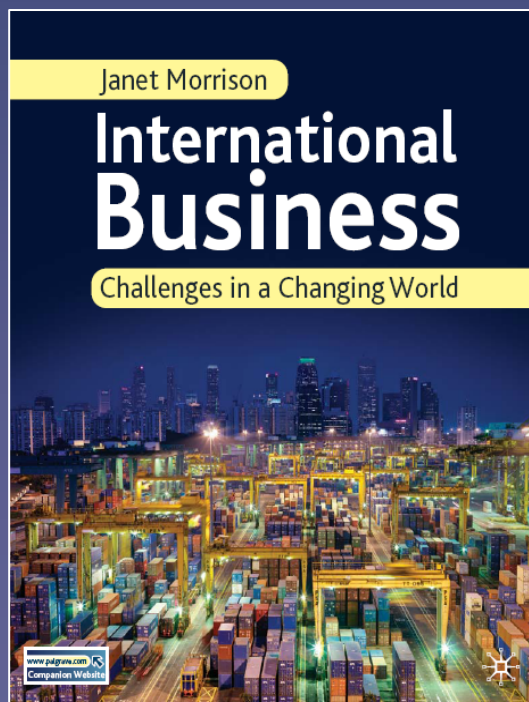


**INTERNATIONAL BUSINESS:
Challenges in a Changing World**
Janet Morrison

LECTURER MANUAL



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Introduction

The aim of this lecturer manual is to provide helpful information for lecturers using *International Business: Challenges in a Changing World* to teach their IB module.

It opens with a set of possible **course outlines** including a range of course lengths and differing emphases between lectures, seminars and workshops.

The **chapter guides** then highlight the main issues and points that arise in connection with each of the major learning features included in the book and on the website. Most do not lend themselves to ‘model answers’, and seminar discussions invariably differ from group to group – hence, the guidelines in this manual are intended to provide helpful teaching suggestions and discussion ideas rather than prescriptive answers.

The **strategic crossroads** cases and **case studies** are designed for use in seminars. Ideally, students should read the case beforehand, but if they have not, 10-15 minutes should suffice.

The **pause to reflect** features can be used as discussion topics in seminars, possibly in conjunction with a **case study**. Many of these are based on a dichotomy of viewpoints. In these, a debate between the ‘pros’ and ‘cons’ can add interest, with a general summing up at the end. It will seldom be the case that either side has won decisively, but students should be better able to appreciate the arguments on both sides as a result.

The **pause to reflect** features can also be used as **assignments**, as can the **Part B review questions**. For these, students can be invited to produce individually written essays.

In all these pedagogical features, students will approach the issues from a variety of perspectives. It is hoped that these features will serve as an aid to tutors in encouraging students to appreciate varying viewpoints and develop skills in critical thinking.

The guideline answers for each chapter are arranged in the following order:

- Strategic crossroads cases
- Case studies
- Country focus features
- Pause to reflect features
- Part B review questions
- Web-based assignments (online)
- Synthesis and reflection questions (online; discussion guidelines are given at the end of the last Chapter in the relevant part – hence, Part 1 synthesis and reflection questions appear at the end of Chapter 2, and so on).

Finally, at the end of the manual you will find guideline answers to the questions set in the *Journal for International Business Studies* section of the companion website, at www.palgrave.com/business/morrisonib/jibs.

DESIGNING YOUR COURSE IN INTERNATIONAL BUSINESS

This text has been written for use in both undergraduate and postgraduate courses. It assumes no background knowledge of business and management. Basic concepts and organizational forms are introduced in Chapter 1, and each following chapter builds on the knowledge of the previous one. It is therefore best from a learning perspective to take topics and chapters roughly in the order in which they appear in the book. In designing module outlines, I have borne in mind the differing needs of undergraduate and postgraduate students, discussed in the subsections below. There are other factors which module leaders will take into account. For example, differing cohorts of students have their own distinctive needs, and the module outline needs to allow for some flexibility in content and delivery. Another consideration is the extent to which international content is treated in other modules within a particular course. For example, if students are all required to do an international marketing module, the module leader for IB may well skip over Chapter 8 in this book.

As an undergraduate module

In undergraduate business studies and management courses, International Business is typically a Level 2 module. Students will probably have completed a Level 1 module on the business environment, and will therefore have some background. However, there are two provisos in this regard:

- (1) Business environment modules vary considerably. Many are economics based, with little treatment of other dimensions. Some in the UK are heavily UK focused, although with the addition of international content. Therefore, the Level 2 IB module should be designed to build on the Level 1 foundation material in business environment.
- (2) Not all courses and not all students will have followed the institution's internal business environment module just referred to. Some students will have transferred from different institutions or different degrees, and therefore need an introduction to the basics. Chapter 1 of this text is designed to meet the needs of these students, and also to refresh the memories of those who have completed a Level 1 business environment module.

As a postgraduate module

A Masters or MBA course often consists of a one-year taught course, followed by a dissertation. These students present considerable diversity in their backgrounds. Some will have a business background, either a degree or employment experience. Some have relevant experience, but come with a non-business degree. Their first degree could have been a few years ago, and even if it was a business degree, they need to refresh their knowledge and skills. For many postgraduate students, English is not their first language. Therefore, they are building language skills along with their academic studies. This text is written with the diverse needs of all these students in mind. The student with less background will take longer over reading the chapters, and will benefit from the approach taken here, as the concepts are clearly presented, with discussion and relevant examples linked in. There are numerous case studies and pause-to-reflect features which will interest and stimulate the student who is familiar with the basic concepts and can read the chapters more quickly. These more experienced students will also find the further reading and JIBS articles add to the academic depth.

Length of modules

International Business is a broad subject, which is best accommodated in a full module, typically carrying 20 credits. This would entail approximately 30 hours of class contact over a 15-week semester. In theory, this total could be divided into 15 1-hour lectures and the remaining 15 hours to seminars, tutorials or workshops. The 15 lectures would correspond to the 15 chapters in the book and could be delivered weekly, with the addition of a 1-hour seminar in each week. However, in practice, the semester might contain only 13 teaching weeks, to allow for an assessment period at the end. In this situation, there could still be 30 hours of class contact, but alternatives are 26 or 28 hours. This could be the case for both undergraduate and postgraduate modules.

The balance between lectures and seminars is often driven by the existing pattern in the degree course overall. The plans suggested here propose a balance between the two. For international students and those from diverse backgrounds, the interaction with the tutor and fellow students in the classroom enhances their communication skills. Seminars are also stimulating for students who have some background in business studies and are able to grasp concepts and knowledge from the textbook in their own time. More challenging issues (such as those in the pause to reflect boxes) can be incorporated into seminars, to stimulate this more experienced student. This textbook offers abundant seminar material (along with guidance answers) which can be adapted flexibly for the needs of differing groups.

The outlines presented below offer a balanced approach between lectures and seminars. Varying patterns of seminars are detailed, from the 1-hour seminar to the 2.5-hour workshop. Case studies, country focus features and pause to reflect features can be accommodated flexibly in these differing seminar formats.

