Chapter 2: International economic systems and comparative management

Aims of the chapter

This chapter aims to provide a comparison of different national economic systems and how these differences affect the strategic choices of firms that operate within them.

You will be exposed to questions about the relationship between domestic economic organisation, national competitiveness and growth. The implications of Michael Porter’s Diamond model of international competitiveness will also be presented and critiqued from a variety of points of view. The role of specific corporate modes of organisation, national culture, labour relations and financial management will also be presented in order to assess the challenges facing managers as they attempt to service the different markets in which they produce and sell goods.

Learning objectives

By the end of this chapter and the relevant reading, you should be able to:

• identify the major features of the leading world economies and the differences between them
• discuss the validity of the term ‘national competitiveness’ as well as its determinants
• explain the different ways that governments can become involved in the economy
• describe the significance of cultural factors and the areas where they affect business
• outline the role of technological change on business strategy and organisation.

Essential reading

Gilpin, R. Global political economy. Chapters 7–9.

Recommended reading

Griffin, R.W. and M.W. Pustay International business: a managerial perspective. Chapters 1, 3, 10, 16 and 20.
Further reading

Krugman, P. ‘Competitiveness: a dangerous obsession’, *Foreign Affairs* 73(2) 1994a, pp.28–44.

Works cited


Introduction

Some indication of the complexities of management has already been given in unit 107 *Introduction to business and management*. That unit focused mainly on the various internal challenges and functions of management. However, business is increasingly conducted across borders and so it is ever more important to take into account the external environment in which it takes place. This will vary over time and between locations.

In the previous chapter we saw some of the features of the world economy, as well as a consideration of the theory behind trade and capital flows. This chapter will take a more disaggregated view of the world in recognising that there are several varieties of capitalism (VOC) which coexist.¹ First it

¹ For a thorough review of this literature, see Peter Hall and David Soskice, *Varieties of capitalism* (2001).
will examine some of the different economic systems which exist in which multinational companies operate and will then ask what it is that determines the success of an economy.

The latter part of the chapter will then go on to consider the ways in which the external factors embedded in the economic system in which the firm operates affect firms and the different managerial solutions that result.

Underlying this chapter is the theme that most management responses are heavily influenced by the environment in which business is being conducted. What may be an optimal strategy or structure in one economy could be sub-optimal in another due to different social, economic or political elements.

**Comparative economic performance: North America, Europe and Far East**

The developed world economy is dominated by what has come to be known as the **Triad**. This comprises the United States of America, the European Union and Japan, which together account for around 64 per cent of the world’s output in current (2007) prices or 50 per cent in PPP. Although each of its members is a modern, capitalist economy, there are important differences between the structure and the economic performance of the Triad. In addition, for political, historic, geographic or economic reasons, each of the Triad members tends to have close links with other countries in its region: the USA with Canada, Mexico and South America; the European Union with Eastern Europe, the Middle East and Africa; Japan with various developing Asian economies.²

It is interesting to examine comparative economic performance from two perspectives:

1. In order to identify the macroeconomic characteristics relevant to doing business in each region, we need to ask questions such as how fast is economic growth and how high are income levels?

2. To know what the lessons for developing economies are, we need to ask which policies are most effective and what are the determinants of economic success?

In the immediate post-Second World War period the United States’ economy was pre-eminent, as Europe and Japan struggled to rebuild their war-ravaged industrial base. Over the past half century these two Triad members have gradually caught up with the US and the situation in the first decade of the twenty-first century is one of rough equality. Table 2.1 shows the total value of output of the Group of Eight (G8) economies and the level of income per person.³

<table>
<thead>
<tr>
<th></th>
<th>GDP Bn US$</th>
<th>GDP per head US$</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>13,808</td>
<td>45,721</td>
</tr>
<tr>
<td>Japan</td>
<td>4,382</td>
<td>34,296</td>
</tr>
<tr>
<td>Germany</td>
<td>3,321</td>
<td>40,400</td>
</tr>
<tr>
<td>France</td>
<td>2,594</td>
<td>42,034</td>
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<td>UK</td>
<td>2,804</td>
<td>46,098</td>
</tr>
<tr>
<td>Italy</td>
<td>2,104</td>
<td>35,745</td>
</tr>
<tr>
<td>Canada</td>
<td>1,436</td>
<td>43,684</td>
</tr>
<tr>
<td>Russia</td>
<td>1,290</td>
<td>9,075</td>
</tr>
</tbody>
</table>

**Table 2.1: G8 GDP statistics 2007**

Source: IMF World Economic Outlook (October 2008).
Japan appears to be well behind most of the others, this is largely because of the economic recession and deflation that Japan experienced throughout the 1990s.

**The United States**

The US dominates the economies of the North and South American continents. With 36 per cent of the region’s population it has an annual GDP of $13.8 trillion per year which is 85 per cent (current prices) and 84 per cent (PPP) of the region’s total and 21 per cent of world output (in PPP) and 25 per cent (current prices). International trade is a relatively small, but growing part of the US economy – in 2006 exports of goods and services made up 12 per cent of GDP compared with 7.3 per cent only two decades earlier. Perhaps unsurprisingly, two of its three biggest trade partners are its neighbours and partners in NAFTA, Canada and Mexico, which take almost one third of US exports (the other is China).

