International Business - The New Realities 6th edition Cavusgil Solutions Manual

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PART 1

FOUNDATION CONCEPTS

CHAPTER 1

INTRODUCTION: WHAT IS INTERNATIONAL BUSINESS?
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CKR CAREER PREPARATION KIT™

In this textbook, *International Business: The New Realities,* Cavusgil, Knight, and Riesenberger ("CKR") present guidance on how best to prepare for a career in international business, the CKR CAREER PREPARATION KIT™.

The Unmet Need (The Workplace Demand and Deficiency)

Surveys of employers, educators, and students suggest that current graduates are not prepared for the job market. The *College to Career* gap is characterized by intangible human skills (also referred to as *soft skills*) and tangible process tools pivotal to students' employability and success in the workplace.

The Solution

International Business: The New Realities CKR CAREER PREPARATION KIT has been specifically designed to integrate and advance students' development of intangible human skills and tangible process tools.

CKR Intangible Human Skills™

Surveys and the findings of the Association to Advance Collegiate Schools of Business (AACSB) identify the following Intangible Human Skills as necessary for success in today's workplace:

- *Written and oral communication*
- *Ethical understanding and reasoning*
- *Information technology*
- *Analytical thinking*
- *Diverse and multicultural work environments*
- *Reflective thinking*
- *Application of knowledge*
- *Interpersonal relations and teamwork*

Each CKR chapter specifically addresses these important human skills and integrates them to promote student learning. End-of-chapter exercises—Test Your

Comprehension, Apply Your Understanding, and globalEDGE Internet Exercises—cultivate the development of these critical skills.

I. LECTURE STARTER/LAUNCHER

■ Consider having everyone in class introduce themselves. One way to initiate introductions is distribute random pages torn from business magazines, in which each person receives one page. Next, each student circles words on the page that describe him/her. In groups of two or three, each student shares the rationale behind each word that he/she circled. Finally, one of the group members introduces another group member to the class. This process enables students to immediately know at least one other student in the class. The circled words and explanations are often humorous, which serve as icebreakers during your first classroom encounter.

■ **globalEDGE™** (globaledge.msu.edu) assembles a collection of tools and games that will allow you to compare countries on a variety of statistical indicators, rank countries based on these indicators, and test your knowledge of country capitals from around the world.

Get Insights By Country:
http://globaledge.msu.edu/Global-Insights/By/country
Currency Converter:
http://www.xe.com/
Country Comparator:
http://globaledge.msu.edu/comparator
Ranking Countries:
http://globaledge.msu.edu/global-resources/resource/5128
Country Tools and Data:
http://globaledge.msu.edu/tools-and-data
Global Resource Directory:
http://globaledge.msu.edu/global-resources/

■ Under Country Insights click on a region, then select a country, Zimbabwe for example.
http://globaledge.msu.edu/Countries/Zimbabwe
Everyone in the class should be assigned a different country. Each student is then responsible for becoming an expert on that country. Twice during the term, each student could report on their country and summarize a newspaper article published in their country, i.e., an International Newspaper Memorandum assignment.

[1] An exciting way to introduce your students to International Business is the *CIA Maps,* from the CIA World Factbook, which provides an interactive and fun tool to introduce to international business:
https://www.cia.gov/the-world-factbook/

[2] Another great way to introduce student to the world of international business is to direct them to the BBC website:
http://news.bbc.co.uk/1/hi/country_profiles/default.stm

[3] Comic relief: Humor and culture in international business | Chris Smit | TEDxLeuven
Mar 18, 2015 ● 14:42 Minutes ● Stereotypes.
https://www.youtube.com/watch?v=MB6NXzGKMKg

USEFUL REFERENCES FOR INTERNATIONAL BUSINESS

UNIVERSITY LIBRARY (e.g., GSU LIBRARY)

Database	**How to reach?**
FACTIVA	http://library.gsu.edu/ >> Databases by Name A-Z >> F
LEXIS/NEXIS	http://library.gsu.edu/ >> Databases by Name A-Z >> L

NEWSPAPERS

Paperboy - World Newspapers	www.thepaperboy.com/newspapers-by-country.cfm
World Newspapers and Magazines	www.world-newspapers.com/index.html
BBC News	http://news.bbc.co.uk/2/hi/country_profiles/default.stm
Bloomberg Businessweek	http://www.bloomberg.com/businessweek
Financial Times	www.ft. com
IB Times	http://www.ibtimes.com/business
Wall Street Journal	http://www.wsj.com/news/business

PORTALS

GlobalEdge	www.globaledge.msu.edu
U.S. Department of Commerce	https://www.export.gov/
CIA - The World Factbook	https://www.cia.gov/the-world-factbook/
U.S. Department of State	www.state.gov/misc/list/index.htm
World Economic Forum	www.weforum.org
World Bank - Countries	www.worldbank.org/en/country
World Bank Data: By country or Indicator	https://data.worldbank.org/
World Bank - Doing Business	http://www.doingbusiness.org/rankings
IMF Data	https://www.imf.org/en/Home
UNDP (United Nations Development Programme - Human Development Reports)	https://hdr.undp.org/data-center

CONSULTING COMPANIES

A.T. Kearney	https://www.atkearney.com/ideas-insights
Boston Consulting Group	www.bcgperspectives.com
Deloitte	www.deloitte.com
KPMG	www.kpmg.com
McKinsey & Company	www.mckinsey.com
PricewaterhouseCoopers	http://www.pwc.com/us/en/publications.html

INTERNATIONALIZATION AT HARLEY-DAVIDSON [CLOSING CASE]

■ Harley Davidson is the chapter Closing Case. These questions serve as hooks for students to familiarize themselves with the chapter concepts.
■ In **1908**, Harley Davidson sold the first Harley police motorcycle to which police department?
ANSWER: Detroit; nearly every large U.S. police department employed Harley motorcycles.
■ In **1988**, Harley Davidson opened up its first foreign production facility in which country?
ANSWER: Brazil (Manaus)… Why is Brazil an important foray into the international arena? It represents a key emerging market country.
■ There have been recent updates to the situation of Harley Davidson regarding its performance and international activities. In particular, Harley management has sought to move more of the firm's production and marketing activities abroad, in light of higher manufacturing costs in the United States and the fact that the market for Harley sales is increasingly saturated in U.S. and millennials and other younger consumers are less interested in buying large motorcycles. These trends have been reported in numerous accounts in the news media.

II. LEARNING OBJECTIVES AND THE OPENING VIGNETTE

LEARNING OBJECTIVES

After studying this chapter, you should be able to do the following:

1.1 Describe the key concepts in international business.
1.2 Understand how international business differs from domestic business.
1.3 Identify major participants in international business.
1.4 Explain why firms internationalize.
1.5 Appreciate why you should study international business.
1.6 Learn the CKR Intangible Human Skills™ and the CKR Tangible Process Tools™ to improve your employability and success in the workplace.

Key Themes

■ In this chapter, there are five themes:
[1] What Are the Key Concepts in International Business?
[2] How Does International Business Differ from Domestic Business?
[3] Who Participates in International Business?
[4] Why Do Firms Internationalize?
[5] Why Study International Business?

■ This chapter is the introduction to the text, as well as to the foundation concepts. The first part of this text (Chapters 1–8) explores globalization from a macro, environmental level, while the second part (Chapters 9–17) examines international business from a more micro, organizational level. The fundamental concepts introduced in Chapter 1 are central to both macro and micro perspectives for understanding international business. Thus, these basic concepts permeate the entire text, and students should be well-acquainted with them.

■ In this chapter, use a macro lens to introduce students to some of the fundamental international business concepts.

■ Cross-border trading has been around for centuries; contemporary international business has gained considerable momentum/complexity over the past four decades.

■ **International business** refers to the trade and investment activities by companies across national borders. **Globalization of markets** refers to ongoing economic integration and growing interdependency of countries worldwide. Stress the dramatic growth in world trade (accompanied by substantial flows of capital, technology, data, and communications), with exports alone exceeding some $22 trillion annually.

- In **2004**, total cross-border bandwidth in digital data transfer and communications was practically zero.
- **Today**, total cross-border bandwidth flows now exceed 1 million gigabits per second, with virtually every type of international transaction including a digital component.
- Greater collaboration among nations through multilateral agencies such as the World Trade Organization (WTO, www.wto.org) and the International Monetary Fund (IMF, www.imf.org).

■ There are two ways to invest internationally—passively (**portfolio investment**—financial assets) or actively (**foreign direct investment**—capital, technology, labor, land, plant, and equipment).

■ Also important are **importing** (global sourcing)—buying products/services from abroad and bringing them back to the home country. **Exporting**—manufacturing a product or service in one country and selling it to another.

■ Address the broader questions of:

> ◘ **Why firms go international?** Primarily to increase sales and profits!
>
> ◘ **What is the difference between internationalization and globalization?** Former—expansion of international business activities verses, latter—integration, interdependency and interconnectedness of internationalization (the 4 I's).
> Example: Increasing exports versus sourcing value-chain activities strategically around the globe to leverage factor efficiencies.
>
> ◘ **How international business is different from domestic business?** Complexity and 4-Risks
>
> ◘ **Who participates in international business?**
> **Multinational Enterprise** (MNE)
> **Small and Medium-sized Enterprise** (SME)
> **Born Global**: Entrepreneurial firm that is international from almost inception
>
> ◘ **Why you should study international business**? Competitive advantage—for you and your firm!

■ Note that international business is **both** a cause and a result of increasing national prosperity.

Teaching Tips

■ In this chapter, use a broad-brush approach in generating excitement about the importance of international business activity. Ask students to examine their clothing, watches, iPhones, and iPods and report where in the world each item was manufactured. This discussion underscores the profound and pervasive impact that globalization has had on all of us.

■ Next, ask students what they would like to do professionally, after they graduate. Once they respond, ask if they can accomplish that successfully without understanding international business, and the impact of global trends on their industry and business? The answer is, of course, a resounding NO!!!

Commentary on the Opening Vignette:
INSTAGRAM: A GLOBAL PHENOMENON

- **Key message**

■ Instagram is a photo- and video-sharing network enjoyed by smartphone owners worldwide who use the service to share photos and short videos with others. The site has more than 2 billion active monthly users, that is, about one-quarter of the world, the majority of whom are under age 35. Instagram was acquired by Facebook in 2012 for US$1 billion, which underscores the economic, political, and personal interconnectedness among countries, companies, and consumers.

- **Uniqueness of the situation described**

■ What is striking about this vignette is that by the time the reader finishes this case, Instagram usage will have again jumped globally. The number of smartphone users worldwide has surpassed **6 billion**, about three-quarters of world population.
■ Available in 32 languages, Instagram has a dual identity—a for-profit business and a vehicle for our personal lives.
■ Instagram is the fourth most popular social media platform worldwide, after Facebook, YouTube, and WhatsApp.

- **Classroom Discussion**

■ This example underscores how globalization has permeated our everyday lives.
■ Specific country examples (Russia, Turkey, Brazil, Poland, United Kingdom, and United States) illustrate the overall theme: the Instagram phenomenon highlights how converging lifestyles, modern communications technology, and imaginative entrepreneurship are facilitating the emergence of global enterprises.
■ The vision of both Instagram and Facebook mirrors this activity by empowering individuals, mapping the social relationships among them, and creating a new system for exchanging information that many find indispensable.
■ Which countries are they especially popular in?

◘ Smartphone ownership is common in the advanced economies—especially in Australia, Europe, Japan, and North America—where **85 percent** of residents own such devices.

◘ The phones are increasingly popular in emerging markets—countries such as Brazil, China, Poland, and Russia—where the ownership rate is more than **70 percent**.

◘ The app is popular worldwide, especially in countries like Russia, Brazil, Turkey, the United Kingdom, Poland, and the United States.

◘ India has the most Instagram users, with more than 250 million. Instagram's top competitor is TikTok, based in China.