Plan A

- **One semester duration:** 15 teaching weeks
- **Class contact:** 30 hours
- **Lectures:** 1 per week x 15 weeks = 15 hours
- **Seminars:** 1 per week x 15 weeks = 15 hours

Week	Topic for both lecture and seminar	Related book chapter
1	Introduction	1
2	Globalization	2
3	Economic environment	3
4	Cultural environment	4
5	Political and legal environment	5
6	Trade and regional integration	6
7	Strategy and organizations	7
8	Marketing	8
9	HRM	9
10	Supply chains	10
11	Finance and accounting	11
12	Innovation and strategy	12
13	Ecological challenges	13
14	CSR	14
15	Global governance	15

Plan B

- **One semester duration:** 15 teaching weeks, including a reading week
- **Class contact:** 28 hours
- **Lectures:** 1 per week x 14 weeks = 14 hours
- **Seminars:** 1 per week x 14 weeks = 14 hours

Week	Topic for both lecture and seminar	Related book chapter
1	Introduction	1
2	Globalization	2
3	Economic environment	3
4	Cultural environment	4
5	Political and legal environment	5
6	Trade and regional integration	6
7	Strategy and organizations	7
8	<i>(Reading week)</i>	<i>n/a</i>
9	Marketing <i>or</i> HRM	8 <i>or</i> 9
10	Supply chains	10
11	Finance and accounting	11
12	Innovation and strategy	12
13	Ecological challenges	13
14	CSR	14
15	Global governance	15

Plan C

- **One semester duration:** 13 teaching weeks (allowing final 2 weeks for assessment)
- **Class contact:** 26 hours
- **Lectures:** 1 per week x 13 weeks = 13 hours
- **Seminars:** 1 per week x 13 weeks = 13 hours

Week	Topic for both lecture and seminar	Related book chapter
1	Introduction	1
2	Globalization	2
3	Economic environment	3
4	Cultural environment	4
5	Political and legal environment	5
6	Trade and regional integration	6
7	Strategy and organizations	7
8	Marketing <i>or</i> HRM	8 <i>or</i> 9
9	Supply chains	10
10	Finance and accounting	11
11	Innovation and strategy	12
12	CSR	14
13	Ecological challenges <i>and</i> Global governance	13 <i>and</i> 15
14	<i>(Final assessment)</i>	<i>n/a</i>
15		

Plan D

This plan is weighted slightly in favour of lectures. It includes lectures on all chapters, with seminars on a selection of topics, which can be varied.

- **One semester duration:** 13 teaching weeks
- **Class contact:** 26 hours
- **Lectures:** 2 per week for first 2 weeks, followed by 1 per week = 15 hours
- **Seminars:** 1 1-hour seminar per week from weeks 3 to 13 = 11 hours

Week	Lecture	Related book chapter	Seminar	Related book chapter
1	1a. Introduction <i>and</i> 1b. Globalization	1 <i>and</i> 2	(None)	n/a
2	2a. Economic environment <i>and</i> 2b. Cultural environment	3 <i>and</i> 4	(None)	n/a
3	Economic environment	3	Globalization	2
4	Cultural environment	4	Economic environment	3
5	Political and legal environment	5	Cultural environment	4
6	Trade and regional integration	6	Political and legal environment	5
7	Strategy and organizations	7	Trade and regional integration	6
8	Marketing <i>or</i> HRM	8 <i>or</i> 9	Strategy and organizations	7
9	Supply chains	10	Marketing <i>or</i> HRM	8 <i>or</i> 9
10	Finance and accounting	11	Supply chains	10
11	Innovation and strategy	12	Finance and accounting	11
12	CSR	14	Innovation and strategy	12
13	Ecological challenges <i>and</i> Global governance	13 <i>and</i> 15	CSR	14

Plan E

The slightly longer seminar sessions in this plan will give greater opportunity to incorporate both a case study and a pause to reflect topic.

- **One semester duration:** 13 teaching weeks
- **Class contact:** 25 hours
- **Lectures:** 1 per week x 13 weeks = 13 hours
- **Seminars:** 8 seminars, 1 hour 30 mins each = 12 hours

Week	Lecture	Related book chapter	Seminar	Related book chapter
1	Introduction	1	(None)	n/a
2	Globalization	2	Globalization	2
3	Economic environment	3	(None)	n/a
4	Political and legal environment	5	Economic and political environment	3 and 5
5	Cultural environment	4	(None)	n/a
6	Trade and regional integration	6	Cultural environment	4
7	Strategy and organizations	7	(None)	n/a
8	Marketing or HRM	8 or 9	Strategy and organizations	7
9	Supply chains	10	(None)	n/a
10	Finance and accounting	11	Supply chains	10
11	Innovation and strategy	12	Finance and accounting	11
12	CSR	14	Innovation and strategy	12
13	Ecological challenges and Global governance	13 and 15	CSR and global challenges	13, 14 and 15

Plan F

The workshops in this plan provide an opportunity to cover a case study plus pause to reflect on two related topics, as indicated below. Where there are several seminar groups, some can take place in even-numbered weeks, and some in odd-numbered weeks.

- **One semester duration:** 13 teaching weeks
- **Class contact:** 28 hours
- **Lectures:** 1 per week x 13 weeks = 13 hours
- **Seminars:** 6 workshops, 2 hour 30 mins each = 15 hours

Week	Lecture	Related book chapter	Workshop	Related book chapter
1	Introduction	1	<i>(None)</i>	n/a
2	Globalization	2	Introductory session and	1 and
3	Economic environment	3	Globalization	2
4	Political and legal environment	5	Economic and political environment	3 and 5
5	Cultural environment	4		
6	Trade and regional integration	6	Cultural environment	4
7	Strategy and organizations	7		
8	Marketing or HRM	8 or 9	Trade, strategy and organisations	6 and 7
9	Supply chains	10		
10	Finance and accounting	11	Supply chains and innovation	10 and 12
11	Innovation and strategy	12		
12	CSR	14	CSR and global challenges	13, 14
13	Ecological challenges and Global governance	13 and 15		and 15

GUIDE TO CHAPTERS

CHAPTER 1

The business enterprise in the international environment

Strategic crossroads

1.1: McDonald's (page 11)

- ◆ *What reasons lie behind the comparative success of McDonald's franchise outlets over the company-owned ones?*

In the franchise outlets, the franchisee invests more of his or her own resources and has a more entrepreneurial approach to the business. Managers of the company-owned outlets, by contrast, have less sense of ownership and a lower level of entrepreneurial drive. This question can be broadened into a discussion of an entrepreneurial approach generally, which can bring in country differences in entrepreneurial environments.

- ◆ *How does the development licence fit in with McDonald's overall revitalization programme?*

The nature of the new developmental licences should be highlighted at the start. They provide that the underperforming outlets should be sold to local entrepreneurs, who would invest their own capital to a greater extent than under McDonald's usual arrangements. The new owners would be imbued with a greater entrepreneurial approach, but would still benefit from the strong brand and supply chain arrangements. Whether these new owners deliver improved financial performance depends on their competitiveness in their local markets. McDonald's executives are stressing the importance of the revitalization programme to win new customers. They look to the new owners to deliver these improvements, reflecting the success of the revitalization programme in the US.

1.2: Ericsson (page 15)

◆ *What were the causes of the crisis at Ericsson?*

Two causes are mentioned in direct connection with the crisis:

- Heavy investment in 3G licences left the large telecoms companies financially weakened, causing them to cut back in capital investment.
- Chinese manufacturers, with their lower costs and ability to undercut Ericsson on price, gained market share.

Another cause which emerges is Ericsson's reliance on equipment manufacturing for revenues, which left it vulnerable to Chinese competitors.