![Figure 2.1: Real GDP growth rates, percentage change per year](image)

*Source: IMF World Economic Outlook (April 2008).*

As can be seen from Figure 2.1, the growth rate of the US economy over the past three decades has been averaging 2.5 per cent per annum. During that time the US experienced three recessions (defined as two or more successive quarters of negative GDP growth), two (1982–3 and 1991–2) as a result of interest rates rising to stamp out inflation and the third (2001–2) due to the bursting of the dot-com bubble. In 2008, the United States is entering its fourth recession in the past 25 years, this time due to the Credit Crunch and the collapse of international financial markets.

Even for an OECD country, an unusually high proportion of the US economy is devoted to the production of services, which accounted for 77 per cent of GDP in 2006, up from 74.8 per cent of output in 1993. Some observers criticise the high dependence on services and relatively low proportion of manufacturing. They see it as a sign of economic weakness which will result in the US falling behind its competitors. They argue that it matters greatly what Americans do for a living and that there is a difference in potential incomes between ‘those who produce microchips and those who serve potato chips’. Others are less concerned and point out that some of the most dynamic global industries of the past decade have been in the service sector: telecommunications, financial services, and computer software. Certainly the major burst of economic growth the United States experienced in the last years of the 1990s was due in large measure to technological innovation, especially in the realm of information technology.
The US is often portrayed as the world’s most unregulated and liberal capitalist economy. It has relatively low levels of taxation, little public ownership of productive facilities and limited social welfare. Historically the government has used macroeconomic policy tools such as interest rates and fiscal policy to try to control the economic cycle, but has eschewed industrial policy. Some would argue that the R&D element in the defence budget amounts to a closet industrial policy. The Credit Crunch and failure of numerous large international financial institutions has led to a rethinking of the relationship between state and society in the United States with a massive $700 billion bailout and part-privatisation of the financial services industry accompanying calls for greater regulation of financial institutions and even suggestions that the government either purchase or guarantee all home mortgages.

Activity
What are the key distinguishing features of the US economy? What explains their persistence in the United States and are they different from those that exist in other major developed economies?

Japan

The post-war success of Japan is such that it is now the second largest economy in the world, with a GDP of $4.4 trillion. Although it was hit by a serious recession in the 1990s in reaction to an asset price inflationary bubble in the late 1980s, it still enjoys a large trade surplus and is the largest creditor nation in the world. Partly because there was an element of ‘catching-up’, Japan’s growth rate was more rapid than that of the US from the 1950s through 1990 (in the 1960s, Japanese GDP growth averaged 10 per cent), but now that both economies are at similar levels of development the differential has been reduced.7

The US remains Japan’s largest trading partner but, in recent years, the increasingly prosperous Asian economies have risen in importance, especially China. Japanese exports now lean more towards Asia and less towards the US, while the focus has shifted from consumer goods to capital goods, primarily for the rapidly developing Chinese market.

Although Japan is a capitalist economy, it is very different from the US. Public ownership of production is low, especially after the privatisation of the telecommunications, railways and tobacco industries in the 1980s. In spite of gradual, but incomplete, liberalisation in recent years it is still quite a highly regulated economy and the government oversees many aspects of economic activity. Another feature that distinguishes Japan from other OECD countries is the low level of inward FDI.

Activity
What are the key distinguishing features of the Japanese economy? What are the main differences between the Japanese and US economies?

The European Union

Although the economies of the 27 members of the European Union (EU) are closely tied together (at least half of the exports of each country go to other EU members), their economic structures are still surprisingly different. In spite of the increased co-operation and convergence which results from initiatives such as the Single European Market and the introduction of the euro, national identities remain strong. The Single
European Market programme was aimed at eliminating all restrictions on the movement of goods, services, labour and capital within the European Union. The Maastricht Treaty provided for closer co-operation on defence and foreign policy matters and led to the creation of a single European currency, the euro, now used by 17 EU countries.\(^8\) The German economy dominates the European Union (especially after the 1990 reunification of the country), but to a lesser extent than the US dominates North America.

There are several distinct forms of economic structure apparent in Europe. Germany has been described as a social market economy, where in the so-called ‘German Model’ the various economic actors (management, unions, government) act in a co-operative fashion.\(^9\) France has been classed as a dirigiste system, where the government takes an active role in guiding the economy using both industrial policy and direct public ownership. Since the advent of Margaret Thatcher in 1979, the UK moved towards the liberal US brand of capitalism, following a programme of privatisation and deregulation, a process that was continued under the Labour government of Tony Blair (1997–2007).\(^10\) In contrast, northern European economies such as Denmark, Sweden and Finland are typified by high levels of taxation and equally high provision of social welfare.\(^11\) The movement towards deregulation in the 1980s and 1990s has led to an erosion of the German and Scandinavian models as less government intervention and greater reliance on market-based solutions have come to challenge the ‘organised capitalism’ that had previously governed the political economy of these societies.

High levels of economic integration mean that growth rates among the major countries are fairly similar. Between 1973 and 2003 average EU growth was two per cent and, of the four main European economies, the weakest was Germany, averaging 1.72 per cent, then the UK (2.15 per cent), Italy (2.17 per cent) and France (2.2 per cent). Although the difference may not appear dramatic, the effect of compound growth meant that at these rates it would take Germany 41 years to double output while France would only take 32 years.\(^12\) A country growing at 10 per cent a year (China for example) would take just seven years to double output.

