability to meet its financial obligations. The risk is that the government may change its economic policies, thereby making a foreign company unprofitable or unable to repatriate its foreign earnings.
8. The regulatory environment comprises the many different laws and courts of those nations in which a company operates. Most legal systems derive from the common law, civil law, or Islamic law.
9. Use of the Internet in e-commerce—in particular, in business-to-business (B2B) transactions—and for intra-company efficiencies is rapidly becoming an important factor in global competitiveness.
10. The appropriability of technology is the ability of the innovating firm to protect its technology from competitors and to obtain economic benefits from that technology. Risks to the appropriability of technology include technology transfer and pirating and legal restrictions on the protection of proprietary technology. Intellectual property can be protected through patents, trademarks, trade names, copyrights, and trade secrets.

Discussion Questions

1. Poll your classmates about their attitudes towards "globalization." What are the trends and opinions around the world that underlie those attitudes?
2. Describe the recent effects of financial globalization on the **world** economy. What actions have governments taken to offset **negative** effects? Are they working?
3. How has the economic downturn impacted trends in protectionism and nationalization?
4. Discuss examples of recent macropolitical risk events and the effect they have or might have on a foreign subsidiary. What are micropolitical risk events? Give some examples and explain how they affect international business.

5. What means can managers use to assess political risk? What do you think is the relative effectiveness of these different methods? At the time you are reading this, what countries or areas do you feel have political risk sufficient to discourage you from doing business there?
6. Can political risk be "managed"? If so, what methods can be used to manage such risk, and how effective are they? Discuss the lengths to which you would go to manage political risk relative to the kinds of returns you would expect to gain.
7. Explain what is meant by the economic risk of a nation. Use a specific country as an example. Can economic risk in this country be anticipated? How? How does economic instability affect other nations?
8. **Discuss the importance of contracts in international management. What steps must a manager take to ensure a valid and enforceable contract?**
9. **Discuss the effects of various forms of technology on international business. What role does the Internet play? Where is all this leading? Explain the meaning of the "appropriability of technology." What role does this play in international competitiveness? How can managers protect the proprietary technology of their firms?**
10. Discuss the risk of terrorism. What means can managers use to reduce the risk or the effects of terrorism? Where in the world, and from what likely sources, would you anticipate terrorism?

Application Exercises

1. Do some further research on the technological environment. What are the recent developments affecting businesses and propelling globalization? What problems have arisen regarding use of the Internet for global business transactions, and how are they being resolved?
2. Consider recent events and the prevailing political and economic conditions in the Russian Federation. As a manager who has been considering investment there, how do you assess the political and economic risks at this time? What should be your company's response to this environment?

Experiential Exercise

In groups of three, represent a consulting firm. You have been hired by a diversified multinational corporation to advise on the political and economic environment in different countries. The company wants to open one or two manufacturing facilities in Asia. Choose a specific type of company and two specific countries in Asia and present them to the class, including the types of risks that would be involved and what steps the firm could take to manage those risks.

Internet Resources

Visit the Deresky Companion Website at www.pearsonhighered.com/deresky for this chapter's Internet resources.

CASE STUDY

Indian BPOs—Waking Up to the Philippines Opportunity?

Since the mid-1990s, Business Process Outsourcing (BPO) firms have been one of the largest job creators in India, redefining pay scales and the work environment for many young Indians. The sector witnessed a flurry of activity in 2004-05, with many multinational companies (MNCs) and Indian companies increasing operations and therefore their hiring numbers. A number of mergers and acquisitions within the sector also signified maturity and consolidation for the industry. The number of captive and third party service providers added up to about 400 companies in the Indian BPO sector. According to industry experts, an educated, young and English speaking population and the cheaper bandwidth were the key factors behind this growth.

In addition to India, outsourcing companies were looking at Singapore, China, the Philippines, and Malaysia as outsourcing destinations. In the mid-2000s the Philippines emerged as a promising outsourcing destination for the western world. Indian companies too started establishing operations in the country. By 2008, companies such as Sitel, Genpact, and Citibank had already set up offices there, and were even shifting local talent from India to fill up senior and middle level management positions in the Philippines.

In 2008, the BPO industry had been in India for about a decade. In these ten years, it had shown tremendous growth and was no longer limited to being an activity of global MNCs. Leading Indian information technology (FT) software and service organizations had also contributed to the growth of the BPO industry in India.

Indian companies offered a bouquet of outsourced services like customer care, medical transcription, medical billing, payroll management, and tax processing. On the strength of this growth, the government identified the information technology enabled services (ITES)/BPO sector as a key-contributor to economic growth, and offered them benefits like tax holidays, previously enjoyed by the software industry. In 1999, after the deregulation of the telecom industry, national long distance and international connectivity also became open to competition.