◆ *How has the company managed to turn the business around, and what are the lingering risks?*

Ericsson's new strategy has been to expand services, providing customers with networking solutions, rather than simply hardware. The growth of mobile phone networks in emerging markets has opened up growth opportunities. The joint venture with Sony to produce handsets also taps into new markets. These markets, however, are highly competitive, with new technology and changing consumer needs. Does Ericsson have the flexibility to rise to these challenges? Its background is that of a conservative engineering company, rather inward-looking in culture. A more outward-focused approach is now needed, but, as the introduction noted, the company's traditional ownership structure, which could be viewed as a source of stability, can be disadvantageous when strategic change is needed.

Case studies

1.1: PepsiCo's path to internationalization (page 20)

1. *How has PepsiCo's diversification strategy proved to be advantageous in comparison to the strategy of Coca-Cola?*

PepsiCo has been able to add new businesses and products by its strategy of diversification, allowing it to respond to changing consumer needs with a wide portfolio of products. In particular, it has added bottled water, snack foods (through the acquisition of Frito-Lay and Quaker Oats), juices (through the acquisition of Tropicana), and the sports drink Gatorade (as part of the Quaker Oats portfolio). These products reduce its dependence on traditional carbonated drinks. They also diversify the range of products for health-conscious consumers.

By comparison, Coke has remained more dependent on its flagship carbonated drink, Coke. Although it has expanded into more markets internationally than PepsiCo, it has been slow to diversify into healthier products.

2. *What trends in consumer preferences has PepsiCo sought to satisfy?*

The main trends which can be highlighted are:

- Consumer concerns over health and obesity
- Rising demand for branded bottled water

- Demand for other alternatives to carbonated drinks, including fruit juices and energy drinks
- Shrinking demand for carbonated beverages
- Demand for alternatives to traditional salty, high-fat snack foods. Frito-Lay now offers a range of baked snack foods.
- More labelling on products, to inform consumers of nutritional information, such as fat content.
- Demand for products designed for local tastes in diverse markets (PepsiCo's products are produced by local companies under licence - see next answer).

3. *How internationalized do you feel PepsiCo has become?*

As the figure shows, international profits account for 22% of PepsiCo's total. International operations for both food and beverages come under its international division. The implication is that PepsiCo is mainly focused on America. However, it is now expanding rapidly in emerging markets, although it has much less presence than Coca-Cola. PepsiCo is perhaps perceived as less an icon of American culture than Coca-Cola or McDonald's. Reliance on local manufacturers to produce its products under licence gives PepsiCo a local feel in many markets – Walkers of the UK is an example.

4. *Describe PepsiCo's current strategy in both its home market and international markets.*

PepsiCo's strategy in the US is to focus on growing its healthier brands and non-carbonated drinks. Internationally, it is focusing on emerging markets, especially China, India and Russia. The lesson from China has been that, although carbonated beverages were targeted as the main product to lead sales, Chinese consumers have shown preferences for bottled water, juices and tea. This seems to indicate that it would be wrong to assume that consumers in developing markets opt first for carbonated drinks, and acquire a taste for alternatives as they become more affluent. Strategy must adapt to tastes in differing markets, where there are usually strong local brands well established.

1.2: Volkswagen (page 35)

1. *What problems which have beset VW in global car markets?*

VW is a mass-market car producer, and has found its competitiveness slipping away in key markets, largely because of high costs in Germany, where it is based. It has traditionally been reluctant to use low-cost locations for components, unlike rival global carmakers. High wages and job protection in Germany have been priorities for the powerful trade union, IG Metall, which is influential on VW's supervisory board. In the US, VW's sales slumped for several reasons: the weakness of the US dollar, the lack of appealing new models and the unwillingness of the company to use local suppliers of components for its Mexican factory. In China, where VW was a market leader, competitive pressures have gathered strength, from both other western entrants and Chinese companies.

VW has inadvertently strengthened Chinese competitors through its joint ventures with SAIC.

2. *How has VW's management brought about changes in strategy?*

Changes in strategy have been forced on the company because of its dwindling competitiveness. The management has persuaded the unions that cost savings are imperative. Wage freezes, early retirement and staff reductions through voluntary schemes are being implemented.

3. *Why has VW's corporate governance been criticized?*

Under Germany's system of corporate governance, co-determination is the governing principle. It is useful to begin by highlighting its implications, namely the strong position of the main trade union on the supervisory board. Also important in the case of VW are the share structure, the German takeover law and the role of Porsche, the family-owned luxury carmaker. The main large shareholders are Porsche and the government of Lower Saxony, which have differing perspectives. The families which own Porsche see the economic benefits for themselves of winning control of VW, while the government and trade union prioritize public benefits such as employment in the region. Clashes in perspective lead to disagreement over strategy.

4. *If you were a shareholder in VW, what changes would you like to see in the way the company is run?*

The small shareholder in VW would probably prefer that members of the board take an overview of the goals of VW as an enterprise in its own right, rather than pursue their own agendas. The senior executives of VW could take more steps to reduce costs, and could seek to make greater use of components from local manufacturers. The trade union has recognized that labour flexibility is needed in order to preserve employment in the long term. However, its influence on the supervisory board and works councils has been criticized. Reforming the co-determination structure in Germany has been proposed, in the belief that union power has not been sufficiently cognizant of multiple stakeholders. Shareholders would certainly applaud such moves.

Country focus

1.1: Japan (page 23)

◆ *What problems have Japanese companies had to overcome in order to regain competitiveness in global markets?*

- *The jobs-for-life guarantee* – Japan's large companies have prided themselves on their employment system which guaranteed a job for life to permanent, full-time employees. This was an important element in Japanese corporate culture, giving employees a strong sense of identity with the company, along with high levels of loyalty. Following decades of rapid economic development, Japan

went into a period of economic downturn in the 1990s, and in the same decade, Japan's companies came under competitive pressures from other East Asian economies which were catching up in terms of economic development. Although Japanese companies needed to restructure and abandon the jobs-for-life policy, they were reluctant to take drastic steps to slim down workforces.

- *Core technology and innovation capacities* – Japan's large companies were famous for their innovations, but in embarking on joint ventures with companies in the rising economies of East Asia, lost control of some of their key innovations. Rethinking their innovation strategies, involving decisions on what to keep in-house and where to seek cooperative strategies, was part of the strategy to regain competitiveness.
- ◆ *Why is the electronics industry one of Japan's best hopes for renewed economic growth?*
Japan's companies have long been at the forefront of imaging technology, including LCD technology, digital cameras and flat TV panels. This gives them a competitive lead in the fast-growing digital sector. By carefully managing this technology, they hope to keep their lead over rivals such as Taiwanese and South Korean companies. The home market is crucial for Japanese companies, and, although Japanese consumers were reluctant to spend during the period of economic downturn, there is hope that consumers will regain their desire for the latest electronic equipment. Companies such as Sony and Toshiba look for renewed growth in their home market.
- ◆ *Asses the impacts of changes in employment patterns on Japanese society*
Changes have involved a shift from lifetime employment and promotions based on seniority to shorter job horizons and performance-based pay and promotion. In addition, there has been a rise in part-time, casual and agency workers – all part of the 'non-regular' workforce. This shift has arguably undermined the famous loyalty and commitment which existed between companies and their employees previously. As a consequence, employees have a greater sense of insecurity in their employment and less loyalty to the company than in the period of rapid economic growth. Are workers becoming more individualistic in this environment? (Cultural dimensions of individualism and collectivism are discussed in Chapter 4.)
Certainly, they are more likely to be concerned over job security, which affects domestic consumer spending, rises in which are seen as key to reviving economic growth.