■ What are the most photographed countries among Instagram users?
◘ Italy, Japan, Indonesia, Kuwait, Thailand, and France
■ Primary revenue generation:
◘ Advertising—Brand awareness—Key
◘ How does Instagram market itself in developing economies, such as Bangladesh, Bolivia, Nigeria, and Pakistan, which have low smartphone penetration rates, mainly due to lower incomes and underdeveloped infrastructure?

◘ The platform allows people in such countries to take and share high-quality photographs using low-resolution phones, as they often cannot afford expensive smartphones or fast Internet connections. Many lack enough phone storage to easily download the app. To get around these problems, Instagram launched an expanded web version that allows users to skip the app's wait time, data costs, and storage needs while still providing basic functionality.

Key revenue source:
■ Retailers and other companies leverage Instagram to market their products and services at low cost. Most of the world's top brands—for example, Apple, BMW, and Sony—have established Instagram pages to facilitate sharing photos about their brands.
■ Use this case as a springboard for the first teaching tip offered above.
■ Also ask students to update the Instagram saga since its sales to Facebook in 2012.

Break students into small groups to work on the following questions, with each group providing a brief presentation of their answers.

QUESTIONS

1-1. What advantages does Instagram obtain from doing business in international markets?
(LO 1.4; AACSB: Application of knowledge)

■ Capitalizing upon the global interdependency and interconnectedness among economic, political, and social forces on professional and personal levels.
■ Instagram appeals to people worldwide who enjoy taking photos and sharing them with others around the world. Many countries constitute key markets for the firm's photo/video sharing services.
■ The tendency of people to create photos and videos of their favorite brands is valuable to brand managers in a world of targeted advertising; reach is enhanced.
■ In 2023, reports estimate Instagram's U.S. ad revenues to be **$39.7 billion.** Given an estimated 127.2 million U.S. users, Instagram's revenue per user averages at about $312.11.

Ask students to check and update these figures.

1-2. What attributes of Instagram have allowed it to gain rapid acceptance in countries around the world?
(LO 1.1; AACSB: Reflective thinking)

■ Widespread adoption of smartphone apps. The number of smartphone users worldwide has surpassed **6 billion**, about three-quarters of world population.
■ Available in 32 languages, Instagram has a dual identity—a for-profit business and a vehicle for our personal lives.
■ Instagram management has developed the service so that it has a truly global platform. Management has used foreign direct investment to establish offices around the world to support customer adoption and better understand Instagram's most popular markets worldwide.
■ The Instagram platform allows people to take and share high-quality photographs using low-resolution phones, which appeals to users in less-developed economies.
■ Instagram also launched an expanded web version that allows users to skip the app's wait time, data costs, and storage needs while still providing basic functionality.
■ In general, Instagram benefits from converging lifestyles, the rise of advanced communications technologies, and imaginative entrepreneurship and skillful management in the firm.

1-3. How do companies use Instagram to market their products and services?
(LO 1.1; AACSB: Diverse and multicultural work environments)
■ Based in Germany, sportswear company Puma contracts with Instagrammers who have many followers to capture photos that showcase the firm's products.
■ Based in Denmark, brewing company Carlsberg launched a marketing strategy called "Happy Hour" that offers half-priced beers in exchange for Instagram posts.
■ Jiffpom is a celebrity dog, with a record number of Instagram followers, who promotes clothing, toys, and other ventures through the app.
Celebrity dog Jiffpom that holds the record for most Instagram followers for an animal: https://www.youtube.com/watch?v=2DMDHO0wa7w
■ In Brazil, sports teams use Instagram to promote themselves.
■ In Portugal, the most popular Instagram influencer is soccer star Cristiano Ronaldo.
■ Worldwide, many firms that market youth-oriented services leverage Instagram to promote their brands. Firms target Instagram for brand promotion among upwardly mobile young managers.

III. DETAILED CHAPTER OUTLINE
WHAT ARE THE KEY CONCEPTS IN INTERNATIONAL BUSINESS?

■ **International business (cross-border business)** refers to cross-border trade and investment activities by firms.

■ Primarily, individual firms engage in international business, yet, governments and international agencies may also conduct international business activities.

■ Exhibit 1.1 Elements of International Business (Six)

[1] Globalization of markets
[2] International trade
[3] International investment
[4] International business risks
[5] Participants: Firms, channel intermediaries, facilitators, and governments
[6] Foreign market entry strategies, including exporting and direct investment

■ **Globalization of markets** (or the globalization of economies) refers to ongoing economic integration and growing interdependency of countries worldwide.
■ Online platforms: Amazon, Alibaba, Facebook, and Instagram underscore this integration and are central to globalization.
■ **Internationalization** refers to the tendency of firms to systematically increase the international dimension of their business activities.
■ This has resulted in the widespread diffusion of products, technology, and knowledge worldwide.
■ **Macro perspective (trend)**: Globalization of markets means intense economic interconnectedness between/among countries.

Market globalization is characterized by several related trends:

● **Unprecedented growth of cross-border transactions** from $300 billion per year in 1960 to current numbers with world exports alone amounting to some $25 trillion annually—that is, $25,000,000,000,000!
● **Trade accompanied by substantial international flows of capital, technology, data, and communications.** In 2004, total cross-border bandwidth in digital data transfer and communications was basically zero. Today, total cross-border bandwidth flows now exceed 1 million gigabits per second, where virtually every international transaction includes a digital component.
● **Development of highly sophisticated global financial systems and mechanisms** that facilitate cross-border flows of products, money, technology, knowledge, and data.
● **Greater collaboration among nations** through multilateral regulatory agencies such as the World Trade Organization (WTO: www.wto.org) and the International Monetary Fund (IMF: www.imf.org).

■ **Micro-perspective (focus)**—Firm level, activity; **Value-chain perspective**—Firms conduct value-adding activities on a *global* scale, i.e., organize, source, manufacture, market, sell, and employ market entry strategies such as exporting, strategic alliances, and direct investment.

■ The text focuses primarily on the international business activities of the individual firm.

■ Globalization both *compels* and *facilitates* companies to expand abroad—international expansion is easier due to market and product globalization.
■ A "level playing field" has made cross-border activities appealing to all types of firms—large and small; manufacturing and service sectors (e.g., banking, engineering, insurance, and retailing).
■ Globalization affects everyone, as evidenced by the global financial crisis (2008). The economic contagion or interconnectedness was underscored as the crisis began in U.S. and rapidly spread to U.S. trade partners, eventually affecting Canada, Mexico, Japan, China, and the world. This manifestation illustrates the integration and interdependency of national economies throughout the world.

WHAT ARE THE KEY CONCEPTS IN INTERNATIONAL BUSINESS?

■ International trade and investment are the most conventional forms of international business transactions.

International Trade

■ Cross-border exchange of products (merchandise) and services (intangibles) typically through exporting and importing.
■ **Exporting** (outbound activity): Entry strategy involving the sale of products/services to customers located abroad.
■ **Importing** (**global sourcing**; inbound activity): The procurement of products/services from foreign suppliers for consumption in the home country or a third country.
■ Exporting and importing may include both intermediate (raw materials and components) and finished products.

International Investment

■ Cross-border investment is the transfer of assets to another country or the acquisition of assets in that country.
■ The ***factors of production*** (assets) include capital, technology, managerial talent, and manufacturing infrastructure.
■ **Trade**: Products and services cross national borders.
■ **Cross-border investment**: The firm itself crosses national borders.

Two Types of International Investment:

■ **International portfolio investment** (typically short-term) is the passive ownership of foreign securities such as stocks and bonds for the purpose of generating financial returns.
■ **Foreign direct investment** (FDI) (typically long-term) is a foreign-market entry strategy that gives investors partial or full ownership of a productive enterprise. The firm establishes a physical presence abroad through acquisition of productive assets such as capital, technology, labor, land, plant, and equipment.

The Nature of International Trade

■ **Macro-International Trade**: Aggregate export and import flows of products and services between nations.

■ **Micro**-International Business: Cross-border transactions of an *individual* business enterprise.
■ **GDP**: Gross domestic product is the total value of products and services produced in a country during a year.
■ **Exhibit 1.2** contrasts the growth of world trade to the growth of world *gross domestic product (GDP)* since 1980.

World Trade and World GDP

Evolution of Globalization Trends: Growth/Recession/COVID/Maturity-Implications

Robust Growth: Favorable Global Conditions

■ Due to the global recession, world trade declined in 2009, ending a 27-year boom period.
■ Trade revived and returned to normal levels in 2012.
■ Remarkable—1980–2008, annual rate of growth in **world exports** surpassed **world GDP** by almost 2x (37.1 to 60.7, as measured by the volume of world trade (the sum of world exports and imports) as a percentage of world GDP).
Three reasons:
¤ **Explosion** of emerging markets—rapidly growing middle-class with substantial disposable income.
¤ **Sourcing** by advanced (developed) economies (U.S. and European Union) to low-cost manufacturing locations as China, India, and Mexico.
¤ **Innovations** in information and transportation technologies, decline of trade barriers, and liberalization of markets fuel the rapid growth of trade.

Recession: Unfavorable Global Conditions

■ **2009—Global Recession**: World trade growth declined and flattened.
■ **2010's:** Protectionist policies leveled globalization trends.

COVID-19: World Pivoted in Unprecedented Fashion

■ **2020—COVID-19**: Cross-border trade slowed.
■ **World Trade Organization:** Globalization peaked.

Flattening of Globalization Pace: Reasons

■ Protectionism, nationalism, and COVID-19.
■ Intense trade tensions two super-powers—China and U.S.
■ War in Ukraine complicated trade in some industries.
■ Insourcing to home markets.
■ Robotics, artificial intelligence, additive manufacturing, and other emergent technologies are facilitating automation and the ability to manufacture goods at lower cost in advanced economies like Germany, Japan, and U.S., resulting in fewer imports.

Implications

■ Natural tendency toward greater *stability* and *maturity* in the evolution of cross-border trade and a transformation in the character of globalization
■ Volume of international trade will remain strong.
■ Interconnectedness of world economies will remain as evidenced by bonds forging in the 20th century among regions, countries, industries, and companies; this is largely irreversible.

■ **Exhibit 1.3** identifies the leading nations in merchandise exports (not including services).
■ Total merchandise trade (exports plus imports) of the countries in panel (a) is nearly $24,000 billion and accounts for about half of world merchandise trade.
■ During the global recession, China surpassed U.S. as the world's leading exporter in total dollar terms, trade accounts for about **30 percent** of its GDP (in U.S., trade is **19 percent** of its GDP).
■ For other economies, merchandise trade is a much larger component of economic activity, e.g., Netherlands (157 percent), Mexico (77 percent), Germany (72 percent), and South Korea (70 percent).

■ **Exhibit 1.4** identifies the top 25 countries in international merchandise trade (not including services). China, U.S., Germany, and Japan are the world's leading international traders, accounting for the vast majority of world merchandise trade.

■ ***Entrepôt economies*** (*intermediate depot*; exports = imports): Singapore, Hong Kong, Malaysia, and the Netherlands export more than 100 percent of their respective GDPs.
■ *Entrepôt* is from the French for "intermediate depot."
■ Such countries import a large volume of products, some of which they process into higher value-added products and some they simply re-export to other destinations.
■ Access to adjacent markets: Singapore is a major entrepôt for Southeast Asia, e.g., for transshipping petroleum products that it receives from the Middle East. Hong Kong is an entrepôt for China. The Netherlands is an entrepôt for the greater European Union.

The Nature of International Investment
■ **Foreign Direct Investment** (FDI) (asset ownership and long-time frame) is the ultimate commitment-level of internationalization, and thus this text focuses primarily on FDI (most common mode of entry strategy) as opposed to International Portfolio investment.
■ New legal business entity, recognized by the host country and subject to its regulations.

■ Motivations for firm FDI (note how these fit into the value chain):
(1) **Primary** Activity: Set up manufacturing/assembly facilities to produce products/services;
(2) **Primary** Activity: Open a sales/representative office to conduct marketing or distribution activities; or
(3) **Support** Activity: Establish a regional headquarters.