**Activity**

What are the key distinguishing features of the European Union’s economy? What are the main differences between it and the economies of other major developed countries?

### Other regions

Outside the OECD only Asia saw an identifiable improvement in per capita income between 1973 and 1992. In other areas, the output growth that did take place was shared among a rapidly increasing population, resulting in stagnant GDP per capita.

<table>
<thead>
<tr>
<th>Region</th>
<th>GDP</th>
<th>GDP per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eastern Europe</td>
<td>1.19</td>
<td>0.87</td>
</tr>
<tr>
<td>Africa</td>
<td>2.97</td>
<td>0.32</td>
</tr>
<tr>
<td>Latin America</td>
<td>2.75</td>
<td>0.83</td>
</tr>
<tr>
<td>Asia (excl. Japan)</td>
<td>5.71</td>
<td>3.88</td>
</tr>
</tbody>
</table>

**Table 2.2: Comparative growth (per cent) of non-OECD regions 1973–2003**

*Source: Adapted from data given in Maddison (2007).*
This apparent ‘success’ of Asia (in particular East and South East Asia) led to discussion of whether an Asian model existed and whether there were lessons for other developing countries. In a 1993 report titled *The East Asian Miracle*, the World Bank argued that Asia’s success was due to the efficient functioning of free markets and not to active government guidance of the economy. While there are some common features, it is important to recognise that there are some major differences in the development paths of each of the Asian Tigers (Korea, Taiwan, Hong Kong and Singapore) and the Asian ‘Cubs’ (Malaysia, Thailand, Indonesia and some of China’s coastal provinces). A list of similarities (which do not necessarily apply in all cases) includes:

- high rates of domestic savings, foregoing consumption for investment and reducing the need for foreign borrowing
- high rates of capital investment, from domestic and/or foreign sources
- a stable political situation, accompanied by an enlightened bureaucracy
- relatively few distortions to the price mechanism
- policies which stress the importance of exporting, which has generated funds to buy capital goods imports
- rapid shift of labour from agriculture into the industrial sector
- land reform which helps to create a domestic market for basic consumer goods
- relatively high levels of education – good human capital.

The 1997 East Asian financial crisis brought many of these assumptions into question. What had previously been seen as an enlightened bureaucracy and ‘trusting’ relations between regulators and those industries they regulated came to be seen as ‘crony capitalism’ rife with insider dealings. The stable political situation in many countries – Indonesia and Thailand, for example – disintegrated when economic conditions deteriorated. A subsequent World Bank investigation into the circumstances surrounding the East Asian crisis blamed poor governance structures and a lack of transparency for sowing the seeds of the crisis.\(^{13}\)

**Activity**

How many of the points in the list above apply to your country and what can be done to improve matters? Much of the statistical data can be found on the web pages of the UNCTAD, IMF and World Bank. Economic surveys of your country or region can also be found periodically in *The Economist* and the *Financial Times*.

In contrast, those countries which failed to develop significantly (notably those in Latin America) frequently displayed opposite features from those listed above: political instability, low savings and investment rates, dependence on foreign borrowing, low education levels, no land reform and misallocation of resources due to price distortions.

More recently Krugman has argued that Asia’s success is not the miracle that some claim, but purely the result of using a greater amount of inputs such as labour and capital.\(^{14}\) Increased inputs produce increased output. In fact the experiences of Asia’s dynamic economies are so different that it is highly debatable whether any general lessons can be learned and even more debatable whether the experience can be transferred to countries with entirely different social and institutional structures.\(^{15}\)


\(^{14}\) Krugman (1994).

Activity
Which form of capitalism best describes the system that operates in your country? What are its main features? Be sure to think about the relationship between government and development, the primary sources of business finance and the role of trade unions.

National economic growth and competitiveness

From the above description of the major world economies it should be clear that there is no single economic system which receives general approval. Perhaps the one lesson of the past two decades is that we know which economic system doesn’t work: the failure of the former communist countries of Eastern Europe to produce efficiently, innovate or grow resulted in their collapse in the late 1980s. It is worth considering exactly what are the factors which determine levels of growth or national competitiveness.

Porter used a diamond to demonstrate his theory of competitiveness.\(^{16}\) Figure 2.2 shows his framework, where the four corners of the Diamond are:

- **Factor conditions:** classical trade theories (Ricardo, Heckscher-Ohlin) argue that the resource endowments of a country determine its pattern of trade. To this Porter adds the ability of a nation to improve its factors of production and to allocate them efficiently.

- **Demand conditions:** firms which face active competition and a sophisticated consumer base in home markets will be better prepared to compete internationally.

- **Related and supporting industries:** where a firm is operating closely with other industries, factors such as timeliness of product and information flows, and general co-operative behaviour are crucial to competitiveness.

- **Firm strategy, structure and rivalry:** these are the conditions which determine how firms operate and the nature of competition. Porter argues that no single managerial, ownership or operational strategy is universally appropriate.

The role of government is one of maintaining and shaping the efficient working of the four factors outlined above. That is not to say that government policy is unimportant. The government has the ability to influence almost every aspect of economic activity (although whether it chooses to do so or not is another question).

Porter’s theory has been criticised from several perspectives.

- **We need to consider what is meant by the term ‘national competitiveness’**. Is it a relative or an absolute concept? Is competitiveness a ‘zero sum game’: that is, does an increase in one country’s competitiveness automatically imply a similar decline in another country’s? Competitiveness is a term which is easily applied to companies, but more problematic when analysing countries. Porter argues that it is misleading to look at the competitiveness of a nation as a whole and concentrates instead on trying to explain what causes productivity and productivity growth.