1.2: Venezuela (page 29)

- ◆ *What are the causes of MNEs' complaints against the Venezuelan government?*
Foreign MNEs desire stability and continuity of policy in the countries in which they operate. Abrupt and unpredictable changes of policy by a government make it difficult for them to plan ahead, and could cause them to leave the country.

Most would prefer to have amicable relations with governments, to negotiate on issues which arise and to reach solutions which are reasonably in the interests of both the companies and the host government. However, adversarial relations, as have developed in Venezuela, make dialogue difficult. In particular, companies have objected to the renegotiation of contracts with the government which leave them with much-reduced stakes in their operations. The oil companies have also objected to government demands for increased payments deemed to reflect the windfalls they had gained. Claims for back taxes which appeared to discriminate against foreign companies have also led to objections, the latest coming from McDonald's.

◆ *To what extent are these complaints justifiable?*

MNEs have learned to expect changes of government policy, whatever the country. Some will be beneficial, but some will be detrimental, causing them to rethink their country strategy. Oil companies have come to realize that that contracts negotiated with governments of oil-rich countries many years ago are now perceived by their political leaders as too favourable to the companies, especially in the context of rising energy prices. Hence, their complaints that governments should not be entitled to an increased share of their rising profits are perhaps unjustifiable. As owners of the vital technology and skills, the energy companies had the upper hand in setting out their terms, but governments are now more assertive of national ownership of energy assets in a world where energy security is becoming increasingly important. How justified are companies in their complaints when 'their' assets are nationalized or placed in joint ventures with governments? It is arguable that the risk was always present, and that their best policy in the circumstances is to achieve the best payment terms (see later case study on Shell, CS 5.2).

◆ *What advice would you give to MNEs wishing to do business in Venezuela at present?*

Foreign energy companies, especially those providing skilled services to the oil industry, are in demand. As the country focus highlights, production by PDVSA (the national oil company) has been weak, and outside investors can contribute to infrastructure projects. Any MNE wishing to invest can expect the Chavez government to press for national benefits, but outside companies have skills and expertise which the country needs, and should be in a relatively strong bargaining position. A risk is that any agreement is likely to be changed unilaterally by the government. However, this is less likely where the company has maintained good working relationships with national authorities and other local stakeholders, and shown willingness to abide by national laws.

Pause to reflect

Going international (page 7)

The pitfalls for the national company wishing to internationalize

- Lack of knowledge about foreign markets
- Foreign exchange risk
- For exporters, the need for more complex transport arrangements.
- Organizational implications, with possible need for an office in a foreign market, or perhaps the acquisition of a foreign company in the target market

Minimizing risk

The risks can be minimized by thorough research on possible target locations. Also recommended is an incremental approach, by which the company enters foreign markets slowly, and gradually builds up a presence as its experience increases.

Example companies

Companies which have succeeded: many MNEs could be mentioned, including car manufacturers, consumer goods companies, pharmaceutical companies and retailers. Some of these have struggled in particular markets. Wal-Mart can be highlighted as an example of the latter (see CS 3.2), partly because of failure to appreciate the differences in markets.

Comparing local, national and international businesses (page 8)

It is up to the individual student to put forward examples. For each, organization, consumers and products should be discussed. For example, a local restaurant, a national bank and an international mobile phone manufacturer might be chosen. Students at this stage may not know much about the firm's organization, and need some help. However, there is a discussion of some basics of organizations in this chapter, which should provide a foundation.

The global entrepreneur (page 12)

Begin by identifying the elements of entrepreneurship. They include identifying new opportunities, providing innovative products and services, finding sufficient resources/backers, and being willing to undertake moderate risk. The statement suggests that these characteristics are more crucial for international businesses. One reason is that competition is fiercer at the international level. In many sectors, such as computing and electronics, innovative new products are crucial to success. Young 'born-global' firms have an international and entrepreneurial approach from the outset. For established firms to remain successful internationally, they must sustain an entrepreneurial approach, constantly looking for new opportunities.

Who controls the company? (page 16)

For each, it is helpful to identify the main relevant characteristics. Discussion of distinctions should focus on culture and strategy.

- *The private company* – Usually family or insider dominated, the private company's culture and strategy are dictated by the dominant owners. This type of company is likely to be inward-looking and conservative. Many, however, have become outward-looking and expansive, often by bringing in managers from outside with

new ideas and broader horizons. Many Scandinavian companies remain private, and are highly competitive globally. Starlinger, the Austrian SME featured in the opening vignette of Chapter 7, is another example.

- *The state-owned company* – The state-owned company tends to be bureaucratic and bound by procedure. These companies often have monopolies in their national environments, for example, in resources, energy and telecoms. With no competition, they have little incentive to be innovative, look to efficiencies or seek to improve consumer services. Although they are perceived as focused on national priorities, state-owned companies have increasingly become major players in international business and finance. Their huge assets and recourse to public funding have made them formidable forces, active in many industries, as will be highlighted throughout this book.
- *The public company in which a single family exerts control* – This company is similar to a private company in that the family maintains a strong grip on culture and strategy. Minority shareholders have little influence. However, the public company does have some traded shares, and it must meet disclosure requirements for financial and other information. Public companies are also required to abide by corporate governance rules laid down by national authorities. These usually include the inclusion of independent (non-executive) directors on their boards, although their selection is controlled by senior management.
- *The public company with diverse shareholders* – In this company, the shareholders with the largest holdings are likely to have seats on the board. The CEO and senior managers are kept on their toes by the need to maintain and improve financial performance, especially because some active investors are likely to be among the diverse shareholders. This company seeks international expansion to remain competitive. Its shareholders, many of whom could well be foreign, expect international success, and tend to punish managers when foreign investments go wrong.

Which is likely to develop successful international strategies?

Successful international businesses fall in all these categories, but the last one, the public company with diverse shareholders, is possibly under the greatest pressure to compete globally, and certainly has greater mechanisms for accountability of managers.

How effective are centralized functions? (Page 21)

- *HRM*: Centralization brings benefits of consistent policies and strategy across different locations. It also promotes a strong focus on overall corporate goals. When staff are appointed directly a central HR department, they will bring more of an overall perspective of corporate goals than staff appointed by local subsidiaries, for whom local issues loom large. This highlights a pitfall, however, in that centralization tends to underestimate local differences in workplace norms and culture, as well as understanding of local environments. Too centralized HRM could lead to disenchantment on the part of workers in countries where the

culture is radically different from that of the parent company's home country. These workers might feel their needs are not being sufficiently taken into account, which could undermine performance.

- *Marketing*: A global marketing strategy is a key feature of centralized marketing, which is disseminated to the different country markets. This is beneficial for companies with strong global brands, and allows the company to use the same advertising campaign in all locations, bringing cost benefits. A pitfall is that it takes little account of country differences. Country markets differ in their consumer environments, preferences for products, distribution systems and marketing communications.
- *R&D*: Traditionally, companies concentrate R&D at the centre. This has been true of the large western MNEs which have been at the forefront of cutting edge research. High costs in developed economies have been a factor in encouraging these companies to look to other locations for R&D. Emerging economies, such as India and China, now have large numbers of skilled researchers, and have attracted significant R&D activity. This decentralization benefits from lower costs and proximity to these growing markets.