■ **FDI and Competitive Advantage**:

Large, resourceful companies with substantial international operations are better able to leverage FDI to:

(1) Manufacture/assemble products in low-cost labor countries (or for natural resources), i.e., China, India, and Mexico:
■ **Example**
¤ Ford invested some $3 billion to build a new car factory in **Mexico** to manufacture Fiesta automobiles.
(2) Global challengers originating in rapidly developing economies invest in western markets:
■ **Examples**
¤ **Chinese** company Haier:
●2012: Acquired New Zealand's appliance manufacturer Fisher & Paykel.
●2016: Purchased General Electric's appliance division for $5.4 billion.
●2018: Acquired the Italian major appliance manufacturer Candy Group.
●2020: Became the number one global brand in major home appliances.
¤ **Turkey** in 2014: Yildiz paid over three billion dollars to acquire British-based cookie and snack maker, United Biscuits.
¤ **India's** Mittal Steel Co. acquired the Belgium-based Arcelor SA in August 2006, creating a $38 billion conglomerate—the world's largest steel company.
¤ **Russian** oil and gas firm Lukos established thousands of service stations in U.S. and Europe.

■ **Exhibit 1.5** shows the dramatic growth of FDI since the 1980s.
■ **September 11, 2001-** a worldwide panic ensued following the terrorist attacks in U.S., which interrupted FDI inflows.
■ Global recession interrupted FDI again in **2008.**
■ **Developed (advanced) economies**: Japan, Australia, Canada, U.S., and most countries in Western Europe. Dollar volume of FDI has grown immensely since the 1980s.
■ In **2020**, inflows plunged due to **COVID-19**. Both direct and indirect effects:
¤ Initially, it disrupted manufacturing, logistics, transportation, and marketing.
¤ To slow the spread of COVID-19, authorities worldwide imposed restrictions that further impeded normal business operations.
¤ Thus MNEs moderated their foreign investment activities. New FDI projects were put on hold. Global FDI flows fell sharply, especially in 2020.
¤ In 2021, FDI rebounded, but progress was slow and uneven.
■ Stability in world economy is key.
■ **Developing economies**: Parts of Africa, Asia, and Latin America.
■ Particularly significant is the growth of FDI into developing economies (surpassing advanced economy inflows in 2010) despite widespread poverty, lower incomes, less-developed industrial bases, and less investment capital than advanced economies, and represent the need for modern industrial infrastructure.
■ Emerging economies: Target markets and sourcing bases.

Services as Well as Products

■ Key international players: Tangible merchandise (products) and intangibles (services, e.g., banks, consulting firms, hotels, construction companies, retailers, airlines, etc.).
■ International trade in services accounts for about **one-quarter** of all global trade and is growing faster than products; however, the value of merchandise trade is still much greater than the value of services trade.
■ Challenges unique to services:
 ◘ Not all services can be exported, e.g., restaurant experience and repair work.
 ◘ Physical presence in host country is a prerequisite for many services.
■ More than $2 trillion worth of services are sold abroad every year.
■ Examples:
 ◘ Instagram—the opening case—is a leading services firm that has rapidly internationalized.
 ◘ Dutch bank ABN Amro underwrites mortgages.
 ◘ French firm Sodexho manages/owns cafeterias on university campuses.
 ◘ Riot Games expanded its operations into Germany, Ireland, China, Turkey, and numerous other countries to meet rapidly rising demand for its online video games. Demand for its *League of Legends* game has spread rapidly, prompting the need to establish offices at gamer locations worldwide. The 2022 League of Legends World Championship attracted fans from around the world for several weeks of competition initiated in Mexico City, with teams representing dozens or worldwide regions.

■ **Exhibit 1.6** identifies the leading countries in total international services trade.
■ Larger, developed economies account for the greatest proportion of services—as services typically comprise more than 2/3 of the GDPs of these countries.
■ China, India, and Ireland have emerged as leaders in world services trade as a percentage of GDP.
■ eBay: The giant Internet retailer earned $10 billion in 2022, of which 60 percent came from international sales.
■ eBay expanded to India, China, Korea, and Europe in anticipation of most of its future revenue growth coming from abroad.
■ When developing its business in India, eBay acquired the Mumbai-based e-retailer Baazee.

■ Ask students to compare the value of merchandise trade in **Exhibit 1.3** with the value of services trade in **Exhibit 1.6** for each country.

■ The value of merchandise trade is still much larger than international trade of services, which has remained relatively robust.
■ ***Sharing economy***: Firms/individuals engage in online peer-to-peer exchange of various goods and services.
 ◘ Uber and Airbnb are examples of a growing number of global firms that allow people to borrow or rent assets from others.
 ◘ Uber, based in San Francisco and operating in more than 10,000 cities worldwide, helps people bypass taxis, and Airbnb allows them to book rooms in private homes worldwide.
 ◘ In Australia, people use Freelancer to hire needed workers.

◘ UK based firm Streetbank helps neighbors share tools, appliances, and other household items and has expanded to Australia, Canada, and numerous other countries.

■ **Exhibit 1.7** (great chart) illustrates the diversity of service sectors that are internationalizing.

The International Financial Services Sector

■ **Banking and financial services are the most active** cross-border services.
■ Explosive growth of global capital markets is attributed to:

(1) Internationalization of Banks/Financial institutions → increased amount of cheap, local investment capital, stimulating local financial markets and encouraging savings
(2) International Flow of Money → into pension funds and portfolio investments

■ Developing economies: Banks/financial institutions have fostered economic activity by increasing the availability of local investment capital, which stimulates the development of financial markets and encourages savings.
■ International banking is primarily conducted by very large banks.
■ Governments worldwide imposed many new regulations in the banking industry following the global financial crisis that arose in 2008.
■ Consumers and local businesses generally prefer to deal with local banks, obtaining financial services from homegrown "brick-and-mortar" branches and personnel who understand local conditions.
■ China is now home to the world's five largest banks, specifically ICBC, China Construction Bank, the Agricultural Bank of China, and the Bank of China.
■ London had long been the banking hub of Europe, but this status is threatened with the United Kingdom's 2020 exit from the EU (Brexit). London's lost competitive advantage in banking results in a growing role for Dublin, Frankfurt, and Paris as leading European banking centers.

HOW DOES INTERNATIONAL BUSINESS DIFFER FROM DOMESTIC BUSINESS?

■ **Complexity**: Macro forces differ from country to country; economic conditions, national culture, legal and political systems vary by country.
■ **Risk**: *Uncontrollable variables*—the firm has little or no control over these resulting in volatility, uncertainty, complexity, and ambiguity.
■ Foreign environments involve new risks that firms must manage.
■ **Instagram** (opening case): Exemplifies how distinctive conditions in each country lead businesses and consumers to adapt products and utilize services differently, from country to country.

The Four Risks in Internationalization

■ Universal/generic: Affect all industries, all companies.

■ Examples: pollution, climate change, biodiversity loss, disease pandemics, cyber-attacks, and other technological risks.
■ Firm-specific examples: Reputational risk refers to scandals, harmful rumors, or other events that damage perceptions about the firm's image.
■ This text focuses on risks specific to globalization and international business, which fall into four major risk types.

■ **Exhibit 1.8** summarizes the four major risks: commercial risk, cross-cultural risk, country risk, and currency (financial) risk.

Commercial Risk
■ Firms loss/failure from poor formulation/implementation of business strategies, tactics, and/or procedures, e.g., partnering selections, market entry timing, pricing, product features, and promotional themes.
■ Failures in international markets are far more costly than domestic business blunders.
■ Firm reputation and profitability may also be at risk from marketing harmful products, failing customer expectations, or providing inadequate customer service.
■ Commercial risk is often affected by currency risk, because fluctuating exchange rates can affect various types of business deals.

Cross-Cultural Risk
■ Situations where a cultural misunderstanding places some human value at risk.
■ Differences in language, lifestyles, mind-sets, customs, and religion.
■ Cross-cultural literacy: Critical to embrace culturally valued mind-set and/or work style.
■ Cultural blunders: Hinder the effectiveness of foreign managers.
■ Language is a critical dimension of culture and a window to value systems.
■ Language challenges impede effective communication.
■ Cultural differences may lead to inappropriate business strategies and ineffective customer relations.
■ This risk can also occur domestically, when management meets with customers or business associates who visit company headquarters from abroad.

Country Risk or Political Risk
■ Differences in host country's political, legal, and economic environments may adversely affect a firm's profitability.
■ Government intervention: Restricts market access, imposes bureaucratic procedures hindering business transactions, and limits the amount of income that firms may repatriate from foreign operations. It varies by country.
■ Economic freedom differs among nations. The Index of Economic Freedom from the Heritage Foundation ranks countries according to a myriad of economic freedom variables.
■ Hong Kong, Singapore, and Australia typically occupy the top three countries in terms of having the highest levels of economic freedom, see http://www.heritage.org. Ireland also ranks high in terms of a liberal economic environment; whereas China and Russia are the opposite, and they regularly intervene in business.

■ Critical Legal Dimensions: Laws and regulations, e.g., intellectual property protection, product liability, taxation policies, inflation, national debt, and unbalanced international trade may encumber firm operations and performance.

Currency or Financial Risk

■ Risk of adverse fluctuations in exchange rates.
(**Exchange rates**: the value of one currency in terms of another).
■ Inflation and other harmful economic conditions create uncertainty of returns due to the growing interconnectedness of national economies.
■ When international transactions are conducted in more than one national currency, currency risk arises.
■ The value of a firm's earnings may be substantially reduced when currencies fluctuate significantly.
■ Inflation and other harmful economic conditions experienced in one country may have immediate consequences for exchange rates due to the interconnectedness of national economies, i.e., contagion.
■ **Examples:**

◘ **2022-23**: Rising value of U.S. dollar relative to key currencies cut into revenues of U.S. multinational firms, e.g., Netflix, IBM, and Johnson & Johnson.

◘ Microsoft saw its slowest growth in five years, with currency fluctuations depressing revenues by $2.3 billion.

◘ Procter & Gamble experienced a significant sales decline, blaming the strong dollar for affecting its sales dramatically.

Two contemporary risk types—**cyber risk and social media risk**—have emerged in international business. Both are the result of vulnerabilities in affected organizations.

— *Cyber risk* results from attacks on, or breaches of, the firm's information systems. Recent data breaches have afflicted eBay, Uber, Tesco Bank, and Sony Playstation Network.

— *Social media risk* refers to rapid and widespread circulation of unfavorable "buzz" about the firm. Such negative news is accelerated and amplified by social media. In 2015, for example, regulators announced that Volkswagen had installed software in its vehicles aimed at evading environmental regulations intended to reduce engine pollutants. When the scandal went viral on Twitter, Facebook, and other sites, Volkswagen's brand image was damaged. By late 2015, Volkswagen's buzz score had descended to its lowest point in several years.

Risks: Always Present but Manageable

■ These types of risks are omnipresent in international business.
■ Managers need to understand their implications, anticipate them, and employ proactive measures to reduce their adverse effects.
■ **Example:** The Greek debt crisis has lingered for several years and affects not only the European Union but also creditors elsewhere.

WHO PARTICIPATES IN INTERNATIONAL BUSINESS? (Four categories)

[1] *Focal firm*: The initiator of an international business transaction, which conceives, designs, and produces offerings intended for consumption by customers worldwide. Focal firms are primarily MNEs and SMEs.

[2] *Distribution channel intermediary*: A specialist firm that provides various logistics and marketing services for focal firms as part of international supply chains, both in the home country and abroad.

[3] *Facilitator*: A firm or an individual with special expertise in banking, legal advice, customs clearance, or related support services that assists focal firms in the performance of international business transactions.

¤ **Freight forwarder:** A specialized logistics service provider that arranges international shipping on behalf of exporting firms.

[4] *Governments* (public sector): Act as suppliers, buyers, and regulators.

¤ **Russia, China, and Brazil:** State-owned enterprises account for a substantial portion of economic value added, even in these rapidly liberalizing emerging markets.

¤ **France, Australia, and Sweden**: Governments in these advanced economies have significant ownership of companies in telecommunications, banking, and natural resources.