- **Dunning has argued that Porter’s Diamond neglects the impact of international production.** Foreign production of multinational corporations now exceeds the value of exports, so it is a mistake to underestimate their role in determining national competitiveness.\(^{17}\)

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\(^{16}\) See Porter (1990).

Stopford and Strange argue that Porter can explain average national competitiveness, but cannot explain why the points in his Diamond are having a different effect on different companies. It tells us nothing about why one firm succeeds and another fails and it could even be argued that it does not explain why one industry succeeds and another fails.¹⁸

Krugman questions the value of competitiveness when applied to a nation rather than a corporation.¹⁹ He argues that, while firms may be competing with each other in a zero sum game, the same is not true for nations as a whole. Greater prosperity of one country tends to imply higher demand for products from other countries, which in turn boosts their economies. Note the problems encountered in various South East Asian economies in the early 1980s when the United States – their major market – went into recession.

Krugman asserts that it is wrong to talk about a nation’s competitiveness, because what we are really interested in is productivity and productivity growth. To Krugman the discussion on competitiveness is a ‘dangerous obsession’ because it invites government to interfere in the economy and the government lacks the information to direct resources more efficiently than the market.

**Activity**

Who is right? Does the government have an important role to play in improving national competitiveness? If so, what sort of measures can it take?

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¹⁸ Stopford and Strange (1991) p.75.
Partial excellence

No country is good at everything. The productivity and flexibility of Japanese manufacturers may be legendary, but its distribution system is highly inefficient. China excels in the production of labour-intensive goods, but has an under-developed financial sector. The UK has become a financial centre, but has lost much of its industrial base since the 1980s. Germany is extremely competitive at making machine tools, quality automobiles and pharmaceuticals, but is weak in consumer electronics and has a weak service sector. The US leads the world in computer software, telecommunications and high-tech electronics, but has seen its consumer electronics and automobile sectors battered by foreign competition.

Note also that it is extremely rare for a country to dominate an industry entirely. Japan makes excellent automobiles, but that does not prevent countries from Sweden to Brazil from competing. Trade between developed economies is largely of the ‘intra-industry’ variety; that is, even though Germany sells machine tools to the US, the US also sells machine tools to Germany.

Activity

In which sectors does your country excel? Consider your country’s primary exports and industries in which it is extremely competitive either internationally or domestically (perhaps, financial services or tourism).

Government–business relations

In the first decade of the twenty-first century, most governments in the developing world welcome investment from foreign companies. There are three attitudes. Some governments make an effort to secure foreign direct investment. Others treat foreign firms as they do domestic firms, which is called national treatment. A declining minority treat foreign investment with suspicion and discriminate against it. This has not always been the situation in the past 50 years.

Post-war relations between states and firms can be broken down into three periods:

- **1945 to 1960s**: firms dominant. Eager to rebuild after the devastation of the Second World War, many countries readily accepted investment indiscriminately. Firms were also seen as bringing foreign exchange, jobs and technology.

- **1960s and 1970s**: conflict. An ideological shift combined with cases of exploitation by multinational corporations, resulting in greater tensions between states and firms.

- **1980s to present**: co-operation. Each side recognises the importance of good relations with the other. The recent financial crisis has brought some of these assumptions into question, as lack of regulation is widely blamed for excessively risky investments and the ensuing ‘Credit Crunch’.

There is a bargain between the state and the firm inherent in any FDI, as each side has resources that affect the other. This bargain will vary depending on the resources and strategy of the firm, the ideology of the state and conditions in the host market.20

In OECD countries the debate was focused after the 1980s (and continues to this day) when huge US current account deficits necessitated equally large inflows of foreign capital. Part of this came in the form of FDI, 20 Strange’s article in Frieden and Lake (2000) examines the relations between states and firms in the modern world economy.
a large proportion of which was made by Japanese companies. Two divergent schools of thought emerged in the US. The first saw FDI as jeopardising the future of the US economy. Some of the views are summarised by Omestad who argues that America's relative openness to FDI makes it overly dependent on others, while it brings few benefits in terms of employment.\(^\text{21}\) The other view is that FDI is benign. Reich argues that investment creates jobs for Americans, irrespective of who owns the facilities.\(^\text{22}\) Coughlin claims that FDI benefits the host country as it promotes trade, results in technology transfer and imposes a competitive discipline on US firms.\(^\text{23}\)

More recent concerns in the United States about national security have led to heightened interest in the identity of foreign owners of US-based assets. The attempt in 2006–7 by Dubai Ports World to purchase and operate a number of American ports through one of their British subsidiaries foundered amid American fears of foreign (especially Middle Eastern) control of American points of entry. Domestic political opinion and biases can play an important role in whether or not foreign investment is welcome. Many countries, especially in Latin America, are wary of allowing control over their nation's raw materials to fall to US-based TNCs. The issue is whether governments should act to restrict or attract FDI, or whether FDI should receive the same treatment as domestic investment. Countries taking a positive view towards FDI – and these range from Ireland to Mexico – offer an array of incentives. These can include:

- tariff protection to give the investing firm an advantage in the host market
- duty-free imports to lower production costs
- financial assistance in the form of grants or low interest loans
- tax concessions such as tax holidays
- reduced transaction costs by cutting red tape.

