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MODULE 1: IT'S A SMALL WORLD

OVERVIEW

This week we will begin our semester long journey into the world of International Business with a look at the globalization of business. After reading/viewing the module content you will complete your first written assignment. Everything that you need to successfully complete this assignment is located in the Module Assessments folder, but if you have questions – please just ask!

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Understand what is meant by “Global Business”
- Describe the general international business environment
- Identify potential impacts of globalization on business operations

DISCUSSION POST: SELF INTRODUCTION

Please begin by posting to the Discussion Forum where you will introduce yourself to your classmates. Please be sure to meet the deadlines defined in Blackboard.

Self-Introduction: You are so amazed and intrigued by the subject of International Business that you decide to change your major from general Business Administration to International Business. It is highly likely that your degree in International Business will provide you the opportunity to work in almost any country in the world. Suppose you have now graduated and are offered the “dream job” as the manager for the international division of a company …. your new company looks at you and asks you to select WHERE IN THE WORLD you would like to work. The only thing you have to do in order to get the location of your dreams is tell them not just WHERE, but WHY …. Be sure to post your response as well as respond to at least TWO of your classmates by the deadlines indicated in Blackboard.
READING: WHAT IS INTERNATIONAL BUSINESS?

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- Know the definition of international business.
- Comprehend how strategic management is related to international business.
- Understand how entrepreneurship is related to international business.

The Definition of International Business

International business relates to any situation where the production or distribution of goods or services crosses country borders. Globalization—the shift toward a more interdependent and integrated global economy—creates greater opportunities for international business. Such globalization can take place in terms of markets, where trade barriers are falling and buyer preferences are changing. It can also be seen in terms of production, where a company can source goods and services easily from other countries. Some managers consider the definition of international business to relate purely to “business,” as suggested in the Google case. However, a broader definition of international business may serve you better both personally and professionally in a world that has moved beyond simple industrial production. International business encompasses a full range of cross-border exchanges of goods, services, or resources between two or more nations. These exchanges can go beyond the exchange of money for physical goods to include international transfers of other resources, such as people, intellectual property (e.g., patents, copyrights, brand trademarks, and data), and contractual assets or liabilities (e.g., the right to use some foreign asset, provide some future service to foreign customers, or execute a complex financial instrument). The entities involved in international business range from large multinational firms with thousands of employees doing business in many countries around the world to a small one-person company acting as an importer or exporter. This broader definition of international business also encompasses for-profit border-crossing transactions as well as transactions motivated by nonfinancial gains (e.g., triple bottom line, corporate social responsibility, and political favor) that affect a business’s future.

Strategic Management and Entrepreneurship

A knowledge of both strategic management and entrepreneurship will enhance your understanding of international business. Strategic management is the body of knowledge that answers questions about the development and implementation of good strategies and is mainly concerned with the determinants of firm performance. A strategy, in turn, is the central, integrated, and externally oriented concept of how an organization will achieve its performance objectives. One of the basic tools of strategy is a SWOT (strengths, weaknesses, opportunities, threats) assessment. The SWOT tool helps you take stock of an organization’s internal characteristics—its strengths and weaknesses—to formulate an action plan that builds on what it does well while overcoming or working around weaknesses. Similarly, the external part of SWOT—the opportunities and threats—helps you assess those environmental conditions that favor or threaten the organization’s strategy. Because strategic management is concerned with organizational performance—be that social, environmental, or economic—your understanding of a company’s SWOT will help you better assess how international business factors should be accounted for in the firm’s strategy.
Entrepreneurship, in contrast, is defined as the recognition of opportunities (i.e., needs, wants, problems, and challenges) and the use or creation of resources to implement innovative ideas for new, thoughtfully planned ventures. An entrepreneur is a person who engages in entrepreneurship. Entrepreneurship, like strategic management, will help you to think about the opportunities available when you connect new ideas with new markets. For instance, given Google’s current global presence, it’s difficult to imagine that the company started out slightly more than a decade ago as the entrepreneurial venture of two college students. Google was founded by Larry Page and Sergey Brin, students at Stanford University. It was first incorporated as a privately held company on September 4, 1998. Increasingly, as the Google case study demonstrates, international businesses have an opportunity to create positive social, environmental, and economic values across borders. An entrepreneurial perspective will serve you well in this regard.

Spotlight on International Strategy and Entrepreneurship

Hemali Thakkar and three of her fellow classmates at Harvard found a way to mesh the power of play with electrical power. The foursome invented “a soccer ball with the ability to generate electricity,” Thakkar said. Every kick of the ball creates a current that’s captured for future use. Fifteen minutes of play lights a lamp for three hours.

Called the sOccket, the soccer ball can bring off-grid electricity to developing countries. Even better, the soccer ball can replace kerosene lamps. Burning kerosene is not only bad for the environment because of carbon dioxide emissions but it’s also a health hazard: according to the World Bank, breathing kerosene fumes indoors has the same effects as smoking two packs of cigarettes per day.

How did the idea of sOccket emerge? All four students (Jessica Lin, Jessica Matthews, Julia Silverman, and Hemali Thakkar) had experience with developing countries, so they knew that kids love playing soccer (it’s the world’s most popular sport). They also knew that most of these kids lived in homes that had no reliable energy.

As of November 2010, the sOccket prototype cost $70 to manufacture, but the team hopes to bring the cost down to $10 when production is scaled up. One ingenious way to bring costs down is to set up facilities where developing-world entrepreneurs assemble and sell the balls themselves.

At this point it’s also important to introduce you to the concepts of intrapreneurship and the intrapreneur. Intrapreneurship is a form of entrepreneurship that takes place inside a business that is already in existence. An intrapreneur, in turn, is a person within the established business who takes direct responsibility for turning an idea into a profitable finished product through assertive risk taking and innovation. An entrepreneur is starting a business, while an intrapreneur is developing a new product or service in an already existing business. Thus, the ideas of entrepreneurship can be applied not only in new ventures but also in the context of existing organizations—even government.

KEY TAKEAWAYS

International business encompasses a full range of cross-border exchanges of goods, services, or resources between two or more nations. These exchanges can go beyond the exchange of money for physical goods to include international transfers of other resources, such as people, intellectual property (e.g., patents, copyrights, brand trademarks, and data), and contractual assets or liabilities (e.g., the right to use some foreign asset, provide some future service to foreign customers, or execute a complex financial instrument).

Strategic management is the body of knowledge that answers questions about the development and implementation of good strategies and is mainly concerned with the determinants of firm performance. Because strategic management is concerned with organizational performance, your understanding of a company’s SWOT (strengths, weaknesses, opportunities, threats) helps you better assess how international business factors should be accounted for in the firm’s strategy.

Entrepreneurship is the recognition of opportunities (i.e., needs, wants, problems, and challenges) and the use or creation of resources to implement innovative ideas. Entrepreneurship helps you think about the opportunities available when you connect new ideas with new markets.
**EXERCISES**

(AACSB: Reflective Thinking, Analytical Skills)

- What is international business?
- Why is an understanding of strategy management important in the context of international business?
- Why is an understanding of entrepreneurship important in the context of international business?

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**VIDEO: GLOBALIZATION EXPLAINED**

Goal: Discuss globalization of markets, economies and jobs.

Watch this video online: [https://youtu.be/JJ0nFD19eT8](https://youtu.be/JJ0nFD19eT8)

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**VIDEO: MINIATURE EARTH**

Goal: Discuss globalization of markets, economies and jobs.

Watch this video online: [https://youtu.be/rvTFKplaQhM](https://youtu.be/rvTFKplaQhM)
The Scenario: One of your friends plans to return to the family alfalfa farm in central California after college and has an idea to export a compressed form of alfalfa (alfalfa pellets) to be used as high-quality animal feed. Your friend knows that you are studying international business and has asked you for guidance. Prepare a summary for your friend of the issues that need to be considered.

Instructions:

Your assignment should follow the “Guidelines for Written Assignments.” This means your submission should be a minimum of 2 pages, maximum of 3 pages. For additional criteria, please refer to the guidelines.

Information on how your assignment will be graded is contained in the “Written Assignment Grading Rubric.”

For assistance, you can consult the “A Basic Guide to Exporting” series of webinars found on the globalEDGE website (http://globaledge.msu.edu). A link to this and other useful resources is located in the student resources module.

Please include the URL and/or link to all resources you use for this assignment. You do not need “in line” citations, but at the end of the paper please provide a list of what you used. This DOES NOT count toward your overall required length.
MODULE 2: TRADE THEORY, FROM MERCANTILISM TO FREE TRADE

OVERVIEW

In this module we will explore the reasons that nations trade and how they determine what to trade and with whom.

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Identify and explain the difference between Absolute and Comparative Advantage
- Explain the Heckscher-Olin Theory
- Summarize Porter’s Theory of National Competitive Advantage

READING: WHY TRADE?

Goals:

- Discuss globalization of markets, economies, and jobs.
- Explain international trade, foreign direct investments, and global monetary systems.

Read the article, “Why Trade?” from the Nobel Prize website linked below.

http://www.nobelprize.org/educational/economic-sciences/trade/ohlin.html
VIDEO: COMPARATIVE ADVANTAGE AND TRADE

Goals:

• Discuss globalization of markets, economies, and jobs.
• Explain international trade, foreign direct investments, and global monetary systems

Watch this video online: https://youtu.be/38hvAzugXZY

READING: COMPETITIVE ADVANTAGE

Competitive advantage is defined as the strategic advantage one business entity has over its rival entities within its competitive industry.

<table>
<thead>
<tr>
<th>KEY Points</th>
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<tbody>
<tr>
<td>• A country is said to have a comparative advantage in the production of a good (say cloth) if it can produce cloth at a lower opportunity cost than another country.</td>
</tr>
<tr>
<td>• Competitive advantage seeks to address some of the criticisms of comparative advantage.</td>
</tr>
<tr>
<td>• Competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allows it to outperform its competitors.</td>
</tr>
</tbody>
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Terms

• **Comparative advantage**: The concept that a certain good can be produced more efficiently than others due to a number of factors, including productive skills, climate, natural resource availability, and so forth.
• **Opportunity cost**: The cost of an opportunity forgone (and the loss of the benefits that could be received from that opportunity); the most valuable forgone alternative.

Examples

• Opportunity cost – The opportunity cost of cloth production is defined as the amount of wine for example, that must be given up in order to produce one more unit of cloth.

Competitive advantage is defined as the strategic advantage one business entity has over its rival entities within its competitive industry. Achieving competitive advantage strengthens and positions a business better within the business environment.
Competitive advantage seeks to address some of the criticisms of comparative advantage. A country is said to have a comparative advantage in the production of a good (say cloth) if it can produce cloth at a lower opportunity cost than another country. The opportunity cost of cloth production is defined as the amount of wine that must be given up in order to produce one more unit of cloth. Thus, England would have the comparative advantage in cloth production relative to Portugal if it must give up less wine to produce another unit of cloth than the amount of wine that Portugal would have to give up to produce another unit of cloth.

Competitive Advantage

The 640GB drive has a competitive advantage over the 500GB drive in terms of both cost and value.

Michael Porter proposed the theory of competitive advantage in 1985. The competitive advantage theory suggests that states and businesses should pursue policies that create high-quality goods to sell at high prices in the market. Porter emphasizes productivity growth as the focus of national strategies. This theory rests on the notion that cheap labor is ubiquitous, and natural resources are not necessary for a good economy. The other theory, comparative advantage, can lead countries to specialize in exporting primary goods and raw materials that trap countries in low-wage economies due to terms of trade. The competitive advantage theory attempts to correct for this issue by stressing maximizing scale economies in goods and services that garner premium prices.

Competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allows it to outperform its competitors. These attributes can include access to natural resources, such as high grade ores or inexpensive power or access to highly trained and skilled personnel human resources. New technologies, such as robotics and information technology, are either to be included as a part of the product or to assist making it. Information technology has become such a prominent part of the modern business world that it can also contribute to competitive advantage by outperforming competitors with regard to Internet presence. From the very beginning (i.e., Adam Smith’s Wealth of Nations), the central problem of information transmittal, leading to the rise of middle men in the marketplace, has been a significant impediment in gaining competitive advantage. By using the Internet as the middle man, the purveyor of information to the final consumer, businesses can gain a competitive advantage through creation of an effective website, which in the past required extensive effort finding the right middle man and cultivating the relationship.

<table>
<thead>
<tr>
<th>GLOSSARY</th>
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<tbody>
<tr>
<td><strong>Business environment</strong></td>
</tr>
<tr>
<td>The system within which companies exist.</td>
</tr>
<tr>
<td><strong>Consumer</strong></td>
</tr>
<tr>
<td>Someone who acquires goods or services for direct use or ownership rather than for resale or use in production and manufacturing. The consumer is the one who pays to consume the goods and services produced. As such, consumers play a vital role in the economic system of a nation. In the absence of their effective demand, the producers would lack a key motivation to produce, which is to sell to consumers.</td>
</tr>
<tr>
<td><strong>Economy</strong></td>
</tr>
<tr>
<td>Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.</td>
</tr>
<tr>
<td><strong>Exporting</strong></td>
</tr>
<tr>
<td>The act of selling to a foreign country the sale of capital, goods, and services across international borders or territories.</td>
</tr>
<tr>
<td><strong>Good</strong></td>
</tr>
<tr>
<td>An object produced for market.</td>
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</tbody>
</table>
Industry
The sector of the economy consisting of large-scale enterprises.

Lead
Potential opportunity for a sale or transaction, a potential customer.

Leading
To conduct or direct with authority the management function of determining what must be done in a situation and getting others to do it.

Market
A group of potential customers for one's product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

Premium
Bonus paid in addition to normal payments. The price above par value at which a security is sold. Something offered at a reduced price as an inducement to buy something else. The amount a policy-holder or his sponsor must pay to a health plan to purchase health coverage.

Price
The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Product
Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

READING: ABSOLUTE ADVANTAGE

GOALS
By the end of this section, you will be able to:

- Discuss globalization of markets, economies, and jobs.
- Explain international trade, foreign direct investments, and global monetary systems.
Absolute advantage and balance of trade are two important aspects of international trade that affect countries and organizations.

**KEY Points**

- **Absolute advantage**: In economics, the principle of absolute advantage refers to the ability of a party (an individual, or firm, or country) to produce more of a good or service than competitors, using the same amount of resources.
- **Net exports**: The balance of trade (or net exports, sometimes symbolized as NX) is the difference between the monetary value of exports and imports of output in an economy over a certain period. It is the relationship between a nation’s imports and exports.
- **Advantageous trade**: Advantageous trade is based on comparative advantage and covers a larger set of circumstances while still including the case of absolute advantage and hence is a more general theory.

**Terms**

- **Absolute advantage**: The capability to produce more of a given product using less of a given resource than a competing entity.
- **Advantageous**: Being of advantage; conferring advantage; gainful; profitable; useful; beneficial; as, an advantageous position.

In the drive for international trade, it is important to understand how trade affects countries positively and negatively—both how a country’s imports and exports affect its economy and how effectively the country’s ability to create and export vital goods affects the businesses within that country. Absolute advantage and balance of trade are two important aspects of international trade that affect countries and organizations.

**European Free Trade Agreement**

The European Free Trade Agreement has helped countries international trade without worrying about absolute advantage and increases net exports.

**Absolute Advantage**

In economics, the principle of absolute advantage refers to the ability of a party (an individual, a firm, or a country) to produce more of a good or service than competitors while using the same amount of resources. Adam Smith first described the principle of absolute advantage in the context of international trade, using labor as the only input. Since absolute advantage is determined by a simple comparison of labor productivities, it is possible for a party to have no absolute advantage in anything; in that case, according to the theory of absolute advantage, no trade will occur with the other party. It can be contrasted with the concept of comparative advantage, which refers to the ability to produce a particular good at a lower opportunity cost.

**Balance of Trade**

The balance of trade (or net exports, sometimes symbolized as NX) is the difference between the monetary value of exports and imports in an economy over a certain period. A positive balance is known as a trade surplus if it consists of exporting more than is imported; a negative balance is referred to as a trade deficit or, informally, a trade gap. The balance of trade is sometimes divided into a goods and a services balance.
The difference between the monetary value of exports and imports in an economy over a certain period of time.

**Comparative advantage**
The ability of a party to produce a particular good or service at a lower marginal and opportunity cost over another. The concept that a certain good can be produced more efficiently than others due to a number of factors, including productive skills, climate, natural resource availability, and so forth.

**Economy**
Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

**Export**
To sell (goods) to a foreign country. Any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade.

**Exporting**
The act of selling to a foreign country the sale of capital, goods, and services across international borders or territories.

**Good**
An object produced for market.

**Input**
Something fed into a process with the intention of it shaping or affecting the outputs of that process. Each participant’s contributions that are viewed as entitling him/her to rewards or costs. Examples include time, effort, and loyalty.

**Opportunity cost**
The cost of an opportunity forgone (and the loss of the benefits that could be received from that opportunity); the most valuable forgone alternative. The cost of any activity measured in terms of the value of the next best alternative forgone (that is not chosen). The value forfeited by taking a particular route.

**Output**
Production; quantity produced, created, or completed. Data sent out of the computer, as to output device such as a monitor or printer.

**Productivity**
Productivity is a measure of the efficiency of production and is defined as total output per one unit of a total input. The rate at which goods or services are produced by a standard population of workers. A ratio of production output to what is required to produce it (inputs). The state of being productive, fertile, or efficient. The rate at which products and services are produced relative to a particular workforce.

**Resource**
Something that one uses to achieve an objective, e.g. raw materials or personnel.

**Services**
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

**Trade deficit**
A negative balance of trade.

**Trade surplus**
A positive balance of trade.

**Value**
The degree of importance given to something. A value is extremely absolute or relative ethical value, the assumption of which can be the basis for ethical action. A customer’s perception of relative price (the cost to own and use) and performance (quality)

**Values**
A collection of guiding principles; what one deems to be correct and desirable in life, especially regarding personal conduct.
VIDEO: PORTER'S NATIONAL DIAMOND FRAMEWORK EXPLAINED

Porter’s National Diamond Framework explains why some countries tend to be stronger in different industries in relation to other countries.

1. Factor Conditions
2. Related and Supporting Industries
3. Structure, Strategy and Rivalry
4. Demand Conditions

Watch this video online: https://youtu.be/OZ4IFJ7Z8D4

Filmed in Vaduz, Liechtenstein December 2008

ASSIGNMENT: THE "TRADER RULER GAME"

This assignment has TWO parts (1. Play the game and 2. Post to the discussion):

I. To complete Trade Ruler Game you will need to:

1. Watch the Instructional Video that shows you how to get yourself set up and ready to play
2. Click on the link for the “Trade Rule Game”
3. Complete your “rounds” and be sure to record your high score because you will need this for your Discussion Posting

PLAY the Trader Ruler Game

II. To complete the “Trade Ruler Discussion” –

1. In your initial post, include your name and your score (i.e., Linda Williams – 57,640). This is your 150 – 200 word post. Post your thoughts on your experience as the Trade Ruler of your Island. In your initial post you should, at a minimum, answer the following:
   1. Which Island did you select?
   2. Why did you select this one?
3. What would you have done DIFFERENTLY?
4. What did this teach you about comparative and competitive advantage?
2. RESPOND to at least TWO of your classmates. (50 – 100 words each)
MODULE 3: DIFFERENT STROKES .... POLITICAL AND ECONOMIC SYSTEMS AROUND THE GLOBE

OVERVIEW

In this module we will explore the different economic and political systems and how they impact global trade and business.

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Identify and explain the different political systems around the globe
- Identify and compare market, command and mixed economies
- Summarize the characteristics of political structures (including socialism, communism, democracy, totalitarianism)

VIDEO: ECONOMIC SYSTEMS

Please view the video.

Watch this video online: https://youtu.be/d8ivuSUfTg4
A free-enterprise system is based on private ownership as the means of production.

### KEY Points

- Free-market systems operate in capitalist economies.
- There are multiple variants of capitalism depending on interpretation and practice.
- Economists emphasize the degree to which markets are free of government control (laissez faire) in capitalism.
- Political economists focus on the presence of private property, as well as power, wage, and class relations.
- Mixed economies and state capitalism are systems that incorporate different amounts of planned and market-driven elements in the state’s economic system.

### Terms

- **Laissez-faire**: A policy of governmental non-interference in economic affairs.
- **Mixed economy**: Mixed economy is an economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies. Most mixed economies can be described as market economies with strong regulatory oversight, in addition to having a variety of government-sponsored aspects.
- **State capitalism**: The term state capitalism has various meanings, but is usually described as commercial (profit-seeking) economic activity undertaken by the state with management of the productive forces in a capitalist manner, even if the state is nominally socialist. State capitalism is usually characterized by the dominance or existence of a significant number of state-owned business enterprises.

### Examples

- China is seen as the primary example of a successful state capitalist system. Political scientist Ian Bremmer describes China as the primary driver for the rise of state capitalism as a challenge to the free market economies of the developed world, particularly in the aftermath of the 2008 financial crisis. Bremmer states, “In this system, governments use various kinds of state-owned companies to manage the exploitation of resources that they consider the state’s crown jewels and to create and maintain large numbers of jobs. They use select privately owned companies to dominate certain economic sectors. They use so-called sovereign wealth funds to invest their extra cash in ways that maximize the state’s profits. In all three cases, the state is using markets to create wealth that can be directed as political officials see fit. And in all three cases, the ultimate motive is not economic (maximizing growth) but political (maximizing the state’s power and the leadership’s chances of survival). This is a form of capitalism but one in which the state acts as the dominant economic player and uses markets primarily for political gain.”
Free-Enterprise Defined

The definition of free enterprise is a business governed by the laws of supply and demand, where the government has no involvement in its decisions or actions. This economic system is based solely on private ownership as the means of production.

It is a private system in which all means of production are privately owned and operated.

Link to Capitalism

This is an example of capitalism in which government policies generally target the regulation and not the money.

Capitalism is generally considered to be an economic system that is based on private ownership of the means of production and the creation of goods or services for profit by privately-owned business enterprises.

Some have also used the term as a synonym for competitive markets, wage labor, capital accumulation, voluntary exchange, and personal finance. The designation is applied to a variety of historical cases, varying in time, geography, politics, and culture.

Variations of Capitalism

There are multiple variants of capitalism, including laissez faire, mixed economy, and state capitalism. There is, however, a general agreement that capitalism became dominant in the Western world following the demise of feudalism.

Economists, political economists, and historians have taken different perspectives on the analysis of capitalism. Economists usually emphasize the degree to which government does not have control over markets (laissez faire), as well as the importance of property rights.

Most political economists emphasize private property as well, in addition to power relations, wage labor, class, and the uniqueness of capitalism as a historical formation.

The extent to which different markets are free, as well as the rules defining private property, is a matter of politics and policy. Many states have what are termed mixed economies, referring to the varying degree of planned and market-driven elements in a state’s economic system.

A number of political ideologies have emerged in support of various types of capitalism, the most prominent being economic liberalism.

Capitalism gradually spread throughout the Western world in the 19th and 20th centuries.

<table>
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<th>Key Term GLOSSARY</th>
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<tr>
<td><strong>Economic system</strong></td>
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<tr>
<td>An economic system is the combination of the various agencies, entities (or even sectors as described by some authors) that provide the economic structure that defines the social community.</td>
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<tr>
<td><strong>Enterprise</strong></td>
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<tr>
<td>A company, business, organization, or other purposeful endeavor.</td>
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16
To provide or obtain funding for a transaction or undertaking; to back; to support. The science of management of money and other assets.

**Good**

An object produced for market.

**Leadership**

A process of social influence in which one person can enlist the aid and support of others in the accomplishment of a common task. The capacity of someone to lead. The capacity of someone to lead.

**Manage**

To handle or control a situation or job.

**Mixed Economies**

A system in which both the state and private sector direct the way goods and services are bought and sold.

**Profits**

Collective form of profit.

**Resource**

Something that one uses to achieve an objective, e.g. raw materials or personnel.

**Right**

A legal or moral entitlement.

**Services**

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

**Wage**

An amount of money paid to a worker for a specified quantity of work, usually expressed on an hourly basis.
Capitalism in the US

Democratic capitalism is a political, economic, and social system with a market-based economy that is largely based on a democratic political system.

**KEY points**

- The United States is often seen as having a democratic capitalist political-economic system.
- The three pillars of democratic capitalism include economic incentives through free markets, fiscal responsibility, and a liberal moral-cultural system that encourages pluralism.
- Some commentators argue that, although economic growth under capitalism has led to democratization in the past, it may not do so in the future; for example, authoritarian regimes have been able to manage economic growth without making concessions to greater political freedom.
- Proponents of capitalism have argued that indices of economic freedom correlate strongly with higher income, life expectancy, and standards of living.
- Democratic Peace Theory states that capitalist democracies rarely make war with each other, and have little internal conflict. However, critics argue that this may have nothing to do with the capitalist nature of the states, and more to do with the democratic nature instead.

**Terms**

- **Capitalism:** A socio-economic system based on the abstraction of resources into the form of privately-owned money, wealth, and goods, with economic decisions made largely through the operation of a market unregulated by the state.
- **Tripartite:** In three parts.
- **Polity:** An organizational structure of the government of a state, church, etc.
- **Pluralism:** A social system based on mutual respect for each other’s cultures among various groups that make up a society, wherein subordinate groups do not have to forsake their lifestyle and traditions, but, rather, can express their culture and participate in the larger society free of prejudice.

**Examples**

- Singapore’s de facto one-party system has been described as an example of an authoritarian capitalist system that other authoritarian governments may follow. However, polls have recently suggested that the ruling PAP party is suffering declines in popularity, suggesting that increasing material gains may not make up for a lack of political freedoms. The Singaporean government has introduced limited political concessions, suggesting that authoritarian capitalist systems may transition to democracy in time.

**Democratic Capitalism and the US**

The United States is often seen as having a democratic capitalist political-economic system. Democratic capitalism, also known as capitalist democracy, is a political, economic, and social system and ideology based on a tripartite arrangement of a market-based economy that is based predominantly on a democratic polity. The
three pillars include economic incentives through free markets, fiscal responsibility, and a liberal moral-cultural system, which encourages pluralism.

In the United States, both the Democratic and Republican Parties subscribe to this (little "d" and "r") democratic-republican philosophy. Most liberals and conservatives generally support some form of democratic capitalism in their economic practices. The ideology of “democratic capitalism” has been in existence since medieval times. It is based firmly on the principles of liberalism, which include liberty and equality. Some of its earliest promoters include many of the American founding fathers and subsequent Jeffersonians.

This economic system supports a capitalist, free-market economy subject to control by a democratic political system that is supported by the majority. It stands in contrast to authoritarian capitalism by limiting the influence of special interest groups, including corporate lobbyists, on politics. Some argue that the United States has become more authoritarian in recent decades.

The Relationship between Democracy and Capitalism

The relationship between democracy and capitalism is a contentious area in theory and among popular political movements. The extension of universal adult male suffrage in 19th century Britain occurred alongside the development of industrial capitalism. Since democracy became widespread at the same time as capitalism, many theorists have been led to posit a causal relationship between them. In the 20th century, however, according to some authors, capitalism also accompanied a variety of political formations quite distinct from liberal democracies, including fascist regimes, absolute monarchies, and single-party states.

While some argue that capitalist development leads to the emergence of democracy, others dispute this claim. Some commentators argue that, although economic growth under capitalism has led to democratization in the past, it may not do so in the future. For example, authoritarian regimes have been able to manage economic growth without making concessions to greater political freedom. States that have highly capitalistic economic systems have thrived under authoritarian or oppressive political systems. Examples include:

- Singapore, which maintains a highly open market economy and attracts lots of foreign investment, does not protect civil liberties such as freedom of speech and expression.
- The private (capitalist) sector in the People’s Republic of China has grown exponentially and thrived since its inception, despite having an authoritarian government.
- Augusto Pinochet’s rule in Chile led to economic growth by using authoritarian means to create a safe environment for investment and capitalism.

Peoples’ Republic of China’s Nominal Gross Domestic Product (GDP) Between 1952 to 2005
Scatter graph of the People’s Republic of China’s GDP between years 1952 to 2005, based on publicly available nominal GDP data published by the People’s Republic of China and compiled by Hitotsubashi University (Japan) and confirmed by economic indicator statistics from the World Bank.

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19
Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

**Free Market**

Any economic market in which trade is unregulated; an economic system free from government intervention.

**Incentive**

Something that motivates, rouses, or encourages. It is used to motivate individuals (often, employees) for better performance by providing financial or other types of rewards. An anticipated reward or aversive event available in the environment. Something that motivates an individual to perform an action.

**Interest**

The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. A great attention and concern from someone or something; intellectual curiosity.

**Investment**

The placement or expenditure of capital in expectation of deriving income or profit from its use.

**Lead**

Potential opportunity for a sale or transaction, a potential customer.

**Manage**

To handle or control a situation or job.

**Market**

A group of potential customers for one's product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

**Proponents**

An individual(s) who advocates or supports a particular stance on an issue.

**Standard**

Something used as a measure for comparative evaluations. A level of quality or attainment.

**System**

A whole composed of relationships among the members. The part of the universe being studied, arbitrarily defined to any size desired.

**Transition**

The process of change from one form, state, style, or place to another. A word or phrase connecting one part of a discourse to another.
REASON: SOCIALISM AND PLANNED ECONOMIES

Socialism is characterized by social ownership of the means of production.

### KEY Points

- A planned economy is a type of economy consisting of a mixture of public ownership of the means of production and the coordination of production and distribution through state planning.
- Socialism has many variations, depending on the level of planning versus market power, the organization of management, and the role of the state.
- In a socialist system, production is geared towards satisfying economic demands and human needs. Distribution of this output is based on individual contribution.
- Socialists distinguish between a planned economy, such as that of the former Soviet Union, and socialist economies. They often compare the former to a top-down bureaucratic capitalist firm.

### Terms

- **Socialism**: Any of various economic and political philosophies that support social equality, collective decision-making, distribution of income based on contribution and public ownership of productive capital and natural resources, as advocated by socialists.
- **Planned economy**: An economic system in which government directly manages supply and demand for goods and services by controlling production, prices, and distribution in accordance with a long-term design and schedule of objectives.

### Examples

- There are few clear examples of purely socialist economies; nonetheless, many of the industrialized countries of Western Europe experimented with one form of social democratic mixed economies or another during the twentieth century, including Britain, France, Sweden, and Norway. They can be regarded as social democratic experiments, because they universally retained a wage-based economy and private ownership and control of the decisive means of production. Variations range from social democratic welfare states, such as in Sweden, to mixed economies where a major percentage of GDP comes from the state sector, such as in Norway, which ranks among the highest countries in quality of life and equality of opportunity for its citizens.

### Planned Economy

A planned economy is a type of economy consisting of a mixture of public ownership of the means of production and the coordination of production and distribution through state planning.

### Planned Socialist Economy

Economic planning in socialism takes a different form than economic planning in capitalist mixed economies. In socialism, *planning* refers to production of use-value directly (planning of production), while in capitalist mixed
economies. Planning refers to the design of capital accumulation in order to stabilize or increase the efficiency of its process. While many socialists advocate for economic planning as an eventual substitute for the market for factors of production, others define economic planning as being based on worker-self management, with production being carried out directly to satisfy human needs. Enrico Barone provided a comprehensive theoretical framework for a planned socialist economy. In his model, assuming perfect computation techniques, simultaneous equations relating inputs and outputs to ratios of equivalence would provide appropriate valuations in order to balance supply and demand.

Hierarchy of Needs
Worker self-management and production to satisfy human needs are key.

The command economy is distinguished from economic planning. Most notably, a command economy is associated with bureaucratic collectivism, state capitalism, or state socialism.

Socialism

Socialism is an economic system characterized by social ownership, control of the means of production, and cooperative management of the economy. A socialist economic system would consist of an organization of production to directly satisfy economic demands and human needs, so that goods and services would be produced directly for use instead of for private profit driven by the accumulation of capital. Accounting would be based on physical quantities, a common physical magnitude, or a direct measure of labor-time. Distribution of output would be based on the principle of individual contribution.

There are many variations of socialism and as such there is no single definition encapsulating all of socialism. They differ in:

• The type of social ownership they advocate;
• The degree to which they rely on markets versus planning;
• How management is to be organised within economic enterprises; and
• The role of the state in constructing socialism.

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**Accounting**

The development and use of a system for recording and analyzing the financial transactions and financial status of a business or other organization. The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information. (definition by the American Accounting Association)

**Capital**

Money and wealth. The means to acquire goods and services, especially in a non-barter system. Already-produced durable goods available for use as a factor of production, such as steam shovels (equipment) and office buildings (structures).

**Capitalism**

A socio-economic system based on the abstraction of resources into the form of privately-owned money, wealth, and goods, with economic decisions made largely through the operation of a market unregulated by the state. A socio-economic system based on private property rights, including the private ownership of resources or capital, with economic decisions made largely through the operation of a market unregulated by the state.

**Command Economy**
Most of the economy is planned by a central government authority and organized along a top-down administration where decisions regarding production output requirements and investments are decided by planners from the top, or near the top, of the chain of command.

**Cooperative**
A type of company that is owned partially or wholly by its employees, customers, or tenants. Abbreviation: co-op.

**Coordination**
The resulting state of working together; cooperation; synchronization.

**Demand**
The desire to purchase goods or services, coupled with the power to do so, at a particular price.

**Design**
To plan and carry out (a picture, work of art, construction etc.).

**Distribution**
The process by which goods get to final consumers over a geographical market, including storing, selling, shipping, and advertising. the set of relative likelihoods that a variable will have a value in a given interval. A probability distribution; the set of relative likelihoods that a variable will have a value in a given interval.

**Economic System**
An economic system is the combination of the various agencies, entities (or even sectors as described by some authors) that provide the economic structure that defines the social community.

**Economy**
Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

**Efficiency**
The extent to which a resource, such as electricity, is used for the intended purpose; the ratio of useful work to energy expended. The extent to which time is well used for the intended task. Improved efficiency was a principle goal of progressives, one they thought attainable by the application of scientific and rational thought to social problems.

**Framework**
The identification and categorization of processes or steps that constitute a complex task or mindset in order to render explicit the tacit and implicit. A basic conceptual structure.

**GDP**
Gross domestic product (GDP) is the market value of all officially recognized final goods and services produced within a country in a given period of time. A measure of the economic production of a particular territory in financial capital terms over a specific time period.

**Good**
An object produced for market.
| **Input** | Something fed into a process with the intention of it shaping or affecting the outputs of that process. Each participant’s contributions that are viewed as entitling him/her to rewards or costs. Examples include time, effort, and loyalty. |
| **Management** | The act of getting people together to accomplish desired goals and objectives using available resources efficiently and effectively. Administration; the process or practice of managing. |
| **Market** | A group of potential customers for one’s product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange. |
| **Mixed Economies** | A system in which both the state and private sector direct the way goods and services are bought and sold. |
| **Mixed Economy** | An economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies. Most mixed economies can be described as market economies with strong regulatory oversight, in addition to having a variety of government-sponsored aspects. |
| **Output** | Production; quantity produced, created, or completed. Data sent out of the computer, as to output device such as a monitor or printer. |
| **Planning** | The act of formulating a course of action, or of drawing up plans. |
| **Process** | A series of events to produce a result, especially as contrasted to product. In reference to capabilities, a process is how the capability is executed. |
| **Profits** | Collective form of profit. |
| **Ratio** | A number representing a comparison between two things. The relative magnitudes of two quantities (usually expressed as a quotient). |
| **Services** | That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work. |
| **Supply Provisions** | The amount of some product that producers are willing and able to sell at a given price, all other factors being held constant. |
| **State Capitalism** | The term state capitalism has various meanings, but is usually described as commercial (profit-seeking) economic activity undertaken by the state with management of the productive forces in a capitalist manner, |
even if the state is nominally socialist. State capitalism is usually characterized by the dominance or existence of a significant number of state-owned business enterprises.

**System**

The part of the universe being studied, arbitrarily defined to any size desired A whole composed of relationships among the members.

**Welfare State**

A social system in which the state takes overall responsibility for the welfare of its citizens, providing health care, education, unemployment compensation and social security.

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**READING: THE BENEFITS OF SOCIALISM**

Socialism has a number of theoretical benefits, based on the idea of social equality and justice.

**KEY points**

- Advantages of socialism relating to social equality include a focus on reducing wealth disparities, unemployment and inflation (through price controls).
- Advantages of socialism related to economic planning include an ability to make good use of land, labor and resources, as well as avoiding excess or insufficient production.
- Additional benefits of Socialism: Nationalization of key industries, redistribution of wealth, social security schemes, minimum wages, employment protection and trade union recognition rights.

**Terms**

- *Public Benefit*: A payment made in accordance with an insurance policy or a public assistance scheme.
- *Redistribution*: The act of changing the distribution of resources

**Examples**

- Socialist systems have a number of policy tools to help them achieve these goals. Nationalization of key industries such as mining, oil, and energy allows the state to invest directly, set prices and production levels, publicly fund research, and avoid exploitation. Wealth redistribution can occur through targeted, progressive taxation and welfare policies such as free/subsidized education and access to housing. Social security schemes also provide security in old age, while minimum wages, employment protection, and other labor rights ensure a fair wage and safety at work.
How Economies Can Benefit From Socialism

Socialist economics entails the following:

Socialism
A graphical illustration of socialism.

1. Nationalization of key industries, such as mining, oil, steel, energy and transportation. A common model includes a sector being taken over by the state, followed by one or more publicly owned corporations arranging its day-to-day running. Advantages of nationalization include: the ability of the state to direct investment in key industries, distribute state profits from nationalized industries for the overall national good, direct producers to social rather than market goals, and better control the industries both by and for the workers. Additionally, nationalization enables the benefits and burdens of publicly funded research and development to be extended to the wider populace.

2. Redistribution of wealth, through tax and spending policies that aim to reduce economic inequalities. Social democracies typically employ various forms of progressive taxation regarding wage and business income, wealth, inheritance, capital gains and property. On the spending side, a set of social policies typically provides free access to public services such as education, health care and child care. Additionally, subsidized access to housing, food, pharmaceutical goods, water supply, waste management and electricity is common.

3. Social security schemes in which workers contribute to a mandatory public insurance program. The insurance typically includes monetary provisions for retirement pensions and survivor benefits, permanent and temporary disabilities, unemployment and parental leave. Unlike private insurance, governmental schemes are based on public statutes rather than contracts; therefore, contributions and benefits may change in time, and are based on solidarity among participants. Its funding is done on an ongoing basis, without direct relationship to future liabilities.

4. Minimum wages, employment protection and trade union recognition rights for the benefit of workers. These policies aim to guarantee living wages and help produce full employment. While a number of different models of trade union protection have evolved throughout the world over time, they all guarantee the right of workers to form unions, negotiate benefits and participate in strikes. Germany, for instance, appointed union representatives at high levels in all corporations, and as a result, endured much less industrial strife than the UK, whose laws encouraged strikes rather than negotiation.

The benefits of socialism also include the following:

- In theory, based on public benefits, socialism has the greatest goal of common wealth;
- Since the government controls almost all of society’s functions, it can make better use of resources, labors and lands;
- Socialism reduces disparity in wealth, not only in different areas, but also in all societal ranks and classes. Those who suffer from illnesses or are too old to work are still provided for and valued in by the government, assuming that the government is more compassionate that the individual’s family;
- Excess or insufficient production can be avoided;
- Prices can be controlled in a proper extent;
- Socialism can tackle unemployment to a great extent.

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**GLOSSARY**

**Benefit**
An advantage, help or aid from something. Employee benefits and (especially in British English) benefits in kind (also called fringe benefits, perquisites, perqs or perks) are various non-wage compensations provided to employees in addition to their normal wages or salaries.

**Capital**
Money and wealth. The means to acquire goods and services, especially in a non-barter system. Already-produced durable goods available for use as a factor of production, such as steam shovels (equipment) and office buildings (structures).
Corporation
A group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members.

Disability
State of being disabled; deprivation or want of ability; absence of competent physical, intellectual, or moral power, means, fitness, and the like.

Economy
Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

Employment
The work or occupation for which one is used, and often paid.

Goal
A desired result that one works to achieve.

Good
An object produced for market.

Guarantee
To assume responsibility for a debt.

Industry
The sector of the economy consisting of large-scale enterprises.

Inflation
A rise in the general level of prices of goods and services in an economy over a period of time. An increase in the general level of prices or in the cost of living. An increase in the quantity of money, leading to a devaluation of existing money.

Insurance
A means of indemnity against a future occurrence of an uncertain event.

Investment
The placement or expenditure of capital in expectation of deriving income or profit from its use.

Justice
The ideal of fairness, impartiality, etc., especially with regard to the punishment of wrongdoing.

Liabilities
Probable future sacrifices of economic benefits arising from present obligations to transfer assets or providing services as a result of past transactions or events. An amount of money in a company that is owed to someone and has to be paid in the future, such as tax, debt, interest, and mortgage payments. An obligation of an entity arising from past transactions or events, including any type of borrowing.

Management
The act of getting people together to accomplish desired goals and objectives using available resources efficiently and effectively. Administration; the process or practice of managing.

**Market**

A group of potential customers for one's product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

**Minimum Wage**

The lowest rate at which an employer can legally pay an employee; usually expressed as pay per hour.

**Pension**

A gratuity paid regularly as a benefit due to a person in consideration of past services; notably to one retired from service, on account of retirement age, disability or similar cause; especially a regular stipend paid by a government to retired public officers, disabled soldiers; sometimes passed on to the heirs, or even specifically for them, as to the families of soldiers killed in service.

**Planning**

The act of formulating a course of action, or of drawing up plans.

**Price**

The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

**Profits**

Collective form of profit.

**Resource**

Something that one uses to achieve an objective, e.g. raw materials or personnel.

**Retirement**

Retirement is the point where a person stops employment completely. A person may also semi-retire by reducing work hours.