Governance models (page 22)

Advantages and disadvantages of shareholder and stakeholder models:

- *Shareholder model* – The notion of 'advantages' depends largely on your point of view. For shareholders, this model is advantageous in theory, as it emphasizes maximizing value for them as owners, whose interests are the focus of the single-tier board. Although the board tends to be dominated by senior managers, the presence of non-executive directors aims (in theory) to oversee shareholder interests as a whole. This model could be seen as disadvantageous in terms of other stakeholders, and also other goals, such as environmental concerns.
- *Stakeholder model* – This model, while it aims to take into account other interests than owners, in practice focuses on employee interests. The supervisory board contains a proportion of employee representatives, usually representing the major trade unions. It is arguable that under this model, there is a risk that labour union interests can take precedence over the interests of the enterprise as a whole (see case study 1.2 on VW).

Students are invited to express a view on which of these is preferable. There will probably be supporters on both sides, which could lead to a mini-debate. This type of discussion of pros and cons will not come down conclusively on one side or the other, but it serves the purpose in making people look at the arguments on both sides.

Co-operate or go it alone? (page 27)

Alliances, networks and joint ventures all offer the possibility of tapping into knowledge and expertise which can benefit the company in achieving its corporate goals.

- *Alliances* with one or more other organizations can be in a number of areas, such as R&D, distribution and product design.

- *Networks* are often more fluid and informal, offering means by which participants from different organizations can share ideas and experience. These are beneficial to companies aiming to internationalize, but whose managers and other staff have little international experience.
- The *joint venture* is a more formal arrangement, but still benefits from the sharing of risk with one or more other partners, whose inputs (such as expertise and local knowledge) will improve the chances of success in new markets.

Government for better or worse (page 31)

Responses will depend on the student's home country. Governments in developed countries will diverge from those in developing or emerging economies. In addition, authoritarian governments (often characteristic of developing countries) diverge from democratic governments. The topics – taxation, health & safety at work, environmental protection and corporate governance – are all ones which will feature in the rest of this book. Some students (for example, master's degree students) may have foundation knowledge in these areas. However, most will not, and will respond in terms of personal perceptions and experience. At this stage, this type of reflection is nonetheless helpful, as it raises the issues which governments everywhere must deal with. Here are some prompt questions to get the discussion going:

- Are the government's taxation policies perceived as fair by citizens?
- Does the government try to improve standards of health & safety and environmental protection?
- Is the country a good place to live for employees and consumers?
- Are companies governed for the benefit of 'insider' owners or the state? Or are they accountable to a range of stakeholders?

MNE responses to external influences (page 34)

Students should be asked first to identify the main business, society and government relationships referred to in this question.

Most would agree that MNEs risk losing sight of enterprise goals as they strive to manage external relationships, co-operate with governments and respond to pressures for CSR and environmental strategies. A distinction can be drawn between corporate goals and the means of achieving them. International managers may have clear ideas of what their broad long-term goals are, but have difficulty in finding the best means, best alliances and best locations to achieve them. An increasingly important issue is that goals, once thought to be simply about profit maximization, are now becoming more blurred, as societal and environmental impacts are shifting from being aspects of the means to being aspects of the goals themselves. Some participants might argue that the notion of enterprise goals should now be revised to include non-economic goals. The introduction of these issues at this early stage provides a framework for later discussions, culminating in Part 5.

Part B review questions (page 35)

1. *Entrepreneurs are generally acknowledged to be innovators and wealth creators. However, as Figure 1.3 shows, there are significant differences between countries in the proportion of people involved in start-ups. What are the causes of these differences, and what can government authorities do to encourage more entrepreneurs?*

Figure 1.3 shows large differences in early-stage entrepreneurial activity in different countries. Among those with the highest levels are China and Australia. On the face of it, these countries seem to have little in common. Hence, there are no simple ways of predicting where entrepreneurs will flourish and how to encourage them. China, India and Brazil are emerging economies, where opportunities are abundant and growth rates are high. Increasingly affluent consumers form an attractive potential market for entrepreneurs. Entrepreneurs therefore see good growth potential in these markets. However, these countries all suffer to a degree from bureaucracy and regulatory burdens, posing challenges for entrepreneurs. By contrast, Australia, also near the top of the chart, enjoys a business-friendly environment in which starting a business is relatively easy. In countries near the bottom of the chart, with low start-up activity, there are both cultural and regulatory causes. In some, such as Japan, working for a large organization is considered more secure and preferable to taking individual risks. For governments, making it easier and cheaper for people to start businesses will help to encourage would-be entrepreneurs. Also needed, however, are educational and training opportunities designed to foster entrepreneurship.

2. *In what ways do ownership profile and control influence a company's culture and strategy? Give some examples from the case studies and strategic crossroads boxes.*

Concentrated ownership, for example, in a founder, family or the state, exerts a huge influence on the company's culture and strategy. An example is Ericsson, dominated by the Wallenberg family. The introduction of an outside CEO was key to strategic changes. PepsiCo has a diverse array of shareholders, but is US dominated. It has expanded internationally more slowly than its rival, Coca-Cola. Volkswagen (in the case study which follows) has suffered from conflicting views of the company pursued by dominant shareholders. It is also helpful to recall the contrast between McDonald's (SX1.1) and White Castle, one of its US rivals, which is a private company (see page 14), now in the third generation of family owners.

3. *Give some examples of stakeholders in international businesses. In what ways do companies take account of their interests, or fail to?*

First, define 'stakeholder', and identify the main interests included in the term. Stakeholders in international business include employees in different locations where the MNE has operations, local suppliers and customers, and local communities in which the MNE is located. Trade unions are active in many countries, and companies must maintain dialogue with them as employee

representatives. In addition, bodies such as governmental authorities are influential. As the country focus on Venezuela highlights, relations with government can be crucial. Economic, social, legal and ethical considerations arise for companies in managing these relations. Moreover, environmental concerns are increasingly seen as stakeholder issues. Residents near a factory may have little organized voice, but increasingly, non-governmental organizations (NGOs) are working with MNEs on environmental issues. Students should glean from this brief list that complex (and sometimes conflicting) interests are involved in stakeholder management for international business. This theme recurs throughout the book, and is developed in greater detail in Part 5.

4. *National governments often seek to shape business behaviour and intervene in the business environment to achieve national economic goals. What such activities by governments are mentioned in this chapter, and are they justified?*

Some examples from the chapter:

- Japan's guidance of its companies during the period of rapid economic growth.
- Venezuela, through state-owned companies in the oil industry; also through legal changes which foreign companies are compelled to comply with, such as the formation of joint ventures with PDVSA.
- Laws governing the formation/registration of companies; also laws and policies on corporate governance.
- France's ownership of key utilities
- The block of VW shares owned by the government of Lower Saxony; also the takeover laws in Germany which are perceived as safeguarding VW against takeover.
- The banning of Pepsi and Coke in several states in India, due to allegedly excessive amounts of pesticides (CS1.1)
- Reports that French political leaders resisted any attempts by PepsiCo to take over Danone.

Views will differ on whether governments have been justified in these and other interventions mentioned in this chapter. Company law and law on financial disclosure help to give the public confidence that companies are run in a legal and transparent manner, especially important if private investors are invited to buy shares. Some government policies have arguably strengthened national industries, such as Japan's industrial policy and France's state ownership of key utilities. Venezuela's aggressive stance towards foreign investors has possibly been harmful; the national oil company has not increased productivity, and foreign investors who could benefit the country are deterred. India's targeting of foreign multinationals seems to reflect, at least in part, anti-American sentiment.