¤ The recent global financial crisis led governments to step up their involvement in business, especially as regulators.

¤**State-owned enterprise** (SOE): A company that is founded and owned by a government in order to undertake commercial activities on the government's behalf.

■ The focal firm performs certain activities internally and delegates other functions to intermediaries and facilitators when their special expertise is needed. So the focal firm becomes a client of intermediaries and facilitators who provide services on a contractual basis.

■ **Supply side of IB transactions:** Focal firms, intermediaries, and facilitators.
■ **Demand side of IB transactions:** Customers or buyers. Customers consist of:
- Individual *consumers and households*.
- *Retailers*—businesses that purchase finished goods for the purpose of resale.
- *Organizational buyers*—businesses, institutions, and governments that purchase goods/services as inputs to a production process or as supplies needed to run a business or organization. Governments and nonprofit organizations such as CARE (www.care.org) and UNICEF (www.unicef.org) also represent customers.

Focal Firms in International Business [Most prominent players]
Three Types: MNE and **SME** and **Born Global**

Multinational Enterprise (MNE)
Also known as Multinational Corporation (MNC)

■ MNE owns a worldwide network of subsidiaries and affiliates located in multiple countries; large firm with a home office and substantial resources.
■ Multinational enterprises have historically been the most important type of focal firm; adding value in multiple countries, through subsidiary affiliates, leveraging R&D, procurement, manufacturing, and marketing activities, to exploit economic advantages.
■ **FDI** (Foreign Direct Investment): Key entry strategy.
■ Leading MNEs are listed in the *Fortune Global 500* (http://fortune.com).
■ **Examples:**

◘ **Alcon**: Swiss pharmaceutical firm that established major R&D facilities in U.S., leveraging local talent in the chemicals sector.

◘ **Verizon Wireless**: Located much of its technical support operations in India, taking advantage of high-quality, low-cost customer support personnel.

◘ **Royal Dutch Shell**: Owns several oil refineries and nearly 2,000 gasoline stations in Canada.

◘ **Typical MNEs:** Coca-Cola, Nestlé, Sony, Citibank, Unilever, Nokia, Ford, Barclays, DHL, Four Seasons Hotels, Shell Oil, Exxon-Mobil, Royal Dutch Shell, General Motors, Honda, and Walmart.

■ **Affiliates:** Network of subsidiaries that MNEs collaborate with.
■ **MNEs**: For many, more than 50 percent of total sales/profits comes from international operations, e.g., Exxon, Honda, and Coca-Cola.
■ In 1970, fewer than **7,500** MNEs worldwide; today at least **75,000**.

■ **Exhibit 1.9** (great chart) provides a geographic distribution of the world's leading MNEs, drawn from *Fortune*'s Global 500 list—concentrated in mostly advanced economies.
■ **U.S.** is home to 124 of the top 500 MNEs (in 2022), a number that has declined over time as other countries' firms increase in size.
■ **China** has the most MNEs (136 firms—up from 70 just 10 years earlier), and rising. **Europe** is home to many top MNEs: **Germany** (28 firms), **France** (25 firms), and the **United Kingdom** (18 firms).
■ **China:** Most top firms are state-owned enterprises; owned by the Chinese government, which provides them substantial advantages.

■ For the first time since World War II, a nation other than U.S. has reached the top global business ranks. **China's new status** as the top country in the Global 500 signifies the emergence of a new global economic power and an important shift in the international competitive landscape.
■ This shift reflects tensions between U.S. and China, with implications for technological development, as China will set standards for new technologies, set explicit goals to dominate artificial intelligence, quantum computing, robotics, and other technologies.

■ **Global Challengers from Emerging Market Countries: New Contenders:** Large MNEs have begun to appear in emerging market countries, such as China, Mexico, and Russia—leveraging home-country natural resources and low-cost labor, posing legitimate competitive challenges for advanced economy; incumbents in world markets.
■ **Examples:**

◘ The Mexican firm **Cemex** is one of the world's largest cement producers.
◘ Russia's **Lukoil** has big ambitions in the global energy sector.
◘ In China, **Mobile** dominates the cell phone industry in Asia.

Small and Medium-Sized Enterprises (SME)

■ SME is a company with 500 or fewer employees (in Canada and U.S.).
■ SME has 250 or fewer employees in the EU and elsewhere.
■ Small firms comprise 90 percent to 95 percent of all firms in most economies.
■ Even MNEs started out small.

■ SME's Strategies for Success:

(1) SMEs are more innovative, entrepreneurial, flexible, adaptable, and have quicker response times.
(2) SMEs are less bureaucratic.
(3) SMEs are better able to serve niche markets.
(4) Due to limited financial and human resources, SMEs tend to minimize fixed investments costs and outsource, e.g., FedEx and DHL.

SMEs OVERALL

■ **Exporting**: Primary foreign market entry strategy as FDI is more expensive.
■ **Niche markets**: Target specialized products too small to interest large MNEs.
■ **Success**: Enabled by foreign intermediaries, facilitators, and global logistics specialists such as FedEx and DHL.
■ **Proficiencies**: Information and communication technologies enable SMEs to identify global market niches and efficiently serve specialized buyer needs.
■ International business complexities are considerably more challenging for SMEs than MNEs—requiring specialized knowledge, commitment of resources, and considerable time to develop foreign business partnerships.
■ **SMEs** are gaining equal footing with MNEs in marketing sophisticated products around the world.

■ Born Global Firms

Young, entrepreneurial SMEs that initiate international business close to inception (within 3 years) and are found in both advanced economies, e.g., Australia and Japan, as well as emerging markets such as China and India.
■ Export to 20 or more countries, generating over 25 percent of their sales from abroad.
◘ **Example: Logitech** (www.logitech.com) is a born global firm based in Switzerland specializing in accessories for mobile phones and personal computers, especially mice and keyboards. Within a few years of founding, Logitech expanded it sales to countries around Asia, Europe, and North America.
◘ In its first 5 years, the firm expanded its sales exporting about 70 percent of its total production.
◘ Biggest markets: France, Germany, Italy, Spain, and the Americas, recently opening a subsidiary in North America.
◘ Today Logitech has more than 7,000 employees in some 30 countries.

■ Born Globals Strategies for Success:

(1) Born globals account for a substantial proportion of national exports in countries like Australia, Denmark, Ireland, and U.S.
(2) Born globals offer leading-edge products with strong potential to generate international sales.
(3) They leverage the Internet and digital platforms to facilitate early and efficient international operations.
(4) Born globals' emergence is linked with *international entrepreneurship*, where innovative, smaller firms pursue business opportunities regardless of national borders.
(5) Entrepreneurs are creative, proactive, adaptable, and risk-takers.
(6) Born globals leverage communications and transportation technologies, falling trade barriers, and niche markets to compete globally.

■ The widespread emergence of born globals means that any firm, regardless of size or experience, can succeed in international business.

Governments and Nongovernmental Organizations (NGOs)
■ Governments are central participants in international trade and investment.
■ **State-owned enterprises (SOEs)** account for a substantial portion of economic value added in many countries, even rapidly liberalizing emerging markets such as Russia, China, and Brazil. Governments in advanced economies such as France, Australia, and Sweden have significant ownership of companies in telecommunications, banking, and natural resources.
■ *Nonprofit* international organizations include charitable groups and *nongovernmental organizations* (NGOs).
■ Non-profit organizations serve special causes—education, research, health care, human development, and the natural environment.

■ **Examples** (Nonprofit Organizations):
- ◘ Bill and Melinda Gates Foundation.
- ◘ British Wellcome Trust: Supports health and education.
- ◘ CARE: Dedicated to reducing poverty.

■ **Examples** (MNE-operating charitable foundations):
- ◘ GlaxoSmithKline (GSK): Canada, France, Italy, Romania, Spain and U.S.

ADDITIONAL TOPICS OF CONVERSATION
GSK Global Partnership with Save the Children:
- ● Barretstown, Ireland and L'Envol, France for seriously ill children
- ● Slovakia: Promote healthy eating/exercise for children
- ● Spain: Healthcare for homeless children
- ● Russia: Children with disabilities
- ● Ethiopia: Reduction of preventable children's' diseases
- ● Vietnam: Birthing support

■ IN-CLASS EXERCISE

In small groups, ask students to research GlaxoSmithKline (GSK) and their flagship employee volunteer programs: PULSE and Orange Day. Then research any MNE, SME, or Born Global and the charitable work that they engage in. Finally, ask students for a brief compare/contrast report on the firm of their choice versus GSK. With limited class time, the research portion may be assigned outside of class.

WHY DO FIRMS INTERNATIONALIZE?

Firms internationalize seeking growth and profit opportunities, enhancing their competitive advantage.

■ **Strategic** (**Proactive)** motive: Tap foreign market opportunities and/or acquire new knowledge.

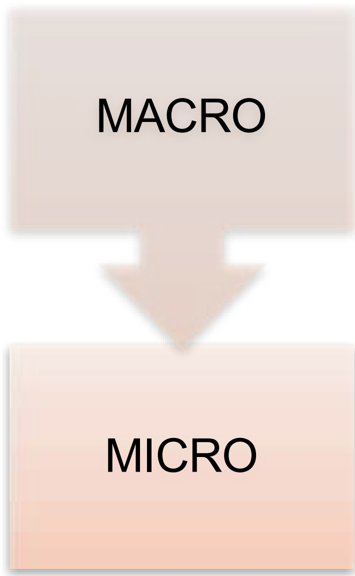
■ **Reactive** motive: Serve a key customer that has expanded abroad.

Nine specific motives:

1. Seek growth opportunities through market diversification.
2. Earn higher margins and profits.
3. Gain new ideas about products, services, and business methods.
4. Serve key customers better that have relocated abroad.
5. Locate closer to supply sources, benefit from global sourcing advantages, or gain flexibility in product sourcing.
6. Gain access to lower-cost or better-value factors of production.
7. Develop economies of scale in sourcing, production, marketing, and R&D.
8. Confront international competitors more effectively or thwart the growth of competition in the home market.
9. Invest in a potentially rewarding relationship with a foreign partner.

WHY STUDY INTERNATIONAL BUSINESS?

This question may be considered from various perspectives: global economy, national economy, the firm, and the manager.



● **Global Economy**
Dimensions in the world that influence all nations.

● **National Economy**
Set of factors that influence all firms competing in a single country.

● **Firm**
Focuses on each company and its competitors.

● **Manager**
Individual variables: Ambiguity tolerance, Interpersonal skills, Self-confidence, Goal commitment, etc.

Facilitator of the Global Economy and Interconnectedness

■ Since the General Agreement on Tariffs and Trade (GATT) (1947), following World War II, international business has transformed the world with unprecedented growth in trade and investment.
■ **1980s**: Political/economic transformations of **Emerging Markets** (some 30 countries) have given new impetus to worldwide economic interconnectedness.
■ Fast-growth developing economies—Brazil, Russia, India, and China [**BRICs**]—have registered substantial market liberalization, privatization, and industrialization, fueling global economic transformation.
■ **Emerging markets**:
- ◘ Located on every continent.
- ◘ Home to the largest proportion of the world population.
- ◘ Increasingly immersed in foreign trade.

■ Facebook: Numerous emerging markets, including China, India, and Poland.

■ **Two MEGATRENDS** underlying the changing business landscape—globalization and technology.
- ◘ **Globalization**: Accelerates the development of the latest technologies.
- ◘ **Technology**: Facilitates globalization to progress more rapidly.

■ The Internet/e-commerce and production/process technologies make international business a viable, cost-efficient, and increasingly imperative mandate for firms of all sizes and resource levels.
■ Technological advances **both** accelerate and are accelerated by globalization.

Contributor to National Economic Well-Being

■ International business promotes economic prosperity through efficient resource allocation, increased consumer options, and world interconnectedness.
■ Governments have increasingly opened their borders to foreign trade and investment.
■ International trade is a pivotal engine for job creation.
◘ It is estimated that every $1 billion increase in exports creates more than 6,000 new jobs.
◘ Cross-border trade directly supports at least 36 million U.S. jobs.
◘ One of every seven dollars of U.S. sales is made abroad.
◘ One of every three U.S. farm acres, and one of every six U.S. jobs, is producing export markets.
◘ On average, exporting firms create jobs faster and provide better pay, than nonexporting firms.