**Right**

A legal or moral entitlement.

**Security**

The condition of not being threatened, especially physically, psychologically, emotionally, or financially. proof of ownership of stocks, bonds, or other investment instruments.

**Services**

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

**Social Democracy**

A moderate political philosophy or ideology that aims to achieve socialistic goals within capitalist society such as by means of a strong welfare state and regulation of private industry.
Social Security
A system whereby the state either through general or specific taxation provides various benefits to help ensure the well-being of its citizens.

Socialism
A political philosophy based on principles of community decision making, social equality, and the avoidance of economic and social exclusion, with preference to community goals over individual ones. Any of various economic and political philosophies that support social equality, collective decision-making, distribution of income based on contribution and public ownership of productive capital and natural resources, as advocated by socialists. The intermediate phase of social development between capitalism and full communism. This is a strategy whereby the state has control of all key resource-producing industries and manages most aspects of the economy, in contrast to laissez-faire capitalism.

Solidarity
A bond of unity between individuals, united around a common goal or against a common enemy, such as the unifying principle that defines the labor movement. It is the integration—and degree and type of integration—shown by a society or group with people and their neighbors.

Supply Provisions
The amount of some product that producers are willing and able to sell at a given price, all other factors being held constant.

System
A whole composed of relationships among the members. The part of the universe being studied, arbitrarily defined to any size desired.

Wage
An amount of money paid to a worker for a specified quantity of work, usually expressed on an hourly basis.

READING: THE DISADVANTAGES OF SOCIALISM

Despite the theoretical benefits of socialist economic systems, there are also disadvantages that may arise in application.

KEY Points
- Disadvantages of socialism include slow economic growth, less entrepreneurial opportunity and competition, and a potential lack of motivation by individuals due to lesser rewards.
- Critics of socialism claims that it creates distorted or absent price signals, results in reduced incentives, causes reduced prosperity, has low feasibility, and that it has negative social and political effects.
Economic liberals and pro-capitalist libertarians see private ownership of the means of production and the market exchange as natural entities or moral rights, which are central to their conceptions of freedom and liberty.

Terms

- **Economy**: The system of production and distribution and consumption. The overall measure of a currency system.
- **Socialism**: Any of various economic and political philosophies that support social equality, collective decision-making, distribution of income based on contribution and public ownership of productive capital and natural resources, as advocated by socialists.

Examples

- Austrian school economists, such as Friedrich Hayek and Ludwig Von Mises, have argued that the elimination of private ownership of the means of production would inevitably create worse economic conditions for the general populace than those that would be found in market economies. Without the price signals of the market, they state that it is impossible to calculate rationally how to allocate resources.

The Disadvantages of Socialism

Economic liberals and pro-capitalist libertarians see private ownership of the means of production and the market exchange as natural entities or moral rights which are central to their conceptions of freedom and liberty. They, therefore, perceive public ownership of the means of production, cooperatives and economic planning as infringements upon liberty. Some of the primary criticisms of socialism are claims that it creates distorted or absent price signals, results in reduced incentives, causes reduced prosperity, has low feasibility, and that it has negative social and political effects.

Critics from the neoclassical school of economics criticize state-ownership and centralization of capital on the grounds that there is a lack of incentive in state institutions to act on information as efficiently as capitalist firms because they lack hard budget constraints, resulting in reduced overall economic welfare for society. Economists of the Austrian school argue that socialist systems based on economic planning are unfeasible because they lack the information to perform economic calculations in the first place, due to a lack of price signals and a free-price system, which they argue are required for rational economic calculation.

Thus, Socialism can have several disadvantages:

Socialism

Some of the primary criticisms of socialism are claims that it creates distorted or absent price signals, results in reduced incentives, causes reduced prosperity, has low feasibility, and that it has negative social and political effects.

- The national economy develops relatively slowly;
- There is an inability to obtain the upmost profit from the use of resources, labors and land;
- Places that have a geographical advantage lose chances to develop better and people who have intelligence and wealth lose chances to make their businesses become bigger and more powerful;
- People lose initiative to work and enthusiasm to study as doing more isn’t rewarded.

GLOSSARY

| Benefit |
An advantage, help or aid from something. Employee benefits and (especially in British English) benefits in kind (also called fringe benefits, perquisites, perqs or perks) are various non-wage compensations provided to employees in addition to their normal wages or salaries.

**Budget**

An itemized summary of intended expenditure; usually coupled with expected revenue. The amount of money or resources earmarked for a particular institution, activity, or time-frame.

**Capital**

Money and wealth. The means to acquire goods and services, especially in a non-barter system. Already-produced durable goods available for use as a factor of production, such as steam shovels (equipment) and office buildings (structures).

**Centralization**

The act or process of centralizing, or the state of being centralized; the act or process of combining or reducing several parts into a whole like the centralization of power in the general government or the centralization of commerce in a city.

**Cooperative**

A type of company that is owned partially or wholly by its employees, customers, or tenants. Abbreviation: co-op.

**Economic System**

An economic system is the combination of the various agencies, entities (or even sectors as described by some authors) that provide the economic structure that defines the social community.

**Incentive**

Something that motivates, rouses, or encourages. It is used to motivate individuals (often, employees) for better performance by providing financial or other types of rewards. An anticipated reward or aversive event available in the environment. Something that motivates an individual to perform an action.

**Market**

A group of potential customers for one’s product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

**Motivation**

Willingness of action, especially in behavior. An incentive or reason for doing something. The psychological feature that arouses an organism to action toward a desired goal and elicits, controls, and sustains certain goal directed behaviors.

**Planning**

The act of formulating a course of action, or of drawing up plans.

**Potential**

Currently unrealized ability. A curve describing the situation where the difference in the potential energies of an object in two different positions depends only on those positions.

**Price**
The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

**Profits**

Collective form of profit.

**Resource**

Something that one uses to achieve an objective, e.g. raw materials or personnel.

**Right**

A legal or moral entitlement.

**System**

A whole composed of relationships among the members. The part of the universe being studied, arbitrarily defined to any size desired.

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**READING: THE COMMUNIST ECONOMIC SYSTEM**

The communist economic system is one where class distinctions are eliminated and the community as a whole owns the means to production.

**KEY points**

- Karl Marx and Freidrich Engels wrote the Communist Manifesto in 1848, in response to poor working conditions for workers across Europe. The goal was to establish a system where class distinctions were eliminated and the means of production were owned by the masses.
- Recent attempts at creating political economic systems have led to state-driven authoritarian economies with unaccountable political elites, further driving power away from the hands of the masses.
- A Command Economy is characterized by collective ownership of capital: property is owned by the State, production levels are determined by the State via advanced planning mechanisms rather than supply and demand, and prices are regulated and controlled.
Terms

- **Proletariat**: The proletariat (from Latin proletarius, a citizen of the lowest class) is a term used to identify a lower social class, usually the working class; a member of such a class is proletarian. Originally it was identified as those people who had no wealth other than their children.
- **Bourgeoisie**: In sociology and political science, bourgeoisie (Fr.: [buʁˈʒwaˈzi] | Eng.: /ˈbʊrʒwɑːzi/) and the adjective bourgeois are terms that describe a historical range of socio-economic classes. Since the late 18th century in the Western world, the bourgeoisie describes a social class that is characterized by their ownership of capital and their related culture. In contemporary academic theories, the term bourgeoisie usually refers to the ruling class in capitalist societies. In Marxist theory, the abiding characteristics of this class are their ownership of the means of production.
- **Command economy**: Most of the economy is planned by a central government authority and organized along a top-down administration where decisions regarding production output requirements and investments are decided by planners from the top, or near the top, of the chain of command.

Examples

- The former USSR (or Soviet Union) is the typical example of a communistic, command economy. It was formed in 1922 by the Bolshevik party of the former Russian Empire. In 1928, Joseph Stalin achieved party leadership and introduced the first Five Year Plan, ending the limited level of capitalism that still existed. In 1991, under Mikhail Gorbachev, the Soviet Union was dissolved.
- A modern day example is China, particularly in the 70s, 80s and 90s. Today, China is seen to be more of an authoritarian capitalist rather than communistic command economy.

The Communist Economic System

A communist economic system is an economic system where, in theory, economic decisions are made by the community as a whole. In reality, however, attempts to establish communism have ended up creating state-driven authoritarian economies and regimes which benefit single party political élite who are not accountable to the people or community.

Communist theory was developed by a German philosopher in the 1800s named Karl Marx. He thought that the only way to have a harmonious society was to put workers in control. This idea was established during the Industrial Revolution when many workers were treated unfairly in France, Germany, and England.

Communist Ideology
The Hammer and Sickle represents the communion of the peasant and the worker.

Marx did not want there to be a difference in economic classes and he wanted class struggle to be eliminated. His main goal was to abolish capitalism (an economic system ruled by private ownership). Marx abhorred capitalism because the proletariat was exploited and unfairly represented in politics, and because capitalism allows the bourgeoisie to control a disproportionate amount of power. Therefore, he thought that if everything was shared and owned by everyone, a worker’s paradise or Utopia could be achieved.

Together with Friedrich Engel, a German economist, Marx wrote a pamphlet called the Communist Manifesto. This was published in 1848 and it expressed Marx’s ideas on communism. However, it was later realized that communism did not work. Most interpretations or attempts to establish communism have ended up creating state-driven authoritarian economies and regimes which benefit single party political élite who are not accountable to the people at all.

Command Planned Economy

An economy characterized by Command Planning is notable for several distinguishing features:
1. Collective or state ownership of capital: capital resources such as money, property and other physical assets are owned by the State. There is no (or very little) private ownership.

2. Inputs and outputs are determined by the State: the State has an elaborate planning mechanism in place that determines the level and proportions of inputs to be devoted to producing goods and services. Local planning authorities are handed 1 year, 5 year, 10 year or, in the case of China, up to 25-year plans. The local authorities then implement these plans by meeting with State Owned Enterprises, whereby further plans are developed specific to the business. Inputs are allocated according to the plans and output targets are set.

3. Labor is allocated according to state plans: in a command planning economy, there is no choice of profession; when a child is in school (from a very early age), a streaming system allocates people into designated industries.

4. Private ownership is not possible: under a command planning system an individual cannot own shares, real estate, or any other form of physical or non-physical asset. People are allocated residences by the State.

5. Prices and paying for goods and services: prices are regulated entirely by the State with little regard for the actual costs of production. Often a currency does not exist in a command planning economy and when it does, its main purpose is for accounting. Instead of paying for goods and services when you need to buy them, you are allocated goods and services. This is often also called rationing.

In western democratic and capitalist societies, the price mechanism is a fundamental operator in allocating resources. The laws of demand and supply interact, the price of goods (and services) send signals to producers and consumers alike to determine what goods and quantities are produced, and helps determine what the future demands and quantities will be.

The law of demand states that the higher the price of a good or service, the less the amount of that good or service will be consumed. In other words, the quantity of a good or service demanded, rises when the price falls and falls when the price increases.

### GLOSSARY

**Economic System**

An economic system is the combination of the various agencies, entities (or even sectors as described by some authors) that provide the economic structure that defines the social community.

**Ending**

A termination or conclusion.

**Enterprise**

A company, business, organization, or other purposeful endeavor.

**Good**

An object produced for market.

**Industry**

The sector of the economy consisting of large-scale enterprises.

**Inputs**

Each participant’s contributions that are viewed as entitling him/her to rewards or costs. Examples include time, effort, and loyalty.

**Leadership**

A process of social influence in which one person can enlist the aid and support of others in the accomplishment of a common task. The capacity of someone to lead. The capacity of someone to lead.
Price Mechanism
An economic term that refers to the buyers and sellers who negotiate prices of goods or services depending on demand and supply. A price mechanism or market-based mechanism refers to a wide variety of ways to match up buyers and sellers through price rationing.

Resource
Something that one uses to achieve an objective, e.g. raw materials or personnel.

Services
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

Streaming
The transmission of digital audio or video, or the reception or playback of such data without first storing it.

READING: THE BENEFITS OF COMMUNISM

Communism ideology supports widespread universal social welfare, including improvements in public health and education.

KEY points

- The theoretical advantages of communism are built around equality and strong social communities.
- Communist ideology advocates universal education with a focus on developing the proletariat with knowledge, class consciousness, and historical understanding.
- Communism supports the emancipation of women and the ending of their exploitation.
- Communist ideology emphasizes the development of a “New Man”—a class-conscious, knowledgeable, heroic, proletarian person devoted to work and social cohesion, as opposed to the antithetic “bourgeois individualist” associated with cultural backwardness and social atomisation.

Terms

- **Communism**: A political philosophy or ideology advocating holding the production of resources collectively
- **Antithetic**: Diametrically opposed.
- **Bourgeois**: Of or relating to capitalist exploitation of the proletariat.
- **Proletariat**: The working class or lower class.
Examples

• In theory, Communism seems to have some very desirable characteristics. In practice, however, it has many drawbacks, and historically it seems that only the most corrupt members of Communist governments have gained advancement within systems. When a system depends on an entire community but is controlled by a few corrupt bureaucrats, it cannot be successful.

• However, this is not to say that state run enterprises in certain areas are a bad idea. Publicly-owned utilities such as water, electricity, and postal services have proven to be beneficial in countries, even when no communist system exists.

The Benefits of Communism

Theoretically, there are many benefits that can be achieved through a communist society. Communist ideology supports widespread universal social welfare. Improvements in public health and education, provision of child care, provision of state-directed social services, and provision of social benefits will, theoretically, help to raise labor productivity and advance a society in its development. Communist ideology advocates universal education with a focus on developing the proletariat with knowledge, class consciousness, and historical understanding. Communism supports the emancipation of women and the ending of their exploitation. Both cultural and educational policy in communist states have emphasized the development of a “New Man”—a class-conscious, knowledgeable, heroic, proletarian person devoted to work and social cohesion, as opposed to the antithetic “bourgeois individualist” associated with cultural backwardness and social atomization.

Other theoretically beneficial ideas characteristic of communist societies include:

1. *People are equal.* In a communist regime, people are treated equally in the eyes of the government regardless of education, financial standing, et cetera. Economic boundaries don’t separate or categorize people, which can help mitigate crime and violence.

2. *Every citizen can keep a job.* In a communist system, people are entitled to jobs. Because the government owns all means of production, the government can provide jobs for at least a majority of the people. Everyone in a communist country is given enough work opportunities to live and survive. Every citizen, however, must do his or her part for the economy to receive pay and other work benefits.

3. *There is an internally stable economic system.* In communism, the government dictates economic structure; therefore, economic instability is out of the question. Every citizen is required to work in order to receive benefits, and those who don’t have corresponding sanctions. This creates an incentive to participate and to encourage economic growth.

4. *Strong social communities are established.* In communism, there are certain laws and goals which determine resource and responsibility allocation. If the citizens abide by these laws, this leads to a harmonious spirit of sharing one goal. Consequently, this builds stronger social communities and an even stronger economy.

5. *Competition doesn’t exist.* In communist societies, everyone can work harmoniously without stepping on each other’s toes. Work, responsibility, and rewards are shared equally among the citizens. If people have no sense of envy, jealousy or ambitions that counter the goals of the state, then a harmonious economic development can be maintained.

6. *Efficient distribution of resources.* In a communist society, the sense of cooperation allows for efficiency in resource distribution. This is very important, especially in times of need and in emergency situations.

**GLOSSARY**

**Benefit**

An advantage, help or aid from something. Employee benefits and (especially in British English) benefits in kind (also called fringe benefits, perquisites, perqs or perks) are various non-wage compensations provided to employees in addition to their normal wages or salaries.

**Competition**
Competition in biology, ecology, and sociology, is a contest between organisms, animals, individuals, groups, etc., for territory, a niche, or a location of resources, for resources and goods, for prestige, recognition, awards, mates, or group or social status, for leadership; it is the opposite of cooperation.

Community
A group of interdependent organisms inhabiting the same region and interacting with each other. A group sharing a common understanding and often the same language, manners, tradition and law. (See civilization)

Developing of a country
Becoming economically more mature or advanced; becoming industrialized.

Distribution
The process by which goods get to final consumers over a geographical market, including storing, selling, shipping, and advertising. the set of relative likelihoods that a variable will have a value in a given interval. A probability distribution; the set of relative likelihoods that a variable will have a value in a given interval.

Economic System
An economic system is the combination of the various agencies, entities (or even sectors as described by some authors) that provide the economic structure that defines the social community.

Economy
Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

Efficiency
The extent to which a resource, such as electricity, is used for the intended purpose; the ratio of useful work to energy expended. The extent to which time is well used for the intended task. Improved efficiency was a principle goal of progressives, one they thought attainable by the application of scientific and rational thought to social problems.

Ending
A termination or conclusion.

Enterprise
A company, business, organization, or other purposeful endeavor.

Goal
A desired result that one works to achieve.

Incentive
Something that motivates, rouses, or encourages. It is used to motivate individuals (often, employees) for better performance by providing financial or other types of rewards. An anticipated reward or aversive event available in the environment. Something that motivates an individual to perform an action.

Lead
Potential opportunity for a sale or transaction, a potential customer.
Productivity

Productivity is a measure of the efficiency of production and is defined as total output per one unit of a total input. The rate at which goods or services are produced by a standard population of workers. A ratio of production output to what is required to produce it (inputs). The state of being productive, fertile, or efficient. The rate at which products and services are produced relative to a particular workforce.

Resource

Something that one uses to achieve an objective; for example, a resource could be a raw material or an employee.

Services

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

System

A whole composed of relationships among the members. The part of the universe being studied, arbitrarily defined to any size desired.

READING: THE DISADVANTAGES OF COMMUNISM

Businesses under Communist system have very strict limitations as to what they can and cannot do, which can hamper productivity and innovation.

KEY Points

- In a Communist system, the central authority dictates the means and quantity of production, and places strict rules on businesses.
- Since there is no competition amongst firms, each is given the same amount of money and each worker is paid the same, with the same expectations of each.
- All businesses are ultimately owned by the government.
- Populations tend to be treated homogeneously, meaning that common goals or sets of rules will not apply to different segments of the population and community.
- Without a price mechanism, supply and demand are difficult to balance perfectly over time.

Term

- *Price mechanism*: An economic term that refers to the buyers and sellers who negotiate prices of goods or services depending on demand and supply. A price mechanism or market-based mechanism refers to a wide variety of ways to match up buyers and sellers through price rationing.
Example

• Ho Chi Minh raised a guerrilla army in Vietnam, promising them a Utopian communist future of rule by the people and a communal country. However, what transpired was a nation ruled by corrupt Party officials, with no rights or civil liberty. The theory peddled by Ho Chi Minh was far removed from the practice of Communism once he was successfully elected. There are many other examples of how Communism has failed the people of a country. Whether this is down simply to corrupt leaders, or to a deeper flaw in the nature of Communism is a subject debated by many scholars.

Disadvantages of Communism

The economic and political system of Communism effectively dictates what can and cannot be done in the realm of business. There are defined limitations for the amount a business can produce and how much money it can earn.

In addition to directly controlling the means of production, Communism places strict rules as to how businesses operate in such a way that a classless society is born. No matter what field a business specializes in, the same amount of funds will be allocated to each, and each worker will receive the same amount of money. This can cause emotional unrest between workers who wish to be specially recognized for their work. It can serve to create uncomfortable conditions for workers in a society without rank or varying specialty. Finally, it can be stifling to entrepreneurial spirit, which is key to a country’s economic growth and development. The U.S., a capitalistic nation, has greatly benefited from that small business and entrepreneurial atmosphere, a backdrop for the American dream.

More specifically, in Communism:

• The government owns all the businesses and properties (the means of production).
• There is no freedom of speech.
• Large or geographically-broad populations tend to be diverse, making it difficult to maintain a common goal or set of rules for shared effort and resources.
• Central planning is difficult to achieve.
• Consumers needs are not taken into consideration.
• Productivity and efficiency are difficult to achieve without profit motive for the workers.
• It is difficult to achieve internal balances between supply and demand without a price mechanism.

The Kremlin
Only the government has a say in production planning under a Communist system.

<table>
<thead>
<tr>
<th>GLOSSARY</th>
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<tbody>
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<td><strong>Productivity</strong></td>
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<tr>
<td><strong>Profits</strong></td>
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<tr>
<td>Collective form of profit.</td>
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<td><strong>Resource</strong></td>
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<td>Something that one uses to achieve an objective, for example a raw material or an employee.</td>
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<td><strong>Right</strong></td>
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A Mixed Economy exhibits characteristics of both market and planned economies, with private and state sectors providing direction.

**KEY points**

- The term Mixed Economy is very broadly defined and has been used to describe economies as diverse as the United States and Cuba.
- The means of production are privately owned, and markets remain the dominant form of economic coordination. However, governments wield significant influence over the economy through monetary and fiscal policy and regulation.
- Characteristics of mixed economies include welfare systems, employment standards, environmental protection, publicly owned enterprises, and antitrust policies.
- Keynesian economics advocates the presence of a mixed economy. This line of thought subsided between 1970 and 2000, but has regained considerable popularity after the financial crisis of 2008.

**Terms**

- *Mixed economy*: An economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies.
- *Welfare state*: A social system in which the state takes overall responsibility for the welfare of its citizens, providing health care, education, unemployment compensation and social security.
- *Mixed economies*: a system in which both the state and private sector direct the way goods and services are bought and sold.
- *Keynesian economics*: The group of macroeconomic schools of thought based on the ideas of 20th-century economist John Maynard Keynes. Advocates of Keynesian economics argue that private sector decisions sometimes lead to inefficient macroeconomic outcomes that require active policy responses by the public sector, particularly monetary policy actions by the central bank and fiscal policy actions by the government to stabilize output over the business cycle.

**Examples**

- The American School (also known as the National System) is the economic philosophy that dominated United States national policies from the time of the American Civil War until the mid-twentieth century, and is an example of a mixed economy. It consisted of a three core policy initiative: protecting industry through high tariffs (1861–1932), government investment in infrastructure through internal improvements, and a national bank to promote the growth of productive enterprises. During this period
the United States grew into the largest economy in the world, surpassing the UK (though not the British Empire) by 1880.

- Dirigisme is an economic policy initiated under Charles de Gaulle of France designating an economy where the government exerts strong directive influence. It involved state control of a minority of the industry, such as transportation, energy and telecommunication infrastructures, as well as various incentives for private corporations to merge or engage in certain projects. Under its influence, France experienced what is called Thirty Glorious Years of profound economic growth.
- Social market economy is the economic policy of modern Germany that steers a middle path between the goals of socialism and capitalism within the framework of a private market economy and aims at maintaining a balance between a high rate of economic growth, low inflation, low levels of unemployment, good working conditions, public welfare and public services by using state intervention.

Mixed Economies

What is a Mixed Economy?

A mixed economy is an economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies. Most mixed economies can be described as market economies with strong regulatory oversight, in addition to having a variety of government-sponsored aspects.

A mail truck

Restrictions are sometimes placed on private mail systems by mixed economy governments. For example, in the United States, the USPS enjoys a government monopoly on non-urgent letter mail as described in the Private Express Statutes.

While there is not one single definition for a mixed economy, the definitions always involve a degree of private economic freedom mixed with a degree of government regulation of markets.

The Plan Behind a Mixed Economy

The basic plan of the mixed economy is that:

- The means of production are mainly under private ownership;
- Markets remain the dominant form of economic coordination; and
- Profit-seeking enterprises and the accumulation of capital would remain the fundamental driving force behind economic activity. However, the government would wield considerable indirect influence over the economy through fiscal and monetary policies designed to counteract economic downturns and capitalism’s tendency toward financial crises and unemployment, along with playing a role in interventions that promote social welfare. Subsequently, some mixed economies have expanded in scope to include a role for indicative economic planning and/or large public enterprise sectors.

The relative strength or weakness of each component in the national economy can vary greatly between countries. Economies ranging from the United States to Cuba have been termed mixed economies. The term is also used to describe the economies of countries which are referred to as welfare states, such as Norway and Sweden.

What Do Governments Provide?

Governments in mixed economies often provide:

- Environmental protection,
- Maintenance of employment standards,
- A standardized welfare system, and
- Maintenance of competition.
Who Supports the Ideal of Mixed Economies?

As an economic ideal, mixed economies are supported by people of various political persuasions, typically center-left and center-right, such as social democrats or Christian democrats. Supporters view mixed economies as a compromise between state socialism and laissez-faire capitalism that is superior in net effect to either of those.

Keynesian economics advocates a mixed economy — predominantly private sector, but with a significant role of government and public sector. It also served as the economic model during the later part of the Great Depression, World War II, and the post-war economic expansion (1945–1973), though it lost some influence following the tax surcharge in 1968 and the stagflation of the 1970s. The advent of the global financial crisis in 2008 has caused a resurgence in Keynesian thought.

**GLOSSARY**

**Capital**
Money and wealth. The means to acquire goods and services, especially in a non-barter system. The uppermost part of a column. Money and wealth; the means to acquire goods and services, especially in a non-barter system. Already-produced durable goods available for use as a factor of production, such as steam shovels (equipment) and office buildings (structures).

**Capitalism**
A socio-economic system based on the abstraction of resources into the form of privately-owned money, wealth, and goods, with economic decisions made largely through the operation of a market unregulated by the state. A socio-economic system based on private property rights, including the private ownership of resources or capital, with economic decisions made largely through the operation of a market unregulated by the state.

**Coordination**
The resulting state of working together; cooperation; synchronization.

**Corporation**
A group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members.

**Depression**
A period of major economic contraction; officially, four consecutive quarters of negative, real GDP growth (according to NBER). In psychotherapy and psychiatry, a period of unhappiness or low morale which lasts longer than several weeks and may include ideation of self-inflicted injury or suicide.

**Economic System**
An economic system is the combination of the various agencies, entities (or even sectors as described by some authors) that provide the economic structure that defines the social community.

**Economy**
Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

**Employment**
The work or occupation for which one is used, and often paid.

**Enterprise**
A company, business, organization, or other purposeful endeavor.

**Fiscal Policy**
Government policy that attempts to influence the direction of the economy through changes in government spending or taxes. In economics and political science, fiscal policy is the use of government revenue collection or taxation, and expenditure (spending) to influence the economy.

**Framework**
The identification and categorization of processes or steps that constitute a complex task or mindset in order to render explicit the tacit and implicit. A basic conceptual structure.

**Goal**
A desired result that one works to achieve.

**Good**
An object produced for market.

**Incentive**
Something that motivates, rouses, or encourages. It is used to motivate individuals (often, employees) for better performance by providing financial or other types of rewards. An anticipated reward or aversive event available in the environment. Something that motivates an individual to perform an action.

**Industry**
The sector of the economy consisting of large-scale enterprises.

**Inflation**
In economics, inflation is a rise in the general level of prices of goods and services in an economy over a period of time. An increase in the general level of prices or in the cost of living. An increase in the quantity of money, leading to a devaluation of existing money.

**Investment**
The placement or expenditure of capital in expectation of deriving income or profit from its use.

**Market**
A group of potential customers for one’s product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

**Monetary Policy**
The process by which the monetary authority of a country controls the supply of money, often targeting a rate of interest for the purpose of promoting economic growth and stability. The process by which the government, central bank, or monetary authority manages the supply of money, or trading in foreign exchange markets.

**Planning**
The act of formulating a course of action, or of drawing up plans.

**Private Sector**
All organizations in an economy or jurisdiction that are not controlled by government, including privately owned businesses and not-for-profit organizations.

**Public Sector**
Industries or services provided or funded by the government.

**Regulation**
A law or administrative rule, issued by an organization, used to guide or prescribe the conduct of members of that organization. Can specifically refer to acts in which a government or state body limits the behavior of businesses. A regulation is a legal provision that creates, limits, or constrains a right; creates or limits a duty; or allocates a responsibility.

**Scope**
The extent of the area or subject matter that something deals with or to which it is relevant. The breadth, depth, or reach of a subject; a domain. The breadth, depth or reach of a subject; a domain.

**Services**
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

**Socialism**
A political philosophy based on principles of community decision making, social equality, and the avoidance of economic and social exclusion, with preference to community goals over individual ones. Any of various economic and political philosophies that support social equality, collective decision-making, distribution of income based on contribution and public ownership of productive capital and natural resources, as advocated by socialists. The intermediate phase of social development between capitalism and full communism. This is a strategy whereby the state has control of all key resource-producing industries and manages most aspects of the economy, in contrast to laissez-faire capitalism.

**Standard**
Something used as a measure for comparative evaluations A level of quality or attainment.

**System**
A whole composed of relationships among the members. The part of the universe being studied, arbitrarily defined to any size desired.

**Tariff**
A system of government-imposed duties levied on imported or exported goods; a list of such duties, or the duties themselves.
READING: THE BENEFITS OF MIXED ECONOMIES

A mixed economy allows private participation in production while ensuring that society is protected from the full swings of the market.

<table>
<thead>
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<th>KEY points</th>
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<tr>
<td>• Mixed economies allow many more freedoms than command economies, such as the freedom to possess the means of production; to participate in managerial decisions; to buy, sell, fire, and hire as needed; and for employees to organize and protest peacefully.</td>
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<tr>
<td>• Mixed economies have a high level of state participation and spending, leading to tax-funded libraries, schools, hospitals, roads, utilities, legal assistance, welfare, and social security.</td>
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<td>• Various restrictions on business are made for the greater good, such as environmental regulation, labor regulation, antitrust and intellectual property laws.</td>
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<td>• The ideal combination of these freedoms and restrictions is meant to ensure the maximum standard of living for the population as a whole.</td>
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Terms

• **Monopoly**: An exclusive control over the trade or production of a commodity or service through exclusive possession.

• **Social Security**: A system whereby the state either through general or specific taxation provides various benefits to help ensure the well-being of its citizens.

• **Protectionism**: A policy of protecting the domestic producers of a product by imposing tariffs, quotas or other barriers on imports.

Examples

• The US economy is best described as a mixed economy, because even though it strongly advocates free market principles, it relies on the government to deal with matters that the private sector overlooks, ranging from education to the environment. The government has also helped nurture new industries and has played a role in protecting American companies from competition abroad. An example of this is the heavily subsidized agriculture industry in the US. Overall, the US has benefited from this combination.

Overview: The Advantages of a Mixed Economy

A mixed economy permits private participation in production, which in return allows healthy competition that can result in profit. It also contributes to public ownership in manufacturing, which can address social welfare needs.

Marketplace

Private investment, freedom to buy, sell, and profit, combined with economic planning by the state, including significant regulations (e.g. wage or price controls), taxes, tariffs, and state-directed investment.
The advantage of this type of market is that it allows competition between producers with regulations in place to protect society as a whole. With the government being present in the economy it brings a sense of security to sellers and buyers. This security helps maintain a stable economy.

Overall, businesses, as well as consumers, in mixed economies have freedoms that are important to both. And while government is actively involved and provides support, its control is limited, which is good for structure.

The Details: The Advantages of a Mixed Economy

- In a mixed economy, private businesses can decide how to run their businesses (e.g. what to produce, at what price, who to employ, etc.).
- Consumers also have a choice in what they want to buy.
- In this system, there is also less income inequality.
- Monopolies, market structures that are the only producer of a certain product, are allowed under government watch so they do not make it impossible for entrepreneurs in the same industry to succeed.

More specifically:

The elements of a mixed economy have been demonstrated to include a variety of freedoms:

- to possess means of production (farms, factories, stores, etc.)
- to participate in managerial decisions (cooperative and participatory economics)
- to travel (needed to transport all the items in commerce, to make deals in person, for workers and owners to go to where needed)
- to buy (items for personal use, for resale; buy whole enterprises to make the organization that creates wealth a form of wealth itself)
- to sell (same as buy)
- to hire (to create organizations that create wealth)
- to fire (to maintain organizations that create wealth)
- to organize (private enterprise for profit, labor unions, workers’ and professional associations, non-profit groups, religions, etc.)
- to communicate (free speech, newspapers, books, advertisements, make deals, create business partners, create markets)
- to protest peacefully (marches, petitions, sue the government, make laws friendly to profit making and workers alike, remove pointless inefficiencies to maximize wealth creation).

They provide tax-funded, subsidized, or state-owned factors of production, infrastructure, and services:

- libraries and other information services
- roads and other transportation services
- schools and other education services
- hospitals and other health services
- banks and other financial services
- telephone, mail, and other communication services
- electricity and other energy services (e.g. oil, gas)
- water systems for drinking, agriculture, and waste disposal
- subsidies to agriculture and other businesses
- government-granted monopoly to otherwise private businesses
- legal assistance
- government-funded or state-run research and development agencies

Such governments also provide some autonomy over personal finances, but include involuntary spending and investments, such as transfer payments and other cash benefits, including:

- welfare for the poor
- social security for the aged and infirm
- government subsidies to business
- mandatory insurance (e.g. automobile)

They also impose regulation laws and restrictions that help society as a whole, such as:

- environmental regulation (e.g. toxins in land, water, air)
labor regulation, including minimum wage laws
consumer regulation (e.g. product safety)
antitrust laws
intellectual property laws
incorporation laws
protectionism
import and export controls, such as tariffs and quotas
taxes and fees written or enforced with manipulation of the economy in mind

GLOSSARY

Agriculture
The art or science of cultivating the ground, including the harvesting of crops, and the rearing and management of livestock; tillage; husbandry; farming.

Autonomy
The capacity to make an informed, uncoerced decision. Self-government; freedom to act or function independently.

Command economy
Most of the economy is planned by a central government authority and organized along a top-down administration where decisions regarding production output requirements and investments are decided by planners from the top, or near the top, of the chain of command.

Benefit
An advantage, help or aid from something. Employee benefits and (especially in British English) benefits in kind (also called fringe benefits, perquisites, perqs or perks) are various non-wage compensations provided to employees in addition to their normal wages or salaries.

Communication
The concept or state of exchanging information between entities. An instance of information transfer; a conversation or discourse.

Consumer
Someone who acquires goods or services for direct use or ownership rather than for resale or use in production and manufacturing. The consumer is the one who pays to consume the goods and services produced. As such, consumers play a vital role in the economic system of a nation. In the absence of their effective demand, the producers would lack a key motivation to produce, which is to sell to consumers.

Economy
Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

Entrepreneur
A person who organizes and operates a business venture and assumes much of the associated risk. A person who organizes a risky activity of any kind and acts substantially in the manner of a business entrepreneur.

Export
This term export is derived from the conceptual meaning to ship the goods and services out of the port of a country. To sell (goods) to a foreign country. Any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade.

**Finance**

To provide or obtain funding for a transaction or undertaking; to back; to support. The science of management of money and other assets.

**Free market**

Any economic market in which trade is unregulated; an economic system free from government intervention.

**Good**

An object produced for market.

**Import**

Something brought in from an exterior source, especially for sale or trade. To bring (something) in from a foreign country, especially for sale or trade.

**Incorporation**

The act of incorporating, forming a corporation or the state of being incorporated.

**Industry**

The sector of the economy consisting of large-scale enterprises.

**Insurance**

A means of indemnity against a future occurrence of an uncertain event.

**Intellectual property**

Any product of someone’s intellect that has commercial value: copyrights, patents, trademarks, and trade secrets. Intellectual property (IP) is a juridical concept that refers to creations of the mind for which exclusive rights are recognized.

**Investment**

The placement or expenditure of capital in expectation of deriving income or profit from its use.

**Labor union**

A continuous association of wage-earners for the purpose of maintaining or improving the conditions of their employment; a trade union. An association of workers for the purpose of consolidating bargaining power in disputes with employers.

**Leading**

The management function of determining what must be done in a situation and getting others to do it to conduct or direct with authority.

**Market**

A group of potential customers for one’s product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.
Minimum wage
The lowest rate at which an employer can legally pay an employee; usually expressed as pay per hour.

Mixed economies
A system in which both the state and private sector direct the way goods and services are bought and sold.

Mixed economy
An economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies. Most mixed economies can be described as market economies with strong regulatory oversight, in addition to having a variety of government-sponsored aspects.

Price
The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Private sector
All organizations in an economy or jurisdiction that are not controlled by government, including privately owned businesses and not-for-profit organizations.

Product
Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

Profits
Collective form of profit.

Regulation
A law or administrative rule, issued by an organization, used to guide or prescribe the conduct of members of that organization; can specifically refer to acts in which a government or state body limits the behavior of businesses. A regulation is a legal provision that creates, limits, or constrains a right; creates or limits a duty; or allocates a responsibility.

Security
Proof of ownership of stocks, bonds, or other investment instruments. The condition of not being threatened, especially physically, psychologically, emotionally, or financially.

Services
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

Standard
Something used as a measure for comparative evaluations. A level of quality or attainment.

System
A whole composed of relationships among the members. The part of the universe being studied, arbitrarily defined to any size desired.
Tariff
A system of government-imposed duties levied on imported or exported goods; a list of such duties, or the duties themselves.

Wage
An amount of money paid to a worker for a specified quantity of work, usually expressed on an hourly basis.

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**READING: THE DISADVANTAGES OF MIXED ECONOMIES**

The disadvantages of mixed economies can be understood through examining criticisms of social democracy.

**KEY points**

- One disadvantage of mixed economies is that they tend to lean more toward government control and less toward individual freedoms.
- While most modern forms of government are consistent with some form of mixed economy, the mixed economy is most commonly associated with social democratic parties or nations run by social democratic governments.
- Some critics of contemporary social democracy argue that when social democracy abandoned Marxism it also abandoned socialism and has become, in effect, a liberal capitalist movement.
- Marxian socialists argue that because social democratic programs retain the capitalist mode of production they also retain the fundamental issues of capitalism, including cyclical fluctuations, exploitation and alienation.
- The democratic socialist critique of social democracy states that capitalism could never be sufficiently “humanized” and any attempt to suppress the economic contradictions of capitalism would only cause them to emerge elsewhere.
- Market socialists criticize social democracy for maintaining a property-owning capitalist class, which has an active interest in reversing social democratic policies and a disproportionate amount of power over society to influence governmental policy as a class.

**Terms**

- **Social democracy**: a moderate political philosophy or ideology that aims to achieve socialistic goals within capitalist society such as by means of a strong welfare state and regulation of private industry.
- **Regulation**: A law or administrative rule, issued by an organization, used to guide or prescribe the conduct of members of that organization.
• **Mixed economy**: Mixed economy is an economic system in which both the state and private sector direct the economy, reflecting characteristics of both market economies and planned economies.

**Examples**

• Many pubs in Britain are suffering due to drinking and smoking regulations imposed by the government for the good of society. As a result, many question whether pubs have a future.

**Disadvantages of Social Democratic Policy In a Mixed Economy**

While most modern forms of government are consistent with some form of mixed economy, given the broad range of economic systems that can be described by the term, the mixed economy is most commonly associated with social democratic parties or nations run by social democratic governments. In contemporary terms, “social democracy” usually refers to a social corporatist arrangement and a welfare state in developed capitalist economies.

Critics of contemporary social democracy argue that when social democracy abandoned Marxism it also abandoned socialism and has become, in effect, a liberal capitalist movement. They argue that this has made social democrats similar to center-left, but pro-capitalist groups, such as the U.S. Democratic Party.

The Democratic Party Logo
The Democratic party in the United States is seen by some critics of contemporary social democracy (and mixed economies) as a watered-down, pro-capitalist movement.

Marxian socialists argue that because social democratic programs retain the capitalist mode of production they also retain the fundamental issues of capitalism, including cyclical fluctuations, exploitation and alienation. Social democratic programs intended to ameliorate capitalism, such as unemployment benefits or taxation on profits and the wealthy, create contradictions of their own through limiting the efficiency of the capitalist system by reducing incentives for capitalists to invest in production.

Others contrast social democracy with democratic socialism by defining the former as an attempt to strengthen the welfare state and the latter as an alternative socialist economic system to capitalism. The democratic socialist critique of social democracy states that capitalism could never be sufficiently “humanized” and any attempt to suppress the economic contradictions of capitalism would only cause them to emerge elsewhere. For example, attempts to reduce unemployment too much would result in inflation, and too much job security would erode labor discipline. In contrast to social democracy, democratic socialists advocate a post-capitalist economic system based either on market socialism combined with workers self-management, or on some form of participatory-economic planning.

Social democracy can also be contrasted with market socialism. While a common goal of both systems is to achieve greater social and economic equality, market socialism does so by changes in enterprise ownership and management, whereas social democracy attempts to do so by government-imposed taxes and subsidies on privately owned enterprises. Market socialists criticize social democracy for maintaining a property-owning capitalist class, which has an active interest in reversing social democratic policies and a disproportionate amount of power over society to influence governmental policy as a class.

<table>
<thead>
<tr>
<th>GLOSSARY</th>
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<tr>
<td><strong>Active</strong></td>
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<tr>
<td>Having the power or quality of acting; causing change; communicating action or motion; acting.</td>
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<td><strong>Benefit</strong></td>
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An advantage, help or aid from something. Employee benefits and (especially in British English) benefits in kind (also called fringe benefits, perquisites, perqs or perks) are various non-wage compensations provided to employees in addition to their normal wages or salaries.

**Capitalism**

A socio-economic system based on the abstraction of resources into the form of privately-owned money, wealth, and goods, with economic decisions made largely through the operation of a market unregulated by the state.

**Economic system**

An economic system is the combination of the various agencies, entities (or even sectors as described by some authors) that provide the economic structure that defines the social community.

**Economy**

Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

**Efficiency**

The extent to which a resource, such as electricity, is used for the intended purpose; the ratio of useful work to energy expended. The extent to which time is well used for the intended task. Improved efficiency was a principle goal of progressives, one they thought attainable by the application of scientific and rational thought to social problems.

**Enterprise**

A company, business, organization, or other purposeful endeavor.

**Fluctuation**

A motion like that of waves; a moving in this and that direction.

**Goal**

A desired result that one works to achieve.

**Good**

An object produced for market.