**Web-based
Assignment (online)****Ericsson as a global company**

This assignment can be an individual written exercise or a group exercise, in which students can discuss the questions and produce a group report on their findings. In this case, the last section would be a summary of their differing views. As this is a Chapter 1 assignment, students cannot be expected to have acquired critical skills to a high degree, or to be able to compare this company with others. However, the striking characteristics about the company should be apparent, and they will be able to compare it with other companies as they move on to later topics. The next chapter – on globalization – will pick up some of the issues from this web-based assignment.

CHAPTER 2

Perspectives on globalization

Strategic crossroads

2.1: Puma (page 45)

◆ *How did Puma manage to recover its profitability?*

A fresh approach by Puma's new CEO was the main factor behind Puma's recovery. Puma has had to compete against larger rivals, Addidas and Nike. Puma's CEO embarked on a distinctive strategy for building the brand by associating it with a sports lifestyle, bringing in the fashion element, which would give products a more exciting image than its rivals. The company reduced costs by shifting production from Europe to Asia.

◆ *What is distinctive about Puma's brand strategy in global markets?*

Puma's brand strategy has been based on fashion trends rather than sports performance. Reinventing Puma as a fashionable brand helped the company to move to more upmarket products, with their greater profit margins. Relying on fashion is risky, as fashion trends can be ephemeral. The luxury group, PPR, has now taken over Puma, seeing its potential as a luxury as well as a sports brand. The luxury element combined with an eye for fashion should benefit the brand, along with PPR's depth of experience in retailing.

Many students will be aware that Puma sponsored the Olympic 100-metre and 200-metre champion and world record-breaker, the Jamaican, Usain Bolt. Although Nike has focused on the sponsoring of individual athletes for many years, Puma has not seen this as a major element of its strategy. However, on this occasion, it clearly struck gold, and is feeling on top of the world, as suggested in the title.

2.2: Dyson (page 56)

◆ *At what points in the growth of Dyson's business did it face strategic crossroads?*

As an inventor, Dyson faced the dilemma of whether to try to develop his inventions on his own or turn to large companies, either to license them or simply to sell his inventions. Having tried to sell his bagless vacuum cleaner to large manufacturers and failed, he decided to form his own company to exploit his patents. He fought numerous legal battles, and had to sell his technology rights during hard times. He also had to decide to expand into international markets, from his base in the UK. Another crossroads was in 2002, when he decided to shift manufacturing to Asia.

- ◆ *What factors influenced the company's choice of direction at these crucial junctures?*
As an entrepreneur, Dyson has had to combine inventive flair with business strategy. A major factor was to his desire to see his inventions succeed as products in large consumer markets. The decision to manufacture in Asia was influenced by global competitive pressures, in that significant cost reductions were available in Malaysia.

- ◆ *Do you agree with Dyson's predictions on the British manufacturing sector generally?*
It is helpful to summarize his views as a starting point. He speaks of the whole sector possibly being driven offshore, but maintains that there is still a role for value-added manufacturing. The discussion should note that he cites government policies and cultural factors as well as the economic environment. Students could be asked which factors are the most influential, and what changes are taking place at present. Is the situation in their view better or worse than when these comments were made, which was 2005.

Case studies

2.1: Nokia (page 50)

1. *Why did Nokia miss consumer trends, belatedly having to match competitors' offerings?*
Nokia relied heavily on the strength of its brand and the quality of its products to retain its large market share, but underestimated the desires of consumers for more eye-catching, innovative models. Rivals such as Samsung were able to produce attractive designs with new features while keeping prices highly competitive. Asian competitors enjoyed cost advantages over Nokia because of their strategies of outsourced manufacturing, in contrast to Nokia, which has been keen to manufacture its own products. Nokia had also been slow to appreciate the fragmentation occurring in the mobile phone market globally, in which different segments are emerging, which require distinctive product portfolios.

2. *How do you explain Nokia's continuing dominance of the mobile one market?*
From the figure, we can see Nokia's rise in market share. Its rise has roughly coincided with the increase in the use of mobile phones generally, especially in the advanced economies. Nokia was the largest handset manufacturer in 1998, and was well placed to benefit from this rapidly growing market. It gained a reputation for quality, and invested heavily in R&D. However, its high costs and relatively high prices made it vulnerable to competitors. When its market share slipped back, it responded with price reductions which, while damaging to margins, helped to rebuild market share. It has shown a resilience in adapting strategy to changing market conditions.

3. *Assess Nokia's current competitive position in global markets, particularly the likelihood of retaining its large market share.*

Nokia has restructured, to focus on particular segments, such as high-end consumers and businesses. Its main mobile phone business is now targeting emerging markets, where growth prospects are the greatest. In all these areas, it faces fierce competition. In particular, in the mass markets of emerging economies, margins must be pared to the minimum. It has shown it can succeed in China, where it had 35% of the market in 2006. Moving production to low-cost locations has been part of its new strategy. Nokia's depth of experience, reputation for quality, strong brand and innovative capacity should help it to retain a strong market share. However, it might be advised to focus on particular segments rather than to attempt to stay on top in all of them.

4. *To what extent is Nokia a global company?*

Discuss first what is meant by a 'global' company. In terms of markets and production, Nokia is certainly global, but as an organization, it has been distinctively Finnish. Its culture has been homogeneous, and its executives, mainly Finnish, are traditionally chosen from inside the company. The organization is gradually changing as the company's operations expand globally, but the board still has only four non-Finnish members out of 12. An interesting point to discuss is whether the company's apparent move away from its Finnish roots will be advantageous in global markets.

2.2: IBM and Lenovo (page 73)

1. *Critically assess the changes in strategy that have taken place at IBM, both before and after the sale of the PC business.*

IBM became famous for its mainframe computers in the 1970s and 1980s. With the growing popularity of PCs, it shifted attention towards building a PC business. However, it relied on other people's technology – processors from Intel, software from Microsoft and outsourced manufacturing. It struggled against Hewlett Packard and Dell, eventually deciding to sell its PC business, to concentrate on higher value activities. Its traditional strength in hardware has been beneficial in building its new servers. It is also building up its expertise in services, including BPO.

2. *What aspects of globalization are highlighted in this case study?*

- The shift of manufacturing of mass-produced products to low-cost locations.
- The fact that a long-established MNE from the developed world would sell off an entire business formerly seen as integral to its operations, to an emerging-market buyer.
- The international expansion of emerging MNEs.

- The growth of global markets in both hardware and IT services.
 - The focus on emerging markets for growth in consumer goods such as PCs.
3. *Analyse the acquisition of IBM's PC business by Lenovo in terms of ownership-specific advantages and location-specific advantages.*
- IBM's ownership-specific advantages are in its strong brands, including IBM itself and the ThinkPad. Lenovo was allowed to use the ThinkPad logo for five years following the sale, but ceased to do so with two years to run. Location-specific advantages are enjoyed by Lenovo. Its entrepreneurial approach and manufacturing expertise have been built up in China, where it has gained expertise in sourcing low-cost local components and building innovative capacity within the cost constraints of a domestic market which is highly price conscious.
4. *Assess Lenovo's prospects in competition with established rivals.*
- With no experience outside its home market before the acquisition, Lenovo has had to learn quickly how to manage an international business. It must co-ordinate between offices in China and the US. It had to learn how to manage international supply chains while attempting to launch its own new products and build its own brand in global markets. Established rivals doubted Lenovo's ability to compete, but it has benefited from much expertise provided by IBM, and its own managers have been keen to show that an emerging MNE can compete globally.