**Activity**

Which are the main sectors where FDI takes place in your country? Do you think foreign direct investment is a benefit to your economy that should be encouraged? Be conscious of its direct economic effects in terms of employment, whether there is a transfer of skills and technology as well as its economic and social consequences in terms of issues such as income inequality, the environment and cultural autonomy.

Incentives are more likely to be useful in determining the location of an investment, rather than whether it takes place at all. It would be a rash company which made an investment whose profitability was dependent solely on incentives from the government.

**Activity**

What sort of incentives are available to foreign firms investing in your country?

Other countries have been less welcoming to FDI. In the past these have ranged from Japan and Korea to several of the more socialist African economies. Barriers could include:

- entry and takeover controls to prevent dominance by foreign firms
- prohibition or limitation of foreign ownership – sensitive industries are reserved for domestically-owned companies
- requirements for domestic-based partners
- controls over natural resource extraction


\(^{22}\) See Reich in Ohmae (1995).

• expropriation – simply taking over the foreign company
• performance requirements such as having a target that a certain proportion of output be exported
• financial and fiscal controls, perhaps to prevent transfer pricing.

It is also possible for the home (as opposed to host) country to become involved in the process of outward FDI. It can encourage through the use of financial benefits such as risk insurance or tax breaks, or it can discourage using administrative requirements or controls on capital outflows.

The bargain struck between the firm and the state becomes obsolete. That is, over time the firm has less to offer the state, while the state has less need of the firm. Unless there is need for a constant transfer of technology there will come a point where the foreign firm will no longer be able to sustain any preferential treatment it received at the time of the initial investment.²⁴

[See the discussion of FDI earlier in this guide, pp.30–32.]

### Business organisation and strategic management

Legal, corporate and institutional features all play a part in determining the most appropriate means of servicing a market. One of the implications of different forms of capitalism is that there are also different types of business organisation.

In the US the emphasis is on competition. There are few areas of the economy not exposed to competitive pressures and this is reflected in corporate structures. Apart from in finance (and to a lesser extent, telecommunications), there are few restrictions on corporate structures. Anti-trust legislation exists to ensure that no company acts in a monopolistic fashion. This contrasts with Japan where the economy is dominated by *keiretsu*, or industrial groupings, where firms in specific industrial sectors are linked through a system of cross-shareholdings, at the centre of which is a powerful bank. In many ways these are similar to the *chaebol* in South Korea.

Again the situation in Europe is more complex. At one extreme is the UK, which is similar to the US system in that the emphasis is on competition and financing via the capital markets. In Germany, there is far more regulation and the links between the commercial banks and companies has traditionally been more important than financial markets. In recent years, the growth of stock markets in Germany as a cheap and alternative form of financing has brought the so-called ‘German model’ into question. Aspects of the French system are similar to those in Japan in that the state interacts closely with firms and there is not the automatic belief that exists in the Anglo-American systems that the ‘consumer is king’. The French *dirigiste* system has historically allowed limits on competition if this was seen as benefiting industrial development in the medium term.²⁵

These different systems have implications for organisational strategy. For example, it is unlikely that a Japanese chemicals company would diversify into pharmaceuticals, because there would already be another company in the same *keiretsu* fulfilling that function. In contrast, there is little to stop a UK mining company from buying a hotel chain, if it so desires.

Strategic management relates to the way in which a company organises the resources at its disposal to achieve its objectives. Strategies will depend partly on the environment in which the firm is operating (exogenous

²⁴ See Tarzi in Frieden and Lake (2000) for more details of the bargain process.

factors), but other factors are internal to the firm (they are endogenous). One endogenous influence on corporate strategies appears to be the ownership structure of the firm.\textsuperscript{26} It is sometimes claimed that the reliance of the Anglo-American system of finance through equity markets creates a tendency towards ‘short-termism’ in management, due to the need to produce dividends to satisfy shareholders. Short-termism is the phenomenon whereby companies maximise short-term profits and short-term dividends payments, which helps to keep its share price high and ward off hostile takeover bids (again, only in the short-term). Such a strategy can come at the expense of longer-term considerations such as R&D or market share. By contrast, Japanese and German companies tend to rely more heavily on bank finance, where the lenders have more of an interest in the long-term prospects of the company, rather than pressing for short-term profits. This may be one of the reasons why Japanese companies pay more attention to increasing market share, rather than profits. However, in recent years German firms have increasingly turned to equity markets for financing and major firms like Daimler-Benz have even been listed on the New York Stock Exchange.\textsuperscript{27}

There is some evidence that the ownership structure of a company has an influence on its business strategy. The management of public sector companies is prone to suffering from a ‘civil service’ type of conservatism and lack of dynamism. Conversely, companies run by ‘entrepreneurs’ often find the discipline of being listed on the stockmarket as being too restrictive. A notable example is that of Virgin Group, run by the British entrepreneur, Richard Branson. Virgin listed on the stockmarket in 1988 but, in 1990, Branson took it private again, as he felt that institutional investors had an overly conventional approach to business and were unable to understand a strategy which has seen Virgin diversify from music to airlines, financial services, cable television and even soft drinks.