India's success as an outsourcing destination was attributed to these reasons—an abundant, skilled, and English speaking manpower; high-end telecom and infrastructure; strong quality orientation within the industry; India's location on the map which allowed it to leverage on time zone differences; a positive policy environment that encouraged investment in the industry; and an attractive and friendly tax structure. NASSCOM[1] surveys showed that Indian companies were more focused on maintaining quality and performance standards. For overseas companies, outsourcing to India offered significant improvements in quality and productivity on crucial parameters such as number of correct transactions, number of total transactions, total satisfaction factor, number of transactions/hour, and the average speed of answers. Indian companies adhered to metrics much better than the peers in some other countries.

The Indian ITES/BPO industry also recorded a growth rate of over 50 percent in the year 2002-03.[2] All these were viewed by experts as an indication of the success and the growth that the industry would enjoy in the future. According to research firm IDC India, India's exports of ITES/BPO services in 2005 were estimated at Rs. 311.91 billion. This was expected to grow at a compound annual growth rate of 26 percent through 2010 to Rs. 1101.75 billion by 2010.[3]

Despite the growth story and promises of a rosy future, industry experts felt that the Indian BPO industry was losing its sheen. There were many reasons for this, the strength of the rupee and the weakening dollar being among the main ones. With the US economy slowing down and market forecasts also being glum, the industry was beginning to feel the heat. Quite simply, with the dollar weakening, the rupees per dollar received went down, affecting the profitability of all international players. To add to their woes, the Indian government was unwilling to extend the STPI (Software Technology Park of India) tax holiday for BPO units beyond 2009. The estimate was that the effective tax rate would be 20 percent once the exemption was removed, as opposed to about 7 percent[4] (approximately) with the tax holiday, and this would put BPO margins under tremendous pressure. The growing infrastructure and transportation costs were also putting more pressure on the margins. The Indian industry faced issues like poor infrastructure, high spending on transporting people, and above all, no incentive of low taxes.

In contrast, countries like the Philippines had world class infrastructure and ten-year tax breaks, and were culturally a better fit owing to 50 years of colonial influence. They had a young, educated workforce, and a history of close ties with the US. Their culture was much more Americanized. The wage structure also was higher than that in India, but the affinity to Western culture and the conversational American-style English that Philippine BPOs offered mattered more to most Western companies. The good basic infrastructure, good language skills, and lower taxation rates were ultimately what made companies favour the Philippines vis-a-vis India. According to research firm IDC, Philippines' capital Manila has already emerged as the #2 among outsourcing destinations in the Asia-Pacific, behind Bangalore.[5]

The statement of Pramod Bhasin, CEO of Genpact, sums up the feeling of major BPO operators in India: "The amount of additional costs I have to bear to do business in India is massive. In The Philippines I don't have to spend a dime on transporting employees—a luxury I can't afford in India. The government there spends $100 million exclusively to train people specific to BPOs' requirements and we get a ten-year tax break. I won't say we can completely shift operations somewhere else in the near future, but it is a definite Plan B."[6]

[1] NASSCOM (acronym for National Association of Software and Service Companies) is the premier trade body and the chamber of commerce of the IT industry in India.
[2] www.outsource2india.com
[3] "India's ITeS-BPO Industry Ready to Face New Challenges; Skilled Manpower, Processes and Enabling Technology 'on tap' to Fuel Future Growth Prospects, says IDC," www.idcindia.com, October 12, 2006.
[4] T. R. Vivek, "Indian BPO Industry in for Tough Times Ahead," *The Economic Times,* April 4, 2008.
[5] "Indians Write the BPO Script in Philippines," http:/economictimes.indiatimes.com, July 22, 2008.
[6] T. R. Vivek, "Indian BPO Industry in for Tough Times Ahead," *The Economic Times,* April 4, 2008.

Additional Readings and References

1. **"India's ITeS-BPO Industry Ready to Face New Challenges; Skilled Manpower, Processes and Enabling Technology 'on tap' to Fuel Future Growth Prospects,** Says **IDC,"** www.idcindia.com, October 12, 2006.
2. **"A Brief History of BPO in the Philippines,"** http://manilamuse.typepad.com, June 4, 2007.
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5. Paul Ancheta, **"Manila Calling,"** www.PaulAncheta.com (Retreived on July 24, 2008)
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Author Information: This case was written by **Barkha Modi** under the direction of **Debapratim Purkayastha,** ICMR. It was compiled from published sources, and is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation. M«

Case Questions

1. How has the global economic downturn, discussed in the opening profile and throughout this chapter, impacted jobs outsourcing in the BPO industry?
2. Referring to this chapter and this case, discuss the general trends in the globalization of human capital.
3. What are the effects of the Indian government policies on the Indian BPO industry and on MNC decisions regarding locations for outsourcing jobs?
4. How does this case highlight the threats and opportunities facing global companies in developing their strategies?