International business is both a CAUSE and a RESULT of increasing national prosperity.

A Competitive Advantage for the Firm

■ To sustain a competitive advantage in the global economy, firms must participate in cross-border business and acquire the necessary skills, knowledge, and competence.
■ **Examples:**
◘ **Procter & Gamble** sells shampoo, disposable diapers, and other consumer products in more than 160 countries.
◘ **MTV** broadcasts its programming in some 180 countries.
◘ **Nestlé** sells its food and beverage products worldwide, obtaining nearly all its revenue from foreign operations.

■ **Global Sourcing**: Firms secure cost-effective factor inputs by establishing manufacturing in emerging markets like Malaysia, Mexico, and Poland, or sourcing from foreign suppliers.
■ **Examples:**
◘ **Microsoft** reduces operational costs by outsourcing software coding to India.
◘ **Renault** gets efficiencies by assembling cars at low-cost factories in Romania.

A Competitive Advantage for You

■ Every day we are affected by a variety of international business transactions.
■ Traveling abroad leads to exciting challenges and learning experiences.
■ Global managers of the world's leading corporations fashioned their managerial skills in international business.
■ The *CKR CAREER PREPARATION KIT* has been specifically designed to integrate and advance students' learning of "CKR Intangible Human Skills" and "CKR Tangible Process Tools" to advance their employability and success in the workplace.

■ In this text, students learn about the merits of gaining international business proficiencies through the experiences of people they can relate to, captured in a special feature called *You Can Do It: Recent Grad in IB*. These graduates describe how they have applied *CKR Intangible Human Skills* and *CKR Tangible Process Tools* in their career development.

An Opportunity to Support Ethics, Sustainability, and Corporate Citizenship

■ With trade barriers declining and global power increasing, environments are increasingly characterized by limited resources, vulnerable human conditions, and stakeholder consciousness.
■ Corporate citizenship dictates that companies consider stakeholders in decision-making and develop sustainable, socially responsible policies and practices.
■ This means employing both economic and social goals; transcending legal requirements by proactively implementing ethical standards.

■ Proactive development and implementation of Corporate Social Responsibility (CSR)
Examples:

- ◘ **Starbucks** will only sell coffee from Rain Forest Alliance certified growers—a nonprofit that promotes the interests of coffee growers and the environment. (www.rainforest-alliance.org),
- ◘ **Philips**, **Unilever**, and **Walmart** follow business practices that promote sustainable development.
- ◘ **McDonald's** purchases beef from farmers certified for animal welfare and environmental standards.
- ◘ **McDonald's** sells only organic milk in Austria, Germany, Sweden, and the United Kingdom.

ADDITIONAL TOPICS OF CONVERSATION

■ Large corporations like **Walmart, Unilever**, and **Sony** have annual revenues larger than the GDPs of many of the nations in which they do business.
■ The globalization of thousands of firms adversely affects the natural environment, e.g., pollution (BP oil spill in the Gulf of Mexico; Royal Dutch Shell's oil refining operations in Nigeria).
■ Large banks and international investment brokers have disrupted the economies of nations with aggressive currency trading or stock markets manipulations, e.g., MNEs abruptly withdrawing invested capital.
■ Human Rights violations: Some MNEs ignore human rights and basic labor standards by establishing factories in countries that pay low wages with substandard working conditions, e.g., Nike in Asia.
■ Building factories abroad often leads to job losses in the home country.
■ National governments and international institutions such as the *World Trade Organization* are working to improve environmental, financial, and labor standards around the world.
■ **CSR is global and strategic**. It must be embedded into global firms at their strategic levels, as well as their processes/practices if international corporate citizenship is to be achieved and sustained. Chapter 4 is devoted to this important topic.

You Can Do It: Recent Grad in IB, Mary Lyles
Jobs held since graduating:

- Buyer and private label project manager, Diaz Foods, Atlanta, USA
- Sourcing analyst, Starbucks, Rancho Cucamonga, California, USA
- Senior sourcing analyst, Starbucks, Seattle, USA
- Global Sourcing Manager, Pier 1 Imports, Fort Worth, Texas, USA
- Senior Sourcing Manager, Target Corporation, remote and Minneapolis, USA

■ Mary's international experience was an impressive asset to prospective employers in U.S.
■ Success factors in working internationally were networking and setting clear goals.
■ Challenges include cultural differences, language gaps, and time changes. She continues to advocate for diversity, equity, and inclusion, workplace wellness, and the prevention of drowning.

Mary's Advice for an International Career
■ Be strategic and patient
■ Be true to yourself

CKR Career Preparation Kit: Tangible Process Tools and Travel Abroad Preparation Checklist
Learn the CKR Intangible Human Skills™ and the CKR Tangible Process Tools™ to advance students' employability and success in the workplace.

Traveling internationally requires thorough, early preparation and entails numerous requirements not needed for domestic travel.
■ Check: Passport expiration, visa requirements, proof of trip requirements and hotel reservations.
■ Comply with country requirements—security, safety, and health care requirements, e.g., COVID-19 guidelines.
■ Check: Currency exchange rates, electricity standards, plug adapters/converters, mobile phone options.
■ Notify your bank and credit card companies of your anticipated transactions abroad.
■ If you will be driving, get an International Driving Permit (IDP) prior to departure.
■ Do not advertise your trip on social media—no need to let the world know that you are not home.
■ Be culturally literate and aware.
■ Consult the Pearson MyLab Management at: www.pearson.com/mylab/management for a link to the *CKR: TRAVEL ABROAD PREPARATION CHECKLIST* ©, a list of these details prior to traveling outside your home country.

IV. CLOSING CASE
INTERNATIONALIZATION AT HARLEY-DAVIDSON

- **Summary [Identifying key issues]**

■ The fundamental concepts introduced in Chapter 1 are central to both macro (Chapters 1–8) and micro (chapters 9–17) perspectives for understanding international business. In this introductory chapter, the Harley-Davidson case illustrates why firms pursue international strategies and how international and domestic businesses differ. With maturing key markets in North America, Europe, and Japan, coupled with falling trade barriers, growing consumer affluence and flourishing capitalism in emerging markets, the only major U.S. manufacturer of heavyweight motorcycles must expand globally to survive.

The following Learning Objectives are emphasized:
[1.1] Learn the key concepts in international business.
[1.2] Understand how international business differs from domestic business.
[1.4] Describe why firms internationalize.

OVERVIEW

■ From a shed with *Harley Davidson Motor Company* scrawled across it in 1903, four men —William Harley and the Davidson brothers, Walter, William, and Arthur—produced the first Harley Davidson motorcycle.
■ Today, Harley-Davidson (HOG) offers Harley models through a global network of nearly 1,400 dealers, with global motorcycle revenue about $5 billion in 2022, continuing a multi-year downward trend since 2014.
■ Harley earns about two-thirds of its total sales in U.S., where it manufactures most of its bikes to ensure quality control.
■ The CEO announced a bold goal to grow international sales to 50 percent of annual volume by 2027.

FOUR KEY SEGMENTS IN THE MOTORCYCLE INDUSTRY

[1] Standard: Practical bikes used for low-cost commuting
[2] Performance: Sleek, sport-style racing bikes built for speed and easy handling
[3] Custom: Stylized bikes customized to customer tastes
[4] Touring: Long-distance, large-capacity, comfort bikes that typically include cruise control, stereos, and luggage racks

■ In U.S., Harley competes primarily in the custom and touring segments, which account for about 85 percent of heavyweight sales.

HARLEY-DAVIDSON MODELS

- **Adventure Touring (7):** Where touring becomes detouring, and everything is a road.
- **Cruiser (27):** Power, style—around town or along country roads.
- **Grand American Touring (58):** Go the wide-open, distance, in style.
- **Sport (10):** Bikes built for carving mountain roads, and blasting through city streets.

- **Trike (14):** Roll with confidence, comfort, and head-turning custom style on 3-wheels.

COMPETITORS

■ Competitors are headquartered outside U.S.:
  - ◘ **Japan**: Honda, Suzuki, Yamaha, and Kawasaki.
  - ◘ **Europe**: BMW, Ducati, and Triumph.
  - ◘ **China**: Emergence of new competitors.

ICONIC BRANDING

■ **Harley Owners Group** (HOG): One key to Harley's success is the club of loyal Harley owners with over one million members, including 100,000 in Europe.
■ HOG is a key marketing tool. In U.S. brand loyalty is fierce, and **switching costs** for Harley owners are high.
■ The mystique associated with its heavyweight bikes drives sales and a culture of Harley tattoos.
■ Harley heavyweight bikes price at $20,000 or more.
■ 50 is the average age of a Harley owner in U.S.

THREAT OF FOREIGN COMPETITORS AND REVIVAL

■ By the 1980s, Honda, Kawasaki, Suzuki, and Yamaha were selling millions of motorcycles in U.S. and specializing in inexpensive, lightweight models.
■ **Myopic**: Harley paid little attention to the competition, focusing on heavyweight bikes, while the market for lightweights continued to grow.
■ **Bankrupt almost**: Major problems with the quality of Harley bikes, poor productivity, image suffered, and sales declined sharply.
■ New CEO adopted Japanese-style management techniques: updated manufacturing methods, improved quality, expanded model offerings, instituted just-in-time inventory systems and total quality management, and empowered production workers.
■ Management increased marketing efforts, improved the dealer network, and undertook various cross-branding ventures.
■ **Repositioned** by mid-1990s, Harley excelled in the performance motorcycle market, dramatically improving the company's image and sales.
■ Global financial crisis and ensuing recession—shipments peaked in 2006 and flattened/declined in 2008 and had not recovered by 2018.

INTERNATIONAL EXPANSION

■ Global markets demonstrate significant growth opportunities.
■ **Japan**: Distribution network and local subsidiary by 2016, annually selling more than 16,000 motorcycles there. Heavyweight motorcycles went for more than $20,000, more than Honda's standard lightweight model.
■ Foreign sales growing, e.g., European sales grew 8 percent annually from 2013 to 2018.
■ Europe, Middle East, and Africa comprise Harley's key regions.
■ COVID-19: **European sales** slumped and have continued to struggle.
■ Tariffs on motorcycle imports into Europe have been high, reaching about 30 percent in 2018, fluctuating in recent years.

Europe	U.S.
■ Vast, fragmented marketplace with diverse needs and tastes. ■ Functional rather than recreational focus. ■ **Performance bikes** dominate—accounting for more than 1/3 of Harley sales, then come Touring, Standard, and Custom bikes. ■ Freeways in Europe have high speed limits that necessitate high-performance bikes. ■ Distinctive tastes, often differing by region. Some buyers prefer Italian styling, which is dominated by Ducati. Others prefer the German styling of BMW. ■ Most Europeans do not relate to Harley's U.S. image of rugged individualism, freedom, and rebellion, and its big bikes are difficult to maneuver in narrow streets and impractical for daily commuting. ■ To enhance its European presence, Harley launched an overseas branch of the **HOG club**. ■ In **2008**, Harley bought the Italian motorcycle firm MV Agusta Group for $109 million. However, economic conditions forced Harley to divest its interest in Agusta in **2010**.	■ Harley competes primarily in the **custom** and **touring** segments accounting for 1/2 and 1/3 of U.S. sales, respectively, which is 85 percent of the total heavyweight market.

■ Emerging markets such as **Brazil**, **China**, **India**, and **Russia** have large populations, rapidly growing middle classes, and increased disposable incomes.

EMERGING MARKETS
■ **Brazil**: Harley's largest potential market in Latin America, yet is fraught with barriers. ■ To address the high import tariffs, Harley established an assembly plant in Brazil. ■ Harley opened a plant in Manaus and expanded its network to 12 dealerships. ■ Local assembly avoids import barriers and reduces costs due to the availability of low-cost workers. ■ Harley has captured a fifth of the motorcycle market in Brazil. ■ Strategy: Attract younger buyers, especially women who make up 1/4 of Brazil's motorcyclist market.