**Incentive**

Something that motivates, rouses, or encourages. It is used to motivate individuals (often, employees) for better performance by providing financial or other types of rewards. An anticipated reward or aversive event available in the environment. Something that motivates an individual to perform an action.

**Inflation**

In economics, inflation is a rise in the general level of prices of goods and services in an economy over a period of time. An increase in the general level of prices or in the cost of living. An increase in the quantity of money, leading to a devaluation of existing money.

**Interest**
The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. A great attention and concern from someone or something; intellectual curiosity.

Lead
Potential opportunity for a sale or transaction, a potential customer.

Management
The act of getting people together to accomplish desired goals and objectives using available resources efficiently and effectively. Administration; the process or practice of managing administration; the process or practice of managing. Administration; the process or practice of managing.

Market
A group of potential customers for one’s product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

Mixed economies
A system in which both the state and private sector direct the way goods and services are bought and sold.

Planning
The act of formulating a course of action, or of drawing up plans.

Price
The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Product
Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

Profits
Collective form of profit.

Recession
A period of reduced economic activity. A significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, and industrial production.

Security
Proof of ownership of stocks, bonds, or other investment instruments. The condition of not being threatened, especially physically, psychologically, emotionally, or financially.

Socialism
Any of various economic and political philosophies that support social equality, collective decision-making, distribution of income based on contribution and public ownership of productive capital and natural resources, as advocated by socialists. A political philosophy based on principles of community decision making, social
equality, and the avoidance of economic and social exclusion, with preference to community goals over individual ones. The intermediate phase of social development between capitalism and full communism. This is a strategy whereby the state has control of all key resource-producing industries and manages most aspects of the economy, in contrast to laissez-faire capitalism.

System

A whole composed of relationships among the members. The part of the universe being studied, arbitrarily defined to any size desired.

Welfare state

A social system in which the state takes overall responsibility for the welfare of its citizens, providing health care, education, unemployment compensation, and social security.

ASSIGNMENT: WRITTEN ASSIGNMENT: "FOREVER BRIGHT" - EXPORTING AND ECONOMIC/POLITICAL SYSTEMS

Attached Files: Forever Bright Export Partners

For this module you will complete a written assignment “Forever Bright”. In order to complete this assignment you will need to:

1. Select ONE COUNTRY from EACH of the columns on the attached sheet. (Free Market, Socialist, Communist). These are the countries where you have identified a potential market for your amazing and highly effective new toothpaste “Forever Bright.”
2. RESEARCH the countries you have selected using the CIA Factbook, globalEDGE, and Vision of Humanity as a starting point to determine the economic and political climate for our business venture.
3. For EACH country:
   1. Identify the OPPORTUNITIES and THREATS to your global business venture posed by the economic/political environment.
   2. If you decide to pursue your business venture in these countries, what are the specific risks that you face as an international business entrepreneur?
   3. What, if anything, can you do to mitigate the risks as an exporter into these countries?
4. FOLLOW the guidelines for a written assignment and review the grading rubric for the assignment as well.

Vision of Humanity: Global Peace Index

This link will take you to the Home Page for “Vision of Humanity.” There you can research information regarding the “Global Peace Index” as part of your research for this Module.
Goal: Describe the differing political, economic, and cultural systems around the world that affect global business. Describe the differing political, economic, and cultural systems around the world that affect global business.
MODULE 4: "THAT'S NOT HOW WE DO IT BACK HOME"... CULTURAL SYSTEMS AROUND THE GLOBE

OVERVIEW

In this module we will explore culture and how it impacts global business efforts.

<table>
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<th>LEARNING OUTCOMES</th>
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<tr>
<td>After you complete the required assignments you will be able to:</td>
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<tr>
<td>• Define culture</td>
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<tr>
<td>• Identify the implications of culture on business operations</td>
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<tr>
<td>• Give examples of cultural differences among countries</td>
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READINGS

INSTRUCTIONS for this Module’s “Readings”

For this Module, you will not have traditional “readings.” Instead, when you click this link Presentation: Culture, it will launch an online Module/Presentation from Michigan State University. You do NOT have to complete the entire Module, so please read the following instructions before you do more work than you have to do.

1. You are responsible for viewing the following:
   1. Section 1: Presentation Slides 1 – 14. The “QUIZ” at the end of this section is NOT REQUIRED.
   2. Section 2: Presentation Slides 18 – 17. The “QUIZ” at the end of this section is NOT REQUIRED.
High-tech and digital news may dominate our attention globally, but no matter where you go, people still need to eat. Food is a key part of many cultures. It is part of the bonds of our childhood, creating warm memories of comfort food or favorite foods that continue to whet our appetites. So it’s no surprise that sugar and sweets are a key part of our food focus, no matter what the culture. Two of the most visible American exports are the twin brands of Dunkin’ Donuts and Baskin-Robbins.

Owned today by a consortium of private equity firms known as the Dunkin’ Brands, Dunkin’ Donuts and Baskin-Robbins have been sold globally for more than thirty-five years. Today, the firm has more than 14,800 points of distribution in forty-four countries with $6.9 billion in global sales.

After an eleven-year hiatus, Dunkin’ Donuts returned to Russia in 2010 with the opening of twenty new stores. Under a new partnership, “the planned store openings come 11 years after Dunkin’ Donuts pulled out of Russia, following three years of losses exacerbated by a rogue franchisee who sold liquor and meat pies alongside coffee and crullers.” [1] Each culture has different engrained habits, particularly in the choices of food and what foods are appropriate for what meals. The more globally aware businesses are mindful of these issues and monitor their overseas operations and partners. One of the key challenges for many companies operating globally with different resellers, franchisees, and wholly owned subsidiaries is the ability to control local operations.

This wasn’t the first time that Dunkin’ had encountered an overzealous local partner who tried to customize operations to meet local preferences and demands. In Indonesia in the 1990s, the company was surprised to find that local operators were sprinkling a mild, white cheese on a custard-filled donut. The company eventually approved the local customization since it was a huge success. [2]

Dunkin’ Donuts and Baskin-Robbins have not always been owned by the same firm. They eventually came under one entity in the late 1980s—an entity that sought to leverage the two brands. One of the overall strategies was to have the morning market covered by Dunkin’ Donuts and the afternoon-snack market covered by Baskin-Robbins. It is a strategy that worked well in the United States and was one the company employed as it started operating and expanding in different countries. The company was initially unprepared for the wide range of local cultural preferences and habits that would culturally impact its business. In Russia, Japan, China, and most of Asia, donuts, if they were known at all, were regarded more as a sweet type of bakery treat, like an éclair or cream puff. Locals primarily purchased and consumed them at shopping malls as an “impulse purchase” afternoon-snack item and not as a breakfast food.

In fact, in China, there was no equivalent word for “donut” in Mandarin, and European-style baked pastries were not common outside the Shanghai and Hong Kong markets. To further complicate Dunkin’ Donuts’s entry into China, which took place initially in Beijing, the company name could not even be phonetically spelled in Chinese.
characters that made any sense, as Baskin-Robbins had been able to do in Taiwan. After extensive discussion and research, company executives decided that the best name and translation for Dunkin’ Donuts in China would read Sweet Sweet Ring in Chinese characters.

Local cultures also impacted flavors and preferences. For Baskin-Robbins, the flavor library is controlled in the United States, but local operators in each country have been the source of new flavor suggestions. In many cases, flavors that were customized for local cultures were added a decade later to the main menus in major markets, including the United States. Mango and green tea were early custom ice cream flavors in the 1990s for the Asian market. In Latin America, dulce de leche became a favorite flavor. Today, these flavors are staples of the North American flavor menu.

One flavor suggestion from Southeast Asia never quite made it onto the menu. The durian fruit is a favorite in parts of Southeast Asia, but it has a strong, pungent odor. Baskin-Robbins management was concerned that the strong odor would overwhelm factory operations. (The odor of the durian fruit is so strong that the fruit is often banned in upscale hotels in several Asian countries.) While the durian never became a flavor, the company did concede to making ice cream flavored after the ube, a sweetened purple yam, for the Philippine market. It was already offered in Japan, and the company extended it to the Philippines. In Japan, sweet corn and red bean ice cream were approved for local sale and became hot sellers, but the two flavors never made it outside the country.

When reviewing local suggestions, management conducts a market analysis to determine if the global market for the flavor is large enough to justify the investment in research and development and eventual production. In addition to the market analysis, the company always has to make sure they have access to sourcing quality flavors and fruit. Mango proved to be a challenge, as finding the correct fruit puree differed by country or culture. Samples from India, Hawaii, Pakistan, Mexico, the Philippines, and Puerto Rico were taste-tested in the mainland United States. It seems that the mango is culturally regarded as a national treasure in every country where it is grown, and every country thinks its mango is the best. Eventually the company settled on one particular flavor of mango.

A challenging balance for Dunkin’ Brands is to enable local operators to customize flavors and food product offerings without diminishing the overall brand of the companies. Russians, for example, are largely unfamiliar with donuts, so Dunkin’ has created several items that specifically appeal to Russian flavor preferences for scalded cream and raspberry jam.[3]

In some markets, one of the company’s brands may establish a market presence first. In Russia, the overall “Dunkin’ Brands already ranks as a dessert purveyor. Its Baskin-Robbins ice-cream chain boasts 143 shops there, making it the No. 2 Western restaurant brand by number of stores behind the hamburger chain McDonald’s Corp.” [4] The strength of the company’s ice cream brand is now enabling Dunkin’ Brands to promote the donut chain as well.

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**Opening Case EXERCISES**

(AACSB: Ethical Reasoning, Multiculturalism, Reflective Thinking, Analytical Skills)

1. If you were a manager for Baskin-Robbins, how would you evaluate a request from a local partner in India to add a sugar-cane-flavored ice cream to its menu? What cultural factors would you look at?

2. Do you think Dunkin’ Brands should let local operators make their own decisions regarding flavors for ice creams, donuts, and other items to be sold in-country? How would you recommend that the company’s global management assess the cultural differences in each market? Should there be one global policy?

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DISCUSSION ASSIGNMENT: DUNKIN' BRANDS -
DUNKIN' DONUTS AND BASKIN-ROBBINS -
MAKING LOCAL GLOBAL

For this module you will complete a written assignment on Dunkin’ Donuts and the company’s global presence. In order to complete this assignment you will need to:

1. **READ** the previous case study: Dunkin Brands Making Local Global
2. **VISIT** the Dunkin’ Donuts website at http://www.dunkindonuts.com. Scroll to the BOTTOM of the web page and find the link that says: “Global Presence” which will allow you to get more information about the extent to which Dunkin’ Donuts has gone global.
3. **GO TO** at least ONE of the countries listed in this area and find out how “Local goes Global.” **PICK ONE COUNTRY/LOCATION** of Dunkin’ Donuts as the basis for your discussion for Question #1.
4. **DISCUSSION BOARD:** You have read the Dunkin’ Donuts case and researched on the corporate website how Dunkin’ “Goes Global.” You will base your INITIAL and TWO RESPONSE POSTS on the following questions:
   1. What are some of the most interesting local adaptations Dunkin’ Donuts has made based on your research?
   2. What cultural factors do you think Dunkin’ Donuts looked at when they made these adaptations?
   3. Do you think Dunkin’ Brands should let local operators make their own decisions regarding flavors for ice creams, donuts, and other items to be sold in-country?
   4. How would you recommend that the company’s global management assess the cultural differences in each market?
   5. Should there be one global policy?

**NOTE:** This is not an assignment where there is a great deal of “research.” The nature of the questions is directed towards what YOU think! You cannot Google the answer to these questions!
MODULE 5: IGNORANCE OF THE LAW IS NO EXCUSE: ETHICAL AND LEGAL ISSUES IN GLOBAL BUSINESS

OVERVIEW

In this module we will look at the way legal and ethical issues impact global business.

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Define ethics in general and business ethics in particular
- Identify the most common ethical issues facing businesses in a global environment
- Explain different theoretical approaches to ethics (such as utilitarian, righteous moralism)

READING: GLOBAL BUSINESS ETHICS

LEARNING OUTCOMES

By the end of this section, you will be able to:

- Define what global business ethics are, and discover how culture impacts business ethics.
- Learn how ethical issues impact global business.
- Identify how companies develop, implement, and enforce ethical standards.

The relationship between ethics and international business is extensive and is impacted by local perceptions, values, and beliefs.
Global Business Ethics

The field of ethics is a branch of philosophy that seeks virtue and morality, addressing questions about "right" and "wrong" behavior for people in a variety of settings; the standards of behavior that tell how human beings ought to act. is a branch of philosophy that seeks to address questions about morality—that is, about concepts such as good and bad, right and wrong, justice, and virtue. Ethics impacts many fields—not just business—including medicine, government, and science, to name a few. We must first try to understand the "origins of ethics—whether they come from religion, philosophy, the laws of nature, scientific study, study of political theory relating to ethical norms created in society or other fields of knowledge." The description below on the field of ethics shows how people think about ethics in stages, from where ethical principles come from to how people should apply them to specific tasks or issues.

This approach will be used in this chapter to help you understand global business ethics in a modern and current sense. As with this chapter’s review of culture, this section on global business ethics is less about providing you with a tangible list of dos and don'ts than it is about helping you understand the thinking and critical issues that global managers must deal with on an operational and strategic basis.

Where Do Our Values Come From?

Just as people look to history to understand political, technical, and social changes, so too do they look for changes in thinking and philosophy. There is a history to how thinking has evolved over time. What may or may not have been acceptable just a hundred years ago may be very different today—from how people present themselves and how they act and interact to customs, values, and beliefs.

Ethics can be defined as a system of moral standards or values. Cultural beliefs and programming influence our values. A sense of ethics is determined by a number of social, cultural, and religious factors; this sense influences us beginning early in childhood. People are taught how to behave by their families, exposure to education and thinking, and the society in which they live. Ethical behavior also refers to behavior that is generally accepted within a specific culture. Some behaviors are universally accepted—for example, people shouldn’t physically hurt other people. Other actions are less clear, such as discrimination based on age, race, gender, or ethnicity.

Culture impacts how local values influence global business ethics. There are differences in how much importance cultures place on specific ethical behaviors. For example, bribery remains widespread in many countries, and while people may not approve of it, they accept it as a necessity of daily life. Each professional is influenced by the values, social programming, and experiences encountered from childhood on. These collective factors impact how a person perceives an issue and the related correct or incorrect behaviors. Even within a specific culture, individuals have different ideas of what constitutes ethical or unethical behavior. Judgments may differ greatly depending on an individual’s social or economic standing, education, and experiences with other cultures and beliefs. Just as in the example of bribery, it should be noted that there is a difference between ethical behavior and normal practice. It may be acceptable to discriminate in certain cultures, even if the people in that society know that it is not right or fair. In global business ethics, people try to understand what the ethical action is and what the normal practice might be. If these are not consistent, the focus is placed on how to encourage ethical actions.

While it’s clear that ethics is not religion, values based on religious teachings have influenced our understanding of ethical behavior. Given the influence of Western thought and philosophy over the world in the last few centuries, many would say that global business has been heavily impacted by the mode of thinking that began with the Reformation and post-Enlightenment values, which placed focus on equality and individual rights. In this mode of thinking, it has become accepted that all people in any country and of any background are equal and should have equal opportunity. Companies incorporate this principle in their employment, management, and operational guidelines; yet enforcing it in global operations can be both tricky and inconsistent.

Did You Know?

What Are the Reformation and Enlightenment?
Modern political and economic philosophies trace their roots back to the Reformation and Enlightenment. The Reformation was a period of European history in the sixteenth century when Protestant thinkers, led by Martin Luther, challenged the teachings of the Roman Catholic Church. As a result of the Reformation, the Catholic Church lost its control over all scientific and intellectual thought. While there were a number of debates and discussions over the ensuing decades and century, the Reformation is widely believed to have led to another historical period called the Age of Enlightenment, which refers to a period in Western philosophical, intellectual, scientific, and cultural life in the eighteenth century. The Enlightenment, as it is commonly called, promoted a set of values in which reason, not religion, was advocated as the primary source for legitimacy and authority. As a result, it is also known as the Age of Reason.

It's important to understand the impact and influence of these two critical historical periods on our modern sense of global business ethics. The prevailing corporate values—including those of institutional and individual equality; the right of every employee to work hard and reap the rewards, financial and nonfinancial; corporate social responsibility; and the application of science and reason to all management and operational processes—have their roots in the thoughts and values that arose during these periods.

Impact of Ethics on Global Business

At first, it may seem relatively easy to identify unethical behavior. When the topic of business ethics is raised, most people immediately focus on corruption and bribery. While this is a critical result of unethical behavior, the concept of business ethics and—in the context of this book—global business ethics is much broader. It impacts human resources, social responsibility, and the environment. The areas of business impacted by global perceptions of ethical, moral, and socially responsible behavior include the following:

- Ethics and management
- Ethics and corruption
- Corporate social responsibility

Ethics and Management Practices

Ethics impacts various aspects of management and operations, including human resources, marketing, research and development, and even the corporate mission.

The role of ethics in management practices, particularly those practices involving human resources and employment, differs from culture to culture. Local culture impacts the way people view the employee-employer relationship. In many cultures, there are no clear social rules preventing discrimination against people based on age, race, gender, sexual preference, handicap, and so on. Even when there are formal rules or laws against discrimination, they may not be enforced, as normal practice may allow people and companies to act in accordance with local cultural and social practices.

Culture can impact how people see the role of one another in the workplace. For example, gender issues are at times impacted by local perceptions of women in the workplace. So how do companies handle local customs and values for the treatment of women in the workplace? If you're a senior officer of an American company, do you send a woman to Saudi Arabia or Afghanistan to negotiate with government officials or manage the local office? Does it matter what your industry is or if your firm is the seller or buyer? In theory, most global firms have clear guidelines articulating antidiscrimination policies. In reality, global businesses routinely self-censor. Companies often determine whether a person—based on their gender, ethnicity, or race—can be effective in a specific culture based on the prevailing values in that culture. The largest and most respected global companies, typically the Fortune Global 500, can often make management and employment decisions regardless of local practices. Most people in each country will want to deal with these large and well-respected companies. The person representing the larger company brings the clout of their company to any business interaction. In contrast, lesser-known, midsize, and smaller companies may find that who their representative is will be more important. Often lacking business recognition in the marketplace, these smaller and midsize companies have to rely on their corporate representatives to create the professional image and bond with their in-country counterparts.

Cultural norms may make life difficult for the company as well as the employee. In some cultures, companies are seen as “guardians” or paternal figures. Any efforts to lay off or fire employees may be perceived as culturally unethical. In Japan, where lifelong loyalty to the company was expected in return for lifelong employment, the
decade-long recession beginning in the 1990s triggered a change in attitude. Japanese companies finally began to alter this ethical perception and lay off workers without being perceived as unethical.

Global corporations are increasingly trying to market their products based not only on the desirability of the goods but also on their social and environmental merits. Companies whose practices are considered unethical may find their global performance impacted when people boycott their products. Most corporations understand this risk. However, ethical questions have grown increasingly complicated, and the “correct” or ethical choice has, in some cases, become difficult to define.

For example, the pharmaceutical industry is involved in a number of issues that have medical ethicists squirming. First, there’s the well-publicized issue of cloning. No matter what choice the companies make about cloning, they are sure to offend a great many consumers. At the same time, pharmaceutical companies must decide whether to forfeit profits and give away free drugs or cheaper medicines to impoverished African nations. Pharmaceutical companies that do donate medicines often promote this practice in their corporate marketing campaigns in hopes that consumers see the companies in a favorable light.

Tobacco companies are similarly embroiled in a long-term ethical debate. Health advocates around the world agree that smoking is bad for a person’s long-term health. Yet in many countries, smoking is not only acceptable but can even confer social status. The United States has banned tobacco companies from adopting marketing practices that target young consumers by exploiting tobacco’s social cache. However, many other countries don’t have such regulations. Should tobacco companies be held responsible for knowingly marketing harmful products to younger audiences in other countries?

Ethics and Corruption

To begin our discussion of corruption, let’s first define it in a business context. Corruption is “giving or obtaining advantage through means which are illegitimate, immoral, and/or inconsistent with one’s duty or the rights of others. Corruption often results from patronage.

Our modern understanding of business ethics notes that following culturally accepted norms is not always the ethical choice. What may be acceptable at certain points in history, such as racism or sexism, became unacceptable with the further development of society’s mind-set. What happens when cultures change but business practices don’t? Does that behavior become unethical, and is the person engaged in the behavior unethical? In some cultures, there may be conflicts with global business practices, such as in the area of gift giving, which has evolved into bribery—a form of corruption.

Paying bribes is relatively common in many countries, and bribes often take the form of grease payments, which are small inducements intended to expedite decisions and transactions. In India and Mexico, for example, a grease payment may help get your phones installed faster—at home or at work. Transparency International tracks illicit behavior, such as bribery and embezzlement, in the public sector in 180 countries by surveying international business executives. It assigns a CPI (Corruption Perceptions Index) rating to each country. New Zealand, Denmark, Singapore, and Sweden have the lowest levels of corruption, while the highest levels of corruption are seen in most African nations, Russia, Myanmar, and Afghanistan.

Even the most respected of global companies has found itself on the wrong side of the ethics issue and the law. In 2008, after years of investigation, Siemens agreed to pay more than 1.34 billion euros in fines to American and European authorities to settle charges that it routinely used bribes and slush funds to secure huge public-works contracts around the world. “Officials said that Siemens, beginning in the mid-1990s, used bribes and kickbacks to foreign officials to secure government contracts for projects like a national identity card project in Argentina, mass transit work in Venezuela, a nationwide cell phone network in Bangladesh and a United Nations oil-for-food program in Iraq under Saddam Hussein. ‘Their actions were not an anomaly,’ said Joseph Persichini Jr., the head of the Washington office of the Federal Bureau of Investigation. ‘They were standard operating procedures for corporate executives who viewed bribery as a business strategy.’”

Ethics in Action

Each year Transparency International analyzes trends in global corruption. The following is an excerpt from their 2010 Global Corruption Barometer report.
“Corruption has increased over the last three years, say six out of 10 people around the world. One in four people report paying bribes in the last year. These are the findings of the 2010 Global Corruption Barometer.

The 2010 Barometer captures the experiences and views of more than 91,500 people in 86 countries and territories, making it the only world-wide public opinion survey on corruption.

Views on corruption were most negative in Western Europe and North America, where 73 per cent and 67 per cent of people respectively thought corruption had increased over the last three years.

“The fall-out of the financial crises continues to affect people’s opinions of corruption, particular in North America and Western Europe. Institutions everywhere must be resolute in their efforts to restore good governance and trust,” said Huguette Labelle, Chair of Transparency International.

In the past 12 months one in four people reported paying a bribe to one of nine institutions and services, from health to education to tax authorities. The police are cited as being the most frequent recipient of bribes, according to those surveyed. About 30 per cent of those who had contact with the police reported having paid a bribe.

More than 20 countries have reported significant increases in petty bribery since 2006. The biggest increases were in Chile, Colombia, Kenya, FYR Macedonia, Nigeria, Poland, Russia, Senegal and Thailand. More than one in two people in Sub-Saharan Africa reported paying a bribe—more than anywhere else in the world.

Poorer people are twice as likely to pay bribes for basic services, such as education, than wealthier people. A third of all people under the age of 30 reported paying a bribe in the past 12 months, compared to less than one in five people aged 51 years and over.

Most worrying is the fact that bribes to the police have almost doubled since 2006, and more people report paying bribes to the judiciary and for registry and permit services than five years ago.

Sadly, few people trust their governments or politicians. Eight out of 10 say political parties are corrupt or extremely corrupt, while half the people questioned say their government’s action to stop corruption is ineffective.


Gift giving in the global business world is used to establish or pay respects to a relationship. Bribery, on the other hand, is more commonly considered the practice in which an individual would benefit with little or no benefit to the company. It’s usually paid in relation to winning a business deal, whereas gift giving is more likely to be ingrained in the culture and not associated with winning a specific piece of business. Bribery, usually in the form of a cash payment, has reached such high proportions in some countries that even locals express disgust with the corruption and its impact on daily life for businesses and consumers.

The practice of using connections to advance business interests exists in just about every country in the world. However, the extent and manner in which it is institutionalized differs from culture to culture.

In Western countries, connections are viewed informally and sometimes even with a negative connotation. In the United States and other similar countries, professionals prefer to imply that they have achieved success on their own merits and without any connections. Gift giving is not routine in the United States except during the winter holidays, and even then gift giving involves a modest expression. Businesses operating in the United States send modest gifts or cards to their customers to thank them for business loyalty in the previous year. Certain industries, such as finance, even set clear legal guidelines restricting the value of gifts, typically a maximum of $100.

In contrast, Asian, Latin American, and Middle Eastern cultures are quick to value connections and relationships and view them quite positively. Connections are considered essential for success. In Asia, gift giving is so ingrained in the culture, particularly in Japan and China, that it is formalized and structured.

For example, gift giving in Japan was for centuries an established practice in society and is still taken seriously. There are specific guidelines for gift giving depending on the identity of the giver or recipient, the length of the business relationship, and the number of gifts exchanged. The Japanese may give gifts out of a sense of
obligation and duty as well as to convey feelings such as gratitude and regret. Therefore, much care is given to the appropriateness of the gift as well as to its aesthetic beauty. Gift giving has always been widespread in Japan.

Today there are still business gift-giving occasions in Japan, specifically *oseibo* (year’s end) and *ochugen* (midsummer). These are must-give occasions for Japanese businesses. Oseibo gifts are presented in the first half of December as a token of gratitude for earlier favors and loyalty. This is a good opportunity to thank clients for their business. *Ochugen* usually occurs in mid-July in Tokyo and mid-August in some other regions. Originally an occasion to provide consolation to the families of those who had died in the first half of the year, ochugen falls two weeks before *obon*, a holiday honoring the dead.

Businesses operating in Japan at these times routinely exchange oseibo and ochugen gifts. While a professional is not obligated to participate, it clearly earns goodwill. At the most senior levels, it is not uncommon for people to exchange gifts worth $300 or $400. There is an established price level that one should pay for each corporate level.

Despite these guidelines, gift giving in Japan has occasionally crossed over into bribery. This level of corruption became more apparent in the 1980s as transparency in global business gained media attention. Asians tend to take a very different view of accountability than most Westerners. In the 1980s and 1990s, several Japanese CEOs resigned in order to apologize and take responsibility for their companies’ practices, even when they did not personally engage in the offending practices. This has become an accepted managerial practice in an effort to preserve the honor of the company. While Japanese CEOs may not step down as quickly as in the past, the notion of honor remains an important business characteristic.

Long an established form of relationship development in all business conducted in Asia, the Arab world, and Africa, gift giving was clearly tipping into outright bribery. In the past two decades, many countries have placed limits on the types and value of gifts while simultaneously banning bribery in any form. In the United States, companies must adhere to the Foreign Corrupt Practices Act, a federal law that specifically bans any form of bribery. Even foreign companies that are either listed on an American stock exchange or conduct business with the US government come under the purview of this law.

There are still global firms that engage in questionable business gift giving; when caught, they face fines and sanctions. But for the most part, firms continue with business as usual. Changing the cultural practices of gift giving is an evolving process that will take time, government attention, and more transparency in the awarding of global business contracts.

Companies and their employees routinely try to balance ethical behavior with business interests. While corruption is now widely viewed as unethical, firms still lose business to companies that may be less diligent in adhering to this principle. While the media covers stories of firms that have breached this ethical conduct, the misconduct of many more companies goes undetected. Businesses, business schools, and governments are increasingly making efforts to deter firms and professionals from making and taking bribes. There are still countless less visible gestures that some would argue are also unethical. For example, imagine that an employee works at a firm that wants to land a contract in China. A key government official in China finds out that you went to the business school that his daughter really wants to attend. He asks you to help her in the admission process. Do you? Should you? Is this just a nice thing to do, or is it a potential conflict of interest if you think the official will view your company more favorably? This is a gray area of global business ethics. Interestingly, a professional’s answer to this situation may depend on his or her culture. Cultures that have clear guidelines for right and wrong behavior may see this situation differently than a culture in which doing favors is part of the normal practice. A company may declare this inappropriate behavior, but employees may still do what they think is best for their jobs. Cultures that have a higher tolerance for ambiguity, as this chapter discusses, may find it easier to navigate the gray areas of ethics—when it is not so clear.

Most people agree that bribery in any form only increases the cost of doing business—a cost that is either absorbed by the company or eventually passed on to the buyer or consumer in some form. While businesses agree that corruption is costly and undesirable, losing profitable business opportunities to firms that are less ethically motivated can be just as devastating to the bottom line. Until governments in every country consistently monitor and enforce anticorruption laws, bribery will remain a real and very challenging issue for global businesses.
Corporate Social Responsibility

Corporate social responsibility (CSR) is defined in Wikipedia as “the corporate conscience, citizenship, social performance, or sustainable responsible business, and is a form of corporate self-regulation integrated into a business model. CSR policy functions as a built-in, self-regulating mechanism whereby business monitors and ensures its active compliance with the spirit of the law, ethical standards, and international norms.”

CSR emerged more than three decades ago, and it has gained increasing strength over time as companies seek to generate goodwill with their employees, customers, and stakeholders. "Corporate social responsibility encompasses not only what companies do with their profits, but also how they make them. It goes beyond philanthropy and compliance and addresses how companies manage their economic, social, and environmental impacts, as well as their relationships in all key spheres of influence: the workplace, the marketplace, the supply chain, the community, and the public policy realm." Source: “Defining Corporate Social Responsibility,” Corporate Social Responsibility Initiative, Harvard Kennedy School, last modified 2008, accessed March 26, 2011, http://www.hks.harvard.edu/m-rcbg/CSRI/init_define.html.

Companies may support nonprofit causes and organizations, global initiatives, and prevailing themes. Promoting environmentally friendly and green initiatives is an example of a current prevailing theme.

Coca-Cola is an example of global corporation with a long-term commitment to CSR. In many developing countries, Coca-Cola promotes local economic development through a combination of philanthropy and social and economic development. Whether by using environmentally friendly containers or supporting local education initiatives through its foundation, Coca-Cola is only one of many global companies that seek to increase their commitment to local markets while enhancing their brand, corporate image, and reputation by engaging in socially responsible business practices.

Companies use a wide range of strategies to communicate their socially responsible strategies and programs. Under the auspices of the United Nations, the Global Compact “is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption.”

Enforcement of Ethical Guidelines and Standards

The concept of culture impacting the perception of ethics is one that many businesspeople debate. While culture does impact business ethics, international companies operate in multiple countries and need a standard set of global operating guidelines. Professionals engage in unethical behavior primarily as a result of their own personal ethical values, the corporate culture within a company, or from unrealistic performance expectations.

In the interest of expediency, many governments—the US government included—may not strictly enforce the rules governing corporate ethics. The practice of gift giving is one aspect of business that many governments don’t examine too closely. Many companies have routinely used gifts to win favor from their customers, without engaging in direct bribery. American companies frequently invite prospective buyers to visit their US facilities or attend company conferences in exotic locales with all expenses paid. These trips often have perks included. Should such spending be considered sales and marketing expenses, as they are often booked, or are these companies engaging in questionable behavior? It’s much harder to answer this question when you consider that most of the company’s global competitors are likely to engage in similarly aggressive marketing and sales behavior.

Governments often do not enforce laws until it’s politically expedient to do so. Take child labor, for example. Technically, companies operating in India or Pakistan are not permitted to use child labor in factories, mines, and other areas of hazardous employment. However, child labor is widespread in these countries due to deep-rooted social and economic challenges. Local governments are often unable and unwilling to enforce national rules and regulations. Companies and consumers who purchase goods made by children are often unaware that these practices remain unchecked.
The Evolution of Ethics

Ethics evolves over time. It is difficult for both companies and professionals to operate within one set of accepted standards or guidelines only to see them gradually evolve or change. For example, bribery has been an accepted business practice for centuries in Japan and Korea. When these nations adjusted their practices in order to enter the global system, the questionable practices became illegal. Hence a Korean businessman who engaged in bribery ten or twenty years ago may not do so today without finding himself on the other side of the law. Even in the United States, discrimination and business-regulation laws have changed tremendously over the last several decades. And who can know what the future holds? Some of the business practices that are commonly accepted today may be frowned on tomorrow.

It’s clear that changing values, as influenced by global media, and changing perceptions and cultures will impact global ethics. The most challenging aspect is that global business does not have a single definition of “fair” or “ethical.” While culture influences the definitions of those ideas, many companies are forced to navigate this sensitive area very carefully, as it impacts both their bottom line and their reputations.

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<td>• Culture impacts how local values influence the concept of global business ethics. Each professional is influenced by the values, social programming, and experiences he or she has absorbed since childhood. These collective factors impact how a person perceives an issue and the related correct or incorrect behavior. For some cultures, the evolution of international business and culture sometimes creates a conflict, such as what is seen in gift-giving practices or views on women in the workplace.</td>
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<tr>
<td>• Ethics impacts global business in the areas of management, corruption, and corporate social responsibility.</td>
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| EXERCISES |
| (AACSB: Reflective Thinking, Analytical Skills) |
| 1. Define ethics and discuss how it impacts global business. |
| 2. How does culture impact global business ethics? |
| 3. How can global firms develop and enforce ethical guidelines and standards? |

VIDEO: LESSONS ABOUT TRUST LEARNED FROM GLOBALIZATION

This video was prepared by the Institute for Corporate Ethics, presented by Andrew Wicks of UVA’s Darden School of Business.

Watch this video online: https://youtu.be/BRn_HSjt37g
ASSIGNMENT: CORRUPTION PERCEPTION AND GLOBAL BUSINESS

WRITTEN ASSIGNMENT: Corruption Perception and Global Business

For this module you will complete a written assignment based on research you will perform on Global Ethics and Business Practices. This is the scenario you will base your assignment on:

You work for a pulp and paper manufacturing company.

1. Using the Corruption Perceptions Index on Transparency International’s website: Transparency International 2012 Corruptions Perception Index, discuss how you would advise your senior management reviewing the possible setup of operations in either Latin America or Africa. Remember, that in considering these two possible locations there may be some individual countries that are better suited than others, relative to the corruption index. You may want to consider selecting the best and worst in each region.

2. Which countries would suggest further research and which countries would pose ethical challenges?

3. How important do you think the Corruption Perceptions Index is to your business objectives?

4. Should it be a factor in determining where you set up operations?

FOLLOW the guidelines for a written assignment and review the grading rubric for the assignment as well.
MODULE 6: IS "FREE TRADE" REALLY FREE? THE POLITICAL CHALLENGES OF OPERATING IN A GLOBAL MARKET

OVERVIEW

In this module we will look at some of the barriers that are created by governments to control international trade. There has been a great deal of debate about “barriers” to international trade and specifically tariffs.

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Differentiate among tariffs, subsidies and quotas
- Explain the advantages and disadvantages of Free Trade
- Illustrate the development of the World Trading System

VIDEO: TYPES OF TRADE RESTRICTIONS

From YouTube description: “In this video, I go over the types of tools that might be used to restrict trade, and the effects of trade restrictions.”

Watch this video online: https://youtu.be/_e2gQxN1OBg
READING: INTERNATIONAL ECONOMIC COOPERATION AMONG NATIONS

**LEARNING OBJECTIVES**

By the end of this section, you will be able to:

- Understand the global trading system.
- Explain how and why the GATT was created and what its historical role in international trade is.
- Know what the WTO is and what its current impact on international trade is.

In the post–World War II environment, countries came to realize that a major component of achieving any level of global peace was global cooperation—politically, economically, and socially. The intent was to level the trade playing field and reduce economic areas of disagreement, since inequality in these areas could lead to more serious conflicts. Among the initiatives, nations agreed to work together to promote free trade, entering into bilateral and multilateral agreements. The General Agreement on Tariffs and Trade (GATT) resulted from these agreements. In this section, you'll review GATT—why it was created and what its historical successes and challenges are. You'll then look at the World Trade Organization (WTO), which replaced GATT in 1995, and study the impact of both these organizations on international trade. While GATT started as a set of rules between countries, the WTO has become an institution overseeing international trade.

**General Agreement on Tariffs and Trade (GATT)**

The General Agreement on Tariffs and Trade (GATT) is a series of rules governing trade that were first created in 1947 by twenty-three countries. By the time it was replaced with the WTO, there were 125 member nations. GATT has been credited with substantially expanding global trade, primarily through the reduction of tariffs.

The basic underlying principle of GATT was that trade should be free and equal. In other words, countries should open their markets equally to member nations, and there should be neither discrimination nor preferential treatment. One of GATT’s key provisions was the most-favored-nation clause (MFN). It required that once a benefit, usually a tariff reduction, was agreed on between two or more countries, it was automatically extended to all other member countries. GATT’s initial focus was on tariffs, which are taxes placed on imports or exports.

**Did You Know?**

**MFN Is Everywhere**

As a concept, MFN can be seen in many aspects of business; it’s an important provision. Companies require MFN of their trading partners for pricing, access, and other provisions. Corporate or government customers require it of the company from which they purchase goods or services. Venture capitalists (VC) require it of the companies in which they invest. For example, a VC wants to make sure that it has negotiated the best price for equity and will ask for this provision in case another financier negotiates a cheaper purchase price for the equity. The idea behind the concept of MFN is that the country, company, or entity that has MFN status shouldn’t be disadvantaged in comparison with others in similar roles as a trading partner, buyer, or investor. In practice, the result is that the signing party given MFN status benefits from any better negotiation and receives the cheaper price point or better term. This terminology is also used in sales contracts or other business legal agreements.

Gradually, the GATT member countries turned their attention to other nontariff trade barriers. These included government procurement and bidding, industrial standards, subsidies, duties and customs, taxes, and licensing. GATT countries agreed to limit or remove trade barriers in these areas. The only agreed-on export subsidies were...
for agricultural products. Countries agreed to permit a wider range of imported products to enter their home markets by simplifying licensing guidelines and developing consistent product standards between imports and domestically produced goods. Duties had to result from uniform and consistent procedures for the same foreign and domestically produced items.

The initial successes in these categories led some countries to get more creative with developing barriers to trade as well as entering into bilateral agreements and providing more creative subsidies for select industries. The challenge for the member countries of GATT was enforcement. Other than complaining and retaliating, there was little else that a country could do to register disapproval of another country’s actions and trade barriers.

Gradually, trade became more complex, leading to the Uruguay Round beginning in 1986 and ending in 1994. These trade meetings were called rounds in reference to the series of meetings among global peers held at a “roundtable.” Prior to a round, each series of trade discussions began in one country. The round of discussions was then named after that country. It sometimes took several years to conclude the topic discussions for a round. The Uruguay Round took eight years and actually resulted in the end of GATT and the creation of the World Trade Organization (WTO). The current Doha Development Round began in 2001 and is actually considered part of the WTO.

World Trade Organization (WTO)

Brief History and Purpose

The World Trade Organization (WTO) developed as a result of the Uruguay Round of GATT. Formed officially on January 1, 1995, the concept of the WTO had been in development for several years. When the WTO replaced GATT, it absorbed all of GATT’s standing agreements. In contrast to GATT, which was a series of agreements, the WTO was designed to be an actual institution charged with the mission of promoting free and fair trade. As explained on its website, the WTO “is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world’s trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business.”


The WTO’s primary purpose is to serve as a negotiating forum for member nations to dispute, discuss, and debate trade-related matters. More than just a series of trade agreements, as it was under GATT, the WTO undertakes discussions on issues related to globalization and its impact on people and the environment, as well as trade-specific matters. It doesn’t necessarily establish formal agreements in all of these areas but does provide a forum to discuss how global trade impacts other aspects of the world.

Headquartered in Geneva, Switzerland, the current round is called the Doha Round and began in 2001. With 153 member nations, the WTO is the largest, global trade organization. Thirty nations have observer status, and many of these are seeking membership. With so many member nations, the concept of MFN has been eased into a new principle of normal trade relations (NTR). Advocates say that no nation really has a favored nation status; rather, all interact with each other as a normal part of global trade.

The biggest change from GATT to the WTO is the provision for the settlement of disputes. If a country finds another country’s trade practices unfair or discriminatory, it may bring the charges to the WTO, which will hear from both countries and mediate a solution.

The WTO has also undertaken the effort to focus on services rather than just goods. Resulting from the Uruguay Round, the General Agreement on Trade in Services (GATS) seeks to reduce the barriers to trade in services. Following the GATT commitment to nondiscrimination, GATS requires member nations to treat foreign service companies as they would domestic ones. For example, if a country requires banks to maintain 10 percent of
deposits as reserves, then this percentage should be the same for foreign and domestic banks. Services have proven to be more complex to both define and regulate, and the member nations are continuing the discussions.

Similar to GATS is the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Intellectual property refers to just about anything that a person or entity creates with the mind. It includes inventions, music, art, and writing, as well as words, phrases, sayings, and graphics—to name a few. The basic premise of intellectual property rights (IPR) law is that the creator of the property has the right to financially benefit from his or her creation. This is particularly important for protecting the development for the creation, known as the research and development (R&D) costs. Companies can also own the intellectual property that their employees generate. This section focuses on the protection that countries agree to give to intellectual property created in another country.

Over the past few decades, companies have become increasingly diligent in protecting their intellectual property and pursuing abusers. Whether it’s the knock-off designer handbag from China that lands on the sidewalks of New York or the writer protecting her thoughts in the written words of a book (commonly understood as content), or the global software company combating piracy of its technical know-how, IPR is now formally a part of the WTO agreements and ongoing dialogue.

**Current Challenges and Opportunities**

Agriculture and textiles are two key sectors in which the WTO faces challenges. Trade in agriculture has been impacted by export-country subsidies, import-country tariffs and restrictions, and nontariff barriers. Whether the United States provides low-cost loans and subsidies to its farmers or Japan restricts the beef imports, agriculture trade barriers are an ongoing challenge for the WTO. Global companies and trade groups that support private-sector firms seek to have their governments raise critical trade issues on their behalf through the WTO.