Country focus

2.1: The USA (page 47)

- ◆ *In what ways are the problems at GM and Delphi illustrative of the problems for manufacturing workers in the US generally?*
- It is helpful to begin by describing the plight of car workers. Three areas can be highlighted:
- *High costs*, especially for healthcare and pensions, have been a major problem for the motor industry, but are also a feature common in US manufacturing generally. Historically, this situation can be traced to the weak welfare-state provisions in the US. Soaring costs in recent years have exacerbated the problems for manufacturing companies.
 - *High wages* earned by 'blue-collar' workers in the US have also become problematic: as manufacturing has become globalized, much of it has migrated to low-cost locations such as China.
 - *Labour unions* in the US have had a traditional stronghold in many industries, such as car manufacturing. They have achieved generous benefit packages for their members, especially in the car industry, but the financial liabilities have spiralled, jeopardizing the employers' long-term viability. A legacy has been confrontational labour relations, and newer companies, such as the foreign-owned carmakers, do not have unionized workforces.

◆ *In the quote from Delphi's CEO, what trends is he referring to?*

This quote is at the bottom of the previous page. He refers to the 'economic and social trends that are on a collision course around the globe'. They include:

- The migration of jobs to low-cost locations.
- The vulnerability of manufacturing jobs, especially low-skilled ones, in high-cost developed economies.
- The gap which has emerged between the well-off segments of society, whose incomes have risen dramatically (often in conjunction with international expansion of their firms), and the lower-income groups, often low-skilled workers, who have seen stagnant or falling earnings. For these latter workers and their families, fears over how to pay for healthcare have mounted.

◆ *Assess the strengths and weaknesses of Delphi's 'survival plan'.*

- *Strengths:* Rewriting labour contracts to reflect financial constraints which it faces; Diversification into high-tech sectors, which are less vulnerable to low-cost competition; closure of plants which it can no longer afford; the shift of manufacturing to lower cost locations.
- *Weaknesses:* Legacies of its financial woes and labour union relations. The company is struggling to come out of bankruptcy and needs new owners. Private equity investors are naturally attracted to companies which seem to have potential for growth, but in times of economic downturn and financial uncertainty, they become risk-averse. Delphi will have difficulty in attracting new owners (see Chapter 11 for a discussion of the role of private equity groups).

2.2: India (page 61)

◆ *Why has India prospered in IT and services, while failing to develop manufacturing industries?*

India's IT companies have benefited from the country's strengths in computing and IT, with the availability of highly skilled domestic staff whose earnings have been much less than those in equivalent positions in western companies. Government policies have also been influential. As India's IT companies prospered, the government promoted computing and IT in education. Manufacturing industries have not enjoyed such a congenial environment, especially compared to the powerhouse of China. Indian governments have historically favoured state-owned industries, not welcoming FDI in the way that China has done. India's weak infrastructure compares poorly with China, which is investing heavily in improved transport.

- ◆ *What factors have played a part in the success of the companies featured in this case study?*
Engineering excellence and the use of advanced technology have featured in the case of Mahindra & Mahindra. Similarly, Bajaj Auto has used advanced manufacturing techniques, despite the country's plentiful supply of low-cost labour. Both these companies are looking to expand internationally, entering joint venture agreements with western partners. (Bajaj Auto has a joint venture agreement with Renault to build a small car to rival the Tata Nano.) Gokal Das Exports, specializing in textiles, are building on one of India's more traditional strong industries, but using high-tech skills and expertise in software.

- ◆ *Assess India's prospects for attracting FDI in manufacturing in the future.*
India's location advantages are highlighted: these include an independent legal system, democratic political system and the widespread use of English. Also, the government is now encouraging foreign investors more than it did in the past. On the minus side, there is the weak infrastructure, social instability due to ethnic and religious conflicts and political instability. In October, 2008, Tata bowed to protests by local farmers, and decided to shift production of its Nano from the original manufacturing site, despite having invested heavily in the site. Tata is a domestic company, but in this type of situation could also arise for a foreign investor.

Pause to reflect

Globalization: myth and reality? (page 43)

We can point to global distribution networks, global media and communications, and the rise of global brands as indicative of the globalization of markets. Students can discuss the extent to which Levitt's views are relevant today. Consumer markets have diverged, whereas he was confident that they would converge with the American model. However, in standard products which are more like commodities, as well as in industrial products, it makes sense to speak of global markets.

Globalization of production should be defined. Advances in transport, communications and technology have facilitated company strategists, who wish to source and manufacture products in the most advantageous locations. These locations might be low in cost, close to raw materials, close to transport links or close to markets. This process has taken place rapidly, whereas the continuing fragmentation of consumer markets has made globalization of markets more problematic. The scope for sourcing a complex product like a car in different locations is pointed to as indicative of globalization of production. The effect has been to reduce costs of goods for consumers, to improve efficiency in production and to increase consumer choice.

New economic geography of manufacturing (page 51)

An advantage of FDI over outsourcing is control over the operation, including management, quality, distribution and marketing. Under outsourcing arrangements, the brand owner will have an agreement with the manufacturer covering all these areas, but will lack hands-on control. Outsourcing has the advantage that the brand

owner does not have to make a large capital investment, and there is flexibility to shift production to another manufacturer or another country.

Does the particular FDI mode of entry matter? The owner has most control over the greenfield site, but this may require a long planning horizon, with additional time to build up production. Acquiring an existing business reduces the time needed to begin production, but adjustments will be needed to accommodate the new owners' way of doing things. Adaptation can take longer than anticipated. The joint venture, too, requires adjustments on the part of staff, as they are likely to be a mixture of people from the two or more partners in the joint venture agreement. When the joint venture company acquires an identity and culture of its own, its success can bring benefits to both 'parents'.

Theories of internationalization (page 57)

Students can be asked to summarize the main points of each theory before citing examples. They can draw on either companies they know or ones featured so far in this book. Examples could be found which demonstrate each of the theories. Product life cycle theory is still relevant for companies manufacturing consumer products – Nokia is an example. Nokia is also an example of incremental internationalization, as it expanded first in markets similar to its home market of Finland, and moved into India and China later. Covering three distinct types of advantages, Dunning's eclectic paradigm can be illustrated by a number of examples. VW is an example of internalization advantages, as the company has traditionally manufactured its own components. Ownership advantages feature strongly in the example of McDonald's, helping to explain its internationalization strategy. Ownership advantages are also important for Dyson. Location advantages feature in the cases of Nokia, Dyson, Ericsson and Puma – all of which now manufacture in low-cost locations. Note that Dunning envisaged a OLI configuration for every firm in terms of FDI.

FDI perspectives (page 63)

FDI can be an opportunity or threat from the perspective of the host country. FDI represents opportunities in terms of employment in the host country, possible technology transfer, spillover effects for local firms, and the raising of skill levels for local workers (the growth of car manufacturing in China is an example of all of these). The capital investment can yield economic benefits, such as tax revenues, for the local economy. The possible threats: Foreign companies may offer only low-skilled work, retaining managerial and highly skilled work for the parent company or parent-company nationals (expatriates). Foreign companies may constitute such strong competition that domestic firms are jeopardized or even put out of business (the expansion of global retailers is an example). Foreign investors, in some cases, pay little heed to environmental implications, and the result can be environmental degradation (oil companies have had a poor record in some locations; Coca-Cola has also been criticized for its poor management of water resources in developing countries). Much depends on whether the host government and communities reach agreement with investors to safeguard the environment, and are able to enforce such agreements.