CHINA
■ Home to 1.4 billion people, many of whom ride small motorcycles, thus central to Harley's internationalization strategy. ■ Income levels are growing rapidly, although average wages are low. ■ Riders prefer small motorcycles. ■ Harley also must overcome the perception that motorcycles are only for

commuting; management wants to develop the market for leisure riding too. ■ To reduce noise and drive-by thefts, motorcycles are restricted in some areas. ■ Harley is concerned about piracy. Chinese entrepreneurs are known for counterfeiting and other intellectual property violations.

INDIA
■ Millions of households have annual incomes over $80,000. ■ Honda, Yamaha, and Kawasaki all have a strong presence. ■ Harley established a subsidiary near Delhi, but market entry has been challenging due to fierce competition, high trade barriers, and local emissions regulations. ■ Accounts for only 2 percent of Harley sales.

ASIA-PACIFIC REGION
■ By 2023, Harley had opened numerous new dealerships in South Korea, Thailand, and Russia with dealer network expansion plans, focusing on China, India, and Malaysia. ■ Tariffs on motorcycles are high in the Asia-Pacific region. China and Malaysia have maintained a **30 percent** tariff on motorcycles, while Thailand's tariff is **60 percent**. ■ In 2018, Harley developed a factory in Thailand to serve the Southeast Asia market and avoid Thailand's high tariffs.

JAPAN
■ Harley holds a roughly 4 percent market share in Japan, but the economy is stagnant, and disposable incomes have declined.

AUSTRALIA
■ With a population of 25 million people, this market is somewhat limited.

ENVIRONMENTAL SUSTAINABILITY

■ **Pollution:** Motorcycles pollute the natural environment.
■ Regulatory sanctions affect Harley because it manufactures very large bikes.
■ **Integrated sustainability strategy**: Harley's greenhouse gas (GHG) emissions emanate from its manufacturing plants, thus, pollution reduction and energy/water conservation initiatives, as well as a recycling program have been implemented.
■ **Climate change**: Transitioning to a lower-carbon economy.
■ California and Taiwan have recently imposed rigorous, new GHG motorcycle standards; Japan and various European countries are developing similar standards aimed at GHG reduction; Harley is proactively staying ahead of evolving regulations, e.g., in **Japan**, they launched a motorcycle recycling program.
■ In 2016, Harley paid a $12 million fine for sales of after-market devices that increase air pollution from motorcycles.

■ Harley is developing an electric motorcycle and other environmental friendly products.
■ As regulations continue to evolve, Harley's sustainability initiatives appeal to governments in China, Europe, India, and elsewhere around the world.
■ In 2019, Harley launched its first **electric motorcycle** model but sales have been sluggish.

THE FUTURE

■ Global recession and COVID-19 hurt Harley as discretionary income fell around the world.
■ **Positioning**: Given declining global demand, how best to position Harley?
■ Management sees **emerging markets** as key to future growth.

■ Key to sustainable growth is global expansion, driven by:
[1] Heightened focus on foreign markets
[2] Appeal to lighter-weight, performance-based international markets
[3] Improved and larger dealer networks
[4] Geographic expansion
[5] Strategic control of distribution

■ Global markets demonstrate significant growth opportunities, while the domestic motorcycle industry is increasingly saturated.
■ Through enhanced distribution networks and a *multidomestic* international strategy that underscores local market preferences, Harley delivers culturally responsive experiences from Spain to Singapore.
■ Revenue stream diversification reduces risk. To reduce its dependence on U.S. sales, Harley strives to increase its international business, targeting an ideal sales mix of 60 percent U.S. and 40 percent international.
■ Harley also needs to balance production and sales for domestic and international markets.
■ The strategy to achieve this goal must be formulated and implemented.
■ In a *VUCA* world characterized by volatility, uncertainty, complexity, and ambiguity, Harley must be proactive in predicting and leveraging trends and disruptions affecting the global business landscape.

CASE UPDATE:
Ask students to update the strategic and financial aspects of this case.

Financials from the 2022 Harley-Davidson Corporate Report:
https://investor.harley-davidson.com/resources/motorcycle-retail-sales/default.aspx

Motorcycle Retail Sales

HARLEY-DAVIDSON MOTORCYCLE RETAIL SALES 2018-2022[1]

	2022[4]	2021	2020	2019	2018
United States	109,190	126,276	103,650	125,960	132,868
Canada	7,924	8,137	6,477	8,946	9,690
Total North America	117,114	134,413	110,127	134,906	142,558
EMEA[2]	30,510	31,101	36,906	44,086	46,602
Asia Pacific[3]	27,905	25,090	27,220	29,513	28,724
Latin America	2,922	3,652	5,995	9,768	10,167
Total Worldwide Retail Sales	178,451	194,256	180,248	218,273	228,051

(1) Data source for retail sales figures shown above is new sales warranty and registration information provided by Harley-Davidson dealers and compiled by the Company. The Company must rely on information that its dealers supply concerning new retail sales, and the Company does not regularly verify the information that its dealers supply. This information is subject to revision.
(2) Europe data includes Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.
(3) Asia Pacific data includes Japan, Australia, New Zealand, Korea, China, India, and Other Asian markets.
(4) Data for 2022 excludes Livewire units.

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● SUGGESTED SOLUTIONS TO CASE QUESTIONS

1-4. Describe the international business environments Harley faces. What types of risk does Harley face?

■ Domestic and international environment: complex and risky
■ All FOUR types of risks in international business are present:

Commercial Risk

With Harley's global expansion, the following acquisition / joint venture / innovation strategies would be subject to commercial risk:

■ China: Three Harley dealerships.
■ In a 2006 vertical acquisition, Harley acquired Castalloy, its Australian wheel and hub supplier.

■ In 2008, HOG acquired MV Augusta (Cagiva brand), a premier Italian sport motorcycle producer, which provided a gateway to the European motorcycle market and accelerated Harley's exposure to younger buyers.
■ International/Domestic Business Risk: Changing Emission Standards
Climate change concerns will lead to tailpipe emission limits, which will eventually require product design strategies to meet the new regulatory requirements.
■ Market Penetration
As most of Harley's core baby-boomer market is currently 44-62 years old, their peak riding years may be behind them.
■ Poor formulation/implementation in terms of partnering selections, market entry timing, pricing, product features, and promotional themes result in commercial risk.
■ Failures in international markets are far more costly than domestic business blunders.

Cross-cultural Risk
Harley-Davidson Motor Company and Buell Motorcycle Company collectively operate eight production/assembly facilities in U.S., Brazil, and Australia, with a global network of nearly 1,500 dealers. Key markets are in North America, Europe, and Japan. The first Beijing Harley dealership was established in 2006. Growth Markets: Canada, Japan, Australia, Latin America (Brazil—Largest Market).
■ Translation of HOG Mystique
Considering the cross-cultural risk category, one of Harley's global challenges is their American icon branding, which may also represent the negative side of globalization. A negative image emerged during the 1950s to 1970s, that of Hells Angels or outlaw motorcyclists, as captured by some Hollywood films. Does the HOG brand translate internationally?
■ Differences in language, lifestyles, mindsets, customs, and religion of a national culture.
■ Cultural blunders can hinder effectiveness of managers in working with foreign business partners.
■ Language is a critical dimension of culture and a window to people's values and living conditions.
■ Language differences may impede effective communication and result in misunderstandings.
■ Cultural differences may lead to inappropriate business strategies and ineffective customer relations.

Country Risk (also known as *political risk)*
■ **Chinese Market**: With the opening of its third dealership in China during 2008, Harley faces a large and potentially risky market.
■ Differences in host countries political, legal, and economic regimes may adversely affect firm profitability.
■ Also, laws, regulations, and indigenous factors, e.g., property rights, intellectual-property protection, product liability, taxation policies, inflation, national debt, and unbalanced international trade may encumber firm operations and performance.
■ Government intervention: Restricts market access, imposes bureaucratic procedures hindering business transactions, and limits the amount of earned income that firms may repatriate from foreign operations.

■ Economic freedom differs among nations. Hong Kong, Singapore, and Ireland are known as having the highest levels of economic freedom, see http://www.heritage.org.

Currency or Financial Risk

■ **International Risk from Global Economic Contagion**

The severity of the world economic recession has significantly affected discretionary purchases. This is exacerbated by a maturing industry which has resulted in a deceleration of domestic Harley sales.

■ **Harley-Davidson Financial Services [HDFS]: Interest Rate/Credit Exposure**

Access to capital markets is becoming increasingly challenging as U.S. economy faces major revitalization efforts in domestic capital markets, with anticipated global ripple effects.

■ **Strong U.S. Dollar**

In 2008, 33.2 percent of Harley's revenue was international in origin. Unlike 2008, which witnessed a 1.7 percent and 2.6 percent favorable impact on sales and operating profit, respectively, 2009 is expected to witness a 1.6 percent and 2.4 percent negative impact, due to a strengthening dollar.

■ Risk of adverse exchange rate fluctuations, inflation, and other harmful economic conditions create uncertainty of returns.

■ When currencies fluctuate significantly, the value of the firm's assets, liabilities, and/or operating income may be substantially reduced.

1-5. How does Harley benefit from expanding abroad? What types of advantages can the firm obtain? What advantages acquired abroad can help Harley improve its performance in its home market?

(LO 1.4; AACSB: Analytical thinking)

■ Harley has reduced its costs of R&D, manufacturing, and service by sourcing plants and other operations in lower-cost locations such as Brazil and closer to target markets, in order to minimize distribution costs, e.g., Australia.

■ Harley could be the exemplar of how internationalization revives declining sales and optimizes cost structures, by developing international value chains that minimize expenses, leading to higher profits.

■ The key to Harley's sustainable growth is global expansion.

1-6. How can Harley effectively compete with rivals from Japan and Europe? What strategies should management apply to grow the firm's sales in those regions?

(LO 1.1; AACSB: Application of knowledge)

■ The Harley icon is a powerful weapon. Advertising strategy should underscore its powerful global branding, yet employ local personnel. A combination of centralized marketing coupled with decentralized human capital will enable Harley to leverage its global core competencies while capitalizing on local market expertise and networks.

■ Harley can leverage global efficiencies in terms of technology, production, and distribution. However, tailoring motorcycle preferences to local markets is also paramount.
■ The European market is fragmented due to country differences and the diversity of European preferences. This is coupled with the narrow European streets and high speed limits, and a functional rather than recreational focus, as one would expect, there is a greater demand for the standard and performance of motorcycle segments in Europe.
■ International expansion into Asia could be hindered by strict emissions standards, high tariffs, and cheaper Asian reproductions of the Harley brand.
■ However, if Harley were to collaborate with a Japanese partner, this mode of entry would enable market knowledge and branding economies with that partner. Additionally, Harley's organic structure of three interlocking circles—(1) Create Demand Circle, (2) Produce Products Circle and a (3) Support Circle with the Leadership/Strategy Council in the center—would fit well with the Japanese culture than a more traditional structure.
■ This industry demands an integrated approach—global yet with a local/regional focus.

1-7. Competitors such as Lifan and Zongshen are beginning to emerge from China, where they enjoy competitive advantages like low-cost labor and extensive experience with emerging markets. How can Harley compete against such firms? Should Harley more aggressively pursue emerging markets such as Brazil, China, and India? If so, what strategies will help them succeed in those markets?
(LO 1.1; AACSB: Diverse and multicultural work environments)

■ Global incumbents must leverage their advantages in terms of global efficiencies in order to compete with global challengers indigenous to emerging, host markets.
■ After China joined the World Trade Organization in 2001, import restrictions, quotas, and tariffs dropped substantially against foreign motorcycle manufacturers.
■ Partnering through strategic alliances affords immense networking opportunities and market expertise otherwise unavailable to a new entrant.
■ Competing with Lifan and Zongshen, China's emerging competitors, presents both challenges and opportunities. Harley may take the offensive and compete even more aggressively in competitors' domestic markets and/or implement a more defensive strategy in their own home market. Either way, innovation and market research will be cardinal.
■ Promote and leverage the HOG experience so that it clearly translates internationally, and in fact turns into a global competitive advantage.
■ An interesting assignment for students would be to divide the class into small groups and assign a Harley Chinese competitor to each group. Each group should briefly research the competitor in terms of strategy, international markets, market share in China, and any other interesting facts. This can be done during class as most students will attend class with their laptops. Use websites such as globaledge.msu.edu and Hoover's database to report their findings.