For example, Japan’s ban of beef imports in response to mad cow disease had a heavy impact on the US beef industry during the first decade of the 21st century. Japan was the largest foreign buyer of U.S. beef before it banned all imports when the first case of the brain-wasting disease, also known bovine spongiform encephalopathy [i.e., mad cow disease], was discovered in the U.S.

Japanese restrictions on U.S. beef created distance between Japan and the U.S. Japan Agriculture Minister Hirotaka Akamatsu told reporters in 2010 after meeting [US Agriculture Secretary Tom] Vilsack in Tokyo. “For us, food safety based on Japan’s scientific standards is the priority. The OIE standards are different from the Japanese scientific ones.”

During the beef export ban, the U.S. beef industry lost about $1 billion a year in sales because of the restrictions, according to the National Cattlemen’s Beef Association, [a trade group supporting the interests of American beef producers].

The ban was eased in 2005 to allow meat from cattle aged 20 months or less, which scientists say are less likely to have contracted the fatal illness. … Japan was the third-largest destination for U.S. beef [in 2009], with trade totaling $470 million, up from $383 million in 2008, according to the U.S. Meat Export Federation. That compares with $1.39 billion in 2003. Mexico and Canada were the biggest buyers of U.S. beef [in 2009]. Source: Jae Hur and Ichiro Suzuki, “Japan, U.S. to Continue Dialogue on Beef Import Curbs (Update 1),” BusinessWeek, April 7, 2010, accessed December 29, 2010, http://www.businessweek.com/news/2010-04-07/japan-u-s-to-continue-dialogue-on-beef-import-curbs-update1-.html. Restrictions were further eased in 2013.

The role of the WTO is to facilitate agreements in difficult bilateral and multilateral trade disputes, but this certainly isn’t easy. Japan’s reluctance for American beef may have appeared to be the result of mad cow disease, but business observers note Japan’s historical cultural preference for Japanese goods, which the country often claims are superior. A similar trade conflict was triggered in the 1980s when Japan discouraged the import of rice from other countries. The prevailing Japanese thought was that its local rice was easier for the Japanese to digest. After extensive discussions in the Uruguay Round of trade talks, on “December 14, 1993 the Japanese government accepted a limited opening of the rice market under the GATT plan.” Source: “Japan Rice Trade,” case study on American University website, accessed January 2, 2010, http://www1.american.edu/ ted/japrice.htm.

Antidumping is another area on which the WTO has focused its attention. Dumping occurs when a company exports to a foreign market at a price that is either lower than the domestic prices in that country or less than the
cost of production. Antidumping charges can be harder to settle, as the charge is against a company and not a country. One example is in India, which has, in the past, accused Japan and Thailand of dumping acetone, a chemical used in drugs and explosives, in the Indian market. In an effort to protect domestic manufacturers, India has raised the issue with the WTO. In fact, India was second only to Argentina among the G-20 (or Group of Twenty) nations in initiating antidumping investigations during 2009, according to a WTO report.

Future Outlook

The future for the WTO and any related organizations remains strong. With companies and countries facing a broader array of trade issues than ever before, the WTO plays a critical role in promoting and ensuring free and fair trade. Many observers expect that the WTO will have to emphasize the impact of the Internet on trade. In most cases, the WTO provides companies and countries with the best options to dispute, discuss, and settle unfair business and trade practices.

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<td>• The World Trade Organization (WTO) is the only global, international organization dealing with the rules of trade between nations. The WTO agreements that have been negotiated and signed by the organization’s 153 member nations and ratified in their parliaments are the heart of the organization. Its goal is to help the producers, exporters, and importers of goods and services conduct business. The latest round of the WTO trade negotiations is called the Doha Round.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EXERCISES</th>
</tr>
</thead>
<tbody>
<tr>
<td>(AACSB: Reflective Thinking, Analytical Skills)</td>
</tr>
<tr>
<td>1. Define GATT and discuss the importance of the successive rounds. Do you think that GATT was essential to promoting world trade or would we be in the same place today without it? Why or why not?</td>
</tr>
<tr>
<td>2. Define WTO. In what ways do you think the WTO is still essential to global trade? Discuss how a private-sector firm would use the WTO to protect its business interests.</td>
</tr>
<tr>
<td>3. Read the following excerpt from a 2010 Wall Street Journal article about the WTO:</td>
</tr>
</tbody>
</table>

The World Trade Organization formally condemned European subsidies to civil-aircraft maker Airbus, concluding the first half of the most expensive trade dispute in WTO history. Its main finding was that more than $20 billion in low-interest government loans used to develop six models of passenger jet constituted prohibited export subsidies. The ruling could force the parent company of Airbus, European Aeronautic Defence & Space Co., to repay some aid money or risk giving the U.S. the right to raise import tariffs in retaliation on goods imported from Europe, such as cars, wines and cheese. Source: John W. Miller and Daniel Michaels, “WTO Condemns Airbus Subsidies,” Wall Street Journal, July 1, 2010, accessed December 29, 2010, http://online.wsj.com/article/SB10001424052748703426004575338773153793294.html. |

Do you agree with the WTO’s assessment? Is it fair for the United States to retaliate against the airplane manufacturer with tariffs on other imported products? How might US consumers react to additional taxes imposed on popular imported products such as cars, wine, and cheese?
TRADE BARRIERS

Trade barriers are government-induced restrictions on international trade, which generally decrease overall economic efficiency.

<table>
<thead>
<tr>
<th>KEY points</th>
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</thead>
<tbody>
<tr>
<td>• Trade barriers cause a limited choice of products and, therefore, would force customers to pay higher prices and accept inferior quality.</td>
</tr>
<tr>
<td>• Trade barriers generally favor rich countries because these countries tend to set international trade policies and standards.</td>
</tr>
<tr>
<td>• Economists generally agree that trade barriers are detrimental and decrease overall economic efficiency, which can be explained by the theory of comparative advantage.</td>
</tr>
</tbody>
</table>

Terms

• **Tariff**: A system of government-imposed duties levied on imported or exported goods; a list of such duties, or the duties themselves.
• **Quota**: A restriction on the import of something to a specific quantity.

Examples

Trade barriers are government-induced restrictions on international trade. Man-made trade barriers come in several forms, including:

• Tariffs
• Non-tariff barriers to trade
• Import licenses
• Export licenses
• Import quotas
• Subsidies
• Voluntary Export Restraints
• Local content requirements
• Embargo
• Currency devaluation
• Trade restriction

Most trade barriers work on the same principle—the imposition of some sort of cost on trade that raises the price of the traded products. If two or more nations repeatedly use trade barriers against each other, then a trade war results.

Economists generally agree that trade barriers are detrimental and decrease overall economic efficiency. This can be explained by the theory of comparative advantage. In theory, free trade involves the removal of all such barriers, except perhaps those considered necessary for health or national security. In practice, however, even those countries promoting free trade heavily subsidize certain industries, such as agriculture and steel. Trade barriers are often criticized for the effect they have on the developing world. Because rich-country players set trade policies, goods, such as agricultural products that developing countries are best at producing, face high barriers. Trade barriers, such as taxes on food imports or subsidies for farmers in developed economies, lead to overproduction and dumping on world markets, thus lowering prices and hurting poor-country farmers. Tariffs also tend to be anti-poor, with low rates for raw commodities and high rates for labor-intensive processed goods. The
Commitment to Development Index measures the effect that rich country trade policies actually have on the developing world. Another negative aspect of trade barriers is that it would cause a limited choice of products and, therefore, would force customers to pay higher prices and accept inferior quality.

In general, for a given level of protection, quota-like restrictions carry a greater potential for reducing welfare than do tariffs. Tariffs, quotas, and non-tariff barriers lead too few of the economy’s resources being used to produce tradeable goods. An export subsidy can also be used to give an advantage to a domestic producer over a foreign producer. Export subsidies tend to have a particularly strong negative effect because in addition to distorting resource allocation, they reduce the economy’s terms of trade. In contrast to tariffs, export subsidies lead to an over allocation of the economy’s resources to the production of tradeable goods.

Singapore
The Port of Singapore is one of the busiest in the world because Singapore must import most of its foodstuffs and consumer goods.

International trade barriers can take many forms for any number of reasons. Generally, governments impose barriers to protect domestic industry or to “punish” a trading partner.

<table>
<thead>
<tr>
<th>GLOSSARY</th>
</tr>
</thead>
</table>
| **Agriculture**  
The art or science of cultivating the ground, including the harvesting of crops, and the rearing and management of livestock; tillage; husbandry; farming. |
| **Comparative advantage**  
The ability of a party to produce a particular good or service at a lower marginal and opportunity cost over another. The concept that a certain good can be produced more efficiently than others due to a number of factors, including productive skills, climate, natural resource availability, and so forth. |
| **Currency**  
Money or other items used to facilitate transactions. In economics, currency is a generally accepted medium of exchange. These are usually the coins and banknotes of a particular government, which comprise the physical aspects of a nation’s money supply. Paper money. |
| **Developing**  
Of a country: becoming economically more mature or advanced; becoming industrialized. |
| **Economy**  
Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy. |
| **Efficiency**  
The extent to which a resource, such as electricity, is used for the intended purpose; the ratio of useful work to energy expended. The extent to which time is well used for the intended task. Improved efficiency was a principle goal of progressives, one they thought attainable by the application of scientific and rational thought to social problems. |
| **Export**  
This term export is derived from the conceptual meaning to ship the goods and services out of the port of a country. To sell (goods) to a foreign country. Any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade. |
Free trade
Free trade is a policy by which a government does not discriminate against imports or interfere with exports by applying tariffs (to imports) or subsidies (to exports) or quotas. International trade free from government interference, especially trade free from tariffs or duties on imports.

Good
An object produced for market.

Import
Something brought in from an exterior source, especially for sale or trade. To bring (something) in from a foreign country, especially for sale or trade.

Industry
The sector of the economy consisting of large-scale enterprises.

Lead
Potential opportunity for a sale or transaction, a potential customer.

License
The legal terms under which a person is allowed to use a product.

Market
A group of potential customers for one’s product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

Potential
Currently unrealized ability. A curve describing the situation where the difference in the potential energies of an object in two different positions depends only on those positions.

Price
The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Product
Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

Resource
Something that one uses to achieve an objective. An example of a resource could be a raw material or an employee. Something that one uses to achieve an objective, e.g. raw materials or personnel.

Resource allocation
Resource allocation is used to assign the available resources in an economic way. It is part of resource management. In project management, resource allocation is the scheduling of activities and the resources required by those activities while taking into consideration both the resource availability and the project time.

**Security**

The condition of not being threatened, especially physically, psychologically, emotionally, or financially. Proof of ownership of stocks, bonds, or other investment instruments.

**Standard**

Something used as a measure for comparative evaluations. A level of quality or attainment.

**Trade war**

The practice of nations creating mutual tariffs or similar barriers to trade.

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**ASSIGNMENT: BARRIERS TO INTERNATIONAL TRADE**

There are many ways that nations can create a competitive advantage, and not all of them are naturally occurring. The strategic use of trade barriers can create an artificial import defect or inflate export figures through manipulation of currency and regulations. In this increasingly interdependent world, the question of whether trade barriers should exist may well now be one of “which ones are the most effective at achieving our goals as a nation.”

Among cries of “protectionism” world leaders are reducing international trade estimates as we speak. The link below will take you to a brief article and interview with Robert Azevedo, Director General of the WTO in an interview on September 6th on CNBC. After you have read the brief article and watched his interview, you will be ready to start your assignment this week.

Link to article and interview: [http://www.cnbc.com/id/101014240](http://www.cnbc.com/id/101014240)

**ASSIGNMENT: Barriers to International Trade**

There are many ways that nations can create a competitive advantage, and not all of them are naturally occurring. The strategic use of trade barriers can create an artificial import defect or inflate export figures through manipulation of currency and regulations. In this increasingly interdependent world, the question of whether trade barriers should exist may well now be one of “which ones are the most effective at achieving our goals as a nation.”

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**WRITTEN ASSIGNMENT:**

1. Select a type of Trade Barrier from the list below.
1. Tariffs
2. Import/Export licenses
3. Import quotas
4. Local Content Requirements
5. Voluntary Export Restraints
6. Currency devaluation

2. Locate one LEGITIMATE article that addresses your Trade Barrier. This article should be NO MORE than 12 months old.

3. Write a ONE PAGE summary of the key points made in the article, making sure to identify or define any information that may be unclear. Be sure to include your source for the article. Submit this as the written portion of your assignment.

DISCUSSION BOARD:

1. In your INITIAL POST, briefly describe your article and the trade barrier it discusses.
2. RESPOND to at least TWO of your classmates.
3. Be sure to focus your discussion on the ADVANTAGES and DISADVANTAGES of Trade Barriers.
MODULE 7: "GOT NAFTA?" … REGIONAL ECONOMIC INTEGRATION

OVERVIEW

In this module we will look at the way that nations have created a web of intricate trade agreements and alliances in order to facilitate international trade. Some of these integration efforts have been more successful than others!

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

• Explain the political debate over regional integration
• Evaluate the current state of regional economic integration in Europe and elsewhere
• Identify and describe economic integration efforts/communities such as EU, ASEAN, NAFTA, CAFTA)

VIDEO: EU CRISIS

Please watch the following video:

Watch this video online: https://youtu.be/ttuXQWV_dtQ
A common market is the first stage towards a single market and may be limited initially to a free trade area.

**KEY Points**

- A common market is the first stage towards a single market and may be limited initially to a free trade area, with relatively free movement of capital and of services. However, it is not to a stage where the remaining trade barriers have been eliminated.
- The European Economic Community (EEC) (also known as the Common Market in the English-speaking world and sometimes referred to as the European Community even before it was renamed as such in 1993) was an international organization created by the 1957 Treaty of Rome.
- The main aim of the EEC, as stated in its preamble, was to "preserve peace and liberty and to lay the foundations of an ever closer union among the peoples of Europe."

**Term**

- **Free trade**: International trade free from government interference, especially trade free from tariffs or duties on imports.

**Example**

- The European Economic Community was the first example of a both common and single market, but it was an economic union since it had additionally a customs union. The European Economic Community (EEC) was an international organization created by the 1957 Treaty of Rome. Its aim was to bring about economic integration, including a common market, among its six founding members: Belgium, France, Germany, Italy, Luxembourg and the Netherlands. Upon the entry into force of the Maastricht Treaty in 1993, the EEC was renamed the European Community (EC) to reflect that it covered a wider range of policy. This was also when the three European Communities, including the EC, were collectively made to constitute the first of the three pillars of the European Union (EU). For the customs union, the treaty provided for a 10% reduction in custom duties and up to 20% of global import quotas. Progress on the customs union proceeded much faster than the twelve years planned.

A common market is a first stage towards a single market and may be limited initially to a free trade area with relatively free movement of capital and of services, but not so advanced in reduction of the rest of the trade barriers.

The European Economic Community (EEC) (also known as the Common Market in the English-speaking world and sometimes referred to as the European Community even before it was renamed as such in 1993) was an international organization created by the 1957 Treaty of Rome. Its aim was to bring about economic integration, including a common market, among its six founding members: Belgium, France, Germany, Italy, Luxembourg, and the Netherlands.

It gained a common set of institutions along with the European Coal and Steel Community (ECSC) and the European Atomic Energy Community (EURATOM) as one of the European Communities under the 1965 Merger Treaty (Treaty of Brussels).

Upon the entry into force of the Maastricht Treaty in 1993, the EEC was renamed the European Community (EC) to reflect that it covered a wider range of policy. This was also when the three European Communities, including
the EC, were collectively made to constitute the first of the three pillars of the European Union (EU), which the treaty also founded. The EC existed in this form until it was abolished by the 2009 Treaty of Lisbon, which merged the EU’s former pillars and provided that the EU would “replace and succeed the European Community. ” The main aim of the EEC, as stated in its preamble, was to “preserve peace and liberty and to lay the foundations of an ever closer union among the peoples of Europe. ” Calling for balanced economic growth, this was to be accomplished through:

- The establishment of a customs union with a common external tariff
- Common policies for agriculture, transport, and trade
- Enlargement of the EEC to the rest of Europe

For the customs union, the treaty provided for a 10% reduction in custom duties and up to 20% of global import quotas. Progress on the customs union proceeded much faster than the 12 years planned. However, France faced some setbacks due to its war with Algeria.

The six states that founded the EEC and the other two communities were known as the “inner six” (the “outer seven” were those countries who formed the European Free Trade Association). The six were France, West Germany, Italy, and the three Benelux countries: Belgium, the Netherlands, and Luxembourg. The first enlargement was in 1973, with the accession of Denmark, Ireland, and the United Kingdom. Greece, Spain, and Portugal joined in the 1980s. Following the creation of the EU in 1993, it has enlarged to include an additional 15 countries by 2007.

There were three political institutions that held the executive and legislative power of the EEC, plus one judicial institution and a fifth body created in 1975. These institutions (except for the auditors) were created in 1957 by the EEC but from 1967 on, they applied to all three communities. The council represents governments, the Parliament represents citizens, and the commission represents the European interest.

European Economic Community
Original member states (blue) and later members (green)
READING: NAFTA

NAFTA is an agreement signed by Canada, Mexico, and the United States, creating a trilateral trade bloc in North America.

<table>
<thead>
<tr>
<th>KEY Points</th>
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</thead>
<tbody>
<tr>
<td>• The North American Free Trade Agreement (NAFTA) is an agreement signed by the governments of Canada, Mexico, and the United States, creating a trilateral trade bloc in North America.</td>
</tr>
<tr>
<td>• NAFTA came into effect on January 1, 1994 and superseded the Canada – United States Free Trade Agreement.</td>
</tr>
<tr>
<td>• Within 10 years of the implementation of NAFTA, all U.S.-Mexico tariffs are to be eliminated except for some U.S. agricultural exports to Mexico which will be phased out within 15 years.</td>
</tr>
<tr>
<td>• Most U.S. – Canada trade was duty free before NAFTA.</td>
</tr>
<tr>
<td>• NAFTA also seeks to eliminate non-tariff trade barriers and to protect the intellectual property right of the products.</td>
</tr>
<tr>
<td>• When viewing the combined GDP of its members, as of 2010 NAFTA is the largest trade bloc in the world.</td>
</tr>
</tbody>
</table>

Terms

• Trade bloc: A trade bloc is a type of intergovernmental agreement, often part of a regional intergovernmental organization, where regional barriers to trade, (tariffs and non-tariff barriers) are reduced or eliminated among the participating states.

• Free trade: International trade free from government interference, especially trade free from tariffs or duties on imports.

• Tariff: A system of government-imposed duties levied on imported or exported goods; a list of such duties, or the duties themselves.

The North American Free Trade Agreement (NAFTA)

The North American Free Trade Agreement (NAFTA) is an agreement signed by the governments of Canada, Mexico, and the United States, creating a trilateral trade bloc in North America. The agreement came into force on January 1, 1994. It superseded the Canada – United States Free Trade Agreement between the U.S. and Canada.

In terms of combined GDP of its members, the trade bloc is the largest in the world as of 2010. NAFTA has two supplements: the North American Agreement on Environmental Cooperation (NAAEC) and the North American Agreement on Labor Cooperation (NAALC). The goal of NAFTA was to eliminate barriers to trade and investment among the U.S., Canada, and Mexico.

The implementation of NAFTA on January 1, 1994 brought the immediate elimination of tariffs on more than one-half of Mexico’s exports to the U.S. and more than one-third of U.S. exports to Mexico. Within 10 years of the implementation of the agreement, all U.S.–Mexico tariffs would be eliminated except for some U.S. agricultural exports to Mexico that were to be phased out within 15 years. Most U.S.–Canada trade was already duty free. NAFTA also seeks to eliminate non-tariff trade barriers and to protect the intellectual property right of the products.

The agreement opened the door for open trade, ending tariffs on various goods and services, and implementing equality between Canada, America, and Mexico. NAFTA has allowed agricultural goods such as eggs, corn, and...
meats to be tariff-free. This allowed corporations to trade freely and import and export various goods on a North American scale.

**NAFTA countries**

**NAFTA member countries**

<table>
<thead>
<tr>
<th><strong>GLOSSARY</strong></th>
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<tbody>
<tr>
<td><strong>Bloc</strong></td>
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<tr>
<td>A group of countries acting together for political or economic goals, an alliance (e.g., the eastern bloc, the western bloc, a trading bloc). A group of voters or politicians who share common goals.</td>
</tr>
<tr>
<td><strong>Corporation</strong></td>
</tr>
<tr>
<td>A group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members. A group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members.</td>
</tr>
<tr>
<td><strong>Ending</strong></td>
</tr>
<tr>
<td>A termination or conclusion.</td>
</tr>
<tr>
<td><strong>Export</strong></td>
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<tr>
<td>This term export is derived from the conceptual meaning to ship the goods and services out of the port of a country. To sell (goods) to a foreign country. Any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade.</td>
</tr>
<tr>
<td><strong>GDP</strong></td>
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<tr>
<td>Gross domestic product (GDP) is the market value of all officially recognized final goods and services produced within a country in a given period of time. Gross Domestic Product (Economics). A measure of the economic production of a particular territory in financial capital terms over a specific time period.</td>
</tr>
<tr>
<td><strong>Goal</strong></td>
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<tr>
<td>A desired result that one works to achieve. A result that one is attempting to achieve. A result that one is attempting to achieve.</td>
</tr>
<tr>
<td><strong>Good</strong></td>
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<tr>
<td><strong>Intellectual property</strong></td>
</tr>
<tr>
<td>Any product of someone’s intellect that has commercial value: copyrights, patents, trademarks, and trade secrets. Intellectual property (IP) is a juridical concept that refers to creations of the mind for which exclusive rights are recognized.</td>
</tr>
<tr>
<td><strong>Investment</strong></td>
</tr>
<tr>
<td>The expenditure of capital in expectation of deriving income or profit from its use.</td>
</tr>
</tbody>
</table>
Product

Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

Right

A legal or moral entitlement.

Services

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

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**READING: EUROPEAN UNION**

The European Union (EU) is an economic and political union made up of 27 member states that are located primarily in Europe.

**KEY TAKEAWAY**

- The European Union (EU) is an economic and political union made up of 27 member states that are located primarily in Europe.
- Members of the EU include Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.
- The EU operates through a system of supranational independent institutions and intergovernmental negotiated decisions by the member states.
- Within the Schengen Area (which includes EU and non-EU states) passport controls have been abolished.
- The creation of a single currency became an official objective of the European Economic Community (EEC) in 1969. On January 1, 2002 euro notes and coins were issued and national currencies began to phase out in the eurozone.
- The ECB is the central bank for the eurozone, and thus controls monetary policy in that area with an agenda to maintain price stability. It is at the center of the European System of Central Banks, which comprises all EU national central banks and is controlled by its General Council, consisting of the President of the ECB, who is appointed by the European Council, the Vice-President of the ECB, and the governors of the national central banks of all 27 EU member states.
Terms

- **Euro**: The currency unit of the European Monetary Union. Symbol: €
- **Transparency**: Open, public; having the property that theories and practices are publicly visible, thereby reducing the chance of corruption.
- **European Union**: A supranational organization created in the 1950s to bring the nations of Europe into closer economic and political connection. At the beginning of 2012, 27 member nations were Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, The Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

Examples

- The euro is designed to help build a single market by easing travel of citizens and goods, eliminating exchange rate problems, providing price transparency, creating a single financial market, stabilizing prices, maintaining low interest rates, and providing a currency used internationally and protected against shocks by the large amount of internal trade within the eurozone. It is also intended as a political symbol of integration.

The European Union

The European Union (EU) is an economic and political union or confederation of 27 member states that are located in Europe, including:

Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

The EU operates through a system of supranational independent institutions and intergovernmental decisions negotiated by the member states. Important institutions of the EU include the European Commission, the Council of the European Union, the European Council, the Court of Justice of the European Union, and the European Central Bank. The European Parliament is elected every five years by EU citizens. The EU has developed a single market through a standardized system of laws that apply in all member states. Within the Schengen Area (which includes EU and non-EU states) passport controls have been abolished. EU policies aim to ensure the free movement of people, goods, services, and capital, enact legislation in justice and home affairs, and maintain common policies on trade, agriculture, fisheries, and regional development. A monetary union, the eurozone, was established in 1999, and as of January 2012, is composed of 17 member states. Through the Common Foreign and Security Policy the EU has developed a limited role in external relations and defense. Permanent diplomatic missions have been established around the world. The EU is represented at the United Nations, the WTO, the G8 and the G-20.

The Euro

The creation of a single European currency became an official objective of the European Economic Community in 1969. However, it was only with the advent of the Maastricht Treaty in 1993 that member states were legally bound to start the monetary union. In 1999 the euro was duly launched by eleven of the then fifteen member states of the EU. It remained an accounting currency until 1 January 2002, when euro notes and coins were issued and national currencies began to phase out in the eurozone, which by then consisted of twelve member states. The eurozone (constituted by the EU member states that have adopted the euro) has since grown to seventeen countries, the most recent being Estonia, which joined on 1 January 2011. All other EU member states, except Denmark and the United Kingdom, are legally bound to join the euro when the convergence criteria are met, however only a few countries have set target dates for accession. Sweden has circumvented the requirement to join the euro by not meeting the membership criteria.

The euro is designed to help build a single market by easing travel of citizens and goods, eliminating exchange rate problems, providing price transparency, creating a single financial market, stabilizing prices, maintaining low interest rates, and providing a currency used internationally and protected against shocks by the large amount of
internal trade within the eurozone. It is also intended as a political symbol of integration. The euro and the monetary policies of those who have adopted it in agreement with the EU are under the control of the European Central Bank (ECB). The ECB is the central bank for the eurozone, and thus controls monetary policy in that area with an agenda to maintain price stability. It is at the center of the European System of Central Banks, which comprises all EU national central banks and is controlled by its General Council, consisting of the President of the ECB, who is appointed by the European Council, the Vice-President of the ECB, and the governors of the national central banks of all 27 EU member states. The monetary union has been shaken by the European sovereign-debt crisis since 2009.

European Union
European Union member countries

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<td>An object produced for market.</td>
</tr>
<tr>
<td><strong>Justice</strong></td>
</tr>
<tr>
<td>The ideal of fairness, impartiality, etc., especially with regard to the punishment of wrongdoing.</td>
</tr>
<tr>
<td><strong>Mission</strong></td>
</tr>
<tr>
<td>A set of tasks that fulfills a purpose or duty; an assignment set by an employer.</td>
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<td><strong>Services</strong></td>
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<td>That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.</td>
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**READING: APEC**

APEC is a forum for 21 Pacific Rim countries that seeks to promote free trade and economic cooperation throughout the Asia-Pacific region.

**KEY TAKEAWAY**

- Asia-Pacific Economic Cooperation (APEC) is a forum for 21 Pacific Rim countries that seeks to promote free trade and economic cooperation.
- APEC was established in 1989 in response to the growing interdependence of Asia-Pacific economies and the advent of regional economic blocs.
- APEC member countries include Australia, Brunei, Canada, Chile, China, Hong Kong (Hong Kong, China), Indonesia, Japan, South Korea, Mexico, Malaysia, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan (Chinese Taipei), Thailand, United States, and Vietnam.
- During the meeting in 1994 in Bogor, Indonesia, APEC leaders adopted the Bogor Goals which aim for free and open trade and investment in the Asia-Pacific by 2010, for industrialized economies and by 2020, for developing economies.
Term

- **Bloc**: A group of countries acting together for political or economic goals, an alliance (e.g., the eastern bloc, the western bloc, a trading bloc).

The Asia-Pacific Economic Cooperation (APEC) is a forum for 21 Pacific Rim countries (formally Member Economies) that seeks to promote free trade and economic cooperation throughout the Asia-Pacific region. Established in 1989 in response to the growing interdependence of Asia-Pacific economies and the advent of regional economic blocs (such as the European Union) in other parts of the world, APEC works to raise living standards and education levels through sustainable economic growth and to foster a sense of community and an appreciation of shared interests among Asia-Pacific countries.

Member countries are: Australia, Brunei, Canada, Chile, China, Hong Kong (Hong Kong, China), Indonesia, Japan, South Korea, Mexico, Malaysia, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan (Chinese Taipei), Thailand, United States, and Vietnam.

APEC member countries
Map of APEC member countries as of 2009

During the meeting in 1994 in Bogor, Indonesia, APEC leaders adopted the Bogor Goals that aim for free and open trade and investment in the Asia-Pacific by 2010, for industrialized economies and by 2020, for developing economies. In 1995, APEC established a business advisory body named the APEC Business Advisory Council (ABAC), composed of three business executives from each membereconomy. To meet the Bogor Goals, APEC carries out work in three main areas:

1. Trade and investment liberalization
2. Business facilitation
3. Economic and technical cooperation

APEC is considering the prospects and options for a Free Trade Area of the Asia-Pacific (FTAAP), which would include all APEC member economies. Since 2006, the APEC Business Advisory Council, promoting the theory that a free trade area has the best chance of converging the member nations and ensuring stable economic growth under free trade, has lobbied for the creation of a high-level task force to study and develop a plan for a free trade area. The proposal for a FTAAP arose due to the lack of progress in the Doha round of World Trade Organization negotiations, and as a way to overcome the “spaghetti bowl” effect created by overlapping and conflicting elements of the umpteen free trade agreements. There are approximately 60 free trade agreements, with an additional 117 in the process of negotiation in Southeast Asia and the Asia-Pacific region.

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**GLOSSARY**

**Community**
A group of interdependent organisms inhabiting the same region and interacting with each other. A group sharing a common understanding and often the same language, manners, tradition and law. (See *civilization*).

**Developing**
Of a country: becoming economically more mature or advanced; becoming industrialized.

**Economy**
Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

**Free trade**
Free trade is a policy by which a government does not discriminate against imports or interfere with exports by applying tariffs (to imports) or subsidies (to exports) or quotas. International trade free from government interference, especially trade free from tariffs or duties on imports.

**Goal**

A desired result that one works to achieve. A result that one is attempting to achieve. a result that one is attempting to achieve.

**Interdependence**

The condition of being interdependent.

**Interest**

The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. A great attention and concern from someone or something; intellectual curiosity.

**Investment**

A placement of capital in expectation of deriving income or profit from its use. The expenditure of capital in expectation of deriving income or profit from its use.

**Process**

A series of events to produce a result, especially as contrasted to product. In reference to capabilities, a process is how the capability is executed.

**Prospect**

The potential things that may come to pass, often favorable. A potential customer.

**Standard**

Something used as a measure for comparative evaluations. A level of quality or attainment.

**Task force**

A group of people working toward a particular task, project, or activity, especially assigned in a particular capacity.
ASSIGNMENT: REGIONAL INTEGRATION

Regional Integration Module

At its most basic level, countries want to encourage the growth of their domestic businesses by expanding trade with other countries—primarily by promoting exports and encouraging investment in their nations. Borders that have fewer rules and regulations can help businesses expand easier and more cheaply. While this sounds great in theory, economists as well as businesspeople often ignore the realities of the political and sociocultural factors that impact relationships between countries, businesses, and people.

Discussion Board Assignment:

Based on what you have read so far about “Culture and Business” select one regional trading bloc. (There is a link provided to help you identify a trading bloc). You may want to use Hofstede's cultural dimensions at http://geert-hofstede.com/countries.html

Your discussion should address the following questions:

1. Discuss the economic motivations for the group of countries in the trading bloc to form an agreement.
2. Do you think the countries in the trading bloc you selected are likely to have cross-cultural similarities or differences?
3. Do you think countries with distinctively different cultural, historical, and economic histories can effectively enter into a trade agreement?

WTO REGIONAL TRADE AGREEMENT DATABASE

WTO Regional Trade Agreement Database

Regional trade agreements (RTAs) have become increasingly prevalent since the early 1990s. As of 31 July 2013, some 575 notifications of RTAs (counting goods, services and accessions separately) had been received by the GATT/WTO. Of these, 379 were in force. What all RTAs in the WTO have in common is that they are reciprocal trade agreements between two or more partners. Information on RTAs notified to the WTO is available in the RTA Database.

The WTO also receives notifications from WTO members regarding preferential trade arrangements (PTAs). In the WTO, PTAs are unilateral trade preferences. Information on PTAs notified to the WTO is available in the PTA Database.
MODULE 8: HOW MANY EUROS TO THE DOLLAR? EXPLORING FOREIGN EXCHANGE MARKETS

OVERVIEW

In this module we will look at the Global Monetary System. We will focus on Exchange Rates and the role of the IMF in global currency markets.

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Explain the evolution of exchange rates, from the gold standard to the float
- Describe the role of the IMF and World Bank in the IMS
- Evaluate the policies of the IMF in the post Bretton-Woods Era

READING: WHAT IS THE INTERNATIONAL MONETARY SYSTEM

Goal: Explain the foreign exchange market, the method in which in which exchange rates are determined, and the international monetary system.

What Is the International Monetary System?

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- Understand the role and purpose of the international monetary system.
Why do economies need money? This module defines *money* as a unit of account that is used as a medium of exchange in transactions. Without money, individuals and businesses would have a harder time obtaining (purchasing) or exchanging (selling) what they need, want, or make. Money provides us with a universally accepted medium of exchange.

Before the current monetary system can be fully appreciated, it's helpful to look back at history and see how money and systems governing the use of money have evolved. Thousands of years ago, people had to barter if they wanted to get something. That worked well if the two people each wanted what the other had. Even today, bartering exists.

History shows that ancient Egypt and Mesopotamia—which encompasses the land between the Euphrates and Tigris Rivers and is modern-day Iraq, parts of eastern Syria, southwest Iran, and southeast Turkey—began to use a system based on the highly coveted coins of gold and silver, also known as bullion, which is the purest form of the precious metal. However, bartering remained the most common form of exchange and trade.

Gold and silver coins gradually emerged in the use of trading, although the level of pure gold and silver content impacted the coins value. Only coins that consist of the pure precious metal are bullions; all other coins are referred to simply as *coins*. It is interesting to note that gold and silver lasted many centuries as the basis of economic measure and even into relatively recent history of the gold standard, which we'll cover in the next section. Fast-forward two thousand years and bartering has long been replaced by a currency-based system. Even so, there have been evolutions in the past century alone on how—globally—the monetary system has evolved from using gold and silver to represent national wealth and economic exchange to the current system.

### Did You Know: Dominant Currencies in History

Throughout history, some types of money have gained widespread circulation outside of the nations that issued them. Whenever a country or empire has regional or global control of trade, its currency becomes the dominant currency for trade and governs the monetary system of that time. In the middle of a period that relies on one major currency, it's easy to forget that, throughout history, there have been other primary currencies—a historical cycle. Generally, the best currency to use is the most liquid one, the one issued by the nation with the biggest economy as well as usually the largest import-export markets. Rarely has a single currency been the exclusive medium of world trade, but a few have come close. Here's a quick look at some of the most powerful currencies in history:

- **Persian daric**: The daric was a gold coin used in Persia between 522 BC and 330 BC.
- **Roman currency**: Currencies such as the aureus (gold), the denarius (silver), the sestertius (bronze), the dupondius (bronze), and the as (copper) were used during the Roman Empire from around 250 BC to AD 250.
- **Thaler**: From about 1486 to 1908, the thaler and its variations were used in Europe as the standard against which the various states’ currencies could be valued.
- **Spanish American pesos**: Around 1500 to the early nineteenth century, this contemporary of the thaler was widely used in Europe, the Americas, and the Far East; it became the first world currency by the late eighteenth century.
- **British pound**: The pound’s origins date as early as around AD 800, but its influence grew in the 1600s as the unofficial gold standard; from 1816 to around 1939 the pound was the global reserve currency until the collapse of the gold standard.
- **US dollar**: The Coinage Act of 1792 established the dollar as the basis for a monetary account, and it went into circulation two years later as a silver coin. Its strength as a global reserve currency expanded in the 1800s and continues today.
- **Euro**: Officially in circulation on January 1, 1999, the euro continues to serve as currency in many European countries today.
Let's take a look at the last century of the international monetary system evolution. International monetary system refers to the system and rules that govern the use and exchange of money around the world and between countries. Each country has its own currency as money and the international monetary system governs the rules for valuing and exchanging these currencies.

Until the nineteenth century, the major global economies were regionally focused in Europe, the Americas, China, and India. These were loosely linked, and there was no formal monetary system governing their interactions. The rest of this section reviews the distinct chronological periods over the past 150 years leading to the development of the modern global financial system. Keep in mind that the system continues to evolve and each crisis impacts it. There is not likely to be a final international monetary system, simply one that reflects the current economic and political realities. This is one main reason why understanding the historical context is so critical. As the debate about the pros and cons of the current monetary system continues, some economists are tempted to advocate a return to systems from the past. Businesses need to be mindful of these arguments and the resulting changes, as they will be impacted by new rules, regulations, and structures.

**Pre–World War I**

As mentioned earlier in this section, ancient societies started using gold as a means of economic exchange. Gradually more countries adopted gold, usually in the form of coins or bullion, and this international monetary system became known as the gold standard. This system emerged gradually, without the structural process in more recent systems. The gold standard, in essence, created a fixed exchange rate system. An exchange rate is the price of one currency in terms of a second currency. In the gold standard system, each country sets the price of its currency to gold, specifically to one ounce of gold. A fixed exchange rate stabilizes the value of one currency vis-à-vis another and makes trade and investment easier.

Our modern monetary system has its roots in the early 1800s. The defeat of Napoleon in 1815, when France was beaten at the Battle of Waterloo, made Britain the strongest nation in the world, a position it held for about one hundred years. In Africa, British rule extended at one time from the Cape of Good Hope to Cairo. British dominance and influence also stretched to the Indian subcontinent, the Malaysian peninsula, Australia, New Zealand—which attracted British settlers—and Canada. Under the banner of the British government, British companies advanced globally and were the largest companies in many of the colonies, controlling trade and commerce. Throughout history, strong countries, as measured mainly in terms of military might, were able to advance the interests of companies from their countries—a fact that has continued to modern times, as seen in the global prowess of American companies. Global firms in turn have always paid close attention to the political, military, and economic policies of their and other governments.

In 1821, the United Kingdom, the predominant global economy through the reaches of its colonial empire, adopted the gold standard and committed to fixing the value of the British pound. The major trading countries, including Russia, Austria-Hungary, Germany, France, and the United States, also followed and fixed the price of their currencies to an ounce of gold.

The United Kingdom officially set the price of its currency by agreeing to buy or sell an ounce of gold for the price of 4.247 pounds sterling. At that time, the United States agreed to buy or sell an ounce of gold for $20.67. This enabled the two currencies to be freely exchanged in terms of an ounce of gold. In essence,

\[ £4.247 = 1 \text{ ounce of gold} = $20.67. \]

The exchange rate between the US dollar and the British pound was then calculated by

\[ $20.67/£4.247 = $4.867 \text{ to } £1. \]

**The Advantages of the Gold Standard**

The gold standard dramatically reduced the risk in exchange rates because it established fixed exchange rates between currencies. Any fluctuations were relatively small. This made it easier for global companies to manage costs and pricing. International trade grew throughout the world, although economists are not always in agreement as to whether the gold standard was an essential part of that trend.
The second advantage is that countries were forced to observe strict monetary policies. They could not just print money to combat economic downturns. One of the key features of the gold standard was that a currency had to actually have in reserve enough gold to convert all of its currency being held by anyone into gold. Therefore, the volume of paper currency could not exceed the gold reserves.

The third major advantage was that gold standard would help a country correct its trade imbalance. For example, if a country was importing more than it is exporting, (called a trade deficit), then under the gold standard the country had to pay for the imports with gold. The government of the country would have to reduce the amount of paper currency, because there could not be more currency in circulation than its gold reserves. With less money floating around, people would have less money to spend (thus causing a decrease in demand) and prices would also eventually decrease. As a result, with cheaper goods and services to offer, companies from the country could export more, changing the international trade balance gradually back to being in balance. For these three primary reasons, and as a result of the 2008 global financial crises, some modern economists are calling for the return of the gold standard or a similar system.

Collapse of the Gold Standard

*If it was so good, what happened?* The gold standard eventually collapsed from the impact of World War I. During the war, nations on both sides had to finance their huge military expenses and did so by printing more paper currency. As the currency in circulation exceeded each country’s gold reserves, many countries were forced to abandon the gold standard. In the 1920s, most countries, including the United Kingdom, the United States, Russia, and France, returned to the gold standard at the same price level, despite the political instability, high unemployment, and inflation that were spread throughout Europe.

However, the revival of the gold standard was short-lived due to the Great Depression, which began in the late 1920s. The Great Depression was a worldwide phenomenon. By 1928, Germany, Brazil, and the economies of Southeast Asia were depressed. By early 1929, the economies of Poland, Argentina, and Canada were contracting, and the United States economy followed in the middle of 1929. Some economists have suggested that the larger factor tying these countries together was the international gold standard, which they believe prolonged the Great Depression. The gold standard limited the flexibility of the monetary policy of each country’s central banks by limiting their ability to expand the money supply. Under the gold standard, countries could not expand their money supply beyond what was allowed by the gold reserves held in their vaults.

Too much money had been created during World War I to allow a return to the gold standard without either large currency devaluations or price deflations. In addition, the U.S. gold stock had doubled to about 40 percent of the world’s monetary gold. There simply was not enough monetary gold in the rest of the world to support the countries’ currencies at the existing exchange rates.