\textbf{National and corporate cultures}

It has already been shown that vastly different forms of capitalism exist through the world economy. Part of these differences can be explained by cultural factors which affect institutional structures, the legal framework, the effectiveness of organisational forms and social attitudes. Culture can be defined as the collection of values, behaviour and attitudes that distinguish one society from another. Examining culture on a national basis is dangerous ground and risks descending into a refined form of racial stereotyping. Some may claim to be able to distinguish between the more ascetic Protestant northern Europe and the less dynamic Catholic south. Others see differences between Confucian East Asian societies with strong family ties and an acceptance of authoritarian hierarchies, and the more individualist US.\textsuperscript{28} Even if these are valid distinctions in a world where there is a trend towards cultural homogenisation as a result of mass media penetration and the use of English as the worldwide business language, there is still a question of the usefulness of such classifications.\textsuperscript{29}

Griffin and Pustay identify five basic elements of culture.\textsuperscript{30}

1. **Social structure.** Which societal groupings are important? What is the stratification of society, how do the strata interact and is there mobility between levels?

Western cultures tend to frown on giving jobs or contracts to members of the same family, as the system is supposed to be demonstrably merit-based. However, in some Chinese-owned firms, such nepotism is standard practice because of the benefits in terms of trust and loyalty.

\textsuperscript{26} Part 4 of Griffin and Pustay (2007) refers to various elements of international management.

\textsuperscript{27} Streeck (1995).

\textsuperscript{28} See, for example, the interview with Lee Kwan Yew in Foreign Affairs (1994) and the rejoinder from Kim Dae Jung, Foreign Affairs (1994).

\textsuperscript{29} Refer back to the Principles of sociology subject guide for more discussion of theories of social change.

There is also a stark contrast between the emphasis that US culture places on individualism and the team-oriented attitudes in Japan, for example. This implies different management attitudes will be needed in terms of remuneration, promotion and employment systems.

An awareness is also needed of any social stratification in society. In India the caste system may need to be taken into account when establishing a hierarchy within a firm. Similarly, in the UK the class system can be a source of tension within an organisation. Meanwhile, in Japan, differences are gender-based, with women usually finding it difficult to achieve positions of authority, due to entrenched social attitudes which override equal opportunities legislation.31

2. **Language.** What does it reveal about societal hierarchies?

In many countries the way that a person speaks conveys a message about his or her social background, but non-native speakers may have difficulty in picking up such nuances.

In spite of his good English language skills, former Soviet Union leader Mikhail Gorbachev used to speak to Americans via an interpreter in order to avoid any misunderstanding. Most businessmen do not have this luxury, leading to ample opportunities for confusion. Lowest common denominator English is becoming the standard means of communication, even when neither side is a native English speaker. The success of the UK in attracting foreign investment from Japan, China and other East Asian economies is partly attributable to the fact that English is the most studied foreign language in those countries, which makes the process of living and doing business in the UK easier than in continental Europe.

Language is also important in product names and advertising. Ford chose the name Mondeo only after it had established that it had no negative meaning in any major market. Other firms have not been so far-sighted and there are endless examples of products whose names have unfortunate meanings in other languages. Few Americans would be likely to savour the Japanese soft drink Pocari Sweat, for example.

3. **Communication.** Do people communicate explicitly or is context more important? What types of non-verbal communication exist? How do negotiating styles differ? What is the etiquette regarding gifts and hospitality?

Much has been written about the use of body language in communication, with different cultures having different physical attitudes. Similar differences apply to spoken language, where what is not said is often as important as what is voiced and certain phrases have different meanings for different people. In the 1980s, US trade negotiators frequently used to think they had succeeded in obtaining promises to open up the Japanese market, while the Japanese interpreted the discussions as producing a delay, due to differing interpretations of the same phrases.

Business etiquette is important, from exchanging business cards to giving gifts. In Japan, sending valued clients summer and year-end gifts is a perfectly normal – indeed necessary – practice. However, in the US such offerings could be construed as bribes and could actually lose a firm business. In Europe the situation is more confused, and recent scandals in Italy are leading to a reassessment of where the line lies between corporate hospitality and corruption.

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4. **Religion.** What are the values of the dominant religion and how strong is its influence?

Awareness of the religious norms of a country is important for successful operations and marketing in any culture. However, over-sensitivity can also mean lost opportunities, especially in more developed economies, as religious devotion tends to decline with income levels. Nevertheless, religion provides the background to many attitudes within a society, with the initial rise of Western Europe attributed to the Protestant work-ethic by Weber,32 or the more recent emergence of East Asian economies linked to Confucian attitudes towards authority.

5. **Values and attitudes.** Consider elements such as respect for authority, education levels, age and status.

The more individualist American system tends to incorporate less respect for authority than in most other countries – to them respect is earned through actions, not titles. Similarly, Americans tend to see a 50-year-old worker as past his prime, while in other cultures the experience of older workers is highly valued and respected.

In countries where social hierarchies are less strong, educational achievement has become a proxy for ability. The Japanese ministry of finance is renowned for being staffed by graduates from Tokyo University’s law department, while in the US an MBA (especially one from Harvard or Stanford) opens many doors.

In general, it tends to be more rigid or traditional societies where a person's age, position or social class determine attitudes. These rigidities tend to break down as economies become more developed.

These elements combine in a complex web and affect any business expanding outside its national borders. However, it is worth questioning how far international business should go in making allowances for cultural differences. Many of the pitfalls offered in textbooks are banal and would be avoided by any business worker in possession of a modicum of common sense and cultural sensitivity. There is also the possibility that some workers will be attracted to foreign firms precisely because of their different cultural attitudes.