Should Harley more aggressively pursue emerging markets such as Brazil, China, and India? If so, what strategies will help Harley succeed in those markets?

■ One of the fundamental reasons for pursuing international markets is to rejuvenate the product life-cycle (Vernon). Other reasons include (1) seeking growth opportunities through market diversification; (2) earning higher profits; (3) capitalizing on new products, services, and business models; (4) leveraging global sourcing advantages; (5) accessing lower-cost or better-value production factors; (6) developing production or marketing economies of scale; (7) thwarting foreign competition; and (8) investing in foreign strategic alliances/foreign direct investment. Considering these reasons for economic expansion, coupled with maturing markets in developed countries, emerging markets provide growth opportunities for the motorcycle industry, among others. Pursuing emerging markets such as Brazil, China, and India make perfect sense, especially if Harley were to source production to these low-cost locations. Foreign direct investment through production initiatives would be an investment in the community, resulting in job creation and thus sending an important message to stakeholders.

1-8. Evaluate Harley's environmental sustainability initiatives in the evolving regulatory environment on global greenhouse gas. What advantages does Harley gain by attempting to produce environmentally safe and sustainable products?
(LO 1.3; AACSB: Application of knowledge)

■ Like automobiles, motorcycles pollute the natural environment, and Harley is vulnerable to regulatory sanctions because it manufactures very large bikes.
■ Most of Harley's greenhouse gas (GHG) emissions emanate from its manufacturing plants, and management is moving to reduce pollution, as well as energy and water usage, as part of an integrated sustainability strategy.
■ HOG is also addressing climate change by preparing for the transition to a lower-carbon economy.
■ California and Taiwan have recently imposed rigorous new GHG standards on motorcycles.
■ Japan and various European countries are developing similar new standards aimed at GHG reduction.
■ Harley is attempting to stay ahead of evolving regulations. In 2005, they launched a motorcycle recycling program in Japan.
■ In 2019, Harley launched its first **electric motorcycle** model but sales have been sluggish.

■ These actions, and its recycling program, help align Harley's actions with stakeholder expectations and strengthen their brand, which is in fact builds Harley's competitive advantage.

Acknowledgements: With many thanks to **Casey Long**, Business Liaison Librarian at Georgia State University for her proficiency and research assistance.

V. END OF CHAPTER QUESTIONS

●TEST YOUR COMPREHENSION

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1-9. Distinguish between international business and globalization of markets.
(LO 1.2; AACSB: Analytical thinking)

■ International business represents the performance of trade and investment activities by firms across national borders. It is specifically a company-level phenomenon.
■ By contrast, the globalization of markets refers to ongoing economic integration and growing interdependency of countries worldwide. It is a country-level phenomenon.
■ In a sense, both international business and globalization refer to internationalization—the tendency of business and economic activity to be performed increasingly across national borders, or to be integrated across national borders. However, international business is a firm-level phenomenon, while globalization is a country or world-level phenomenon. To a large extent, it is the international business activities of countless firms that are driving the globalization of markets.

1-10. What is the difference between exporting and foreign direct investment?
(LO 1.1; AACSB: Application of knowledge)

■ Level of commitment.
■ *Exporting* is the sale of products/services to customers located abroad.
■ *Foreign direct investment* (typically long-term) gives investors partial or full ownership of a company or productive assets such as capital, technology, labor, land, plant, and equipment.

1-11. What makes international business different from domestic business?
(LO 1.2; AACSB: Application of knowledge)

International firms are constantly exposed to four major categories of risk that must be managed. Cross-cultural risk refers to a situation or event when some human value has been put at stake due to a cultural misunderstanding. Country risk refers to the potentially adverse effects on company operations and profitability caused by developments in the political, legal, and economic environment in a foreign country. Currency risk refers to the risk of adverse fluctuations in exchange rates. Commercial risk arises from the possibility of a firm's loss or failure from poorly developed or executed business strategies, tactics, or procedures. The risks are ever-present in international business, and firms take proactive steps to reduce their effects.

1-12. What types of risks do firms face when they conduct international business?
(LO 1.2; AACSB: Reflective thinking)

Commercial risk

■ Less than optimal formulation and/or implementation of strategies, tactics, or procedures, e.g., partnering selections, market entry timing, pricing, product features, and promotional themes.
■ Failures in international markets are far more costly than domestic business blunders.

Cross-cultural risk
■ Differences in language, lifestyles, attitudes, customs, and religion, where a cultural miscommunication jeopardizes a culturally valued mindset or behavior.
■ Cultural blunders: Hinder the effectiveness of foreign managers.
■ Language: Critical dimension of culture and a window to people's values.
■ Language differences impede effective communication.
■ Cultural differences may lead to suboptimal business strategies.

Country risk (also known as political risk)
■ Differences in host country's political, legal, and economic regimes may adversely affect firm profitability.
■ Also, laws, regulations and indigenous factors, e.g., property rights, intellectual-property protection, product liability, taxation policies, inflation, national debt, and unbalanced international trade may encumber firm operations and performance.
■ Government intervention: Restricts market access, imposes bureaucratic procedures hindering business transactions, and limits the amount of earned income that firms may repatriate from foreign operations.
■ Economic freedom differs among nations. Hong Kong, Singapore, and Ireland are known as having the highest levels of economic freedom, see http://www.heritage.org.

Currency or financial risk
■ Risk of adverse exchange rate fluctuations, inflation, and other harmful economic conditions create uncertainty of returns.
■ When currencies fluctuate significantly, the value of the firm's assets, liabilities, and/or operating income may be substantially reduced.

Risks: Always present but manageable
■ The four types of risks in international business are omnipresent.

1-13. Who are the major participants in international business?
(LO 1.3; AACSB: Application of knowledge)

A key participant in international business is the multinational enterprise (MNE), a large company with many resources whose business activities are performed by a network of subsidiaries located in multiple countries. Also active in international business are small- and medium-sized enterprises (SMEs), companies with 500 or fewer employees. Born global firms are entrepreneurial firms that initiate international business from or near their founding. Nongovernmental organizations (NGOs) are nonprofit organizations that pursue special causes and serve as an advocate for the arts, education, politics, religion, and research.

WHO PARTICIPATES IN INTERNATIONAL BUSINESS? (Four categories)

[1] *Focal firm*: The initiator of an international business transaction, which conceives, designs, and produces offerings intended for consumption by customers worldwide. Focal firms are primarily MNEs and SMEs.

[2] *Distribution channel intermediary*: A specialist firm that provides various logistics and marketing services for focal firms as part of international supply chains, both in the home country and abroad.

[3] *Facilitator*: A firm or an individual with special expertise in banking, legal advice, customs clearance, or related support services that assists focal firms in the performance of international business transactions.

■ **Freight forwarder:** A specialized logistics service provider that arranges international shipping on behalf of exporting firms.

[4] *Governments*: (public sector) act as suppliers, buyers, and regulators.

◘ **Russia, China, and Brazil:** State-owned enterprises account for a substantial portion of economic value added, even in these rapidly liberalizing emerging markets.

◘ **France, Australia, and Sweden**: Governments in these advanced economies have significant ownership of companies in telecommunications, banking, and natural resources.

◘ The recent global financial crisis led governments to step up their involvement in business, especially as regulators.

1-14. What is the difference between a multinational enterprise (MNE) and a small and medium-sized enterprise (SME)?

(LO 1.3; AACSB: Application of knowledge)

Multinational Enterprise (MNE):

■ Multinational enterprise is the most important type of focal firm; add value in multiple countries, through a network of subsidiaries, leveraging manufacturing, R&D, procurement, and marketing activities to yield the most economic sense.

■ In addition to a home office, an MNE owns a worldwide network of subsidiaries.

■ **Exhibit 1.9** provides a geographic distribution of the world's leading MNEs. The size of each circle represents total MNE revenues per country.

***Small and Medium-sized Enterprise (SME)*:**

■ SME is a company with 500 or fewer employees.

■ Small firms comprise 90 percent to 95 percent of all firms in most economies.

■ Increasingly, more SMEs participate in exporting, licensing, and global sourcing.

■ Small firms:

◘ Are the drivers for innovation.

◘ Account for one-third of exports from Asia; a quarter of the exports from the affluent countries in Europe and North America.

◘ Contribute more than 50 percent of total national exports in Italy, South Korea, and China.

■ ***Born-global firms***: Young, entrepreneurial SMEs that initiate international business from inception and are found in both advanced economies as well as emerging markets such as China and India.

■ International business complexities are considerably more challenging for SMEs than MNEs.

■ SME strategies for success:

(1) SMEs are often more innovative, adaptable, and have quicker.

(2) SMEs are better able to serve niche markets.

(3) Smaller firms can better leverage the Internet.

(4) Due to limited resources, SMEs tend to minimize fixed costs and outsource.

(5) Smaller firms tend to flourish on private knowledge that they cultivate through their knowledge networks and international social capital.

1-15. What are some of the key motivations for firms to engage in international business?

(LO 1.4; AACSB: Reflective thinking)

Firms internationalize seeking growth and profit opportunities to enhance competitive advantage. Specifically:

A. Increase sales by seeking new markets and market diversification.

B. Earn higher margins and profits.

C. Better serve key markets or customers who have relocated abroad.

D. Get access to lower-cost or better-value factors of production.

E. Locate closer to supply sources, benefit from global sourcing advantages, or gain flexibility in the sourcing of products.

F. Develop economies of scale in production, marketing, and other activities.

G. Confront global competitors more effectively and/or thwart the growth of domestic competition.

H. Invest in a potentially rewarding relationship with a foreign partner.

I. Gain new ideas about products, services, and business approaches.

1-16. Why should you care about international business?

(LO 1.5; AACSB: Reflective thinking)

A Competitive Advantage

■ We are touched everyday by a variety of global business transactions.

■ Consider a career in international business because of its importance and growing role in the world.

■ Working across national cultures exposes managers to a range of enlightening experiences, new knowledge, novel ways of seeing the world, and unusual challenges.

■ Managers with extensive international experience are more self-confident, cosmopolitan, and have positioned themselves for unique professional development opportunities.

● APPLY YOUR UNDERSTANDING

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1-17. Richard Bendix is the marketing manager at a firm that makes and sells high-quality prefabricated houses. He believes there is little difference between his home-country market and foreign markets, and that he can use the same methods for selling in Asia or Latin America as he does in his home country. Write a memo in which you explain to Richard the differences between domestic and international business. Explain the risks and other differences that Richard's firm will likely encounter if it expands abroad.
(LO 1.2; AACSB: Analytical thinking)

TO: Richard
FROM: Myself
DATE: 07/07/24
RE: International versus Domestic Business: Differences, Opportunities and Threats

Differences:
■ Complexity: Environmental forces differ from country to country—economic conditions, political systems, laws and regulations, and national culture—vary according to nation.
■ Risk: Each of these factors introduces an element of risk for the firm.