By 1931, the United Kingdom had to officially abandon its commitment to maintain the value of the British pound. The currency was allowed to float, which meant that its value would increase or decrease based on demand and supply. The U.S. dollar and the French franc were the next strongest currencies and nations sought to peg the value of their currencies to either the dollar or franc. However, in 1934, the United States devalued its currency from $20.67 per ounce of gold to $35 per ounce. With a cheaper U.S. dollar, U.S. firms were able to export more as the price of their goods and services were cheaper vis-à-vis other nations. Other countries devalued their currencies in retaliation of the lower U.S. dollar. Many of these countries used arbitrary par values rather than a price relative to their gold reserves. Each country hoped to make its exports cheaper to other countries and reduce expensive imports. However, with so many countries simultaneously devaluing their currencies, the impact on prices was canceled out. Many countries also imposed tariffs and other trade restrictions in an effort to protect domestic industries and jobs. By 1939, the gold standard was dead; it was no longer an accurate indicator of a currency’s real value.

Post–World War II

The demise of the gold standard and the rise of the Bretton Woods system pegged to the U.S. dollar was also a changing reflection of global history and politics. The British Empire’s influence was dwindling. In the early 1800s, with the strength of both their currency and trading might, the United Kingdom had expanded its empire. At the end of World War I, the British Empire spanned more than a quarter of the world; the general sentiment was that “the sun would never set on the British empire.” British maps and globes of the time showed the empire’s expanse
proudly painted in red. However, shortly after World War II, many of the colonies fought for and achieved independence. By then, the United States had clearly replaced the United Kingdom as the dominant global economic center and as the political and military superpower as well.

### Did You Know: U.S. Companies Going Global

Just as the United States became a global military and political superpower, U.S. businesses were also taking center stage. Amoco (today now part of BP), General Motors (GM), Kellogg’s, and Ford Motor Company sought to capitalize on U.S. political and military strength to expand in new markets around the world. Many of these companies followed global political events and internally debated the strategic directions of their firms. For example, GM had an internal postwar planning policy group.

Notwithstanding the economic uncertainties that were bound to accompany the war’s end, a few of the largest U.S. corporations, often with considerable assets seized or destroyed during the war, began to plan for the postwar period. Among these was General Motors. As early as 1942 the company had set up a postwar planning policy group to estimate the likely shape of the world after the war and to make recommendations on GM’s postwar policies abroad.

In 1943 the policy group reported the likelihood that relations between the Western powers and the Soviet Union would deteriorate after the war. It also concluded that, except for Australia, General Motors should not buy plants and factories to make cars in any country that had not had facilities before the conflict. At the same time, it stated that after the war the United States would be in a stronger state politically and economically than it had been after World War I and that overseas operations would flourish in much of the world. The bottom line for GM, therefore, was to proceed with caution once the conflict ended but to stick to the policy it had enunciated in the 1920s—seeking out markets wherever they were available and building whatever facilities were needed to improve GM’s market share. Source: Encyclopedia of the New American Nation, s.v. “Multinational Corporations—Postwar Investment: 1945–1955,” accessed February 9, 2011, [http://www.americanforeignrelations.com/E-N/Multinational-Corporations-Postwar-investment-1945-1955.html#ixzz18TCwg8VJ](http://www.americanforeignrelations.com/E-N/Multinational-Corporations-Postwar-investment-1945-1955.html#ixzz18TCwg8VJ).

### Bretton Woods

In the early 1940s, the United States and the United Kingdom began discussions to formulate a new international monetary system. John Maynard Keynes, a highly influential British economic thinker, and Harry Dexter White, a U.S. Treasury official, paved the way to create a new monetary system. In July 1944, representatives from forty-four countries met in Bretton Woods, New Hampshire, to establish a new international monetary system.


### Did You Know: Outcomes of Bretton Woods

Throughout history, political, military, and economic discussions between nations have always occurred simultaneously in an effort to create synergies between policies and efforts. A key focus of the 1940s efforts for a new global monetary system was to stabilize war-torn Europe.

In the decade following the war the administrations of both Harry Truman and Dwight Eisenhower looked to the private sector to assist in the recovery of western Europe, both through increased trade and direct foreign investments. In fact, the $13 billion Marshall Plan, which became the engine of European recovery between 1948 and 1952, was predicated on a close working relationship between the public and private sectors. Similarly, Eisenhower intended to bring about world economic recovery through liberalized world commerce and private investment abroad rather than through foreign aid. Over the course of his two administrations (1953–1961), the president modified his policy of “trade not aid” to one of “trade and aid” and changed his focus from western Europe to the Third World, which he felt was most threatened by communist expansion. In
particular he was concerned by what he termed a “Soviet economic offensive” in the Middle East, that is, Soviet loans and economic assistance to such countries as Egypt and Syria. But even then he intended that international commerce and direct foreign investments would play a major role in achieving global economic growth and prosperity.

The resulting Bretton Woods Agreement created a new dollar-based monetary system, which incorporated some of the disciplinary advantages of the gold system while giving countries the flexibility they needed to manage temporary economic setbacks, which had led to the fall of the gold standard. The Bretton Woods Agreement lasted until 1971 and established several key features.

Fixed Exchange Rates

Fixed exchange rates are also sometimes called pegged rates. One of the critical factors that led to the fall of the gold standard was that after the United Kingdom abandoned its commitment to maintaining the value of the British pound, countries sought to peg their currencies to the US dollar. With the strength of the U.S. economy, the gold supply in the United States increased, while many countries had less gold in reserve than they did currency in circulation. The Bretton Woods system worked to fix this by tying the value of the U.S. dollar to gold but also by tying all of the other countries to the U.S. dollar rather than directly to gold. The par value of the U.S. dollar was fixed at $35 to one ounce of gold. All other countries then set the value of their currencies to the U.S. dollar. In reflection of the changing times, the British pound had undergone a substantial loss in value and by that point, its value was $2.40 to £1. Member countries had to maintain the value of their currencies within 1 percent of the fixed exchange rate. Lastly, the agreement established that only governments, rather than anyone who demanded it, could convert their U.S. dollar holdings into gold—a major improvement over the gold standard. In fact, most businesspeople eventually ignored the technicality of pegging the U.S. dollar to gold and simply utilized the actual exchange rates between countries (e.g., the pound to the dollar) as an economic measure for doing business.

National Flexibility

To enable countries to manage temporary but serious downturns, the Bretton Woods Agreement provided for a devaluation of a currency—more than 10 percent if needed. Countries could not use this tool to competitively manipulate imports and exports. Rather, the tool was intended to prevent the large-scale economic downturn that took place in the 1930s.

Creation of the International Monetary Fund and the World Bank

“What Is the Role of the IMF and the World Bank?” looks at the International Monetary Fund and the World Bank more closely, as they have survived the collapse of the Bretton Woods Agreement. In essence, the IMF’s initial primary purpose was to help manage the fixed rate exchange system; it eventually evolved to help governments correct temporary trade imbalances (typically deficits) with loans. The World Bank’s purpose was to help with post–World War II European reconstruction. Both institutions continue to serve these roles but have evolved into broader institutions that serve essential global purposes, even though the system that created them is long gone. “What Is the Role of the IMF and the World Bank?” explores them in greater detail and addresses the history, purpose, evolution, and current opportunities and challenges of both institutions.

Collapse of Bretton Woods

Despite a fixed exchange rate based on the US dollar and more national flexibility, the Bretton Woods Agreement ran into challenges in the early 1970s. The U.S. trade balance had turned to a deficit as Americans were importing more than they were exporting. Throughout the 1950s and 1960s, countries had substantially increased their holdings of U.S. dollars, which was the only currency pegged to gold. By the late 1960s, many of these countries expressed concern that the U.S. did not have enough gold reserves to exchange all of the U.S. dollars in global circulation. This became known as the Triffin Paradox, named after the economist Robert Triffin, who identified this problem. He noted that the more dollars foreign countries held, the less faith they had in the ability
of the U.S. government to convert those dollars. Like banks, though, countries do not keep enough gold or cash on hand to honor all of their liabilities. They maintain a percentage, called a reserve. Bank reserve ratios are usually 10 percent or less. (The low reserve ratio has been blamed by many as a cause of the 2008 financial crisis.) Some countries state their reserve ratios openly, and most seek to actively manage their ratios daily with open-market monetary policies—that is, buying and selling government securities and other financial instruments, which indirectly controls the total money supply in circulation, which in turn impacts supply and demand for the currency.

The expense of the Vietnam War and an increase in domestic spending worsened the Triffin Paradox; the US government began to run huge budget deficits, which further weakened global confidence in the U.S. dollar. When nations began demanding gold in exchange for their dollars, there was a huge global sell-off of the U.S. dollar, resulting in the Nixon Shock in 1971.

The Nixon Shock was a series of economic decisions made by the US President Richard Nixon in 1971 that led to the demise of the Bretton Woods system. Without consulting the other member countries, on August 15, 1971, Nixon ended the free convertibility of the US dollar into gold and instituted price and wage freezes among other economic measures.

Later that same year, the member countries reached the Smithsonian Agreement, which devalued the US dollar to $38 per ounce of gold, increased the value of other countries’ currencies to the dollar, and increased the band within which a currency was allowed to float from 1 percent to 2.25 percent. This agreement still relied on the U.S. dollar to be the strong reserve currency and the persistent concerns over the high inflation and trade deficits continued to weaken confidence in the system. Countries gradually dropped out of system—notably Germany, the United Kingdom, and Switzerland, all of which began to allow their currencies to float freely against the dollar. The Smithsonian Agreement was an insufficient response to the economic challenges; by 1973, the idea of fixed exchange rates was over.

Before moving on, recall that the major significance of the Bretton Woods Agreement was that it was the first formal institution that governed international monetary systems. By having a formal set of rules, regulations, and guidelines for decision making, the Bretton Woods Agreement established a higher level of economic stability. International businesses benefited from the almost thirty years of stability in exchange rates. Bretton Woods established a standard for future monetary systems to improve on; countries today continue to explore how best to achieve this. Nothing has fully replaced Bretton Woods to this day, despite extensive efforts.

**Post–Bretton Woods Systems and Subsequent Exchange Rate Efforts**

When Bretton Woods was established, one of the original architects, Keynes, initially proposed creating an international currency called Bancor as the main currency for clearing. However, the Americans had an alternative proposal for the creation of a central currency called unitas. Neither gained momentum; the U.S. dollar was the reserve currency. Reserve currency is a main currency that many countries and institutions hold as part of their foreign exchange reserves. Reserve currencies are often international pricing currencies for world products and services. Examples of current reserve currencies are the U.S. dollar, the euro, the British pound, the Swiss franc, and the Japanese yen.

Many feared that the collapse of the Bretton Woods system would bring the period of rapid growth to an end. In fact, the transition to floating exchange rates was relatively smooth, and it was certainly timely: flexible exchange rates made it easier for economies to adjust to more expensive oil, when the price suddenly started going up in October 1973. Floating rates have facilitated adjustments to external shocks ever since.


After the collapse of Bretton Woods and the Smithsonian Agreement, several new efforts tried to replace the global system. The most noteworthy regional effort resulted in the European Monetary System (EMS) and the creation of a single currency, the euro. While there have been no completely effective efforts to replace Bretton Woods on a global level, there have been efforts that have provided ongoing exchange rate mechanisms.
Jamaica Agreement

In 1976, countries met to formalize a floating exchange rate system as the new international monetary system. The Jamaica Agreement established a managed float system of exchange rates, in which currencies float against one another with governments intervening only to stabilize their currencies at set target exchange rates. This is in contrast to a completely free floating exchange rate system, which has no government intervention; currencies float freely against one another. The Jamaica Agreement also removed gold as the primary reserve asset of the IMF. Additionally, the purpose of the IMF was expanded to include lending money as a last resort to countries with balance-of-payment challenges.

The Gs Begin

In the early 1980s, the value of the U.S. dollar increased, pushing up the prices of US exports and thereby increasing the trade deficit. To address the imbalances, five of the world’s largest economies met in September 1985 to determine a solution. The five countries were Britain, France, Germany, Japan, and the United States; this group became known as the Group of Five, shortened to G5. The 1985 agreement, called the Plaza Accord because it was held at the Plaza Hotel in New York City, focused on forcing down the value of the U.S. dollar through collective efforts.

By February 1987, the markets had pushed the dollar value down, and some worried it was now valued too low. The G5 met again, but now as the Group of Seven, adding Italy and Canada—it became known as the G7. The Louvre Accord, so named for being agreed on in Paris, stabilized the dollar. The countries agreed to support the dollar at the current valuation. The G7 continued to meet regularly to address ongoing economic issues.

The G7 was expanded in 1999 to include twenty countries as a response to the financial crises of the late 1990s and the growing recognition that key emerging-market countries were not adequately included in the core of global economic discussions and governance. It was not until a decade later, though, that the G20 effectively replaced the G8, which was made up of the original G7 and Russia. The European Union was represented in G20 but could not host or chair the group.

Keeping all of these different groups straight can be very confusing. The news may report on different groupings as countries are added or removed from time to time. The key point to remember is that anything related to a G is likely to be a forum consisting of finance ministers and governors of central banks who are meeting to discuss matters related to cooperating on an international monetary system and key issues in the global economy.

The G20 is likely to be the stronger forum for the foreseeable future, given the number of countries it includes and the amount of world trade it represents. “Together, member countries represent around 90 per cent of global gross national product, 80 per cent of world trade (including EU intra-trade) as well as two-thirds of the world’s population.” Source: “About G-20,” G-20, accessed July 25, 2010, http://www.g20.org/en.

Did You Know: G-ology

“At present, a number of groups are jostling to be the pre-eminent forum for discussions between world leaders. The G20 ended 2009 by in effect replacing the old G8. But that is not the end of the matter. In 2010 the G20 began to face a new challenger—G2 [the United States and China]. To confuse matters further, lobbies have emerged advocating the formation of a G13 and a G3.” Source: Gideon Rachman, “A Modern Guide to G-ology,” Economist, November 13, 2009, accessed February 9, 2011, http://www.economist.com/node/14742524.

The G20 is a powerful, informal group of nineteen countries and the European Union. It also includes a representative from the World Bank and the International Monetary Fund. The list developed from an effort to include major developing countries with countries with developed economies. Its purpose is to address issues of the international financial system.

So just who’s in the current G20?
Today's Exchange Rate System

While there is not an official replacement to the Bretton Woods system, there are provisions in place through the ongoing forum discussions of the G20. Today's system remains—in large part—a managed float system, with the U.S. dollar and the euro jostling to be the premier global currency. For businesses that once quoted primarily in U.S. dollars, pricing is now just as often noted in the euro as well.

Ethics in Action

The Wall Street Journal's July 30, 2010, edition noted how gangsters are helping provide stability in the euro zone. The highest denomination of a euro is a €500 bill, in contrast to the United States, where the largest bill is a $100 bill.

The high-value bills are increasingly “making the euro the currency of choice for underground and black economies, and for all those who value anonymity in their financial transactions and investments,” wrote Willem Buiter, the chief economist at Citigroup. When euro notes and coins went into circulation in January 2002, the value of €500 notes outstanding was €30.8 billion ($40 billion), according to the ECB [European Central Bank]. Today some €285 billion worth of such euro notes are in existence, an annual growth rate of 32 percent. By value, 35 percent of euro notes in circulation are in the highest denomination, the €500 bill that few people ever see. In 1998, then-U.S. Treasury official Gary Gensler worried publicly about the competition to the $100 bill, the biggest U.S. bank note, posed by the big euro notes and their likely use by criminals. He pointed out that $1 million in $100 bills weighs 22 pounds; in hypothetical €500 bills, it would weigh just 4.4 pounds.

Police forces have found the big euro notes in cereal boxes, tires and in hidden compartments in trucks, says Soren Pedersen, spokesman for Europol, the European police agency based in The Hague. “Needless to say, this cash is often linked to the illegal drugs trade, which explains the similarity in methods of concealment that are used.” Source: Stephen Fidler, “How Gangsters Are Saving Euro Zone,” Wall Street Journal, July 30, 2010,
While you might think that the ECB should just stop issuing the larger denominations, it turns out that the ECB and the member governments of the euro zone actually benefit from this demand. The profit a central bank gains from issuing currency—as well as from other privileges of a central bank, such as being able to demand no-cost or low-cost deposits from banks—is known as seigniorage. It normally accrues to national treasuries once the central banks account for their own costs. The ECB’s gains from seigniorage are becoming increasingly important, with profits from issuing new paper currency upwards of €50 billion annually.

Some smaller nations have chosen to voluntarily set exchange rates against the dollar while other countries have selected the euro. Usually a country makes the decision between the dollar and the euro by reviewing their largest trading partners. By choosing the euro or the dollar, countries seek currency stability and a reduction in inflation, among other various perceived benefits. Many countries in Latin America once dollarized to provide currency stability for their economy. Today, this is changing, as individual economies have strengthened and countries are now seeking to dedollarize.

**Spotlight on Dollarizing and Dedollarizing in Latin America**

Many countries in Latin America have endured years of political and economic instability, which has exacerbated the massive inequality that has characterized the societies in modern times. Most of the wealth is in the hands of the white elite, who live sophisticated lives in the large cities, eating in fancy restaurants and flying off to Miami for shopping trips. Indeed, major cities often look much like any other modern, industrialized cities, complete with cinemas, fast-food restaurants, Internet cafés, and shopping malls.

But while the rich enjoy an enviable lifestyle, the vast majority of the continent’s large indigenous population often lives in extreme poverty. While international aid programs attempt to alleviate the poverty, a lot depends on the country’s government. Corrupt governments slow down the pace of progress.

Over the past two decades, governments in Ecuador and Peru—as well as others in Latin America including Bolivia, Paraguay, Panama, El Salvador, and Uruguay—have opted to dollarize to stabilize their countries’ economies. Each country replaced its national currency with the US dollar. Each country has struggled economically despite abundant natural resources. Economic cycles in key industries, such as oil and commodities, contributed to high inflation. While the move to dollarize was not always popular domestically initially, its success has been clearly evident. In both Ecuador and Peru, dollarizing has provided a much needed benefit, although one country expects to continue aligning with the US dollar and the other hopes to move away from it.

In Ecuador, for example, a decade after dollarizing, one cannot dismiss the survival of dollarization as coincidence. Dollarization has provided Ecuador with the longest period of a stable, fully convertible currency in a century. Its foremost result has been that inflation has dropped to single digits and remained there for the first time since 1972. The stability that dollarization has provided has also helped the economy grow an average of 4.3 percent a year in real terms, fostering a drop in the poverty rate from 56 percent of the population in 1999 to 35 percent in 2008. As a result, dollarization has been popular, with polls showing that more than three-quarters of Ecuadorians approve of it.

However, this success could not protect the country from the effects of the 2008 global financial crisis and economic downturn, which led to falling remittances and declining oil revenue for Ecuador. The country “lacks a reliable political system, legal system, or investment climate. Dollarization is the only government policy that provides Ecuadorians with a trustworthy basis for earning, saving, investing, and paying.” *Source: Pedro P. Romero, “Ecuador Dollarization: Anchor in a Storm,” Latin Business Chronicle, January 23, 2009, accessed February 9, 2011, http://www.latinbusinesschronicle.com/app/article.aspx?id=3096.*

Peru first opted to dollarize in the early 1970s as a result of the high inflation, which peaked during the hyperinflation of 1988–90. “With high inflation, the U.S. dollar started to be the preferred means of payments and store of value.” *Source: Mercedes García-Escritano, “Peru: Drivers of De-dollarization,” International Monetary Fund, July 2010, accessed May 9, 2011, http://www.bcrp.gob.pe/docs/Publicaciones/Documentos-de-Trabajo/2010/Documento-de-Trabajo-11-2010.pdf.* Dollarization was the only option to stabilize prices. A key cost of dollarizing, however, is losing monetary independence. Another cost is that the business cycle in the country is
tied more closely to fluctuations in the US economy and currency. Balancing the benefits and the costs is an ongoing concern for governments.

Despite attempts to dedollarize in the 1980s, it was not until the recent decade that Peru has successfully pursued a market-driven financial dedollarization. Dedollarization occurs when a country reduces its reliance on dollarizing credit and deposit of commercial banks. In Peru, as in some other Latin American countries—such as Bolivia, Uruguay and Paraguay—dedollarization has been “driven by macroeconomic stability, introduction of prudential policies to better reflect currency risk (such as the management of reserve requirements), and the development of the capital market in soles” (the local Peruvian currency). Source: Mercedes García-Escribano, “Peru: Drivers of De-dollarization, International Monetary Fund,” July 2010, accessed May 9, 2011, http://www.bcrp.gob.pe/docs/Publicaciones/Documentos-de-Trabajo/2010/Documento-de-Trabajo-11-2010.pdf.

Dedollarizing is still a relatively recent phenomenon, and economists are still trying to understand the implications and impact on businesses and the local economy in each country. What is clear is that governments view dedollarizing as one more tool toward having greater control over their economies.

KEY TAKEAWAYS

- The international monetary system had many informal and formal stages. For more than one hundred years, the gold standard provided a stable means for countries to exchange their currencies and facilitate trade. With the Great Depression, the gold standard collapsed and gradually gave way to the Bretton Woods system.
- The Bretton Woods system established a new monetary system based on the US dollar. This system incorporated some of the disciplinary advantages of the gold system while giving countries the flexibility they needed to manage temporary economic setbacks, which had led to the fall of the gold standard.
- The Bretton Woods system lasted until 1971 and provided the longest formal mechanism for an exchange-rate system and forums for countries to cooperate on coordinating policy and navigating temporary economic crises.
- While no new formal system has replaced Bretton Woods, some of its key elements have endured, including a modified managed float of foreign exchange, the International Monetary Fund (IMF), and the World Bank—although each has evolved to meet changing world conditions.

EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. What is the international monetary system?
2. What was the gold standard, and why did it collapse?
3. What was Bretton Woods, and why did it collapse?
4. What is the current system of exchange rates?

VIDEO: WHAT IS THE WORLD BANK?

Goal: Explain the foreign exchange market, the method in which in which exchange rates are determined, and the international monetary system.
Watch this video online: https://youtu.be/kvjo8Ur1IGE

VIDEO: ABOUT THE IMF

Goal: Explain the foreign exchange market, the method in which exchange rates are determined, and the international monetary system.

Watch this video online: https://youtu.be/XYkUkTkN060

VIDEO: FIXED VS. FLOATING EXCHANGE RATES

Goal: Explain the foreign exchange market, the method in which exchange rates are determined, and the international monetary system.

http://vimeo.com/40448527

"//player.vimeo.com/video/40448527?byline=0&portrait=0" width="500" height="375" frameborder="0"
allowfullscreen="allowfullscreen"

ECON333 Floating VS Fixed Exchange Rates from PSULiberalArts on Vimeo.
MODULE 9: DOES THE WORLD BANK HAVE AN ATM? UNDERSTANDING THE INTERNATIONAL MONETARY SYSTEM

OVERVIEW

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Explain how the foreign exchange market operates
- Differentiate among the different exchange rates
- Explain how business can overcome the risks and challenges of the foreign exchange markets

VIDEO: EXCHANGE RATES

From YouTube description: “How do currency values rise and fall? Why would a country want to manipulate the value of its own currency?”

Watch this video online: https://youtu.be/xwtgByffoUw
ASSIGNMENT: THE "BIG MAC" INDEX

ASSIGNMENT: The "Big Mac" Index

The Big Mac Index explained as a way to measure "PPP" or Purchasing Power Parity across the globe.

What is the "Big Mac" Index?

One suggested method of predicting exchange rate movements is that the rate between two currencies should naturally adjust so that a sample basket of goods and services should cost the same in both currencies Purchasing power parity.

In the Big Mac Index, the basket in question is a single Big Mac burger as sold by the McDonald’s fast food restaurant chain. The Big Mac was chosen because it is available to a common specification in many countries around the world as local McDonald’s franchisees at least in theory have significant responsibility for negotiating input prices. For these reasons, the index enables a comparison between many countries' currencies.

The Big Mac PPP exchange rate between two countries is obtained by dividing the price of a Big Mac in one country (in its currency) by the price of a Big Mac in another country (in its currency). This value is then compared with the actual exchange rate; if it is lower, then the first currency is under-valued (according to PPP theory) compared with the second, and conversely, if it is higher, then the first currency is over-valued.

Watch this video online: https://youtu.be/6F9xlj1YDxo

ASSIGNMENT:

1. Watch the Video: “The Big Mac Index” (8:38)
2. Follow the LINK to the current Big Mac Index: The ECONOMIST’S “BIG MAC” INDEX This Index is located on the Economist Magazine's website. This is an interactive site, so you can click onto the map and see how much the Big Mac will cost in various countries. This also gives you information about whether the currency of that country is under- or over-valued.
3. Go to the Internet and Google NEWS for “Exchange Rates and International Trade" (or similar search terms). See example below.
4. Select a news item relating to Exchange Rates and International Trade. Be sure to copy the LINK to the news item or article that you select. You will need to include this in your initial discussion board posting.

Discussion Board: Exchange Rates and International Trade:

1. Make your initial Discussion Board Posting (125 – 150 words). In this post you should include/answer/address the following:
   1. BRIEFLY explain your news item to the class
   2. Include the LINK to your news item so your classmates and I can read the full story. (You do not need to attach a copy of the item, just include the link)
   3. What are the challenges that currency exchange rates pose to doing business in a global market?
   4. How can business use exchange rates to their advantage in conducting business globally?
2. Respond to at least TWO of your classmates (50 – 75 words, each).
XE CURRENCY CONVERTER

XE Currency Converter

This is a link to a FAST and EASY currency converter website (XE). Simply select the two currencies and the exchange rate will be calculated in real time!
MODULE 10: BUYING A "BIG MAC" IN LONDON: FOREIGN DIRECT INVESTMENT

OVERVIEW

FDI is practiced by companies in order to benefit from cheaper labor costs, tax exemptions, and other privileges in that foreign country. But why would a company go to the trouble of FDI when there are other options open to them in order to access foreign markets? In this module we will consider FDI (Foreign Direct Investment) as the option of choice for business going global.

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Identify trends in FDI
- Explain the costs and benefits of FDI
- Discuss the role of government in business’s decision to undertake Foreign Direct Investment

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READING: FOREIGN DIRECT INVESTMENT

FDI is practiced by companies in order to benefit from cheaper labor costs, tax exemptions, and other privileges in that foreign country.

<table>
<thead>
<tr>
<th>KEY TAKEAWAYS</th>
</tr>
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<tbody>
<tr>
<td>• Foreign Direct Investment (FDI) is the flow of investments from one company to production in a foreign nation, with the purpose of lowering labor costs and gaining tax incentives.</td>
</tr>
<tr>
<td>• FDI can help the economic situations of developing countries, as well as facilitate progressive internal policy reforms.</td>
</tr>
<tr>
<td>• A major contributing factor to increasing FDI flow was internal policy reform relating to trade openness and participation in international trade agreements and institutions.</td>
</tr>
</tbody>
</table>

Term

• Foreign direct investment: Investment directly into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

Example

• Intel is headquartered in the United States, but it has made foreign direct investments in a number of Southeast Asian countries where they produce components of their products in Intel-owned factories.

Foreign direct investment (FDI) is investment into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

FDI is done for many reasons including to take advantage of cheaper wages in the country, special investment privileges, such as tax exemptions, offered by the country as an incentive to gain tariff-free access to the markets of the country or the region. FDI is in contrast to portfolio investment which is a passive investment in the securities of another country, such as stocks and bonds.

One theory for how to best help developing countries, is to increase their inward flow of FDI. However, identifying the conditions that best attract such investment flow is difficult, since foreign investment varies greatly across countries and over time. Knowing what has influenced these decisions and the resulting trends in outcomes can be helpful for governments, non-governmental organizations, businesses, and private donors looking to invest in developing countries.

A study from scholars at Duke University and Princeton University published in the American Journal of Political Science, “The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements,” examines trends in FDI from 1970 to 2000 in 122 developing countries to assess what the best conditions are for attracting investment. The study found the major contributing factor to increasing FDI flow was internal policy reform relating to trade openness and participation in international trade agreements and institutions. The researchers conclude that, while “democracy can be conducive to international cooperation,” the strongest indicator for higher inward flow of FDI for developing countries was the number of trade agreements and institutions to which they were party.
São Paulo

São Paulo, Brazil, home to a growing middle class and significant direct investments.

ASSIGNMENT: THE WORLD OF FOREIGN DIRECT INVESTMENT

The World of Foreign Direct Investment

Foreign direct investment (FDI) is a key element in international economic integration. FDI creates direct, stable, and long-lasting links between economies. It encourages the transfer of technology and know-how between countries, and allows the host economy to promote its products more widely in international markets. FDI is also an additional source of funding for investment and, under the right policy environment, it can be an important vehicle for development.

FDI is defined as cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the enterprise. Ownership of at least 10% of the voting power, representing the influence by the investor, is the basic criterion used. Source: [http://www.oecd-ilibrary.org/sites/factbook-2013-en/04/02/01/index.html?itemId=/content/chapter/factbook-2013-34-en](http://www.oecd-ilibrary.org/sites/factbook-2013-en/04/02/01/index.html?itemId=/content/chapter/factbook-2013-34-en)

DISCUSSION BOARD ASSIGNMENT:

1. **RESEARCH FDI on the Internet.** You may select FDI in either the U.S. or abroad. For background information, the link to the OECD iLibrary has been provided: [OECD iLibrary](http://www.oecd-ilibrary.org)

2. **SELECT AN ARTICLE OR NEWS ITEM THAT DEALS WITH FDI.** This is a link to an article that I found about China in Time magazine: “Hey China, Foreign Direct Investors Just Aren’t That Into You” [http://time.com/13789/hey-china-foreign-investors-just-arent-that-into-you/](http://time.com/13789/hey-china-foreign-investors-just-arent-that-into-you/)

3. **COPY THE LINK TO YOUR ARTICLE** into your initial post.

DISCUSSION POSTINGS:

- INITIAL POST (150 – 175 words)
1. Briefly describe your article and what it says about FDI. Make sure to include information about any trends that you find in your article. Is FDI on the rise or decline? Is it shifting from one country to another?
2. Why is FDI such a good option for businesses that want to go global? What does your article or research say that supports your position?
3. What do you think the future is for FDI?
   • POST RESPONSES TO AT LEAST 2 OF YOUR CLASSMATES. (75 – 100 words)
MODULE 11: I'M FROM THE IMF AND I'M HERE TO HELP: GLOBAL ORGANIZATIONS FOR GLOBAL BUSINESS

OVERVIEW

Both the IMF and the World Bank act as global outreach partners to assist both developed and developing countries in areas that range from Economic Management to Rule of Law to Human Development. Although controversial at times, these two organizations and their over 180 members have touched almost every country on the globe, either directly or indirectly. In this module we will examine the difference between the two organizations and look at some of the projects they have undertaken.

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Illustrate the history of the WTO and its contribution to international business
- Identify ways that the World Bank and IMF provide support to global business ventures
- Identify the impact global organizations have on business decisions to trade internationally

VIDEO: GTT/WTO

From the YouTube description: “Just a quick overview of the history of GATT (General Agreement on Tariffs and Trade), which eventually became the WTO (World Trade Organization).”

Watch this video online: https://youtu.be/27J3CBxXKow
“What Is the International Monetary System?” discusses how, during the 1930s, the Great Depression resulted in failing economies. The fall of the gold standard led countries to raise trade barriers, devalue their currencies to compete against one another for export markets and curtail usage of foreign exchange by their citizens. All these factors led to declining world trade, high unemployment, and plummeting living standards in many countries. In 1944, the Bretton Woods Agreement established a new international monetary system. The creation of the International Monetary Fund (IMF) and the World Bank were two of its most enduring legacies.

The World Bank and the IMF, often called the Bretton Woods Institutions, are twin intergovernmental pillars supporting the structure of the world’s economic and financial order. Both have taken on expanding roles, and there have been renewed calls for additional expansion of their responsibilities, particularly in the continuing absence of a single global monetary agreement. The two institutions may seem to have confusing or overlapping functions. However, while some similarities exist (see the following figure), they are two distinct organizations with different roles.
“Despite these and other similarities, however, the Bank and the IMF remain distinct. The fundamental difference is this: the Bank is primarily a \textit{development} institution; the IMF is a \textit{cooperative} institution that seeks to maintain an orderly system of payments and receipts between nations. Each has a different purpose, a distinct structure, receives its funding from different sources, assists different categories of members, and strives to achieve distinct goals through methods peculiar to itself.” Source: David D. Driscoll, “The IMF and the World Bank: How Do They Differ?,” International Monetary Fund, last updated August 1996, accessed February 9, 2011, \url{http://www.imf.org/external/pubs/ft/expd/differ/differ.htm} (emphasis added). This section explores both of these institutions and how they have evolved in the almost seventy years since their creation.

\section*{International Monetary Fund}

\subsection*{History and Purpose}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{IMF_Headquarters.jpg}
\caption{IMF Headquarters in Washington, DC}
\end{figure}

The architects of the Bretton Woods Agreement, John Maynard Keynes and Harry Dexter White, envisioned an institution that would oversee the international monetary system, exchange rates, and international payments to enable countries and their citizens to buy goods and services from each other. They expected that this new global entity would ensure exchange rate stability and encourage its member countries to eliminate the exchange restrictions that hindered trade. Officially, the IMF came into existence in December 1945 with twenty-nine member countries. (The Soviets, who were at Bretton Woods, refused to join the IMF.)

In 1947, the institution’s first formal year of operations, the French became the first nation to borrow from the IMF. Over the next thirty years, more countries joined the IMF, including some African countries in the 1960s. The Soviet bloc nations remained the exception and were not part of the IMF until the fall of the Berlin Wall in 1989. The IMF experienced another large increase in members in the 1990s with the addition of Russia; Russia was also placed on the IMF’s executive committee. Today, 187 countries are members of the IMF; twenty-four of those countries or groups of countries are represented on the executive board.
The purposes of the International Monetary Fund are as follows:

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
2. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
5. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

In addition to financial assistance, the IMF also provides member countries with technical assistance to create and implement effective policies, particularly economic, monetary, and banking policy and regulations.

**Special Drawing Rights (SDRs)**

A Special Drawing Right (SDR) is basically an international monetary reserve asset. SDRs were created in 1969 by the IMF in response to the Triffin Paradox. The Triffin Paradox stated that the more U.S. dollars were used as a base reserve currency, the less faith that countries had in the ability of the US government to convert those dollars to gold. The world was still using the Bretton Woods system, and the initial expectation was that SDRs would replace the U.S. dollar as the global monetary reserve currency, thus solving the Triffin Paradox. Bretton Woods collapsed a few years later, but the concept of an SDR solidified. Today the value of an SDR consists of the value of four of the IMF’s biggest members’ currencies—the U.S. dollar, the British pound, the Japanese yen, and the euro—but the currencies do not hold equal weight. SDRs are quoted in terms of U.S. dollars. The basket, or group of currencies, is reviewed every five years by the IMF executive board and is based on the currency’s role in international trade and finance. The following chart shows the current valuation in percentages of the four currencies.

<table>
<thead>
<tr>
<th>Currency</th>
<th>Weighting</th>
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<tbody>
<tr>
<td>U.S. dollar</td>
<td>44 percent</td>
</tr>
<tr>
<td>Euro</td>
<td>34 percent</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>11 percent</td>
</tr>
<tr>
<td>British pound</td>
<td>11 percent</td>
</tr>
</tbody>
</table>

The SDR is not a currency, but some refer to it as a form of IMF currency. It does not constitute a claim on the IMF, which only serves to provide a mechanism for buying, selling, and exchanging SDRs. Countries are allocated SDRs, which are included in the member country’s reserves. SDRs can be exchanged between countries along with currencies. The SDR serves as the unit of account of the IMF and some other international organizations, and countries borrow from the IMF in SDRs in times of economic need.
The IMF's Current Role and Major Challenges and Opportunities

Criticism and Challenging Areas for the IMF

The IMF supports many developing nations by helping them overcome monetary challenges and to maintain a stable international financial system. Despite this clearly defined purpose, the execution of its work can be very complicated and can have wide repercussions for the recipient nations. As a result, the IMF has both its critics and its supporters. The challenges for organizations like the IMF and the World Bank center not only on some of their operating deficiencies but also on the global political environment in which they operate. The IMF has been subject to a range of criticisms that are generally focused on the conditions of its loans, its lack of accountability, and its willingness to lend to countries with bad human rights records.

These criticisms include the following:

1. **Conditions for loans.** The IMF makes the loan given to countries conditional on the implementation of certain economic policies, which typically include the following:
   - Reducing government borrowing (higher taxes and lower spending)
   - Higher interest rates to stabilize the currency
   - Allowing failing firms to go bankrupt
   - Structural adjustment (privatization, deregulation, reducing corruption and bureaucracy)

   The austere policies have worked at times but always extract a political toll as the impact on average citizens is usually quite harsh. The opening case in Chapter 2 “International Trade and Foreign Direct Investment” presents the current impact of IMF policies on Greece. Some suggest that the loan conditions are “based on what is termed the ‘Washington Consensus,’ focusing on liberalisation—of trade, investment and the financial sector—, deregulation and privatisation of nationalised industries. Often the conditionalities are attached without due regard for the borrower countries’ individual circumstances and the prescriptive recommendations by the World Bank and IMF fail to resolve the economic problems within the countries. IMF conditionalities may additionally result in the loss of a state’s authority to govern its own economy as national economic policies are predetermined under IMF packages.”

2. **Exchange rate reforms.** “When the IMF intervened in Kenya in the 1990s, they made the Central bank remove controls over flows of capital. The consensus was that this decision made it easier for corrupt politicians to transfer money out of the economy (known as the Goldman scandal). Critics argue this is another example of how the IMF failed to understand the dynamics of the country that they were dealing with—insisting on blanket reforms.”

3. **Devaluations.** In the initial stages, the IMF has been criticized for allowing inflationary devaluations.

4. **Free-market criticisms of the IMF.** “Believers in free markets argue that it is better to let capital markets operate without attempts at intervention. They argue attempts to influence exchange rates only make things worse—it is better to allow currencies to reach their market level.” They also assert that bailing out countries with large debts is morally hazardous; countries that know that there is always a bailout provision will borrow and spend more recklessly.

5. **Lack of transparency and involvement.** The IMF has been criticized for “imposing policy with little or no consultation with affected countries.”

6. **Supporting military dictatorships.** The IMF has been criticized over the decades for supporting military dictatorships.


Opportunities and Future Outlook for the IMF

The 2008 global economic crisis is one of the toughest situations that the IMF has had to contend with since the Great Depression.

For most of the first decade of the twenty-first century, global trade and finance fueled a global expansion that enabled many countries to repay any money they had borrowed from the IMF and other official creditors. These countries also used surpluses in trade to accumulate foreign exchange reserves. The global economic crisis that
began with the 2007 collapse of mortgage lending in the United States and spread around the world in 2008 was preceded by large imbalances in global capital flows. Global capital flows fluctuated between 2 and 6 percent of world GDP between 1980 and 1995, but since then they have risen to 15 percent of GDP. The most rapid increase has been experienced by advanced economies, but emerging markets and developing countries have also become more financially integrated.

The founders of the Bretton Woods system had taken for granted that private capital flows would never again resume the prominent role they had in the nineteenth and early twentieth centuries, and the IMF had traditionally lent to members facing current account difficulties. The 2008 global crisis uncovered fragility in the advanced financial markets that soon led to the worst global downturn since the Great Depression. Suddenly, the IMF was inundated with requests for standby arrangements and other forms of financial and policy support.

The international community recognized that the IMF’s financial resources were as important as ever and were likely to be stretched thin before the crisis was over. With broad support from creditor countries, the IMF’s lending capacity tripled to around $750 billion. To use those funds effectively, the IMF overhauled its lending policies. It created a flexible credit line for countries with strong economic fundamentals and a track record of successful policy implementation. Other reforms targeted low-income countries. These factors enabled the IMF to disburse very large sums quickly; the disbursements were based on the needs of borrowing countries and were not as tightly constrained by quotas as in the past.

Many observers credit the IMF’s quick responses and leadership role in helping avoid a potentially worse global financial crisis. As noted in the Chapter 5 “Global and Regional Economic Cooperation and Integration” opening case on Greece, the IMF has played a role in helping countries avert widespread financial disasters. The IMF’s requirements are not always popular but are usually effective, which has led to its expanding influence. The IMF has sought to correct some of the criticisms; according to a Foreign Policy in Focus essay designed to stimulate dialogue on the IMF, the fund’s strengths and opportunities include the following (Source: Martin S. Edwards, “The IMF’s New Toolkit: New Opportunities, Old Challenges,” Foreign Policy in Focus, September 17, 2009, accessed June 28, 2010, http://www.fpif.org/articles/the_imfs_new_toolkit_new_opportunities_old_challenges):

1. **Flexibility and speed.** “In March 2009, the IMF created the Flexible Credit Line (FCL), which is a fast-disbursing loan facility with low conditionality aimed at reassuring investors by injecting liquidity...Traditionally, IMF loan programs require the imposition of austerity measures such as raising interest rates that can reduce foreign investment...In the case of the FCL, countries qualify for it not on the basis of their promises, but on the basis of their history. Just as individual borrowers with good credit histories are eligible for loans at lower interest rates than their risky counterparts, similarly, countries with sound macroeconomic fundamentals are eligible for drawings under the FCL. A similar program has been proposed for low-income countries. Known as the Rapid Credit Facility, it is front-loaded (allowing for a single, up-front payout as with the FCL) and is also intended to have low conditionality.”

2. **Cheerleading.** “The Fund is positioning itself to be less of an adversary and more of a cheerleader to member countries. For some countries that need loans more for reassurance than reform, these changes to the Fund toolkit are welcome.” This enables more domestic political and economic stability.

3. **Adaptability.** “Instead of providing the same medicine to all countries regardless of their particular problems, the new loan facilities are intended to aid reform-minded governments by providing short-term resources to reassure investors. In this manner, they help politicians in developing countries manage the downside costs of integration.”

4. **Transparency.** The IMF has made efforts to improve its own transparency and continues to encourage its member countries to do so. Supporters note that this creates a barrier to any one or more countries that have more geopolitical influence in the organization. In reality, the major economies continue to exert influence on policy and implementation.