It is also possible for cultural differences to exist within countries as well as between them. Consider, for example, whether a German manager of a multinational corporation will have more in common with a similar American manager, or with a German construction worker.

It may be more productive to consider the impact of cultural differences on corporate organisation. Consider, specifically, the automobile industry. In the early 1980s, ‘the Big Three’ United States car manufacturers (Ford, General Motors and Chrysler) were under severe pressure from Japanese producers. The Japanese had developed more efficient and dynamic production systems (known as ‘lean production’), using concepts such as just-in-time inventory control and Kaizen (or continuous improvement). The American ‘Fordist’ system, based on inflexible methods and extreme specialisation, lost market share to Japanese assemblers.33

In order to ease competitive pressures on US car manufacturers, the Japanese were persuaded to impose voluntary export restraints (VERs), thereby limiting their ability to gain market share in the US by exporting. Encouraged further by a strong yen, their response was to...
embark on an aggressive FDI programme to build plants within North America. This gives us the opportunity to compare the transferability of different production systems.

Table 2.3 shows various measures of productivity under different systems. In 1989, less than a decade after the beginning of large-scale Japanese FDI in the USA, the transplant factories were able to replicate many of the features of plants in their home country. By the mid-1990s anecdotal evidence suggested that the productivity gap between American-owned plants and transplants had narrowed, as the former adopted ‘lean production’ techniques. So it appears that differences in productivity are due more to different processes than to cultural factors.

<table>
<thead>
<tr>
<th></th>
<th>Japanese in Japan</th>
<th>Japanese in America</th>
<th>Americans in America</th>
<th>European producers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Productivity (hours per vehicle)</td>
<td>16.8</td>
<td>21.2</td>
<td>25.1</td>
<td>36.2</td>
</tr>
<tr>
<td>Assembly defects per 100 vehicles</td>
<td>60.0</td>
<td>65.0</td>
<td>82.0</td>
<td>97.0</td>
</tr>
<tr>
<td>Repair area (% of assembly space)</td>
<td>4.1</td>
<td>4.9</td>
<td>12.9</td>
<td>14.4</td>
</tr>
<tr>
<td>Stocks (days for eight sample parts)</td>
<td>0.2</td>
<td>1.6</td>
<td>2.9</td>
<td>2.0</td>
</tr>
<tr>
<td>Workforce in a team (per cent)</td>
<td>69.3</td>
<td>71.3</td>
<td>17.3</td>
<td>0.6</td>
</tr>
<tr>
<td>Number of job classifications</td>
<td>12.0</td>
<td>9.0</td>
<td>67.0</td>
<td>15.0</td>
</tr>
<tr>
<td>Training of new workers (hours)</td>
<td>380.0</td>
<td>370.0</td>
<td>46.0</td>
<td>173.0</td>
</tr>
<tr>
<td>Absenteeism (per cent)</td>
<td>5.0</td>
<td>4.8</td>
<td>11.7</td>
<td>12.1</td>
</tr>
<tr>
<td>Automation (percentage of process automated)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Welding</td>
<td>86.2</td>
<td>85.0</td>
<td>76.2</td>
<td>76.6</td>
</tr>
<tr>
<td>Painting</td>
<td>54.6</td>
<td>40.7</td>
<td>33.6</td>
<td>38.2</td>
</tr>
<tr>
<td>Assembly</td>
<td>1.7</td>
<td>1.1</td>
<td>1.2</td>
<td>3.1</td>
</tr>
</tbody>
</table>

Table 2.3: Assembly plant characteristics (regional averages, 1989)

Source: Uses data adapted from The Economist (August 10, 1991).

Some companies attempt to generate a corporate culture: that is, a set of features or behavioural patterns which are peculiar to that organisation. This is related to the objective of providing a consistent service, or applying the same methodology to every situation. One of the classic examples of corporate culture was IBM, but it has largely moved away from its no-beard, white shirt, blue suit policy, perhaps in recognition of the fact that such uniformity can stifle creativity. More recently, Google has become renowned for its relaxed corporate culture and workplace filled with recreational activities for its workers, who typically come to work in casual attire. However, other companies continue to see benefits in a more regimented system which binds its workers together, improves teamwork and raises morale. It could be argued that the armed forces is the strongest example of corporate culture in most economies.

Activity

Think of some examples where cultural differences can be helpful and where they are damaging.
Technology and operations management

As the technological revolution progresses, it has an impact on international business from several angles. Its essence is the increase in information flows.

It is often claimed that there is a homogenisation of demand among world consumers, based on information flows and travel. The mirror image of this is homogenisation of production. If a firm manages its operations in an innovative fashion that gives it a competitive edge, then other firms in the same industry will soon imitate it. Witness, for example, the adoption of Japanese-style practices such as just-in-time inventory management and production techniques in the 1980s by US automobile makers. The elevation of business to a subject worthy of academic study and the profusion of journals in the field has increased the speed and the breadth at which information flows. If there is a ‘best practice’ in any field then it should be quickly adopted worldwide – the continuation of different operational systems suggests that in many cases there is no recognised ‘best practice’.