Opportunities: Internationalization affords certain opportunities that are unavailable to domestic businesses, which may lead to competitive advantages and superior performance:
■ Maximizing returns
■ Attaining global scale economies
■ Resource acquisition ease and cost
■ Enhanced competitiveness
■ Knowledge transfer
At the same time, threats are also more pronounced:

Threats:
Complexity and risk.
Complexity is due to the interrelatedness and layering of numerous political, social, and economic systems.
Risk consists of the four types of omnipresent risks in international business:
■ Cross-cultural risk
■ Country risk
■ Currency or financial risk
■ Commercial risk

1-18. Suppose that after graduation you get a job with Cottonwood Corporation, a small firm that does business only in its domestic market. You have just completed coursework in international business, are aware of various business opportunities abroad, and believe that Cottonwood should internationalize. Write a memo to your boss in which you explain why your company should pursue international business. What are the benefits to Cottonwood of venturing abroad? Explain why firms internationalize.
(LO 1.4; AACSB: Analytical thinking)

Your memo should include:
Cottonwood Corporation should internationalize to expand growth and profit opportunities in order to build competitive advantage. Specifically:
A. Increase sales by seeking new markets and market diversification.
B. Earn higher margins and profits.
C. Better serve key markets or customers who have relocated abroad.
D. Get access to lower-cost or better-value factors of production.
E. Locate closer to supply sources, benefit from global sourcing advantages, or gain flexibility in the sourcing of products.
F. Develop economies of scale in production, marketing, and other activities.
G. Confront global competitors more effectively and/or thwart the growth of domestic competition.
H. Invest in a potentially rewarding relationship with a foreign partner.
I. Gain new ideas about products, services, and business approaches.

Due diligence mandates that a risk assessment also be conducted. Risk consists of the four types of omnipresent risks in international business:
■ Commercial risk
■ Cross-cultural risk
■ Country risk
■ Currency or financial risk

1-19. You have become the president of the International Business Club at your school. You are trying to recruit new members and find that many students do not recognize the importance of international business or the career opportunities available to them. You decide to give a presentation on this theme. Prepare an outline of a presentation in which you explain what types of companies participate in international business, why students should study international business, and what career opportunities they might find.
(LO 1.5; AACSB: Analytical thinking)

Your presentation should include:
Who Participates in International Business?
■ *Focal firm*: Firms that initiate and implement international business activities.
■ *Distribution channel intermediary* [Chapter 3]: Distributors and retailers that provide distribution services in international markets.

■ *Facilitator or support firm* [Chapter 3]: Freight forwarders and banks that assist the focal firms with specialized needs.

Multinational Enterprise (MNE)
■ Multinational enterprise is the most important type of focal firm; add value in multiple countries, through a network of subsidiaries, leveraging manufacturing, R&D, procurement, and marketing activities to yield the most economic sense.
■ In addition to a home office, an MNE owns a worldwide network of subsidiaries.
■ **Exhibit 1.9** provides a geographic distribution of the world's leading MNEs.

Small and Medium-sized Enterprise (SME)
■ SME is a company with 500 or fewer employees.
■ Small firms comprise 90 percent to 95 percent of all firms in most economies.
■ Increasingly, more SMEs participate in exporting, licensing, and global sourcing.
■ Small firms:
◘ Are the drivers for innovation.
◘ Account for one-third of exports from Asia; a quarter of the exports from the affluent countries in Europe and North America
◘ Contribute more than 50 percent of total national exports in Italy, South Korea, and China.
■ *Born-global firms*: Young, entrepreneurial SMEs that initiate international business from inception and are found in both advanced economies as well as emerging markets such as China and India.
■ International business complexities are considerably more challenging for SMEs than MNEs.
■ SME Strategies for success:
(1) SMEs are often more innovative, adaptable, and have quicker.
(2) SMEs are better able to serve niche markets.
(3) Smaller firms can better leverage the Internet.
(4) Due to limited resources, SMEs tend to minimize fixed costs and outsource.
(5) Smaller firms tend to flourish on private knowledge that they cultivate through their knowledge networks and international social capital.

Why Study International Business?
A Competitive Advantage
■ The role of international business grows in importance and impact, daily.
■ Cross-national experiences expose managers to diversity, new knowledge, novel ways of seeing the world, and unusual challenges.
■ Managers with extensive international experience are typically more self-confident, cosmopolitan, are positioned for unique professional development opportunities, and essentially have a competitive advantage over others.

● GlobalEDGE™ INTERNET EXERCISES http://globaledge.msu.edu

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1-20. You can gain valuable insights into international business by examining how countries compare to each other. Various research groups and international agencies systematically examine economic, political, and other features of nations. Visit globalEDGE™ Tools and Data, scroll down and click Interactive Rankings. Select Countries. You will find dozens of criteria ranking countries based on GDP per capita; Education—literacy rate; People—population total; People—population density; Health—mortality rate; Energy—electricity production; Infrastructure—mobile cellular subscriptions; Infrastructure—roads, total network; Trade and Investment—foreign direct investment net inflows; and many other factors. Choose the ranking criteria that interest you most and then examine the following three countries: Germany, India, and South Africa. Based on your analysis, explain why they rank where they do. Do their relative positions make sense to you? Does each country seem like a good place to do business? Why or why not? *Hint:* Evaluate countries on a per-capita basis by dividing each criterion by the country's population.
(LO 1.4; AACSB: Analytical thinking)

The question can be answered in various ways. A hypothetical answer is given below, using country rankings based on data from the CIA World Factbook. Germany, India, and South Africa are compared based on the following:

Previous data:

Country	GDP (ppp) US$ million	GDP real growth rate (%)	GDP per capita (ppp) US$/person	Industrial production growth rate	Inflation rate (%)
Germany	3,058,600	3.7	37,400	8.0	1.1
India	4,421,000	6.8	3,700	4.8	8.9
South Africa	528,200	2.8	10,500	2.5	4.3

Current data:

Country	GDP (ppp) US$ million	GDP real growth rate (%)	GDP per capita (ppp) US$/person	Industrial production growth rate	Inflation rate (%)
Germany	4,424,000	2.63	53,200	3.61	3.14

India	9,279,000	8.68	6,600	10.27	5.13
South Africa	790,625	4.91	13,300	6.12	4.61

■ India and South Africa are emerging markets. Germany is an advanced economy.

For current data, **Germany** is ranked:

- Second in GDP
- Last in GDP real growth rate
- First in GDP per capita
- Last in industrial production growth rate
- Lowest on inflation

For current data, **India** is ranked:

- First in GDP
- First in GDP real growth rate
- Last in GDP per capita
- First in industrial production growth rate
- Highest on inflation

For current data, **South Africa** is ranked:

- Last in GDP
- Second in GDP real growth rate
- Second in GDP per capita
- Second in industrial production growth rate
- In the middle on inflation

■ As an advanced economy, it stands to reason that Germany would have the highest GDP and GDP per capita relative to India and South Africa. But it does not. India has a higher GDP than Germany. However, when population is taken into account, note that India has the second highest population in the world after China; this is reflected in its GDP per capita—roughly one-tenth of Germany's.

■ With a well-developed infrastructure (transportation, information and communication, power, etc.), **Germany** is poised to accentuate its information and communication technologies position relative to other advanced economies. However, there is "less room" for growth in its economy, which is partly explained by its low real growth rate in GDP and low industrial production rate. The country's inflation rate of 3.14 percent compares favorably among the three countries. Moreover, each German Euro bought more goods and services with such a low inflation rate relative to the purchasing power of the Rupee and the Rand in the respective countries.

■ **India's** emerging economy experienced a hefty real growth rate in GDP and GDP real growth rate compared to Germany. India is a large emerging economy both in population (about 1.41 billion) and GDP. On the other hand, its low per capita GDP indicates relatively low economic wealth among its citizens, although the high industrial production illustrated in the current data underscore the dramatic changes implemented in India to catapult it into the international business arena with significant global challengers. While the country's per capita GDP, for the relevant period, may be lowest among the three countries, it is poised to increase as the economy grows.

■ **South Africa's** inflation was the second highest among the three countries compared; it is still low for an emerging economy. With GDP at US$790,625 billion, it is small in comparison to Germany's developed economy, but it compares favorably with that of India when GDP per capita is considered.

1-21. In this chapter, we reviewed the four major risks that firms face in international business: cross-cultural risk, country risk, currency risk, and commercial risk. Identify one or more countries that interest you and then visit globalEDGE™ and research the countries to uncover examples of each of the four types of risks. For example, China is characterized by various cultural differences and a national government that tends to intervene in business. Research by entering the country name in the search engine. Visit Global Insights and Market Potential Index. Illustrate each risk with examples.
(LO 1.2; AACSB: Analytical thinking)

This can be answered in various ways. One example is the Czech Republic.
■ **Commercial risk**: Agents and distributors in the Czech Republic expect exclusivity in representing a foreign company's product or service according to published reports. Research reveals that many Czech Republic agents and distributors are undercapitalized and understaffed, but still represent a wide diversity of foreign products. Thus foreign exporters and manufacturers should be careful to avoid weak partners by negotiating an agreement that ties exclusivity to performance via a time limitation on the agent/distributor agreement or an escape clause to terminate the partnership for nonperformance.
■ **Cross-cultural risk**: One of the main business cultural differences between U.S. businesspeople, for example, and those in the Czech Republic is the "urgency" of making a sale. While the typical American "let's get down to business" approach is effective domestically, Czechs are more reserved and will have reservation about this way of doing business. They prefer to get to know a potential U.S. business partner's background and company and will be offended by too much emphasis on an immediate sales pitch.
■ **Country risk**: Although the Czech Republic has made various improvements, its tax, labor, environment, health and safety laws are considered to discourage inward foreign investment. Research reveals that domestic and foreign investors perceive that government bureaucracy and unnecessary red tape remain a source of frustration. Moreover, it is not uncommon for investors to experience delays and potentially corruption, especially in the company registration process and in changes to corporate structure.
■ **Currency risk**: Inflation in the Czech Republic has been running at about 2 percent. Although low by most standards, volatility in this rate directly affects the value of the koruna (crown) (CZK) against the US dollar and the euro. U.S. and European zone

companies that do business with Czech Republic firms will experience higher or lower cost as the CZK rises or falls in value relative to dollar and the euro.

1-22. You have recently been hired by a smaller firm that is beginning to expand internationally. When first starting out, most firms choose exporting as their main foreign market entry strategy. However, no one in your firm knows how to conduct exporting. Therefore, your boss has given you an assignment: Prepare a presentation for your coworkers on how to engage in exporting. Using globalEDGE™, find and review Guide to Exporting, which you can use to create your presentation.
(LO 1.4; AACSB: Analytical thinking)

A presentation on how to export would include some or all of the following topics:

■ **Understanding Exporting**
- ◘ Assess and develop export knowledge in the firm; evaluate the importance of exporting, its pros and cons, as well as the firm's strengths and weaknesses
- ◘ Explain the role that trade-related data will play in the company's export decision

■ **Ensure the Basics of Exporting Are Met Prior to Execution**
- ◘ Do a preliminary screening and select a country or region
- ◘ Conduct an industry market potential analysis
- ◘ Select a foreign partner and structure the relationship
- ◘ Conduct a company sales potential analysis

■ **Evaluate Our Company's Ability to Export**
- ◘ Understand how Assessment of Company Readiness to Export (CORE) software can assist with assessing our export capability
- ◘ Prepare for defensive competition
- ◘ Assess top management's commitment to the company's export capability
- ◘ Assess the significance of company and product readiness as they influence our export capability

■ **Preparing a Budget for Exporting**
- ◘ Assess the effects of foreign exchange rates on the company's export budgeting
- ◘ Understand how to control the export budget
- ◘ Explore the areas where standard cost can be applied

■ **Assessing Export Cost**
- ◘ Compose a list of export cost elements
- ◘ Perform a cost-volume-profit analysis with different tools
- ◘ Assess the important factors involved in costing a product for an overseas market(s)

■ **Understanding Export Documentation**
- ◘ Identify and understand the mandatory documents for exporting
- ◘ Understand documents such as a bill of lading, commercial invoice, and packing list
- ◘ Understand significant financial exchange documents such as the bill of exchange, sight draft, and time draft
- ◘ Assess the pros and cons of the letter of credit's value in the exporting process

■ **Export Financing**

◘ Assess the effective use of methods of payments and insurance
◘ Evaluate the details of international countertrade
◘ Assess the details of private and non-private financing

■ **Export Marketing and Logistics**

◘ Explain the necessity of an export marketing plan and information required to prepare it
◘ Assess movement and storage options for exporting the company's products that include understanding warehouse location and inventory levels
◘ Assess the requirements for effective export pricing