To underscore the global expectations for the IMF’s role, China, Russia, and other global economies have renewed calls for the G20 to replace the U.S. dollar as the international reserve currency with a new global system controlled by the IMF.

The *Financial Times* reported that Zhou Xiaochuan, the Chinese central bank’s governor, said the goal would be to create a reserve currency that is disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies. “This is a clear sign that China, as the largest holder of US dollar financial assets, is concerned about the potential inflationary risk of the US Federal Reserve printing money,” said Qu Hongbin, chief China economist for HSBC. Although Mr. Zhou did not mention the U.S. dollar, the essay gave a pointed critique of the current dollar-dominated monetary...
system: “The outbreak of the [current] crisis and its spillover to the entire world reflected the inherent vulnerabilities and systemic risks in the existing international monetary system,” Mr Zhou wrote.

China has little choice but to hold the bulk of its $2,000bn of foreign exchange reserves in U.S. dollars, and this is unlikely to change in the near future. To replace the current system, Mr. Zhou suggested expanding the role of special drawing rights, which were introduced by the IMF in 1969 to support the Bretton Woods fixed exchange rate regime but became less relevant once that collapsed in the 1970s.... Mr Zhou said the proposal would require “extraordinary political vision and courage” and acknowledged a debt to John Maynard Keynes, who made a similar suggestion in the 1940s. Source: Jamil Anderlini, “China Calls for New Reserve Currency," Financial Times, March 24, 2009, accessed February 9, 2011, http://www.ft.com/cms/s/0/7851925a-17a2-11de-8c9d-0000779fd2ac.html#axzz1DTvW5Kyl.

China is politically and economically motivated to recommend an alternative reserve currency. Politically, the country whose currency is the reserve currency is perceived as the dominant economic power, as Section 6.1 “What Is the International Monetary System?” discusses. Economically, China has come under increasing global pressure to increase the value of its currency, the renminbi.

The World Bank and the World Bank Group

History and Purpose

Figure 6.2 World Bank Headquarters in Washington, DC

The World Bank came into existence in 1944 at the Bretton Woods conference. Its formal name is the International Bank for Reconstruction and Development (IBRD), which clearly states its primary purpose of financing economic development. The World Bank’s first loans were extended during the late 1940s to finance the reconstruction of the war-ravaged economies of Western Europe. When these nations recovered some measure
of economic self-sufficiency, the World Bank turned its attention to assisting the world’s poorer nations. The World Bank has one central purpose: to promote economic and social progress in developing countries by helping raise productivity so that their people may live a better and fuller life:

[In 2009,] the World Bank provided $46.9 billion for 303 projects in developing countries worldwide, with our financial and/or technical expertise aimed at helping those countries reduce poverty. The Bank is currently involved in more than 1,800 projects in virtually every sector and developing country. The projects are as diverse as providing microcredit in Bosnia and Herzegovina, raising AIDS-prevention awareness in Guinea, supporting education of girls in Bangladesh, improving health care delivery in Mexico, and helping East Timor rebuild upon independence and India rebuild Gujarat after a devastating earthquake.

Today, the World Bank consists of two main bodies, the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), established in 1960. The World Bank is part of the broader World Bank Group, which consists of five interrelated institutions: the IBRD; the IDA; the International Finance Corporation (IFC), which was established in 1956; the Multilateral Investment Guarantee Agency (MIGA), which was established in 1988; and the International Centre for Settlement of Investment Disputes (ICSID), which was established in 1966. These additional members of the World Bank Group have specific purposes as well. The IDA typically provides interest-free loans to countries with sovereign guarantees. The IFC provides loans, equity, risk-management tools, and structured finance. Its goal is to facilitate sustainable development by improving investments in the private sector. The MIGA focuses on improving the foreign direct investment of developing countries. The ICSID provides a means for dispute resolution between governments and private investors with the end goal of enhancing the flow of capital.

The current primary focus of the World Bank centers on six strategic themes:

1. **The poorest countries.** Poverty reduction and sustainable growth in the poorest countries, especially in Africa.
2. **Postconflict and fragile states.** Solutions to the special challenges of postconflict countries and fragile states.
3. **Middle-income countries.** Development solutions with customized services as well as financing for middle-income countries.
4. **Global public goods.** Addressing regional and global issues that cross national borders, such as climate change, infectious diseases, and trade.
5. **The Arab world.** Greater development and opportunity in the Arab world.
6. **Knowledge and learning.** Leveraging the best global knowledge to support development.

The World Bank provides low-interest loans, interest-free credits, and grants to developing countries. There’s always a government (or “sovereign”) guarantee of repayment subject to general conditions. The World Bank is directed to make loans for projects but never to fund a trade deficit. These loans must have a reasonable likelihood of being repaid. The IDA was created to offer an alternative loan option. IDA loans are free of interest and offered for several decades, with a ten-year grace period before the country receiving the loan needs to begin repayment. These loans are often called soft loans.

Since it issued its first bonds in 1947, the IBRD generates funds for its development work through the international capital markets. The World Bank issues bonds, typically about $25 billion a year. These bonds are rated AAA (the highest possible rating) because they are backed by member states’ shared capital and by borrowers’ sovereign guarantees. Because of the AAA credit rating, the World Bank is able to borrow at relatively low interest rates. This provides a cheaper funding source for developing countries, as most developing countries have considerably low credit ratings. The World Bank charges a fee of about 1 percent to cover its administrative overheads.

**What Are the World Bank’s Current Role and Major Challenges and Opportunities?**

Like the IMF, the World Bank has both its critics and its supporters. The criticisms of the World Bank extend from the challenges that it faces in the global operating environment. Some of these challenges have complicated causes; some result from the conflict between nations and the global financial crisis. The following are four examples of the world’s difficult needs that the World Bank tries to address:
1. Even in 2010, over 3 billion people lived on less than $2.50 a day.
2. At the start of the twenty-first century, almost a billion people couldn’t read a book or sign their names.
3. Less than 1 percent of what the world spends each year on weapons would have put every child into school by the year 2000, but it didn’t happen.
4. Fragile states such as Afghanistan, Rwanda, and Sri Lanka face severe development challenges: weak institutional capacity, poor governance, political instability, and often ongoing violence or the legacy of past conflict.

According to the Encyclopedia of the New American Nation and the New York Times, the World Bank is criticized primarily for the following reasons:

- **Administrative incompetence.** The World Bank and its lending practices are increasingly scrutinized, with critics asserting that “the World Bank has shifted from being a ‘lender of last resort’ to an international welfare organization,” resulting in an institution that is “bloated, incompetent, and even corrupt.” Also incriminating is that “the bank’s lax lending standards have led to a rapidly deteriorating loan portfolio.”

- **Rewarding or supporting inefficient or corrupt countries.** The bank’s lending policies often reward macroeconomic inefficiency in the underdeveloped world, allowing inefficient nations to avoid the types of fundamental reforms that would in the long term end poverty in their countries. Many analysts note that the best example is to compare the fantastic growth in East Asia to the deplorable economic conditions of Africa. In 1950 the regions were alike—South Korea had a lower per capita GDP than Nigeria. But by pursuing macroeconomic reforms, high savings, investing in education and basic social services, and opening their economies to the global trading order, the “Pacific Tigers” have been able to lift themselves out of poverty and into wealth with very little help from the World Bank. Many countries in Africa, however, have relied primarily on multilateral assistance from organizations like the World Bank while avoiding fundamental macroeconomic reforms, with deplorable but predictable results.

Conservatives point out that the World Bank has lent more than $350 billion over a half-century, mostly to the underdeveloped world, with little to show for it. One study argued that of the sixty-six countries that received funding from the bank from 1975 to 2000, well over half were no better off than before, and twenty were actually worse off. The study pointed out that Niger received $637 million between 1965 and 1995, yet its per capita GNP had fallen, in real terms, more than 50 percent during that time. In the same period Singapore, which received one-seventh as much World Bank aid, had seen its per capita GNP increase by more than 6 percent a year.

- **Focusing on large projects rather than local initiatives.** Some critics claim that World Bank loans give preference to “large infrastructure projects like building dams and electric plants over projects that would benefit the poor, such as education and basic health care.” The projects often destroy the local environment, including forests, rivers, and fisheries. Some estimates suggest “that more than two and a half million people have been displaced by projects made possible through World Bank loans.” Failed projects, argue environmentalists and antiglobalization groups, are particularly illustrative: “The Sardar Sarovar dam on the Narmada River in India was expected to displace almost a quarter of a million people into squalid resettlement sites. The Polonoroeste Frontier Development scheme has led to large-scale deforestation in the Brazilian rain forest. In Thailand, the Pak Mun dam has destroyed the fisheries of the Mun River, impoverishing thousands who had made their living fishing and forever altering the diet of the region.” Further, the larger projects become targets for corruption by local government officials because there is so much money involved. Another example was in 2009, when an internal audit found that the IFC had “ignored its own environmental and social protection standards when it approved nearly $200 million in loan guarantees for palm oil production in Indonesia…Indonesia is home to the world’s second-largest reserves of natural forests and peat swamps, which naturally trap carbon dioxide—the main greenhouse gas that causes climate change. But rampant destruction of the forests to make way for palm oil plantations has caused giant releases of CO2 into the atmosphere, making Indonesia the third-largest emitter of greenhouse gases on the planet…” For each investment, commercial pressures were allowed to prevail, auditors wrote. Source: Lisa Friedman, “How the World Bank Let ‘Deal Making’ Torch the Rainforests,” New York Times, August 19, 2009, accessed February 9, 2011, http://www.nytimes.com/cwire/2009/08/19/19climatewire-how-the-world-bank-let-deal-making-torch-the-33255.html. However, as this article goes on to point out, such issues are not always as clear-cut as they may seem. The IFC responded to the audit by acknowledging “shortcomings in the review process. But the lender also defended investment in palm oil production as a way to alleviate poverty in Indonesia. ‘IFC believes that production of palm oil, when carried out in an environmentally and socially sustainable fashion, can provide core support for a strong rural economy, providing employment and improved quality of life for millions of the rural poor in tropical areas,’ it said.”

- **Negative influence on theory and practice.** As one of the two Bretton Woods Institutions, the World Bank plays a large role in research, training, and policy formulation. Critics worry that because “the World
Bank and the IMF are regarded as experts in the field of financial regulation and economic development, their views and prescriptions may undermine or eliminate alternative perspectives on development.”


- Dominance of G7 countries. The industrialized countries dominate the World Bank (and IMF) governance structures. Decisions are typically made and policies implemented by these leading countries—the G7—because they are the largest donors, some suggest without sufficient consultation with poor and developing countries. Source: “What Are the Main Concerns and Criticism about the World Bank and IMF?,” Bretton Woods Project, January 25, 2007, accessed February 9, 2011, http://www.brettonwoodsproject.org/item.shtml?x=320869.

Opportunities and Future Outlook for the World Bank

As vocal as the World Bank's critics are, so too are its supporters. The World Bank is praised by many for engaging in development projects in remote locations around the globe to improve living standards and reduce poverty. The World Bank's current focus is on helping countries achieve the Millennium Development Goals (MDGs), which are eight international development goals, established in 2000 at the Millennium Summit, that all 192 United Nations member states and twenty-three international organizations have agreed to achieve by the year 2015. They include reducing extreme poverty, reducing child mortality rates, fighting disease epidemics such as AIDS, and developing a global partnership for development. The World Bank is focused on the following four key issues:

1. Increased transparency. In response to the criticisms over the decades, the World Bank has made progress. More of the World Bank’s decision making and country assessments are available publicly. The World Bank has continued to work with countries to combat corruption both at the country and bank levels.

2. Expanding social issues in the fight on poverty. In 2001, the World Bank began to incorporate gender issues into its policy. “Two years later the World Bank announced that it was starting to evaluate all of its projects for their effects on women and girls,” noting that “poverty is experienced differently by men and women” and “a full understanding of the gender dimensions of poverty can significantly change the definition of priority policy and program interventions.” Source: Robert J. Brym et al., “In Faint Praise of the World Bank’s Gender Development Policy,” Canadian Journal of Sociology Online, March–April 2005, accessed May 23, 2011, http://www.csonline.ca/articles/brymetal05.html.

3. Improvements in countries' competitiveness and increasing exports. The World Bank’s policies and its role as a donor have helped improve the ability of some countries to secure more of the global revenues for basic commodities. In Rwanda, for example, reforms transformed the country’s coffee industry and increased exports. Kenya has expanded its exports of cut flowers, and Uganda has improved its fish-processing industry. World Bank efforts have also helped African financial companies develop. Source; Shanta Devarajan, “African Successes—Listing the Success Stories,” Africa Can…End Poverty (blog), The World Bank Group, September 17, 2009, accessed May 23, 2011, http://blogs.worldbank.org/africacan/african-successes-listing-the-success-stories.


The World Bank continues to play an integral role in helping countries reduce poverty and improve the well-being of their citizens. World Bank funding provides a resource to countries to utilize the services of global companies to accomplish their objectives.

### KEY TAKEAWAYS

- The IMF is playing an expanding role in the global monetary system. The IMF’s key roles are the following:
To promote international monetary cooperation
- To facilitate the expansion and balanced growth of international trade
- To promote exchange stability
- To assist in the establishment of a multilateral system of payments
- To give confidence to members by making the IMF’s general resources temporarily available to them under adequate safeguards
- To shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members

- The World Bank consists of two main bodies, the IBRD and the International Development Association (IDA).
- The World Bank Group includes the following interrelated institutions:
  - IBRD, which makes loans to countries with the purpose of building economies and reducing poverty
  - IDA, which typically provides interest-free loans to countries with sovereign guarantees
  - International Finance Corporation (IFC), which provides loans, equity, risk-management tools, and structured finance with the goal of facilitating sustainable development by improving investments in the private sector
  - Multilateral Investment Guarantee Agency (MIGA), which focuses on improving the foreign direct investment of the developing countries
  - International Centre for Settlement of Investment Disputes (ICSID), which provides a means for dispute resolution between governments and private investors, with the end goal of enhancing the flow of capital

EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. What is the IMF, and what role does it play?
2. What are two criticisms of the IMF and two of its opportunities for the future?
3. Discuss whether SDRs or another global currency created by the IMF should replace the US dollar as the international reserve currency.
4. What is the World Bank, and what role does it play?
5. What are two criticisms of the World Bank and two of its opportunities for the future?

Reading: IMF and the World Bank: How Do They Differ?

If you have difficulty distinguishing the World Bank from the International Monetary Fund, you are not alone. Most people have only the vaguest idea of what these institutions do, and very few people indeed could, if pressed on the point, say why and how they differ. Even John Maynard Keynes, a founding father of the two institutions and considered by many the most brilliant economist of the twentieth century, admitted at the inaugural meeting of the
International Monetary Fund that he was confused by the names: he thought the Fund should be called a bank, and the Bank should be called a fund. Confusion has reigned ever since.

The attached document explains, in detail the difference.


WEBSITES: IMF AND WORLD BANK

Website: IMF

Website: World Bank

ASSIGNMENT: GLOBAL ORGANIZATIONS: THE IMF & WORLD BANK

Global Organizations: The IMF & World Bank

The assignment for this Module has you look at a project that has been or is currently being undertaken by either the World Bank or the IMF. (LINKS to BOTH websites are located earlier in the module.)

Written Assignment:

1. Go to either the IMF or World Bank website and look at what they are doing. You will select one initiative from ONE of the two organizations as the subject of your two-page written paper this week.
   1. At the World Bank site: World Bank, click on the “Projects and Operations” tab from the Home Page. You may then select a project based on Sector, Theme or Country.
   2. At the IMF site: IMF, go to the Home Page and then select “Our Work” which will give you access to information about initiatives being undertaken by the IMF.
2. Select ONE project or initiative of interest from either the IMF or World Bank.
3. Your written assignment should include the following information:
   1. A brief overview of the project or initiative. This should be an overview of the type of project, the partners involved in the project and the goals/outcomes of the project.
   2. How does this project/initiative reflect the role of the organization in the global business environment?
   3. What is the long term benefit of the project/initiative to the global business environment?
4. Be certain to include a source (link/URL) for all of the sources that you used to prepare your assignment.
5. Your assignment should follow the Written Assignment Guidelines posted in the course. It will be graded using the Written Assignment Grading Rubric that is also posted.
MODULE 12: A GAME PLAN FOR "GOING GLOBAL" .... DEVELOPING A CORPORATE STRATEGY

OVERVIEW

International business strategy refers to plans that guide commercial transactions taking place between entities in different countries. Typically, international business strategy refers to the plans and actions of private companies rather than governments; as such, the goal is increased profit.

VIDEO: INTERNATIONAL GLOBAL BUSINESS STRATEGY

This is a short film introducing the topic of global strategy.

Watch this video online: https://youtu.be/9M5wWSA5vQQ

READING: INTERNATIONAL STRATEGY

LEARNING OBJECTIVES

By the end of this section, you will be able to:
At the corporate level, firms choose to use one of three international strategies: multidomestic, global, or transnational (transnational is a combination of multidomestic and global). These three strategies reflect trade-offs between local responsiveness and global efficiency. For firms to gain a competitive advantage, they have to devise strategies that take best advantage of the firm's core competencies and that are difficult for competitors to copy.

**Multidomestic Strategy**

Multidomestic strategy maximizes local responsiveness by giving decentralizing decision-making authority to local business units in each country so that they can create products and services optimized to their local markets. A multidomestic strategy would be appropriate, for instance, where Thomas Friedman's flat-world thesis is not applicable. A multidomestic strategy focuses on competition within each country and maximizes local responsiveness. It assumes that the markets differ and, therefore, are segmented by country boundaries. In other words, consumer needs and desires, industry conditions (e.g., the number and type of competitors), political and legal structures, and social norms vary by country. Using a multidomestic strategy, the firm can customize its products to meet the specific preferences and needs of local customers. As a result, the firm can compete more effectively in each local market and increase its local market share.

The disadvantage of a multidomestic strategy, however, is that the firm faces more uncertainty because of the tailored strategies in different countries. In addition, because the firm is pursuing different strategies in different locations, it cannot take advantage of economies of scale that could help decrease costs for the firm overall. The multidomestic strategy has been more commonly used by European multinational firms because of the variety of cultures and markets found in Europe.

As mentioned earlier, Yum! Brands has a strong incentive to compete internationally with its restaurant concepts (i.e., KFC, Pizza Hut, Taco Bell, A&W Restaurants, and Long John Silver's). Yum! pursues a multidomestic strategy by trying to localize as much as possible. The firm doesn't open restaurants using only the US model. Wherever the company has locations, it consistently adapts to local tastes and negotiates well when cultural and political climates change. According to journalist Brian O'Keefe writing in *Fortune* magazine, "In Japan, for instance, KFC sells tempura crispy strips. In northern England, KFC stresses gravy and potatoes, while in Thailand, it offers fresh rice with soy or sweet chili sauce. In Holland, the company makes a potato-and-onion croquette. In France, it sells pastries alongside chicken. And in China, the chicken gets spicier the farther inland you travel. More and more, if it's only an American brand without a regional appeal, it's going to be difficult to market." Recognizing this constraint, Yum! introduces its products in those foreign markets that are the shortest "taste" distance from its traditional home markets. So, it sticks to high-population areas in which American culture has some appeal as well.

**Global Strategy**

In contrast to a multidomestic strategy, a global strategy is centralized and controlled by the home office and seeks to maximize global efficiency. Under this strategy, products are much more likely to be standardized rather than tailored to local markets. One way to think about global strategies is that if the world is flat, you can sell the same products and services in the same way in every country on the planet. The strategic business units operating in each country are assumed to be interdependent, and the home office attempts to achieve integration across these businesses. Therefore, a global strategy emphasizes economies of scale and offers greater opportunities to utilize innovations developed at the corporate level or in one country in other markets.

Although pursuing a global strategy decreases risk for the firm, the firm may not be able to gain as high a market share in local markets because the global strategy isn't as responsive to local markets. Another disadvantage of the global strategy is that it is difficult to manage because of the need to coordinate strategies and operating
decisions across country borders. Consequently, achieving efficient operations with a global strategy requires the sharing of resources as well as coordination and cooperation across country boundaries, which in turn require centralization and headquartered control. Whether the world is flat or flattening can often depend on the industry. In most cases, the world isn’t flat, but in a few industries the market characteristics are fairly common. The cement and concrete industry is an example of an industry where the flatteners have taken effect. CEMEX, a Mexico-based cement and building materials company founded in 1906, pursued an international business strategy that led to its growth and position as one of the top building materials companies in the world today. CEMEX acquired companies to grow rapidly, took advantage of economies of scale, and used the Internet to lower its cost structure. Perhaps most crucial to its international expansion success was foreseeing the shifts in distribution technologies that would bring previously disparate regional markets closer together. Source: Daniel F. Spulber, Global Competitive Strategy (Cambridge, UK: Cambridge University Press, 2007), 217–18.

In 2009, CEMEX CEO Lorenzo H. Zambrano wrote a message to stakeholders regarding sustainable development:

In 2009, as we coped with the worst crisis to hit the global economy, our industry, and our company in 75 years, we took important and decisive steps to strengthen not only our business model, but also our commitment to sustainable development. As a result, we are a stronger company, well positioned to take advantage of the recovery of the global economy. That is testimony to the quality of our employees, to our company’s core values of collaboration, integrity, and leadership, and to the disciplined execution of sound strategies.

We made several difficult decisions during the year to adjust to a rapidly evolving and extraordinarily challenging market environment. For example, we sold assets, most notably our Australian operations, and reorganized our business to improve efficiency and productivity. Together, these measures brought about an unfortunate, but necessary, reduction in our workforce. However, these steps enabled us to weather the crisis and will position our company for long-term success.

Even as the economic crisis unfolded, we deepened our commitment to our stakeholders. We continued our efforts to ensure the safety of our employees, and many of our country operations recorded solid improvements in their safety performance. However, despite our ongoing efforts, I am deeply saddened to report that 33 people—including employees, contractors, and third parties—died in incidents related to our operations during 2009. This is tragic and unacceptable. We are working harder than ever to identify and address the root causes of all fatalities and serious injuries in order to prevent their recurrence. For example, we are expanding and strengthening our efforts in key areas such as safety training for drivers and contractors. Above all, we remain committed to our global long-term goal of zero incidents.

On the environmental front, we continued to reduce our carbon footprint by improving the energy efficiency of our operations and expanding our use of alternative fuels. As a result, in 2009 we increased our use of alternative fuels to 16.4 percent, exceeding our target for 2015 ahead of time. In addition, Eurus, the wind farm project developed by ACCIONA Energía, became fully operational during the year and can supply 25 percent of our plants’ electricity needs in Mexico.

Finally, we engaged the communities in which we operate through open and ongoing dialogue, social initiatives, and volunteer efforts. We continued to find ways to promote access to housing and community infrastructure. For example, we launched our most successful low-income housing solution, Patrimonio Hoy, in the Dominican Republic.

As a global company, we are deeply aware of our responsibility to address complex sustainability challenges. We are committed to further reducing our impact on the environment and recognize that we have many opportunities to improve. We reconfirm our commitment to address climate change and to the development of a low-carbon economy. We actively engage with our global panel of sustainability experts, who provide important and valuable advice. On a personal note, I thank them for their feedback and for continuously challenging us to make further progress.

We present our 2009 sustainable development report within the framework of our overall sustainability website to better communicate our sustainability performance. We have provided an executive summary that highlights our performance on our key sustainability issues. We hope that you find the report engaging, transparent, and comprehensive, and we welcome your feedback.
Transnational Strategy

Transnational strategy seeks to combine the best of multidomestic strategy and a global strategy to get both global efficiency and local responsiveness. For many industries, given the differences across markets and the similarities being fostered by the flatteners, this form of strategy is highly desirable and appropriate. The difficulty is that combining the multidomestic and global strategies is hard to do because it requires fulfilling the dual goals of flexibility and coordination. Firms must balance opposing local and global goals. On the positive side, firms that effectively implement a transnational strategy often outperform competitors who use either the multidomestic or global corporate-level strategies.

The Ford Motor Company and BMW are examples of firms pursuing a transnational strategy. Ford, for example, is focusing on the “world car,” building one core car that will be sold globally. This strategy lowers Ford’s development costs, because rather than developing different cars for different countries or regions, Ford will sell the same car to all markets. The world car strategy, however, poses a major hurdle: how to design a car that appeals to consumers in many different countries. To tackle the issue, Ford took a page from BMW, which uses the concept of “fashion forward” when designing its 3 Series cars for multiple markets. The secret, according to Verena Kloos, president of BMW’s DesignworksUSA studio in California, is to “show consumers what the next big thing is, not reflect what they think now.” As James D. Farley, Ford’s global marketing chief, sees it, the global appeal of the 3 Series rests on trust and aspiration. People worldwide see the same design, which builds trust through ubiquity and familiarity and leads them to aspire to own the car themselves.

International Strategy and the Local Environment

Sometimes, firms expanding into new geographic markets find that they must adapt certain components of their strategies to accommodate local environments. In the United States, for instance, Dell is famous for the business model that allows it to skip middlemen and go directly to suppliers and customers. In its early years, Dell experimented with a brick-and-mortar retail strategy but quickly retrenched. As it expanded into international markets, however, Dell has found that it has to suspend its direct model, at least temporarily. Why? Basically because it needs local intermediaries to help develop both a base of business and acceptable levels of customer awareness and sophistication. Such has been the case first in India and then in China, which constitute huge markets for Dell.

While Dell provides a good example of adaptation, most global firms tend to approach corporate strategy from the perspective of their domestic market constraint, which can be problematic. Microsoft is a case in point. The United States and the European Union (EU) have very different traditions and models of competition, which in turn means that strategies must vary across these important markets. Had you not been aware of these differences, you might think that Microsoft followed an ideal resource-based corporate strategy in its diversification into Europe. It bundled its Windows operating system with the Internet Explorer browser and other software to increase the company’s perceived value and, therefore, customers’ willingness to pay. It also used its extensive experience with home-computer software, operating systems, and applications to better penetrate the server market for software and operating systems, where customers are primarily businesses. Finally, Microsoft tried to lock out competitors by including its Windows Media Player as a standard feature in both its server and home PC operating systems.

The EU, however, has made these Microsoft tactics illegal: the bundling strategy “deters innovation and reduces consumer choice in any technologies which Microsoft could conceivably take an interest in and tie with Windows in the future.” Source: “EU Lowers Boom on Microsoft,” Wired, March 24, 2004, accessed November 10, 2010, http://www.wired.com/techbiz/media/news/2004/03/62789. The EU signaled its disapproval by imposing a fine of over $600 million and giving Microsoft ninety days to release versions of its Windows operating systems for home PCs and servers without the Windows Media Player and to begin providing rivals access to the details of the code underlying its proprietary server systems, used primarily in business settings. This is not the first time such differences in regulatory environments have been ignored or underestimated by global firms. Just a few years
earlier, the European Commission’s ruling dealt a fatal blow to the all-but-done merger between Honeywell and General Electric (GE), citing that the merger would reduce competition in the aerospace industry.

### KEY TAKEAWAYS

- Multidomestic strategy maximizes local responsiveness by giving decentralizing decision-making authority to local business units in each country so that they can create products and services optimized to their local markets. This strategy allows firms to compete more effectively in the local market and increase their share in that market. The disadvantage of a multidomestic strategy, however, is that the firm faces more uncertainty because of the tailored strategies in different countries. In addition, because the firm is pursuing different strategies in different locations, it cannot take advantage of economies of scale that could help decrease costs for the firm overall.
- A global strategy is centralized and controlled by the home office and seeks to maximize global efficiency. Under this strategy, products are much more likely to be standardized rather than tailored to local markets. Although pursuing a global strategy decreases risk for the firm, the firm may not be able to gain as high a market share in local markets because the global strategy isn't as responsive to local markets.
- A transnational strategy offers the advantages of both the multidomestic strategy (efficiency) and global strategy (responsiveness to local conditions) but has the disadvantage that it is difficult to simultaneously execute the dual goals of flexibility and coordination.

### EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. When should a firm choose the global strategy rather than a multidomestic strategy?
2. How might a given country’s regulatory environment impact a firm’s international strategy?
3. How do the international strategies affect the trade-offs managers must make between local responsiveness and global efficiency?
MODULE 13: HOW DO YOU GET FROM "HERE" TO "THERE" ... STRATEGIES FOR ENTERING FOREIGN MARKETS

OVERVIEW

In this Module we will explore the various ways that businesses can enter foreign markets – and there are a variety from which to choose. Each strategy has its advantages and disadvantages and sometimes it works but other times ... well, not so much! Often times it is not the product or service that is a failure, but the ability to replicate success on an international scale has eluded some VERY big names ... WalMart, Coke, McDonalds. So, now we will see what options are available to business and take a look at what works and what doesn't work.

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

- Identify the various strategies of international business and the strategic ways to enter a foreign market
- Compare and contrast strategies for entering world markets
- Determine the most appropriate strategy for entering a specific market or specific product

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READING: MULTINATIONAL FIRMS

With the advent of improved communication and technology, corporations have been able to expand into multiple countries.

### KEY Points

- Multinational corporations operate in multiple countries.
- MNCs have considerable bargaining power and may negotiate business or trade policies with success.
- A corporation may choose to locate in a special economic zone, a geographical region that has economic and other laws that are more free-market-oriented than a country’s typical or national laws.

### Term

- **Multinational corporation**: A corporation or enterprise that operates in multiple countries.

### Example

- McDonalds operates in over 119 different countries, making it a fairly large MNC by any standard

A multinational corporation (MNC) or multinational enterprise (MNE) is a corporation registered in more than one country or has operations in more than one country. It is a large corporation which both produces and sells goods or services in various countries. It can also be referred to as an international corporation. The first multinational corporation was the Dutch East India Company, founded March 20, 1602.

**Ford Motor Corp.**
Ford is a MNC with operations throughout the world.

Corporations may make a foreign direct investment. Foreign direct investment is direct investment into one country by a company located in another country. Investors buy a company in the country or expand operations of an existing business in the country.

A corporation may choose to locate in a special economic zone, a geographical region with economic and other laws that are more free-market-oriented than a country’s typical or national laws.

Multinational corporations are important factors in the processes of globalization. National and local governments often compete against one another to attract MNC facilities, with the expectation of increased tax revenue, employment and economic activity. To compete, political powers push toward greater autonomy for corporations. MNCs play an important role in developing economies of developing countries.

Many economists argue that in countries with comparatively low labor costs and weak environmental and social protection, multinationals actually bring about a “race to the top.” While multinationals will see a low tax burden or low labor costs as an element of comparative advantage, MNC profits are tied to operationalefficiency, which includes a high degree of standardization. Thus, MNCs are likely to adapt production processes in many of their operations to conform to the standards of the most rigorous jurisdiction in which they operate.
As for labor costs, while MNCs pay workers in developing countries far below levels in countries where labor productivity is high (and accordingly, will adopt more labor-intensive production processes), they also tend to pay a premium over local labor rates of 10% to 100%.

Finally, depending on the nature of the MNC, investment in any country reflects a desire for a medium- to long-term return, as establishing a plant, training workers and so on can be costly. Therefore, once established in a jurisdiction, MNCs are potentially vulnerable to arbitrary government intervention like expropriation, sudden contract renegotiation and the arbitrary withdrawal or compulsory purchase of licenses. Thus both the negotiating power of MNCs and the “race to the bottom” critique may be overstated while understating the benefits (besides tax revenue) of MNCs becoming established in a jurisdiction.

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</table>
Employment
The work or occupation for which one is used, and often paid.

Enterprise
A company, business, organization, or other purposeful endeavor.

Facility
The physical means or contrivances to make something (especially a service) possible; the required equipment, infrastructure, location etc.

Foreign direct investment
Investment into production or business in a country by an individual or company of another country. Foreign direct investment is investment directly into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

Globalization
A common term for processes of international integration arising from increasing human connectivity and interchange of worldviews, products, ideas, and other cultural phenomena. In particular, advances in transportation and telecommunications infrastructure, including the rise of the Internet, represent major driving factors in globalization and precipitate the further interdependence of economic and cultural activities.

Good
An object produced for market.

Investment
A placement of capital in expectation of deriving income or profit from its use. The expenditure of capital in expectation of deriving income or profit from its use.

Jurisdiction
The limits or territory within which authority may be exercised. The limits or territory within which authority may be exercised, the power, right, or authority to interpret and apply the law.

License
The legal terms under which a person is allowed to use a product.

Operation
The method or practice by which actions are done. A procedure for generating a value from one or more other values.

Premium
A bonus paid in addition to normal payments. The price above par value at which a security is sold. Something offered at a reduced price as an inducement to buy something else. Something offered at a reduced price as an incentive to buy something else. The premium is the amount a policy-holder or his sponsor must pay to a health plan to purchase health coverage.

Process
A series of events to produce a result, especially as contrasted to product. In reference to capabilities, a process is how the capability is executed. An outgrowth of tissue or cell.

**Productivity**

Productivity is a measure of the efficiency of production and is defined as total output per one unit of a total input. The rate at which goods or services are produced by a standard population of workers. A ratio of production output to what is required to produce it (inputs). The state of being productive, fertile, or efficient; the rate at which goods or services are produced by a standard population of workers. The rate at which goods or services are produced relative to a particular workforce.

**Profits**

Collective form of profit.

**Revenue**

Income that a company receives from its normal business activities, usually from the sale of goods and services to customers. The total income received from a given source.

**Revenues**

In business, revenue or turnover is income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

**Services**

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

**Standard**

Something used as a measure for comparative evaluations. A level of quality or attainment. Standardization the process of setting certain norms or standards for a product with regard to shape, size, color, quantity, quality, weight etc.

**Standardization**

The process of setting certain norms or standards for a product with regard to shape, size, color, quantity, quality, weight etc.
In a joint venture business model, two or more parties agree to invest time, equity, and effort for the development of a new shared project.

**KEY TAKEAWAYS**

- Joint business ventures involve two parties contributing their own equity and resources to develop a new project. The enterprise, revenues, expenses and assets are shared by the involved parties.
- Since money is involved in a joint venture, it is necessary to have a strategic plan in place.
- As the cost of starting new projects is generally high, a joint venture allows both parties to share the burden of the project as well as the resulting profits.

**Term**

- *Joint venture*: A cooperative partnership between two individuals or businesses in which profits and risks are shared.

**Example**

- Sony Ericsson is a joint venture between Swedish telecom corporation Ericsson and Japanese electronics manufacturer Sony to develop cellular devices.

**Joint Ventures**

A joint venture is a business agreement in which parties agree to develop a new entity and new assets by contributing equity. They exercise control over the enterprise and consequently share revenues, expenses and assets.

Joint Venture

Sony Ericsson is a joint venture between Swedish telecom corporation Ericsson and Japanese electronics manufacturer Sony to develop cellular devices.

When two or more persons come together to form a partnership for the purpose of carrying out a project, this is called a joint venture. In this scenario, both parties are equally invested in the project in terms of money, time and effort to build on the original concept. While joint ventures are generally small projects, major corporations use this method to diversify. A joint venture can ensure the success of smaller projects for those that are just starting in the business world or for established corporations. Since the cost of starting new projects is generally high, a joint venture allows both parties to share the burden of the project as well as the resulting profits. Since money is involved in a joint venture, it is necessary to have a strategic plan in place. In short, both parties must be committed to focusing on the future of the partnership rather than just the immediate returns. Ultimately, short term and long term successes are both important. To achieve this success, honesty, integrity and communication within the joint venture are necessary.

A consortium JV (also known as a cooperative agreement) is formed when one party seeks technological expertise, franchise and brand-use agreements, management contracts, and rental agreements for one-time
contracts. The JV is dissolved when that goal is reached. Some major joint ventures include Dow Corning, MillerCoors, Sony Ericsson, Penske Truck Leasing, Norampac, and Owens-Corning.

**GLOSSARY**

**Assets**
Economic resources that represent value of ownership that can be converted into cash (although cash itself is also considered an asset). Any property or object of value that one possesses, usually considered as applicable to the payment of one’s debts. A resource with economic value that an individual, corporation, or country owns or controls with the expectation that it will provide future benefit.

**Asset**
Something or someone of any value; any portion of one's property or effects so considered. Something or someone of any value; any portion of one's property or effects so considered. Any component, model, process, or framework of value that can be leveraged or reused. Items of ownership convertible into cash; total resources of a person or business, as cash, notes and accounts receivable; securities and accounts receivable, securities, inventories, goodwill, fixtures, machinery, or real estate (as opposed to liabilities).

**Business model**
The particular way in which a business organization ensures that it generates income, one that includes the choice of offerings, strategies, infrastructure, organizational structures, trading practices, and operational processes and policies.

**Communication**
The concept or state of exchanging information between entities. An instance of information transfer; a conversation or discourse the concept or state of exchanging data or information between entities.

**Cooperative**
A type of company that is owned partially or wholly by its employees, customers, or tenants. Abbreviation: co-op.

**Corporation**
A group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members. A group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members.

**Enterprise**
A company, business, organization, or other purposeful endeavor.

**Equity**
A legal tradition that deals with remedies other than monetary relief, such as injunctions, divorces and similar actions. Justice, impartiality or fairness. Internal and external equity relate to a comparative level of pay compared to both internal and external candidates. Ownership interest in a company as determined by subtracting liabilities from assets. Ownership interest in a company, as determined by subtracting liabilities from assets. Ownership interest in a company, as determined by subtracting liabilities from assets. Justice, impartiality or fairness. The residual claim or interest to investors in assets after all liabilities are paid. If liability exceeds assets, negative equity exists and can be purchased through stock. Ownership, especially in terms of net monetary value, of a business. Ownership, especially in terms of net monetary value of some business.

**Expense**
A spending or consuming. Often specifically an act of disbursing or spending funds. In accounting, an expense is money spent or costs incurred in an businesses efforts to generate revenue.
Franchise

The authorization granted by a company to sell or distribute its goods or services in a certain area.

Goal

A result that one is attempting to achieve. A desired result that one works to achieve. A result that one is attempting to achieve.

Management

The act of getting people together to accomplish desired goals and objectives using available resources efficiently and effectively. Administration; the process or practice of managing administration; the process or practice of managing. Administration; the process or practice of managing.

Money

A generally accepted means of exchange and measure of value. A generally accepted means of exchange and measure of value.

Partnership

An association of two or more people to conduct a business. A business owned by two or more people. A partnership is a form of business in which two or more people operate for the common goal of making profit. Each partner has total and unlimited personal liability of the debts incurred by the partnership.

Profits

Collective form of profit.

Resource

Something that one uses to achieve an objective. An examples of a resource could be a raw material or an employee. Something that one uses to achieve an objective, e.g. raw materials or personnel.

Revenue

Income that a company receives from its normal business activities, usually from the sale of goods and services to customers. The total income received from a given source. In business, revenue or turnover is income that a company receives from its normal business activities, usually from the sale of goods and services to customers.
READING: CONTRACT MANUFACTURING

In contract manufacturing, a hiring firm makes an agreement with the contract manufacturer to produce and ship the hiring firm’s goods.

<table>
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<tr>
<td>• A hiring firm may enter a contract with a contract manufacturer (CM) to produce components or final products on behalf of the hiring firm for some agreed-upon price.</td>
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<td>• There are many benefits to contract manufacturing, and companies are finding many reasons why they should be outsourcing their production to other companies.</td>
</tr>
<tr>
<td>• Production outside of the company does come with many risks attached. Companies must first identify their core competencies before deciding about contract manufacture.</td>
</tr>
</tbody>
</table>

Terms

- **Contract manufacturing**: Business model in which a firm hires a contract manufacturer to produce components or final products based on the hiring firm’s design. A business model where a firm hires another firm to produce components or products.

A contract manufacturer (“CM”) is a manufacturer that enters into a contract with a firm to produce components or products for that firm. It is a form of outsourcing. In a contract manufacturing business model, the hiring firm approaches the contract manufacturer with a design or formula. The contract manufacturer will quote the parts based on processes, labor, tooling, and material costs. Typically a hiring firm will request quotes from multiple CMs. After the bidding process is complete, the hiring firm will select a source, and then, for the agreed-upon price, the CM acts as the hiring firm’s factory, producing and shipping units of the design on behalf of the hiring firm.
Benefits

Contract manufacturing offers a number of benefits:

- **Cost Savings:** Companies save on their capital costs because they do not have to pay for a facility and the equipment needed for production. They can also save on labor costs such as wages, training, and benefits. Some companies may look to contract manufacture in low-cost countries, such as China, to benefit from the low cost of labor.

- **Mutual Benefit to Contract Site:** A contract between the manufacturer and the company it is producing for may last several years. The manufacturer will know that it will have a steady flow of business at least until that contract expires.

- **Advanced Skills:** Companies can take advantage of skills that they may not possess, but the contract manufacturer does. The contract manufacturer is likely to have relationships formed with raw material suppliers or methods of efficiency within their production.

- **Quality:** Contract Manufacturers are likely to have their own methods of quality control in place that help them to detect counterfeit or damaged materials early.

- **Focus:** Companies can focus on their core competencies better if they can hand off base production to an outside company.

- **Economies of Scale:** Contract Manufacturers have multiple customers that they produce for. Because they are servicing multiple customers, they can offer reduced costs in acquiring raw materials by benefiting from economies of scale. The more units there are in one shipment, the less expensive the price per unit will be.

Risks

Balanced against the above benefits of contract manufacturing are a number of risks:

- **Lack of Control:** When a company signs the contract allowing another company to produce their product, they lose a significant amount of control over that product. They can only suggest strategies to the contract manufacturer; they cannot force them to implement those strategies.

- **Relationships:** It is imperative that the company forms a good relationship with its contract manufacturer. The company must keep in mind that the manufacturer has other customers. They cannot force them to produce their product before a competitor’s. Most companies mitigate this risk by working cohesively with the manufacturer and awarding good performance with additional business.