The role of technology on the operations of a firm has been a key element behind the globalisation of business. It makes possible new organisational structures and new corporate strategies. For example, the constraints previously imposed by geographical separation have dropped considerably with the widespread use of the internet, while the rapid accumulation and analysis of information make new marketing strategies possible. Indeed, the ease with which information can now be managed has led to the success of many internet-based companies such as Amazon, Expedia and products such as Apple Computer’s iTunes.34

Management of human resources

Comparisons of the unemployment rate in the Triad show three very different trends (see Figure 2.3). In Japan the unemployment rate has traditionally been low and shows little variation until recent years. In Europe it has risen sharply at times of recession, falling back less strongly during periods of growth. In the United States it is much more volatile, rising and falling with the economic cycle. Part of the difference is explained by different corporate approaches to human resource management, part to legal and social conditions.

In Japan many workers in large companies enjoy ‘lifetime employment’, where the implicit guarantee of a job for life is exchanged for co-operation from the workforce. Firms are unwilling to renege on this bargain during recessions as it will make it more difficult to hire quality workers when the economy improves – although the severity and length of the 1990s recession forced some firms to reassess the situation and brought the institution of ‘lifetime employment’ into question. The ability to retain workers for a long period of time – often their whole working life – means that training is both more important and offers better returns for the company. The importance of human resource management means that the personnel department is typically a major power centre in Japanese companies and most managers will, at some stage, have spent two or three years in personnel. During recessions the government will also provide subsidies to companies to retain excess workers and thus prevent the workers from becoming dependent on the state for support.

34 Dicken (2007) pp.75–103 examines the various dimensions of technological change.
The rise in the unemployment rate in Europe is attributed to recession when companies see profits fall and go bankrupt or lay off workers to cut costs. However, a major OECD report argues that strict labour laws and union power mean that it is complex and costly to cut the workforce. Therefore, many companies do not recruit as actively when the economy recovers, relying instead on overtime, part-time workers or sub-contracting to meet extra demand. The result is that unemployment is slower to fall in a boom than it is to rise in a recession. The US has far more liberal labour markets, making it relatively easy for firms to recruit and release labour, according to the demands of the economic cycle. The implications on human resource management of the European and American systems are similar. In neither case is there a long-term commitment on the part of either the firm or the employee. The result is less incentive to engage in training programmes, and less reason for workers to moderate wage claims in the longer-term interests of the company. The inevitable consequence is a more conflictual relationship between employers and employees.

The management of foreign investment is a highly visible area in human resources. Expatriate managers are often used initially because they are in touch with aims of head office, they are trusted to implement group policy, they have a track record and may have experience of starting up operations. The use of expatriates fades as investment matures and companies switch to local managers, who are cheaper, understand the local market and local workforce, as well as having had a chance to build up ties with the head office. Japanese companies have fewer host country chief executive officers (CEOs) in foreign plants than the USA or Europe.

Activity

Consider whether differences in human resource management in the United States are due to different management methods, or simply reflect the stage in the FDI cycle, with much of Japanese FDI occurring since the mid-1980s. Are these cultural differences conducive to the success of a firm or indicative of potential management problems?

Finance and corporate control

There have been three significant developments in the financial management of firms in recent years. First, the role of the financial managers has increased dramatically. In the US in particular an increasing proportion of CEOs are accountants, or former chief financial officers,
whereas in the past they might equally well have come from the planning, engineering or marketing departments. This reflects the growing need for a firm grasp of financial principles in running a business. Note that the winning bid for a major infrastructure project is determined as much by which company can offer the most attractive financing package, as by the engineering specifications of the bid.

A secondary issue is that the treasury department is increasingly seen as a profit centre rather than a cost centre. This was very much the case in Japan in the late 1980s when zaitech, or financial engineering, boosted the profits of many non-financial companies. Toyota's excellent credit rating and strong cash reserves led to it being known as the Bank of Toyota. This trend has spread to other OECD countries and one less attractive side effect has been a series of large losses in complex financial markets, such as derivatives by companies such as Metallgesellschaft Glaxo and Kashima Oil. American automobile companies such as GM have made large profits in their financing of consumer purchases of cars.

The most important recent development in the realm of financial management is the ongoing fallout from the credit crisis. Major industrial firms are increasingly finding it difficult to borrow money from financial institutions due to concerns about the credit-worthiness of banks and non-bank financial companies. The lack of availability of short-term capital markets to provide funds for corporations to meet their payroll, commodity, production and other operational expenses has led many firms to lay off thousands of workers and scale back operations. The consequences of this tightening of credit markets is still itself playing out, but it is having severe consequences for non-financial sector firms and their employees.

A reminder of your learning outcomes

By the end of this chapter and the relevant reading, you should be able to:

• identify the major features of the leading world economies and the differences between them
• discuss the validity of the term ‘national competitiveness’ as well as its determinants
• explain the different ways that governments can become involved in the economy
• describe the significance of cultural factors and the areas where they affect business
• outline the role of technological change on business strategy and organisation.

Sample examination questions

1. What is meant by ‘national competitiveness’ and how might governments seek to influence it? Illustrate your answer with examples.

2. What are the distinctive features of the Japanese form of capitalism compared to that of the rest of the Triad?

3. ‘In the twenty-first century every government should be aiming to attract foreign direct investment.’ Discuss.
4. Which methods could a government use to attract foreign direct investment and how advisable is such a policy?

5. Suggest some ways in which cultural factors are important to international business.

6. Which is a more important factor in international management: a firm’s corporate culture or the national culture in its home country?