- **Quality:** When entering into a contract, companies must make sure that the manufacturer’s standards are congruent with their own. They should evaluate the methods in which they test products to make sure they are of good quality. The company has to ensure the contract manufacturer has suppliers that also meet these standards.

- **Intellectual Property Loss:** When entering into a contract, a company is divulging their formulas or technologies. This is why it is important that a company not give out any of its core competencies to contract manufacturers. It is very easy for an employee to download such information from a computer and steal it. The recent increase in intellectual property loss has corporate and government officials struggling to improve security. Usually, it comes down to the integrity of the employees.

- **Outsourcing Risks:** Although outsourcing to low-cost countries has become very popular, it does bring along risks such as language barriers, cultural differences, and long lead times. This could make the management of contract manufacturers more difficult, expensive, and time-consuming.

- **Capacity Constraints:** If a company does not make up a large portion of the contract manufacturer’s business, they may find that they are de-prioritized over other companies during high production periods. Thus, they may not obtain the product they need when they need it.

- **Loss of Flexibility and Responsiveness:** Without direct control over the manufacturing facility, the company will lose some of its ability to respond to disruptions in the supply chain. It may also hurt their ability to respond to demand fluctuations, risking their customer service levels.

<table>
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An advantage, help or aid from something. Employee benefits and (especially in British English) benefits in kind (also called fringe benefits, perquisites, perqs or perks) are various non-wage compensations provided to employees in addition to their normal wages or salaries. An advantage, help, or aid from something.

**Business model**

The particular way in which a business organization ensures that it generates income, one that includes the choice of offerings, strategies, infrastructure, organizational structures, trading practices, and operational processes and policies.

**Capacity**

The maximum that can be produced on a machine or in a facility or group.

**Capital**

Money and wealth. The means to acquire goods and services, especially in a non-barter system. The uppermost part of a column. Money and wealth; the means to acquire goods and services, especially in a non-barter system. Already-produced durable goods available for use as a factor of production, such as steam shovels (equipment) and office buildings (structures).

**Corporate**

An incorporated entity is a separate legal entity that has been incorporated through a legislative or registration process established through legislation.

**Demand**

The desire to purchase goods or services, coupled with the power to do so, at a particular price. The desire to purchase goods and services.

**Design**

To plan and carry out (a picture, work of art, construction etc.).

**Economies of scale**

A process where an increase in quantity will result in a decrease of average cost of production (per unit). The characteristics of a production process in which an increase in the scale of the firm causes a decrease in the long run, average cost of each unit. The cost advantages that an enterprise obtains due to expansion. As the scale of output is increased, factors such as facility size and usage levels of inputs cause the producer's average cost per unit to fall. The characteristics of a production process in which an increase in the scale of the firm causes a decrease in the long run average cost of each unit. The characteristics of a production process in which an increase in the scale of the firm causes a decrease in the long-run average cost of each unit.

**Economy**

Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy. The system of production and distribution and consumption. The overall measure of a currency system.

**Efficiency**

The extent to which a resource, such as electricity, is used for the intended purpose; the ratio of useful work to energy expended. The extent to which time is well used for the intended task. Improved efficiency was a principle goal of progressives, one they thought attainable by the application of scientific and rational thought to social problems. The extent to which time is well used for the intended task.
Facility
The physical means or contrivances to make something (especially a service) possible; the required equipment, infrastructure, location etc.

Flexibility
The quality of being flexible; suppleness; pliability. fluctuation A motion like that of waves; a moving in this and that direction.

Good
An object produced for market.

Intellectual property
Any product of someone’s intellect that has commercial value: copyrights, patents, trademarks, and trade secrets. Intellectual property (IP) is a juridical concept that refers to creations of the mind for which exclusive rights are recognized. Any product of someone’s knowledge that has commercial value: copyrights, patents, trademarks and trade secrets.

Language barrier
A figurative phrase for the difficulties faced when people who have no language in common attempt to communicate with each other.

Lead
Potential opportunity for a sale or transaction, a potential customer.

Lead time
The amount of time between the initiation of some process and its completion, e.g. the time required to manufacture or procure a product; the time required before something can be provided or delivered.

Loss
The negative difference between revenue and expense.

Management
The act of getting people together to accomplish desired goals and objectives using available resources efficiently and effectively. administration; the process or practice of managing. administration; the process or practice of managing Administration; the process or practice of managing.

Manufacture
The action or process of making goods systematically or on a large scale.

Outsourcing
The transfer of a business function to an external service provider. The transfer of a business function to an external service provider.

Performance
The act of performing; carrying into execution or action; execution; achievement; accomplishment; representation by action; as, the performance of an undertaking of a duty. The act of performing; carrying into execution or action; achievement; accomplishment; representation by action, as the performance of undertaking a duty.

Price
The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Process
A series of events to produce a result, especially as contrasted to product. In reference to capabilities, a process is how the capability is executed. An outgrowth of tissue or cell.

Product
Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. A chemical substance formed as a result of a chemical reaction. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

Quality control
Quality control (QC) is a procedure or set of procedures intended to ensure that a manufactured product or performed service adheres to a defined set of quality criteria or meets the requirements of the client or customer. A control, such as inspection or testing, introduced into an industrial or business process to ensure quality.

Raw materials
A raw material or feedstock is the basic material from which a good product is manufactured or made, frequently used with an extended meaning. For example, the term is used to denote material that came from nature and is in an unprocessed or minimally processed state; e.g., raw latex, iron ore, logs, crude oil or seawater. A raw material is the basic material from which a product is manufactured or made. Materials and components scheduled for use in making a product. A raw material is the basic material from which a good product is manufactured or made, frequently used with an extended meaning.

Risk
The potential (conventionally negative) impact of an event, determined by combining the likelihood of the event occurring with the impact, should it occur. The potential that a chosen action or activity (including the choice of inaction) will lead to a loss (an undesirable outcome). To incur risk [of something].

Security
The condition of not being threatened, especially physically, psychologically, emotionally, or financially. Proof of ownership of stocks, bonds, or other investment instruments.

Services
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

Standard
Something used as a measure for comparative evaluations. A level of quality or attainment.

Strategy
A plan of action intended to accomplish a specific goal.

Supplier
One who supplies; a provider.

Supply provisions
The amount of some product that producers are willing and able to sell at a given price, all other factors being held constant.

Supply chain

A supply chain is a system of organizations, people, technology, activities, information and resources involved in moving a product or service from supplier to customer. A supply chain is a system of organizations, people, technology, activities, information, and resources involved in moving a product or service from the supplier to the customer. Supply chain activities transform natural resources, raw materials, and components into a finished product that is delivered to the end customer. A system of organizations, people, technology, activities, information, and resources involved in moving a product or service from the supplier to the customer. A system of organizations, people, technology, activities, information and resources involved in moving a product or service from supplier to customer. A system of organizations, people, technology, activities, information and resources involved in moving a product or service from supplier to customer. A system of organizations, people, technology, activities, information and resources involved in moving a product or service from suppliers to consumers. A system of organizations, people, technology, activities, information, and resources involved in moving a product or service from supplier to customer.

Wage

An amount of money paid to a worker for a specified quantity of work, usually expressed on an hourly basis.

READING: FRANCHISING

Franchising is the practice of licensing another firm’s business model as an operator.

KEY Points

- Essentially, and in terms of distribution, the franchiser is a supplier who allows an operator, or a franchisee, to use the supplier’s trademark and distribute the supplier’s goods. In return, the operator pays the supplier a fee.
- Thirty three countries, including the United States, China, and Australia, have laws that explicitly regulate franchising, with the majority of all other countries having laws which have a direct or indirect impact on franchising.
- Franchise agreements carry no guarantees or warranties, and the franchisee has little or no recourse to legal intervention in the event of a dispute.

Terms

- **Franchisee**: A holder of a franchise; a person who is granted a franchise.
- **Franchising**: The establishment, granting, or use of a franchise.
• **Franchise**: The authorization granted by a company to sell or distribute its goods or services in a certain area.
• **Franchiser**: A franchisor, a company which or person who grants franchises.

Franchising is the practice of using another firm’s successful business model. For the franchiser, the franchise is an alternative to building “chain stores” to distribute goods that avoids the investments and liability of a chain. The franchiser’s success depends on the success of the franchisees. The franchisee is said to have a greater incentive than a direct employee because he or she has a direct stake in the business. Essentially, and in terms of distribution, the franchiser is a supplier who allows an operator, or a franchisee, to use the supplier’s trademark and distribute the supplier’s goods. In return, the operator pays the supplier a fee.

**Subway Franchise – Russia**

There are over 22,000 Subway restaurant franchises worldwide.

In short, in terms of distribution, the franchiser is a supplier who allows an operator, or a franchisee, to use the supplier’s trademark and distribute the supplier’s goods. In return, the operator pays the supplier a fee.

Each party to a franchise has several interests to protect. The franchiser is involved in securing protection for the trademark, controlling the business concept, and securing know how. The franchisee is obligated to carry out the services for which the trademark has been made prominent or famous. There is a great deal of standardization required. The place of service has to bear the franchiser’s signs, logos, and trademark in a prominent place. The uniforms worn by the staff of the franchisee have to be of a particular design and color. The service has to be in accordance with the pattern followed by the franchiser in the successful franchise operations. Thus, franchisees are not in full control of the business, as they would be in retailing.

A service can be successful if equipment and supplies are purchased at a fair price from the franchiser or sources recommended by the franchiser. A coffee brew, for example, can be readily identified by the trademark if its raw materials come from a particular supplier. If the franchiser requires purchase from his stores, it may come under anti-trust legislation or equivalent laws of other countries. So too the purchase of uniforms of personnel, signs, etc., as well as the franchise sites, if they are owned or controlled by the franchiser.

Franchise agreements carry no guarantees or warranties, and the franchisee has little or no recourse to legal intervention in the event of a dispute. Franchise contracts tend to be unilateral contracts in favor of the franchiser, who is generally protected from lawsuits from their franchisees because of the non-negotiable contracts that require franchisees to acknowledge, in effect, that they are buying the franchise knowing that there is risk, and that they have not been promised success or profits by the franchiser. Contracts are renewable at the sole option of the franchiser. Most franchisers require franchisees to sign agreements that mandate where and under what law any dispute would be litigated.

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<td><strong>Interest</strong></td>
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<tr>
<td>The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. The price paid for obtaining or price received for providing money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. A great attention and concern from someone or something; intellectual curiosity.</td>
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<tr>
<td><strong>Licensing</strong></td>
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<tr>
<td>A business arrangement in which one company gives another company permission to manufacture its product for a specified payment.</td>
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<tr>
<td><strong>Trademark</strong></td>
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<tr>
<td>A word, symbol, or phrase used to identify a particular company’s product and differentiate it from other companies’ products. A trademark, trade mark, or trade-mark is a distinctive sign or indicator used by an individual, business organization, or other legal entity to identify for consumers that the products or services on or with which the trademark appears originate from a unique source, designated for a specific market. It also distinguishes its products or services from those of other entities. A word, symbol, or phrase used to identify a particular company’s product and to differentiate it from other companies’ products.</td>
</tr>
<tr>
<td><strong>Business model</strong></td>
</tr>
</tbody>
</table>
The particular way in which a business organization ensures that it generates income, one that includes the choice of offerings, strategies, infrastructure, organizational structures, trading practices, and operational processes and policies.

**Controlling**
The management function of checking progress against plans to exercise influence over, to suggest or dictate the behavior of, oversee.

**Design**
To plan and carry out (a picture, work of art, construction etc.).

**Distribution**
The process by which goods get to final consumers over a geographical market, including storing, selling, shipping, and advertising. The set of relative likelihoods that a variable will have a value in a given interval. A probability distribution; the set of relative likelihoods that a variable will have a value in a given interval.

**Franchise agreement**
A legal, binding contract that authorizes a company to sell or distribute another’s goods and services in a certain area.

**Good**
An object produced for market.

**Incentive**
Something that motivates, rouses, or encourages. It is used to motivate employees for better performance by providing financial rewards. An anticipated reward or aversive event available in the environment. Something that motivates an individual to perform an action.

**Investment**
A placement of capital in expectation of deriving income or profit from its use. The expenditure of capital in expectation of deriving income or profit from its use.

**Liabilities**
Probable future sacrifices of economic benefits arising from present obligations to transfer assets or providing services as a result of past transactions or events. An amount of money in a company that is owed to someone and has to be paid in the future, such as tax, debt, interest, and mortgage payments. An obligation of an entity arising from past transactions or events, including any type of borrowing.

**Operation**
The method or practice by which actions are done. A procedure for generating a value from one or more other values.

**Price**
The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

**Profits**
Collective form of profit.

**Raw materials**
A raw material or feedstock is the basic material from which a good product is manufactured or made, frequently used with an extended meaning. For example, the term is used to denote material that came from nature and is in an unprocessed or minimally processed state; e.g., raw latex, iron ore, logs, crude oil or seawater. A raw material is the basic material from which a product is manufactured or made. Materials and components scheduled for use in making a product. A raw material is the basic material from which a good product is manufactured or made, frequently used with an extended meaning.

**Risk**
The potential (conventionally negative) impact of an event, determined by combining the likelihood of the event occurring with the impact, should it occur. The potential that a chosen action or activity (including the choice of inaction) will lead to a loss (an undesirable outcome). To incur risk [of something].

**Services**
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

**Standardization**
The process of setting certain norms or standards for a product with regard to shape, size, color, quantity, quality, weight etc

**Supplier**
One who supplies; a provider.

**Supply provisions**
The amount of some product that producers are willing and able to sell at a given price, all other factors being held constant.
READING: LICENSING

Licensing gives a licensee certain rights or resources to manufacture and/or market a certain product in a host country.

**KEY Points**

- Licensing is a business agreement involving two companies: one gives the other special permissions, such as using patents or copyrights, in exchange for payment.
- An international business licensing agreement involves two firms from different countries, with the licensee receiving the rights or resources to manufacture in the foreign country.
- Rights or resources may include patents, copyrights, technology, managerial skills, or other factors necessary to manufacture the good.
- Advantages of expanding internationally using international licensing include: the ability to reach new markets that may be closed by trade restrictions and the ability to expand without too much risk or capital investment.
- Disadvantages include the risk of an incompetent foreign partner firm and lower income compared to other modes of international expansion.

**Terms**

- **Licensing**: A business arrangement in which one company gives another company permission to manufacture its product for a specified payment.
- **License**: The legal terms under which a person is allowed to use a product.

**Examples**

- Suppose Company A, a manufacturer and seller of Baubles, was based in the US and wanted to expand to the Chinese market with an international business license. They can enter the agreement with a Chinese firm, allowing them to use their product patent and giving other resources, in return for a payment. The Chinese firm can then manufacture and sell Baubles in China.

**Licensing**

Licensing is a business arrangement in which one company gives another company permission to manufacture its product for a specified payment.

Licensing generally involves allowing another company to use patents, trademarks, copyrights, designs, and other intellectual in exchange for a percentage of revenue or a fee. It’s a fast way to generate income and grow a business, as there is no manufacturing or sales involved. Instead, licensing usually means taking advantage of an existing company’s pipeline and infrastructure in exchange for a small percentage of revenue.

An international licensing agreement allows foreign firms, either exclusively or non-exclusively, to manufacture a proprietor’s product for a fixed term in a specific market.
To summarize, in this foreign market entry mode, a licensor in the home country makes limited rights or resources available to the licensee in the host country. The rights or resources may include patents, trademarks, managerial skills, technology, and others that can make it possible for the licensee to manufacture and sell in the host country a similar product to the one the licensor has already been producing and selling in the home country without requiring the licensor to open a new operation overseas. The licensor's earnings usually take the form of one-time payments, technical fees, and royalty payments, usually calculated as a percentage of sales.

Batman
The Batman character has been licensed to many companies, such as Lego.

As in this mode of entry the transference of knowledge between the parental company and the licensee is strongly present, the decision of making an international license agreement depend on the respect the host government shows for intellectual property and on the ability of the licensor to choose the right partners and avoid having them compete in each other's market. Licensing is a relatively flexible work agreement that can be customized to fit the needs and interests of both licensor and licensee. The following are the main advantages and reasons to use an international licensing for expanding internationally:

- Obtain extra income for technical know-how and services.
- Reach new markets not accessible by export from existing facilities.
- Quickly expand without much risk and large capital investment.
- Pave the way for future investments in the market.
- Retain established markets closed by trade restrictions.
- Political risk is minimized as the licensee is usually 100% locally owned.

This is highly attractive for companies that are new in international business. On the other hand, international licensing is a foreign market entry mode that presents some disadvantages and reasons why companies should not use it, because there is:
• Lower income than in other entry modes
• Loss of control of the licensee manufacture and marketing operations and practices leading to loss of quality
• Risk of having the trademark and reputation ruined by a incompetent partner
• The foreign partner also can become a competitor by selling its production in places where the parental company has a presence

GLOSSARY

**Interest**
The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. The price paid for obtaining or price received for providing money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. A great attention and concern from someone or something; intellectual curiosity.

**Market**
A group of potential customers for one’s product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

**Trademark**
A word, symbol, or phrase used to identify a particular company’s product and differentiate it from other companies' products. A trademark, trade mark, or trade-mark is a distinctive sign or indicator used by an individual, business organization, or other legal entity to identify for consumers that the products or services on or with which the trademark appears originate from a unique source, designated for a specific market. It also distinguishes its products or services from those of other entities. A word, symbol, or phrase used to identify a particular company’s product and to differentiate it from other companies' products.

**Capital**
Money and wealth. The means to acquire goods and services, especially in a non-barter system. The uppermost part of a column. Money and wealth; the means to acquire goods and services, especially in a non-barter system. Already-produced durable goods available for use as a factor of production, such as steam shovels (equipment) and office buildings (structures).

**Export**
This term export is derived from the conceptual meaning to ship the goods and services out of the port of a country, to sell (goods) to a foreign country Any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade.

**Facility**
The physical means or contrivances to make something (especially a service) possible; the required equipment, infrastructure, location etc.

**Good**
An object produced for market.

**Intellectual property**
Any product of someone’s intellect that has commercial value: copyrights, patents, trademarks, and trade secrets. Intellectual property (IP) is a juridical concept that refers to creations of the mind for which exclusive rights are recognized. Any product of someone’s knowledge that has commercial value: copyrights, patents, trademarks and trade secrets.

**Investment**
A placement of capital in expectation of deriving income or profit from its use. The expenditure of capital in expectation of deriving income or profit from its use.

**Leading**
To conduct or direct with authority the management function of determining what must be done in a situation and getting others to do it.

**Loss**
The negative difference between revenue and expense.

**Manufacture**
The action or process of making goods systematically or on a large scale.

**Marketing**
The process of communicating the value of a product or service to customers. Marketing is the process of communicating the value of a product or service to customers. The promotion, distribution and selling of a product or service; includes market research and advertising.

**Operation**
The method or practice by which actions are done. A procedure for generating a value from one or more other values.

**Patent**
A declaration issued by a government agency declaring someone the inventor of a new invention and having the privilege of stopping others from making, using or selling the claimed invention for a limited time; a letter patent.

**Product**
Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. A chemical substance formed as a result of a chemical reaction. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

**Resource**
Something that one uses to achieve an objective. An example of a resource could be a raw material or an employee. Something that one uses to achieve an objective, e.g. raw materials or personnel.

**Revenue**
Income that a company receives from its normal business activities, usually from the sale of goods and services to customers. The total income received from a given source.

**Right**
A legal or moral entitlement.

**Risk**
The potential (conventionally negative) impact of an event, determined by combining the likelihood of the event occurring with the impact, should it occur. The potential that a chosen action or activity (including the choice of inaction) will lead to a loss (an undesirable outcome). To incur risk [of something].

**Royalty**
Regular payment made from the franchisee to the franchisor for the right to be a franchisee.

**Services**
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

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**ASSIGNMENT: STRATEGIES FOR ENTERING FOREIGN MARKETS**

What is the best way to enter a new market? Should a company first establish an export base or license its products to gain experience in a newly targeted country or region? Or does the potential associated with first-mover status justify a bolder move such as entering an alliance, making an acquisition, or even starting a new subsidiary? Many companies move from exporting to licensing to a higher investment strategy, in effect treating these choices as a learning curve. Each has distinct advantages and disadvantages.

In order to complete this DISCUSSION BOARD assignment, you will need to complete the following:

Using the Internet, find **ONE** example of **ONE** of the following strategies for entering foreign markets that you believe is an excellent example of the **SUCCESSFUL** implementation of the strategy and **ONE** example of **ONE** of the following strategies for entering foreign markets that you believe is an excellent example of the **UNSUCCESSFUL** implementation of the strategy.

- Multinational
- Joint Venture
- Contract Manufacturing
• Franchising
• Licensing

1. In your initial discussion post (150 – 175 words) share your SUCCESSFUL and UNSUCCESSFUL examples! In addition to listing your example of EACH, provide the following information

1. Why do you believe that the company/organization chose the entry strategies they did?
2. What went right with the SUCCESSFUL one and what went wrong with the UNSUCCESSFUL one?
3. What can other companies looking to enter a global market learn from these two examples?

Be sure to post responses to at least TWO of your classmates before the due date. Also, if you have links to articles or resources that you would like to share, please include them in your initial post.

Goal: Identify the various strategies of international business and the strategic ways to enter a foreign market.
MODULE 14: GETTING A WIDGET TO TIMBUKTU: THE LOGISTICS OF GLOBAL BUSINESS

OVERVIEW

We all probably understand logistics better than we think, and in part that is thanks to the UPS commercials where they boil down logistics to its foundation: getting things where they need to be, when they need to be there at a cost that is acceptable to both the seller and buyer. Taking a broad view of logistics we will also look at the idea of export vs. import vs. countertrade. Countertrade may be a new term to you – but we all understand the good old fashioned “Barter System” …. well, countertrade is international barter among governments, businesses and industries. For an interesting look at this, follow this link and read about how in 1994 Mercedes Benz countertraded trucks for BANANAS!

http://www.independent.co.uk/news/business/benz-barters-buses-for-bananas-to-break-trade-impasse-1395558.html

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

• Define logistics and the logistical challenges faced by international trade
• Explain Offshoring and outsourcing how they can support global business
• Explain the advantages and disadvantages of exporting, importing and countertrade

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What is Importing and Exporting?

**LEARNING OBJECTIVES**

By the end of this section, you will be able to:

- Understand what importing and exporting are.
- Learn why companies export.
- Explain the main contractual and investment entry modes.

What Do We Mean by Exporting and Importing?

The history of importing and exporting dates back to the Roman Empire, when European and Asian traders imported and exported goods across the vast lands of Eurasia. Trading along the Silk Road flourished during the thirteenth and fourteenth centuries. Caravans laden with imports from China and India came over the desert to Constantinople and Alexandria. From there, Italian ships transported the goods to European ports.

For centuries, importing and exporting has often involved intermediaries, due in part to the long distances traveled and different native languages spoken. The spice trade of the 1400s was no exception. Spices were very much in demand because Europeans had no refrigeration, which meant they had to preserve meat using large amounts of salt or risk eating half-rotten flesh. Spices disguised the otherwise poor flavor of the meat. Europeans also used spices as medicines. The European demand for spices gave rise to the spice trade. The trouble was that spices were difficult to obtain because they grew in jungles half a world away from Europe. The overland journey to the spice-rich lands was arduous and involved many middlemen along the way. Each middleman charged a fee and thus raised the price of the spice at each point. By the end of the journey, the price of the spice was inflated 1,000 percent.

Exporting is defined as the sale of products and services in foreign countries that are sourced or made in the home country. Importing is the flipside of exporting. Importing refers to buying goods and services from foreign sources and bringing them back into the home country. Importing is also known as global sourcing.

An Entrepreneur’s Import Success Story

Selena Cuffe started her wine import company, Heritage Link Brands, in 2005. Importing wine isn’t new, but Cuffe did it with a twist: she focused on importing wine produced by black South Africans. Cuffe got the idea after attending a wine festival in Soweto, where she saw more than five hundred wines from eighty-six producers showcased. Cuffe did some market research and learned of the $3 billion wine industry in Africa. She also saw a gap in the existing market related to wine produced by indigenous African vintners and decided to fill it. She started her company with $70,000, financed through her savings and credit cards. In the first year, sales were only $100,000 but then jumped to $1 million in the second year, when Cuffe sold to more than one thousand restaurants, retailers, and grocery stores. Even better, American Airlines began carrying Cuffe’s imported wines on flights, thus providing a steady flow of business amid the more uncertain restaurant market. Cuffe has attributed her success to passion as well as to patience for meeting the multiple regulations required when running an import business.
Exporting is an effective entry strategy for companies that are just beginning to enter a new foreign market. It’s a low-cost, low-risk option compared to the other strategies. These same reasons make exporting a good strategy for small and midsize companies that can’t or won’t make significant financial investment in the international market.

Companies can sell into a foreign country either through a local distributor or through their own salespeople. Many government export-trade offices can help a company find a local distributor. Increasingly, the Internet has provided a more efficient way for foreign companies to find local distributors and enter into commercial transactions.

Distributors are export intermediaries who represent the company in the foreign market. Often, distributors represent many companies, acting as the “face” of the company in that country, selling products, providing customer service, and receiving payments. In many cases, the distributors take title to the goods and then resell them. Companies use distributors because distributors know the local market and are a cost-effective way to enter that market.

However, using distributors to help with export can have its own challenges. For example, some companies find that if they have a dedicated salesperson who travels frequently to the country, they’re likely to get more sales than by relying solely on the distributor. Often, that’s because distributors sell multiple products and sometimes even competing ones. Making sure that the distributor favors one firm’s product over another product can be hard to monitor. In countries like China, some companies find that—culturally—Chinese consumers may be more likely to buy a product from a foreign company than from a local distributor, particularly in the case of a complicated, high-tech product. Simply put, the Chinese are more likely to trust that the overseas salesperson knows their product better.

Why Do Companies Export?

Companies export because it’s the easiest way to participate in global trade, it’s a less costly investment than the other entry strategies, and it’s much easier to simply stop exporting than it is to extricate oneself from the other entry modes. An export partner in the form of either a distributor or an export management company can facilitate this process. An export management company (EMC) is an independent company that performs the duties that a firm’s own export department would execute. The EMC handles the necessary documentation, finds buyers for the export, and takes title of the goods for direct export. In return, the EMC charges a fee or commission for its services. Because an EMC performs all the functions that a firm’s export department would, the firm doesn’t have to develop these internal capabilities. Most of all, exporting gives a company quick access to new markets.

Benefits of Exporting: Vitrac

Egyptian company Vitrac was founded by Mounir Fakhry Abdel Nour to take advantage of Egypt’s surplus fruit products. At its inception, Vitrac sourced local fruit, made it into jam, and exported it worldwide. Vitrac has acquired money, market, and manufacturing advantages from exporting.

- **Market.** The company has access to a new market, which has brought added revenues.
- **Money.** Not only has Vitrac earned more revenue, but it has also gained access to foreign currency, which benefits companies located in certain regions of the world, such as in Vitrac’s home country of Egypt.
- **Manufacturing.** The cost to manufacture a given unit decreased because Vitrac has been able to manufacture at higher volumes and buy source materials in higher volumes, thus benefitting from volume discounts.

Risks of Exporting

There are risks in relying on the export option. If you merely export to a country, the distributor or buyer might switch to or at least threaten to switch to a cheaper supplier in order to get a better price. Or someone might start making the product locally and take the market from you. Also, local buyers sometimes believe that a company which only exports to them isn’t very committed to providing long-term service and support once a sale is
complete. Thus, they may prefer to buy from someone who’s producing directly within the country. At this point, many companies begin to reconsider having a local presence, which moves them toward one of the other entry options.

**Ethics in Action**

**Different Countries, Different Food and Drug Rules**

Particular products, especially foods and drugs, are often subject to local laws regarding safety, purity, packaging, labeling, and so on. Companies that want to make a product that can be sold in multiple countries must comply with the highest common denominator of all the laws of all the target markets. Complying with the highest standard could increase the overall cost of the product. As a result, some companies opt to stay out of markets where compliance with the regulation would be more costly. Is it ethical to be selling a product in one country that another country deems substandard?

**Specialized Entry Modes: Contractual**

Exporting is an easy way to enter an international market. In addition to exporting, companies can choose to pursue more specialized modes of entry—namely, contractual modes or investment modes. Contractual modes involve the use of contracts rather than investment. Let’s look at the two main contractual entry modes, licensing and franchising.

**Licensing**

Licensing is defined as the granting of permission by the licensor to the licensee to use intellectual property rights, such as trademarks, patents, brand names, or technology, under defined conditions. The possibility of licensing makes for a flatter world, because it creates a legal vehicle for taking a product or service delivered in one country and providing a nearly identical version of that product or service in another country. Under a licensing agreement, the multinational firm grants rights on its intangible property to a foreign company for a specified period of time. The licensor is normally paid a royalty on each unit produced and sold. Although the multinational firm usually has no ownership interests, it often provides ongoing support and advice. Most companies consider this market-entry option of licensing to be a low-risk option because there’s typically no up-front investment.

For a multinational firm, the advantage of licensing is that the company’s products will be manufactured and made available for sale in the foreign country (or countries) where the product or service is licensed. The multinational firm doesn’t have to expend its own resources to manufacture, market, or distribute the goods. This low cost, of course, is coupled with lower potential returns, because the revenues are shared between the parties.

**Franchising**

Similar to a licensing agreement, under a franchising agreement, the multinational firm grants rights on its intangible property, like technology or a brand name, to a foreign company for a specified period of time and receives a royalty in return. The difference is that the franchiser provides a bundle of services and products to the franchisee. For example, McDonald’s expands overseas through franchises. Each franchise pays McDonald’s a franchise fee and a percentage of its sales and is required to purchase certain products from the franchiser. In return, the franchisee gets access to all of McDonald’s products, systems, services, and management expertise.

**Specialized Entry Modes: Investment**

Beyond contractual relationships, firms can also enter a foreign market through one of two investment strategies: a joint venture or a wholly owned subsidiary.
Joint Ventures

An equity joint venture is a contractual, strategic partnership between two or more separate business entities to pursue a business opportunity together. The partners in an equity joint venture each contribute capital and resources in exchange for an equity stake and share in any resulting profits. (In a nonentity joint venture, there is no contribution of capital to form a new entity.)

To see how an equity joint venture works, let’s return to the example of Egyptian company, Vitrac. Mounir Fakhry Abdel Nour founded his jam company to take advantage of Egypt’s surplus fruit products. Abdel Nour initially approached the French jam company, Vitrac, to enter into a joint venture with his newly founded company, VitracEgypt. Abdel Nour supplied the fruit and the markets, while his French partner supplied the technology and know-how for producing jams.

In addition to exporting to Australia, the United States, and the Middle East, Vitrac began exporting to Japan. Sales results from Japan indicated a high demand for blueberry jam. To meet this demand—in an interesting twist, given Vitrac’s origin—Vitrac had to import blueberries from Canada. Vitrac thus was importing blueberries from Canada, manufacturing the jam in Egypt, and exporting it to Japan. Source: Japan External Trade Organization, “Big in Japan,” case study, accessed August 27, 2010, http://www.jetro.go.jp/en/reports/.

Using French Vitrac’s manufacturing know-how, Abdel Nour had found a new supply and the opportunity to enter new markets with it, thus expanding his partner’s reach. The partnership fit was good. The two companies’ joint venture continued for three years, until the French company sold its shares to Abdel Nour, making Vitrac a 100 percent owned and operated Egyptian company. Abdel Nour’s company reached $22 million in sales and was the Egyptian jam-market leader before being bought by a larger Swiss company, Hero.

Risks of Joint Ventures

Equity joint ventures pose both opportunities and challenges for the companies involved. First and foremost is the challenge of finding the right partner—not just in terms of business focus but also in terms of compatible cultural perspectives and management practices.

Second, the local partner may gain the know-how to produce its own competitive product or service to rival the multinational firm. This is what’s currently happening in China. To manufacture cars in China, non-Chinese companies must set up joint ventures with Chinese automakers and share technology with them. Once the contract ends, however, the local company may take the knowledge it gained from the joint venture to compete with its former partner. For example, Shanghai Automotive Industry (Group) Corporation, which worked with General Motors (GM) to build Chevrolets, has pursued plans to increase sales of its own vehicles tenfold to 300,000 in five years and to compete directly with its former partner. Source: Ian Rowley, “Chinese Carmakers Are Gaining at Home,” BusinessWeek, June 8, 2009, 30–31.

Did You Know: Joint Ventures in China

In the past, joint ventures were the only relationship foreign companies could form with Chinese companies. In fact, prior to 1986, foreign companies could not wholly own a local subsidiary. The Chinese government began to allow equity joint ventures in 1979, which marked the beginning of the Open Door Policy, an economic liberalization initiative. The Chinese government strongly encouraged equity joint ventures as a way to gain access to the technology, capital, equipment, and know-how of foreign companies. The risk to the foreign company was that if the venture soured, the Chinese company could end up keeping all of these assets. Often, Chinese companies only contributed things like land or tax concessions that foreign companies couldn’t keep if the venture ended. As of 2010, equity joint ventures between a Chinese company and a foreign partner require a minimum equity investment by the foreign partner of at least 33 to 70 percent of the equity, but there’s no minimum investment set for the Chinese partner.
Wholly Owned Subsidiaries

Firms may want to have a direct operating presence in the foreign country, completely under their control. To achieve this, the company can establish a new, wholly owned subsidiary (i.e., a greenfield venture) from scratch, or it can purchase an existing company in that country. Some companies purchase their resellers or early partners (as VitracEgypt did when it bought out the shares that its partner, Vitrac, owned in the equity joint venture). Other companies may purchase a local supplier for direct control of the supply. This is known as vertical integration.

Establishing or purchasing a wholly owned subsidiary requires the highest commitment on the part of the international firm, because the firm must assume all of the risk—financial, currency, economic, and political.

Did You Know: McDonald’s International

McDonald’s has a plant in Italy that supplies all the buns for McDonald’s restaurants in Italy, Greece, and Malta. International sales has accounted for as much as 60 percent of McDonald’s annual revenue. Annual revenue in 2008 was $23.5 billion, of which 60 percent was international. Source: Suzanne Kapner, “Making Dough,” Fortune, August 17, 2009, 14.

Cautions When Purchasing an Existing Foreign Enterprise

As we’ve seen, some companies opt to purchase an existing company in the foreign country outright as a way to get into a foreign market quickly. When making an acquisition, due diligence is important—not only on the financial side but also on the side of the country’s culture and business practices. The annual disposable income in Russia, for example, exceeds that of all the other BRIC countries (i.e., Brazil, India, and China). For many major companies, Russia is too big and too rich to ignore as a market. However, Russia also has a reputation for corruption and red tape that even its highest-ranking officials admit. In a BusinessWeek article, presidential economic advisor Arkady Dvorkovich (whose office in the Kremlin was once occupied by Soviet leader Leonid Brezhnev), for example, advises, “Investors should choose wisely” which regions of Russia they locate their business in, warning that some areas are more corrupt than others. Corruption makes the world less flat precisely because it undermines the viability of legal vehicles, such as licensing, which otherwise lead to a flatter world.

The culture of corruption is even embedded into some Russian company structures. In the 1990s, laws inadvertently encouraged Russian firms to establish legal headquarters in offshore tax havens, like Cyprus. A tax haven is a country that has very advantageous (low) corporate income taxes.

Businesses registered in these offshore tax havens to avoid certain Russian taxes. Even though companies could obtain a refund on these taxes from the Russian government, “the procedure is so complicated you never actually get a refund,” said Andrey Pozdnyakov, cofounder of Siberian-based Elecard, in the same BusinessWeek article.

This offshore registration, unfortunately, is a danger sign to potential investors like Intel. “We can’t invest in companies that have even a slight shadow,” said Intel’s Moscow-based regional director Dmitry Konash about the complex structure predicament. Source: Carol Matlack, “The Peril and Promise of Investing in Russia,” BusinessWeek, October 5, 2009, 48–51.

Did You Know: Business Collaborations in China

Some foreign companies believe that owning their own operations in China is an easier option than having to deal with a Chinese partner. For example, many foreign companies still fear that their Chinese partners will learn too much from them and become competitors. However, in most cases, the Chinese partner knows the local culture—both that of the customers and workers—and is better equipped to deal with Chinese bureaucracy and regulations. In addition, even wholly owned subsidiaries can’t be totally independent of Chinese firms, on whom they might have to rely for raw materials and shipping as well as maintenance of government contracts and distribution channels.
Collaborations offer different kinds of opportunities and challenges than self-handling Chinese operations. For most companies, the local nuances of the Chinese market make some form of collaboration desirable. The companies that opt to self-handle their Chinese operations tend to be very large and/or have a proprietary technology base, such as high-tech or aerospace companies—for example, Boeing or Microsoft. Even then, these companies tend to hire senior Chinese managers and consultants to facilitate their market entry and then help manage their expansion. Nevertheless, navigating the local Chinese bureaucracy is tough, even for the most-experienced companies.

Let’s take a deeper look at one company’s entry path and its wholly owned subsidiary in China. Embraer is the largest aircraft maker in Brazil and one of the largest in the world. Embraer chose to enter China as its first foreign market, using the joint-venture entry mode. In 2003, Embraer and the Aviation Industry Corporation of China jointly started the Harbin Embraer Aircraft Industry. A year later, Harbin Embraer began manufacturing aircraft.

In 2010, Embraer announced the opening of its first subsidiary in China. The subsidiary, called Embraer China Aircraft Technical Services Co. Ltd., will provide logistics and spare-parts sales, as well as consulting services regarding technical issues and flight operations, for Embraer aircraft in China (both for existing aircraft and those on order). Embraer will invest $18 million into the subsidiary with a goal of strengthening its local customer support, given the steady growth of its business in China.

Guan Dongyuan, president of Embraer China and CEO of the subsidiary, said the establishment of Embraer China Aircraft Technical Services demonstrates the company’s “long-term commitment and confidence in the growing Chinese aviation market.”

Building Long-Term Relationships

Developing a good relationship with regulators in target countries helps with the long-term entry strategy. Building these relationships may include keeping people in the countries long enough to form good ties, since a deal negotiated with one person may fall apart if that person returns too quickly to headquarters.

Did You Know: Guanxi

One of the most important cultural factors in China is guanxi (pronounced guan shi), which is loosely defined as a connection based on reciprocity. Even when just meeting a new company or potential partner, it’s best to have an introduction from a common business partner, vendor, or supplier—one the Chinese will respect. China is a relationship-based society. Relationships extend well beyond the personal side and can drive business as well. With guanxi, a person invests with relationships much like one would invest with capital. In a sense, it’s akin to the Western phrase “You owe me one.”
Guanxi can potentially be beneficial or harmful. At its best, it can help foster strong, harmonious relationships with corporate and government contacts. At its worst, it can encourage bribery and corruption. Whatever the case, companies without guanxi won’t accomplish much in the Chinese market. Many companies address this need by entering into the Chinese market in a collaborative arrangement with a local Chinese company. This entry option has also been a useful way to circumvent regulations governing bribery and corruption, but it can raise ethical questions, particularly for American and Western companies that have a different cultural perspective on gift giving and bribery.

Conclusion

In summary, when deciding which mode of entry to choose, companies should ask themselves two key questions:

1. How much of our resources are we willing to commit? The fewer the resources (i.e., money, time, and expertise) the company wants (or can afford) to devote, the better it is for the company to enter the foreign market on a contractual basis—through licensing, franchising, management contracts, or turnkey projects.
2. How much control do we wish to retain? The more control a company wants, the better off it is establishing or buying a wholly owned subsidiary or, at least, entering via a joint venture with carefully delineated responsibilities and accountabilities between the partner companies.

Regardless of which entry strategy a company chooses, several factors are always important.

- **Cultural and linguistic differences.** These affect all relationships and interactions inside the company, with customers, and with the government. Understanding the local business culture is critical to success.
- **Quality and training of local contacts and/or employees.** Evaluating skill sets and then determining if the local staff is qualified is a key factor for success.
- **Political and economic issues.** Policy can change frequently, and companies need to determine what level of investment they're willing to make, what's required to make this investment, and how much of their earnings they can repatriate.
- **Experience of the partner company.** Assessing the experience of the partner company in the market—with the product and in dealing with foreign companies—is essential in selecting the right local partner.

Companies seeking to enter a foreign market need to do the following:

- Research the foreign market thoroughly and learn about the country and its culture.
- Understand the unique business and regulatory relationships that impact their industry.
- Use the Internet to identify and communicate with appropriate foreign trade corporations in the country or with their own government’s embassy in that country. Each embassy has its own trade and commercial desk. For example, the US Embassy has a foreign commercial desk with officers who assist US companies on how best to enter the local market. These resources are best for smaller companies. Larger companies, with more money and resources, usually hire top consultants to do this for them. They're also able to have a dedicated team assigned to the foreign country that can travel the country frequently for the later-stage entry strategies that involve investment.

Once a company has decided to enter the foreign market, it needs to spend some time learning about the local business culture and how to operate within it.

<table>
<thead>
<tr>
<th><strong>KEY TAKEAWAYS</strong></th>
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<tr>
<td>- Exporting is the sale of products and services in foreign countries that are sourced or made in the home country. Importing refers to buying goods and services from foreign sources and bringing them back into the home country.</td>
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<td>- Companies export because it’s the easiest way to participate in global trade, it’s a less costly investment than the other entry strategies, and it’s much easier to simply stop exporting than it is to extricate oneself from the other entry modes. The benefits of exporting include access to new markets and revenues as well as lower manufacturing costs due to higher manufacturing volumes.</td>
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<td>- Contractual forms of entry (i.e., licensing and franchising) have lower up-front costs than investment modes do. It’s also easier for the company to extricate itself from the situation if the results aren’t</td>
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favorable. On the other hand, investment modes (joint ventures and wholly owned subsidiaries) may bring the company higher returns and a deeper knowledge of the country.

EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. What are the risks and benefits associated with exporting?
2. Name two contractual modes of entry into a foreign country. Which do you think is better and why?
3. Why would a company choose to use a contractual mode of entry rather than an investment mode?
4. What are the advantages to a company using a joint venture rather than buying or creating its own wholly owned subsidiary when entering a new international market?

Strategic Choices: Export, Local Assembly, and Local Production

When deciding where and how to produce products for international markets, companies typically have a choice of three strategies. The strategies vary in terms of levels of risk, cost, exposure to exchange-rate fluctuations, and leveraging of local capabilities. Companies need to tailor their strategy to fit their product and the country.

Manufacture in the United States and Then Export

The lowest-investment production strategy is to make the product at the company’s existing manufacturing locations and then export them to the new market. Companies use this solution in situations where the total opportunity in the new market doesn’t justify opening a plant. For example, EMC supplies its Asia-Pacific customers from plants in the United States and Ireland. This strategy does have several downsides. Specifically, the company faces higher shipping costs, importation delays, local import duties, risks due to exchange-rate fluctuations, and isolation from local knowledge.
Global Components with Local Assembly

The next level of strategy uses out-of-country suppliers but local assembly. Dell Latin America uses this approach. It buys high-tech computer components globally but performs customized assembly in Brazil. Being closer to the market improves Dell’s sales, service, and customer knowledge.

Another example is Iams. Iams makes its proprietary pet food in the United States and ships it to other countries for packaging. This strategy lets Iams do some local customization and offer better customer response, while gaining tax or tariff incentives from local assembly.

Along with these advantages come increased supplier-coordination issues and concerns about supplier quality. In some cases, local assembly can harm the product, which leads back to the country-of-origin effect associated with standardized vs. customized products”. For example, some markets like Colombia don’t want to buy Colombian-made goods. In those cases, local assembly can harm product sales.

Local Production

Finally, a company can go completely local, sourcing materials in the foreign country and manufacturing the product there. Nokia used this strategy in India. This strategy takes the greatest advantage of lower-cost labor, regional suppliers, and local knowledge. However, it involves high investment and depends heavily on the quality of local resources. It also exposes the company to political risks. However, going 100 percent local may work well in BRIC countries (i.e., Brazil, Russia, India, and China) for labor-intensive, low-value products. These types of products can tolerate the potentially lower levels of quality associated with local suppliers.

Companies that decide to build a local plant have to decide in which country to locate the plant. The criteria to consider are

- political stability,
- statutory/legal environments,
- infrastructure quality,
- foreign-investment incentives,
- local telecommunications and utility infrastructure,
- workforce quality,
- security and privacy,
- compensation costs,
- tax and regulatory costs, and
- communication costs.

Government Incentives

Countries sometimes offer special incentives to attract companies to their area. Malaysia, for example, set up the Multimedia Super Corridor that offers tax breaks, desirable facilities, and excellent infrastructure to foreign companies. Similarly, China has special economic zones (SEZs) that promote international high-quality standards in the Hainan Province, Shenzhen, Shantou, and elsewhere. While one component is a government initiative to set up SEZs or corridors that boast excellent communications infrastructure, other factors, such as uninterrupted power supply and connections to transportation infrastructure, play an important role as well. Even though the economic or political picture of a country may appear appealing, companies also need to understand public policy and the regulatory environment of the specific state or municipality in which they plan to set up operations, because laws on a local level may be different and may create roadblocks for new company operations.

Infrastructure Issues

Emerging-market countries are investing in new infrastructure to varying degrees. China is working hard to grow rail, road, and port infrastructure. In other countries, investment may be lagging. And in some cases, companies have been caught in the middle of governmental problems arising from dealing with officials who turn out to be corrupt.
Locating a plant in China means having to ship products from China. If a company's primary market is in the United States, China is halfway around the world. The company may save on labor, but there are other added costs—extra shipping costs as well as hidden costs of uncertainty. If the company’s products are en route and experience delays, for example, customers might experience a stock-out. A stock-out means that there is no more stock of the company’s product. The product is unavailable to customers who want to buy it. To avoid stock-out situations, a company may decide to hold inventory close to its customers. Called safety stock, this inventory helps ensure that the company won’t run out of products if there’s a delay or crisis in a distant manufacturing region. The downsides of safety stock, however, include the increased costs of carrying that inventory, such as the investment in the products, taxes and insurance, and storage space. In addition, companies risk obsolescence of the products before they're sold.

It’s important to note that China is far away only if the company’s primary markets are outside Asia. The distance that truly matters is the distance to the company’s markets. Companies that sell their products around the world may want to have production facilities around the world as well, so that their products are closer to customers—wherever those customers may be.

Did You Know: Intel's Approach to Managing Risk in Global Production

If a company builds plants in different locations, the company may face the issue of differing quality among its plants. Intel, the world leader in the manufacturing, marketing, and sales of integrated circuits for computing and communications industries worldwide has faced this problem. Quality is a major issue when making these tiny, complex integrated-circuit chips. Intel’s Atom chips, for example, are the size of a grain of rice. To ensure high quality at all of its plants worldwide, Intel devised a strategy called Copy Exact! That is, Intel builds all of its semiconductor-fabrication plants (also known as “fabs”) to the same exact specifications, creating interchangeable processes and interchangeable fabs throughout the company.

Intel began the Copy Exact! strategy in the mid-1980s as a way to cope with the complexity of semiconductor manufacturing. Manufacturing integrated computer chips is highly delicate. The smallest variation in temperature, pressure, chemistry, or handling can mean the difference between producing a wafer that made up of hundreds of $1,000 chips and producing a wafer that is a useless silicon disk. Once Intel has a new semiconductor-manufacturing process debugged at one facility, it copies that process—down to the lengths of the hoses on the vacuum pumps—to other Intel facilities. Intel has realized that this Copy Exact! strategy also provides flexibility in manufacturing. For example, Intel can transfer capacity back and forth between facilities to eliminate manufacturing bottlenecks. When the severe acute respiratory syndrome (SARS) flu epidemic hit Asia during the early 21st century, for example, Intel simply transferred partially completed wafers from one plant to another for finishing.

The Copy Exact! strategy extends beyond semiconductor fabrication to include the assembly and test factories and the contractors that support building electronic boards, such as personal computer motherboards. “If something happens to that facility, we roll over to a subcontractor at another site that can pick up the same assembly test and make sure that we get the same product coming out and the same amounts for our shipping plans,” said Intel’s Steve Lund. Copy Exact! even extends to Intel’s information technology infrastructure. Identical software and hardware architecture support a range of activities, such as ordering and production planning, at eighteen manufacturing, testing, and assembly sites across three continents. Source: Yossi Sheffi, The Resilient Enterprise (Cambridge, MA: MIT Press, 2005), 184.

Outsourcing and Offshoring

Offshoring means setting up operations in a low-cost country for the purpose of hiring local workers at lower labor rates. Offshoring differs from outsourcing in that the firm retains control of the operations and directly hires the employees. In outsourcing, by contrast, the company delegates an entire process (such as accounts payable) to the outsource vendor. The vendor takes control of the operations and runs the operations as they see fit. The company pays the outsource vendor for the end result; how the vendor achieves those end results is up to the vendor.

Companies that choose to offshore face the same location-criteria factors as companies that make production-operation decisions.
The advantages of outsourcing include the following:

- Efficient processes (the outsourcer typically specializes in a particular process or set of processes, giving them high levels of expertise with that process)
- Access to specialized equipment that may be too expensive for a company to invest in unless that process is their chief business

India has long been a favorite location for outsourcing services, such as call centers and software testing, because of its English-speaking, highly educated workforce. The labor-rate ratio has been five to one, meaning that a company based in the United Kingdom, for example, could hire five Indian college graduates for the price of hiring one UK college graduate. Given the high demand for their labor, however, Indian employees’ wages have begun to rise. Offshoring companies are now faced with a new challenge. The firms hire and train Indian employees only to see them leave in a year for a higher salary elsewhere. This wage inflation and high turnover in India has led some companies, like ABN AMRO Bank, to consider whether they should move offshoring operations to China, where wages are still low. The downside is that graduates in China aren’t as knowledgeable about the financial industry, and language problems may be greater.

Diageo, the world’s largest purveyor of spirits, used the following criteria when choosing an offshoring-services location. Diageo analyzed nineteen locations in fourteen countries, ultimately choosing Budapest, Hungary, as the location of its offshore shared-services operations. The primary criteria Diageo used were

- a low-cost base, both in terms of start-up and ongoing running costs;
- a favorable general business environment;
- the availability of suitable staff—particularly with regard to language skills;
- a high level of local and international accessibility with good transport links;
- the attractiveness for international staff; and
- a robust regulatory framework.


Companies save on labor costs when offshoring, but the “hidden costs” can be significant. These hidden costs include the costs of additional facilities, telecommunications, and technological infrastructure. Delays or problems with internal project coordination and the need for redundancy can add even more costs.

Did You Know: Standard Chartered Bank Mitigated Risk by Duplicating Operations in Chennai and Kuala Lumpur

As you can imagine, banks are very concerned about security because of the highly confidential customer information they possess. Some banks try to mitigate the risks by setting up mirror sites. Standard Chartered Bank, for instance, chose Chennai in South India as the hub for its Scope International operations, but some of the tasks are also done in Kuala Lumpur in Malaysia: “Because we run the operations of 52 countries, we have to satisfy information security and business continuity issues in all locations,” says Sreeram Iyer, Group Head, Global Shared Services Centers, Standard Chartered Scope International at the time of the decision. “Kuala Lumpur backs up the Chennai center and vice versa.” Source: Ranganath Iyengar, “Banks: Captive to Third Party Move?,” Global Services, October 30, 2006, accessed November 25, 2010, http://www.globalservicesmedia.com/redesign/BPO/Market-Dynamics/Banks:-Captive-to-Third-Party-Move/23/280/general200705211425.

Supply-Chain Management

Supply-chain management encompasses the planning and management of all activities involved in sourcing and procurement, conversion, and logistics. Importantly, it also includes coordination and collaboration with channel partners, which can be suppliers, intermediaries, third-party service providers, and customers. In essence, supply-chain management integrates supply-and-demand management within and across companies.

Activities in the supply chain include:
demand management (e.g., forecasting, pricing, and customer segmentation),
procurement (e.g., purchasing, supplier selection, and supplier-base rationalization),
inventory management (e.g., raw materials and finished goods),
warehousing and material handling,
production planning and control (e.g., aggregate planning, workforce scheduling, and factory operations),
packaging (i.e., industrial and consumer),
transportation management,
order management,
distribution network design (e.g., facility location and distribution strategy), and
product-return management.

Cross-organizational teams across the supply chain can bring great perspective to the overall team process. Representatives from design, business, purchasing, manufacturing, equipment purchasing, planning, customer, logistics, information technology, and finance all bring their specialized knowledge to the benefit of the supply chain as a whole.

**Spotlight on International Strategy and Entrepreneurship: Entrepreneurial Innovation at P&G**

In 2002, Procter & Gamble (P&G) created a test factory, called the Garage, in Vietnam to experiment with low-cost diaper manufacturing for emerging markets. This factory was different from P&G's US-based factories because it didn't use high-tech, automation-intensive manufacturing processes. Rather, P&G wanted a low-cost, low-tech solution. The factory helped P&G devise a new, low-cost approach to manufacturing in emerging-market countries. The strategy required finding local suppliers, some of whom wouldn't have been acceptable for other P&G products but were suitable for this one. P&G formed a network of 150 low-cost machine builders who could supply manufacturing equipment to P&G's Vietnam factory. This manufacturing equipment was appropriate for emerging-market sites and emerging-market prices. The equipment was not on par to P&G's US-based manufacturing equipment, but P&G could use it in other countries and in other product lines. For example, P&G took the lessons and machine-building know-how it had learned from making low-cost diapers in Asia and applied it to reducing the costs of making feminine pads in Mexico. In transferring this know-how from one country to the next, P&G reduced the costs of its feminine pads in Mexico by 20 percent.

P&G has gone a step further and brought its results back home to the United States in two ways. First, thanks to the North American Free Trade Agreement (NAFTA), P&G can import its low-cost feminine pads from Mexico back into the United States. Second, P&G now sees an opportunity to give a second life to obsolete plants in the United States. The experience P&G has gained in emerging markets has taught the company that not every product in every market needs the latest and greatest approaches to manufacturing in order to be successful. P&G's experience with its Vietnamese factory has given it a scalable approach, which has enabled P&G to make diapers and other similar personal-care products in many different emerging-market countries using widely available, low-cost manufacturing equipment.

**KEY TAKEAWAYS**

- There are several strategic choices available to companies when they decide how to produce their products for international markets. First, companies can manufacture their products in their home countries and export them. This strategy involves the least amount of change but has the downsides of higher supply-chain costs, potential delays, exchange-rate risks, and isolation from local knowledge.
- Second, a company can build components in one country and do local assembly in another. This strategy offers advantages of tax or tariff incentives but increases coordination costs and may bring unfavorable country-of-origin effects.
- Finally, a company can opt for local production. This decision requires a careful evaluation of the risks and rewards of production operations in that country, including assessing political risks, the skills of the local workforce, and the quality of the infrastructure.
- Some companies also choose to outsource or offshore their processes, either giving control to the outsourcing vendor for the process and paying for the results (i.e., outsourcing) or retaining control of the process while taking advantage of lower labor rates (i.e., offshoring).
Supply-chain management is the coordination of a host of activities that can give a company a distinct competitive advantage. Cross-organizational teams are the best way to take advantage of the perspectives of each supply-chain function for the benefit of all.

EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. What processes does supply-chain management encompass?
2. If you were going to build a plant overseas, what factors would you take into account when making your location decisions?
3. What strategic choices do international companies have about where to locate production operations?
4. Describe strategies for mitigating some of the risks of overseas production.
5. What are some advantages and disadvantages of outsourcing?

VIDEO: MADE IN CHINA

Description from YouTube: “A clip from the film ‘Outsourced’ on the issue of american sentiment re losing jobs to india that also addresses all the things we buy that are made in china. We want cheap stuff, however, most of it comes from china. Can’t have it both ways…”

Watch this video online: https://youtu.be/win-EzAX5Fc

VIDEO: USING LOGISTICS TO GO GLOBAL

From YouTube description: “This UPS Game Changers campaign video focuses on a game-changing idea for business: Going global. The best companies understand there are no borders to business. Historically, the most important part of business was your location. Today it’s not about where your product is made. It’s made in the world. Logistics enables any size business to source locally, but to be successful, you have to sell globally. Especially for small businesses, the biggest opportunity for growth is outside the U.S. Logistics breaks down the barriers to international trade, so you don’t have to be fluent in a country’s language, currency or tariffs. UPS is the Official Logistics Supplier for the NCAA®.”

Watch this video online: https://youtu.be/G4EIW0zdapl
VIDEO: BUSINESS OF OFFSHORING AND OUTSOURCING

John Gray, assistant professor of operations at Ohio State University’s Fisher College of Business, gives a business perspective on offshoring and outsourcing.

Watch this video online: https://youtu.be/dZlcBGNc_3g

ASSIGNMENT: POSITION PAPER: OFFSHORING – PRO OR CON?

Position Paper: Offshoring – Pro or Con?

Format and Guidelines:

A “Position Paper” is different than your typical written assignment! In a position paper, you will choose a side on a particular controversial topic and build up a case for your opinion or position. Once you state your position, you will use facts, opinion, statistics and other forms of evidence to convince your reader that your position is the best one. As you collect research for your position paper and begin to craft an outline, you must remember that the goal is a well-constructed argument.

Two documents are posted here for your reference:

1. Position Paper guidelines and outline: BUS280 Format and Outline for Position paper

If you need or want additional information, I suggest using this link to the Purdue University Online Writing Lab which is the best resource out there for writing assistance! Bookmark it … because as you continue in your academic pursuits it will be useful! https://owl.english.purdue.edu/
Please read the following carefully BEFORE beginning your assignment:

Companies have been outsourcing work for many years. This trend has been carried to an extreme in the case of offshoring – sending work to other countries where labor is cheaper. The competitive environment of global business, the struggle to create and maintain competitive advantage as well as the demands by stakeholders for return on their investment of the basic factors of production have made the Outsourcing/Offshoring topic one bathed in controversy. Is it good business or profit driven short sightedness? Does it build or break economies? These are but a tiny sliver of the arguments surrounding these practices. Almost every business now faces this decision, and with every decision controversy arises. Currently, India’s low-cost labor has made it an offshoring destination for global firms like HP, IBM, Accenture, Intel, AMD, Microsoft, Oracle Corporation, Cisco, SAP.

Arguments for and against this strategy are plentiful and in your position paper you will take one side of this debate. However, in writing about this issue you must examine your opinion of the issue critically. Prior to writing your position paper, define and limit your argument carefully. The situation is complex with multiple solutions. Narrow the scope of your position paper to something that is manageable. Research your position thoroughly, consulting experts and obtaining primary documents. Consider feasibility, cost-effectiveness, economic and political/social climate when evaluating your position.

Format guidelines and a rubric have been posted to help you construct your paper. Please refer to these as you draft your assignment. The link to the Purdue OWL has also been provided to help with the mechanics of writing this paper. There are a few key differences in this assignment compared to others you have completed in this course. Please note the following:

1. Your reasoning and strength of evidence/argument is weighted at 80% of the total grade. So, clearly this is where you should focus your efforts.
2. The LENGTH of the paper has been expanded to permit UP TO 4 pages. However, if you can state your points, support them with evidence and come to a conclusion in fewer than 4 – there is NO deduction for length unless you fall below the MINIMUM of 2 pages. This does NOT include your bibliography or table of references!
3. This paper REQUIRES citations! What is the best and easiest way to do this? Use a web-based citation generator such as http://www.bibme.org/. It is fast, FREE and accurate. When you create your citations please use APA Format.
4. This assignment will be submitted as a SafeAssign. Safe Assign is used to prevent plagiarism and to create opportunities to help you identify how to properly attribute sources rather than paraphrase. SafeAssign compares your submitted assignments against a set of academic papers to identify areas of overlap between the submitted assignment and existing works.
5. This assignment will represent TWO assignment grades since it requires more work on your part, so this is your chance to make up a low score somewhere else in the course.

If you have ANY questions or would like for me to REVIEW A DRAFT of your work, please email/text/call me. I am looking forward to reading your papers!

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Global Marketing

As consumers we are constantly flooded with marketing – from pop-up ads on our PC’s, television, radio (even Pandora has ads!) ... everywhere we look someone is marketing something to us to try and get us to part with our hard earned money in exchange for the product, good or service. Well, for marketers inside of the U.S. that’s relatively straightforward – but, how do you market laundry detergent to people living in Norway? Not so simple! There have been literally hundreds of failed global marketing attempts and not all of the companies recovered what they lost. So, now we will look at the traditional components of the marketing mix but from a global perspective!

LEARNING OUTCOMES

After you complete the required assignments you will be able to:

• Explain the 4 P’s of Marketing in the context of a global business environment
• Discuss the importance of Research and Development in reaching international markets
• Explain the challenges of managing operations on a global scale.
Product and promotion in global marketing can work together effectively with proper market research and communication techniques.

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<th>KEY Points</th>
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<td>• The “Four P’s” of marketing—product, price, placement, and promotion—are all affected as a company moves through the different phases to become and maintain dominance as a global company.</td>
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<td>• It is the job of global marketers to create and place product advertisements in settings where local consumers will be most receptive to receiving and acting on those messages.</td>
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<tr>
<td>• Promotion is one crucial component of the global marketing mix that enables a global company to send the same message worldwide using relevant, engaging, and cost-effective techniques.</td>
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Term

- *Integrated marketing communications*: An approach to brand communications where the different modes work together to create a seamless experience for the customer and are presented with a similar tone and style that reinforce the brand’s core message.

The Relationship Between Product and Promotion

With the rapidly emerging force of globalization, the distinction between marketing within an organization’s home country and marketing within external markets is disappearing very quickly. With this in mind, organizations are modifying their marketing strategies to meet the challenges of the global marketplace in addition to sustaining their competitiveness within home markets. These changes also have prompted brands to customize their global marketing mix for different markets, based on local languages, needs, wants, and values.
Product for Chinese Market
An effective global marketing plan enables brands to tweak products for local markets while using the most effective promotional channels to reach consumers.

The Marketing Mix in Global Marketing

The “Four P’s” of marketing—product, price, placement, and promotion—are all affected as a company moves through the different phases to become and maintain dominance as a global company. Promotion becomes particularly important for positioning the company in such a way that a single product can be tweaked instead of revamped for different markets. Coca-Cola is one strong example of global marketing. The drink brand uses two formulas (one with sugar and one with corn syrup) for all markets. The product packaging in every country incorporates Coca-Cola’s contour bottle design and signature ribbon in some shape or form. However, the bottle can also include the country’s native language and appear in identical sizes as other beverage bottles or cans in that country’s market.

Promotion and Product

Before launching promotional programs, global companies must first define their target markets and determine the products that will resonate most with those consumers and businesses. In addition to pinpointing which price point and distribution channels would best serve those country markets, global marketers must decide how to introduce their products. Promotional tactics for global audiences can range from television commercials to social media marketing on Facebook, YouTube, Twitter and other channels. It is the job of global marketers to create and place product advertisements and/or other promotional information in settings where local consumers will be most receptive to receiving and acting on those messages.

After product research, development, and creation, promotion is generally the largest line item in a global company’s marketing budget. Integrated marketing communications can significantly increase efficiency and reduce promotional costs. Moreover, promotion is one crucial component of the mix that enables a global company to send the same message worldwide using relevant, engaging, and cost-effective techniques.

While global promotion enables global brands to engage in uniform marketing practices and promote a consistent brand and image, marketers also face the challenge of responding to differences in consumer response to marketing mix elements. Promotional and product marketing challenges also come into play when dealing with differences in brand and product development and fending off local or global competition.
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<th><strong>GLOSSARY</strong></th>
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<td><strong>Advertisement</strong></td>
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| **Globalization** | The process of international integration arising from the interchange of world views, products, ideas, and other aspects of culture. The process of international integrating arising from the interchange of world views, products, ideas, and other aspects of culture. The process of international integration arising from the interchange of world views, products, ideas, and other aspects of culture; advances in transportation and telecommunications infrastructure, including the rise of the Internet, are major factors that precipitate
interdependence of economic and cultural activities. A common term for processes of international integration arising from increasing human connectivity and the interchange of worldviews, products, ideas, and other aspects of culture. A common term for processes of international integration arising from increasing human connectivity and interchange of worldviews, products, ideas, and other cultural phenomena. In particular, advances in transportation and telecommunications infrastructure, including the rise of the Internet, represent major driving factors in globalization and precipitate the further interdependence of economic and cultural activities. The process of international integration arising from the interchange of world views, products, ideas, and other aspects of culture.

Image
An attitude or lifestyle advertisers attempt to link to a product.

Integrated
Composed and coordinated to form a whole.

Market
A group of potential customers for one's product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

Market Research
The systematic collection and evaluation of data regarding customers’ preferences for actual and potential products and services.

Marketing
The process of communicating the value of a product or service to customers. Marketing is the process of communicating the value of a product or service to customers. The promotion, distribution and selling of a product or service; includes market research and advertising.

Marketing mix
A business tool used in marketing products. The marketing mix is often crucial when determining a product or brand's unique selling point and is often synonymous with the four Ps: price, product, promotion, and place. The marketing mix is often crucial when determining a product or brand's unique selling point (the unique quality that differentiates a product from its competitors), and is often synonymous with the four Ps: price, product, promotion, and place.

Marketing strategy
A process that can allow an organization to concentrate its resources on the optimal opportunities with the goals of increasing sales and achieving a sustainable competitive advantage.

Media
The journalists and other professionals who comprise the mass communication industry. Means and institutions for publishing and broadcasting information. General term for different types of materials. In communications, media (singular medium) are the storage and transmission channels or tools used to store and deliver information or data. It is often referred to as synonymous with mass media or news media, but may refer to a single medium used to communicate any data for any purpose. The mass media are all those media technologies that are intended to reach a large audience by mass communication. In communications, media (singular medium) are the storage and transmission channels or tools used to store and deliver information or data.

Placement
The process of making a product or service accessible for use or consumption by a consumer or business user, using direct means, or using indirect means with intermediaries.

Positioning

The act of positioning; placement. Positioning involves ascertaining how a product or a company is or should be perceived in the minds of consumers. Positioning is the underpinning of messages created to promote a product or company in order to generate positive perceptions in the minds of consumers.

Price

The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Price point

The price of an item, especially seen as one of a number of pricing options. Price points are prices at which demand for a given product is supposed to stay relatively high.

Product

Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

Promotion

Promotion represents all of the methods of communication that a marketer may use to provide information to different parties about the product. Promotion comprises elements such as: advertising, public relations, personal selling and sales promotion. dissemination of information about a product, product line, brand, or company. The advancement of an employee’s rank or position in an organizational hierarchy system.

Social media

Social media refers to interaction among people in which they create, share, and/or exchange information and ideas in virtual communities and networks. Interactive forms of media that allow users to interact with and publish to each other, generally by means of the Internet.

Strategy

A plan of action intended to accomplish a specific goal.

Tactics

The achievement of objectives through strategy.

Target

A person (or group of people) that a person or organization is trying to employ or to have as a customer, audience etc.

Target market

A group of people whose needs and preferences match the product range of a company and to whom those products are marketed. A target market is a group of customers that the business has decided to aim its marketing efforts and ultimately its merchandise toward.

Value
The degree of importance given to something. A customer’s perception of relative price (the cost to own and use) and performance (quality). A value is extremely absolute or relative ethical value, the assumption of which can be the basis for ethical action.

READING: CHANGES IN PROMOTION

Local languages, colors, and religious beliefs all impact how global marketers promote their products and services in different countries.

KEY TAKEAWAY

- To successfully implement global marketing strategies, brands must ensure their promotional campaigns take into account how consumer behavior is shaped by internal conditions and external influences.
- Global companies must be nimble enough to adapt changing local market trends, tastes, and needs to their promotional mix.
- When launching global advertising, public relations or sales campaigns, global companies test promotion ideas to provide results that are comparable across countries.
- Using measures can be particularly helpful for marketers since they are based on visual, not verbal, elements of the promotion.

Terms

- Measure: To ascertain the quantity of a unit of material via calculated comparison with respect to a standard.
- Demographics: The observable characteristics of a population, such as physical traits, economic traits, occupational traits, and more.

Changes in Promotion

Before a company decides to become global, it must consider a multitude of factors unique to the international marketing environment. These factors are social, cultural, political, legal, competitive, economic, and even technological in nature. Ultimately, at the global marketing level, a company trying to speak with one voice is faced with many challenges when creating a worldwide marketing plan. Unless a company holds the same position against its competition in all markets (market leader, low cost, etc.), it is impossible to launch identical marketing plans worldwide. Thus, global companies must be nimble enough to adapt to changing local market trends, tastes, and needs.

Global Promotion
Language is usually one element that is customized in a global promotional mix.

For global advertisers, there are four potentially competing business objectives that must be balanced when developing worldwide advertising: building a brand while speaking with one voice, developing economies of scale in the creative process, maximizing local effectiveness of advertisements, and increasing the company’s speed of implementation. Global marketers can use the following approaches when executing global promotional programs: exporting executions, producing local executions, and importing ideas that travel.

Factors in Global Promotion

To successfully implement these approaches, brands must ensure their promotional campaigns take into how consumer behavior is shaped by internal conditions (e.g., demographics, knowledge, attitude, beliefs) and external influences (e.g., culture, ethnicity, family, lifestyle) in local markets.

- **Language** – The importance of language differences is extremely crucial in global marketing, as there are almost 3,000 languages in the world. Language differences have caused many problems for marketers in designing advertising campaigns and product labels. Language becomes even more significant if a country’s population speaks several languages.
- **Colors** – Colors also have different meanings in different cultures. For example, in Egypt, the country’s national color of green is considered unacceptable for packaging because religious leaders once wore it. In Japan, black and white are colors of mourning and should not be used on a product’s package. Similarly, purple is unacceptable in Hispanic nations because it is associated with death.
- **Values** – An individual’s values arise from his or her moral or religious beliefs and are learned through experiences. For example, Americans place a very high value on material well-being and are much more likely to purchase status symbols than people in India. In India, the Hindu religion forbids the consumption of beef.
- **Business norms** – The norms of conducting business also vary from one country to the next. For example, in France, wholesalers do not like to promote products. They are mainly interested in supplying retailers with the products they need.
- **Religious beliefs** – A person’s religious beliefs can affect shopping patterns and products purchased in addition to his or her values. In the United States and other Christian nations, Christmas time tends to be a major sales period. In other religions, significant religious holidays may or may not serve as popular times for purchasing products.

There are many other factors, including a country’s political or legal environment, monetary circumstances, and technological environment that can impact a brand’s promotional mix. Companies have to be ready to quickly respond and adapt to these challenges as they evolve and fluctuate in the market of each country.

Changing the Global Promotional Mix

When launching global advertising, public relations or sales campaigns, global companies test promotional ideas using marketing research systems that provide results comparable across countries. The ability to identify the elements or moments of an advertisement that contribute to the success of a product launch or expansion is how economies of scale are maximized in marketing communications. Market research measures such as flow of attention, flow of emotion, and branding moments provide insight into what is working in an advertisement in one or many countries. These measures can be particularly helpful for marketers since they are based on visual, not verbal, elements of the promotion.

Considering these measures along with conducting extensive market research is essential to determining the success of promotional tactics in any country or region. Once brands discover what works (and what does not) in their promotional mix, those ideas can be imported by any other market. Likewise, companies can use this intelligence to modify various elements in their promotional mix that are receiving minimal or unfavorable response from global audiences.
### GLOSSARY

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Advertisement</td>
<td>A commercial solicitation designed to sell some commodity or service.</td>
</tr>
<tr>
<td>Advertising</td>
<td>Communication for the purpose of influencing potential customers about products and services. A form of communication for marketing and used to encourage or persuade an audience (viewers, readers or listeners; sometimes a specific group) to continue or take some new action.</td>
</tr>
<tr>
<td>Attitude</td>
<td>A positive or negative evaluation of people, objects, events, or ideas in one’s environment an expression of favor or disfavor toward a person, place, thing, or event (the attitude object). Prominent psychologist Gordon Allport once described attitude as, “the most distinctive and indispensable concept in contemporary social psychology.” Disposition or state of mind.</td>
</tr>
<tr>
<td>Belief</td>
<td>Mental acceptance of a claim as truth regardless of supporting or contrary empirical evidence.</td>
</tr>
<tr>
<td>Brand</td>
<td>A name, symbol, logo, or other item used to distinguish a product, service, or its provider. The reputation of an organization, a product, or a person among some segment of the population.</td>
</tr>
<tr>
<td>Branding</td>
<td>This process involves researching, developing, and implementing brand names, brand marks, trade characters, and trademarks. A business’s ability to communicate a specific image, generally one that will entice consumers.</td>
</tr>
<tr>
<td>Consumer</td>
<td>Someone who acquires goods or services for direct use or ownership rather than for resale or use in production and manufacturing. The consumer is the one who pays to consume the goods and services produced. As such, consumers play a vital role in the economic system of a nation. In the absence of their effective demand, the producers would lack a key motivation to produce, which is to sell to consumers.</td>
</tr>
<tr>
<td>Consumer Behavior</td>
<td>The study of individuals, groups, or organizations and the processes they use to select, secure, and dispose of products, services, experiences, or ideas to satisfy needs; and the impacts that these processes have on the consumer and society.</td>
</tr>
<tr>
<td>Communication</td>
<td>The concept or state of exchanging information between entities. an instance of information transfer; a conversation or discourse the concept or state of exchanging data or information between entities.</td>
</tr>
<tr>
<td>Culture</td>
<td>The beliefs, values, behavior and material objects that constitute a people’s way of life; the arts, customs, and habits that characterize a particular society or nation. The sum of learned beliefs, values, and customs that regulate the behavior of members of a particular society. The arts, customs, and habits that characterize a particular society or nation. The language and peculiarities of a geographical location. A culture is the combination of the language that you speak and the geographical location you belong to. The distinct ways that people living in different parts of the world classified and represented their experiences.</td>
</tr>
</tbody>
</table>
Demographic
A characteristic used to identify people within a statistical framework. A demographic criterion: a characteristic used to classify people for statistical purposes, such as age, race, or gender. A characteristic used to classify people for statistical purposes, such as age, race, or gender. A grouping of people for statistical purposes, based as age, race, gender, etc.

Economies of scale
A process where an increase in quantity will result in a decrease of average cost of production (per unit). The characteristics of a production process in which an increase in the scale of the firm causes a decrease in the long run, average cost of each unit. The cost advantages that an enterprise obtains due to expansion. As the scale of output is increased, factors such as facility size and usage levels of inputs cause the producer’s average cost per unit to fall. The characteristics of a production process in which an increase in the scale of the firm causes a decrease in the long run average cost of each unit.

Global marketing
Global marketing is marketing on a worldwide scale, reconciling or taking commercial advantage of global operational differences, similarities and opportunities in order to meet global objectives.

Market
A group of potential customers for one’s product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

Marketing
The process of communicating the value of a product or service to customers. The promotion, distribution and selling of a product or service; includes market research and advertising.

Marketing environment
The factors and forces that affect a firm’s ability to build and maintain successful relationships with customers.

Market research (also called marketing research)
The function that links the consumers, customers, and public to the marketer through information. This information is used to identify and define marketing opportunities and problems; generate, refine, and evaluate marketing actions; monitor marketing performance; and improve understanding of marketing as a process. The systematic collection and evaluation of data regarding customers’ preferences for actual and potential products and services.

Marketing strategy
A process that can allow an organization to concentrate its resources on the optimal opportunities with the goals of increasing sales and achieving a sustainable competitive advantage

Process
A series of events to produce a result, especially as contrasted to product. in reference to capabilities, a process is how the capability is executed.

Product
Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.
Promotion

The advancement of an employee’s rank or position in an organizational hierarchy system. Promotion represents all of the methods of communication that a marketer may use to provide information to different parties about the product. Promotion comprises elements such as: advertising, public relations, personal selling and sales promotion. Dissemination of information about a product, product line, brand, or company.

Public

People. Includes people who look, think, and act the same as well as those who do not.

Public relations (PR)

The practice of managing the flow of information between an individual or an organization and the public.

Retailer

One who purchases goods or products in large quantities from manufacturers directly or through a wholesale, and then sells smaller quantities to the consumer for a profit.

Service

Action or work that is produced, then traded, bought or sold, and then finally consumed.

Strategy

A plan of action intended to accomplish a specific goal.

Tactics

The achievement of objectives through strategy.

Trend

An inclination in a particular direction the long-term movement in time series data after other components have been accounted for.

Value

The degree of importance given to something. A value is extremely absolute or relative ethical value, the assumption of which can be the basis for ethical action. A customer’s perception of relative price (the cost to own and use) and performance (quality).

Wholesaler

A person or company that sells goods wholesale is a middleman that buys its merchandise from a third party supplier and resells the merchandise to retail businesses or the end consumer. A wholesaler normally does not sell to other wholesalers.
Successfully positioning products on a global scale requires marketers to determine the target market’s preferred combination of attributes.

<table>
<thead>
<tr>
<th>KEY Points</th>
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<tbody>
<tr>
<td>• Placement in global marketing involves conducting extensive research to accurately define the market, as well as the attributes that define the product’s potential environment.</td>
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<tr>
<td>• Regardless of its size or visibility, a global brand must adjust its country strategies to take into account placement and distribution in the marketing mix.</td>
</tr>
<tr>
<td>• In addition to where products are placed, global marketers must consider how these products will be distributed across the different shopping venues and communication channels unique to that particular country or market.</td>
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Terms

- **Positioning**: The act of positioning; placement. Positioning involves ascertaining how a product or a company is or should be perceived in the minds of consumers. Positioning is the underpinning of messages created to promote a product or company in order to generate positive perceptions in the minds of consumers.
- **Marketing mix**: A business tool used in marketing products; often crucial when determining a product or brand’s unique selling point. Often synonymous with the four Ps: price, product, promotion, and place.
- **Dollar store**: A retail store selling inexpensive items, especially one in which all items have a price of one dollar.

Changes in Placement

The global marketing mix comprises four main elements: product, price, placement and promotion. Although product development, promotional tactics and pricing mechanisms are the most visible during the marketing process, placement is just as important in determining how the product is distributed. Placement determines the various channels used to distribute a product across different countries, taking in factors such as competition and how similar brands are being offered to the target market.

Product Placement in Supermarket

Global brands attempt to place products in locations where consumers will be most receptive to their messaging.

Global marketing presents more challenges compared to domestic or local marketing. Consequently, brands competing in the global marketplace often conduct extensive research to accurately define the market, as well as the attributes that define the product’s potential environment. Successfully positioning products on a global scale also requires marketers to determine each product’s current location in the product space, as well as the target market’s preferred combination of attributes. These attributes span the range of the marketing mix, including price, promotion, distribution, packaging and competition.
Regardless of its size or visibility, a global brand must adjust its country strategies to take into account placement and distribution in the marketing mix. For example, not all cultures use or have access to vending machines. In the United States, beverages are sold by the pallet via warehouse stores. However, in India, this is not an option.

Moreover, placement decisions must also consider the product’s positioning in the marketplace. A global luxury brand would not want to be distributed via a “dollar store” in the United States. Conversely, low-end shoemakers would likely be ignored by shoppers browsing in an Italian boutique store.

In addition to where products are placed, global marketers must consider how these products will be distributed across the different shopping venues unique to that particular country or market. Customizing these placement strategies for national and local markets while retaining a strong and consistent brand image can help companies gain significant competitive advantages in the global market.

Glossary

| Attribute | A characteristic or quality of a thing. |
| Brand | A name, symbol, logo, or other item used to distinguish a product, service, or its provider. The reputation of an organization, a product, or a person among some segment of the population. |
| Channel | The method a sender uses to send a message to a receiver. The most common channels humans use are auditory and visual. A distribution channel. |
| Combination | When two or more benefits are demonstrated in an advertisement. |
| Communication | The concept or state of exchanging information between entities. An instance of information transfer. |
| Competitive advantage | Something that places a company or a person above the competition. The strategic advantage one business entity has over its rival entities within its competitive industry. Achieving competitive advantage strengthens and positions a business better within the business environment. |
| Culture | The beliefs, values, behavior and material objects that constitute a people’s way of life; the arts, customs, and habits that characterize a particular society or nation. The sum of learned beliefs, values, and customs that regulate the behavior of members of a particular society. The arts, customs, and habits that characterize a particular society or nation. The language and peculiarities of a geographical location. A culture is the combination of the language that you speak and the geographical location you belong to. The distinct ways that people living in different parts of the world classified and represented their experiences. |
| Development | Development is the application of research findings to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems, or services, before the start of commercial production or use. Human resource development consists of training, organization, and career development efforts to improve individual, group, and organizational effectiveness. The process of developing; growth, directed change. The complete process of bringing a new product to market. The process of soliciting |
and gathering voluntary contributions of money or other resources by requesting donations from individuals, businesses, charitable foundations, or governmental agencies.

**Global marketing**

Global marketing is marketing on a worldwide scale, reconciling or taking commercial advantage of global operational differences, similarities and opportunities in order to meet global objectives.

**Image**

An attitude or lifestyle advertisers attempt to link to a product.

**Market**

A group of potential customers for one's product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

**Marketing**

The process of communicating the value of a product or service to customers. The promotion, distribution and selling of a product or service; includes market research and advertising.

**Price**

The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

**Placement**

The process of making a product or service accessible for use or consumption by a consumer or business user, using direct means, or using indirect means with intermediaries.

**Promotion**

Promotion represents all of the methods of communication that a marketer may use to provide information to different parties about the product. Promotion comprises elements such as: advertising, public relations, personal selling and sales promotion. Dissemination of information about a product, product line, brand, or company. The advancement of an employee's rank or position in an organizational hierarchy system.

**Process**

A series of events to produce a result, especially as contrasted to product. In reference to capabilities, a process is how the capability is executed.

**Product**

Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

**Strategy**

A plan of action intended to accomplish a specific goal.

**Tactics**

The achievement of objectives through strategy.
**Target**

A person (or group of people) that a person or organization is trying to employ or to have as a customer, audience etc.

**Target market**

A group of people whose needs and preferences match the product range of a company and to whom those products are marketed. A target market is a group of customers that the business has decided to aim its marketing efforts and ultimately its merchandise toward.

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**ASSIGNMENT: IT'S A SMALL AD AFTER ALL**

It's a Small Ad After All ...

The process of conceptualizing and then conveying a final product or service worldwide with the hopes of reaching the international marketing community. Proper global marketing has the ability to catapult a company to the next level, if they do it correctly. Different strategies are implemented based on the region the company is marketing to. For example, the menu at McDonald’s varies based on the location of the restaurant. The company focuses on marketing popular items within the country. Global marketing is especially important to companies that provide products or services that have a universal demand such as automobiles and food.

Read more: http://www.businessdictionary.com/definition/global-marketing.html#ixzz2mMy3Shto

In order to complete this **discussion board assignment**, you will need to complete the following:

1. **Using the Internet**, find an ONE example of “Global Marketing” that has been unsuccessful. Be sure to copy links to your articles or sources so that you can put them into your initial post. Your fellow classmates should have the opportunity to read up on your example!
2. **In your INITIAL POST** you will:
   1. Provide a brief synopsis of the example that you selected. Be sure to include the company, market they were entering and why you considered it to be a failure.
   2. Why do you think the company took the approach it did in marketing to an international market?
   3. What did they NOT consider in marketing their product, good or service?
   4. What consequences did the company suffer as a result of this failed marketing effort?
3. Respond to at least TWO of your classmates posts before the deadline.

**Goal:** Identify the various strategies of international business and the strategic ways to enter a foreign market.