Globalization's winners and losers (page 66)

First, summarize who the winners and losers are.

The winners:

- Global companies which have become more efficient and reduced costs of production have gained. These companies are able to sell their products in numerous markets, linked in a global strategy.
- Also benefiting from globalization are workers in favoured FDI locations, where new manufacturing jobs are created, allowing workers to enjoy increases in earnings and improvements in living standards.
- Affluent consumers in all countries have benefited, due to the increased availability of imported goods and greater choice of products.
- Skilled workers in technology have benefited from globalization in all locations.

The losers:

- low-skilled industrial workers in high-cost countries.
- Companies which have nurtured traditional skills, as in textiles and other craft-based industries, have been losers except in certain specialized markets (often luxury goods), as their products cannot compete on price with mass-produced goods, which are now widely available in all markets.
- Local and national businesses, often SMEs, which are unable to compete against multinationals.

Helping the losers without adversely affecting the winners

Where the losers are low-skilled workers, education and training can help to re-skill them for jobs in the sectors which remain buoyant, even in high-cost countries. For local and national businesses which risk being swept away by global companies, government policies can play a role. Some governments do not allow global retailers to move to an area if there is a risk that it will destroy numerous small shops. Local businesses, with their knowledge of local consumers, often represent formidable competition for multinational entrants new to markets. The fact that the market features both the established local company and the foreign entrant with its global brands is a feature of globalization which consumers welcome.

MNEs and social impacts (page 72)

Some students might argue that MNEs need not be concerned at all about social impacts(!) but most would probably acknowledge that they should to some extent.

The reasons draw on CSR and stakeholder arguments:

- Companies now appreciate that their operations impact on communities in which they are located, and that they therefore interact with those communities. Where relations are positive, all participants tend to benefit. The company will attract new recruits who identify with its goals, and communities will be more inclined to look

favourably on expansion plans. Good relations with the government may also lead to more favourable policies which benefit foreign investors.

- Another source of pressure on multinationals to take greater interest in social impacts has come from consumers in western markets. MNEs have attracted considerable adverse publicity over FDI and outsourced production in locations where working conditions are poor and human rights abuses occur. NGOs have brought much of this information to international attention. Companies now risk reputational damage if they ignore these considerations. Most are now paying closer attention to foreign operations, stressing that they now apply the same policies everywhere.

Part B review questions (page 72)

1. *Outsourcing production offers cost advantages to the company, especially in mass-produced manufactured products, but often incurs a 'backlash' of criticism. What are the specific objections voiced against this strategy, and what are the arguments in favour?*

The overwhelming argument in favour is that of cost advantages. Against the strategy are the following: the brand owner often takes too superficial an interest in the working conditions which exist in the factories making its branded products. The brand owner can argue that it abides by local and national law in the country of manufacture, but if child labour and poor working conditions exist, obedience to local law is seen as a thin defence.

2. *In the debate on globalization, to what extent do you agree with those who argue that national and regional differences remain important determinants?*

Most students would probably agree that national and regional differences are still important, although just how important is open to debate. It will help to highlight the areas where national and regional differences continue to exert influence:

- Consumer markets, especially in sectors such as food, media and entertainment.
- Location-specific advantages which influence decisions on where to locate production, for example, low-cost labour.
- Country-specific factors which weigh with MNEs when looking at where to invest, such as political stability, legal protections and government policies.

3. *Assess the winners and losers from globalization, including countries, companies, and groups in societies.*

- *The countries:* the large emerging markets, including China, Brazil and India. Also the countries rich in natural resources have benefited as markets in resources, such as oil, have become globalized. Among the losers have been poor developing countries, especially those with few energy resources and which are reliant on imports.
- *The companies:* large MNEs with geographical scanning across the globe to seek out the most advantageous locations. Also, state-owned companies, perhaps

ironically, have benefited from globalization, as their wealth has given them advantages in global markets. Born-global entrepreneurial companies have been able to grow rapidly, especially in the internet and related sectors, as innovations in these areas are targeted from the outset at global markets (an example is Google). Among the losers have been companies which have failed to respond to changes in technology, products and consumer demand. Often these are national or local companies which assumed they would be sustained indefinitely by their home markets, but have been overtaken by newer offerings from both foreign entrants and more entrepreneurial domestic competitors.

- *Groups in societies:* Workers in ‘new economy’ sectors, such as IT and computing have been winners. Less skilled workers in the older industries, such as traditional manufacturing, have lost out, but this is largely due to advances in technology, not to globalization per se. The numbers of low-skilled jobs in manufacturing in the developed world have tended to diminish as manufacturing of mass-produced products has shifted to low-cost locations.

4. *Globalization is associated with increasing inequality. This is one of the arguments often highlighted as a negative impact. Assess the evidence on the basis of current trends, deciding whether this criticism is justified.*

Inequality is discussed further in Chapter 3. It is raised here specifically in conjunction with globalization. It is helpful to state first why globalization and rising inequality are linked, noting that inequality can exist within a country and between countries. A point which students should have grasped is that those countries and companies with the skills, resources and strategies in the sectors which are rapidly becoming globalized (such as manufacturing, telecoms, finance, internet, extraction industries) can potentially make huge financial gains for their owners. China and India now have the most rapid growth in numbers of billionaires. Although ordinary workers have seen rising wages in both developed and emerging economies, the gap between these workers and the richest in their societies has widened. Students may argue that this is not a negative impact, and globalization should not be blamed for these consequences. They might argue that governments should bear responsibility for the social and economic well-being of all in society. Governments have encouraged market reforms and economic integration, seeking the benefits of economic growth, but rising inequality in many countries can lead to social unrest, often as a backlash against globalization.

5. *Should MNEs concern themselves with adverse social impacts of globalization? If so, what should they be doing in terms of changing their global strategy?*

MNEs now generally accept that they are active participants in the communities in which they operate, whatever the location. While they may view their activities in chiefly economic terms, economic activities are increasingly mingled with social, ethical, environmental and political issues. For this reason, it is arguable that

companies which manage these interactions with a view to social as well as economic goals will build more sustainable long-term strategies in host countries. The implications for global strategy are that local CSR and stakeholder concerns can bring positive benefits. Moreover, for MNEs, reputational damage in one location can lead to negative perceptions of the company in terms of global reputation.

Web-based assignment (online)

World investment prospects

These survey findings should be easy to read and analyse for students. It can be used as an individual written exercise, or as a group one. A seminar group could be divided into teams, each answering one of the questions.

Synthesis and reflection (online)

Part 1: The international dimension and the organization

1. *Which company examples in the two chapters illustrate links between corporate ownership structures (including governance) and corporate strategy?*
 - *Chapter 1:* Ericsson (family influence); White Castle (family influence); Volkswagen (regional government, family influences); Porsche (family owned); Japanese companies ('insider' shareholding arrangements and government guidance).
 - *Chapter 2:* Delphi (GM as parent company); Dyson (founder owner); Nokia (national cultural influence).

2. *Cite some MNEs from emerging economies mentioned in these chapters. In what ways are they challenging established MNEs?*
 - *Chapter 1:* Café Coffee Day of India (challenging Starbucks); PDVSA of Venezuela (Venezuela's national oil company, which is asserting greater ownership and control over US and European oil companies in joint operations); Shanghai Automotive Industry Corporation (SAIC) of China (a joint venture partner of Volkswagen, now making its own cars).
 - *Chapter 2:* Lenovo of China (the computer maker which bought IBM's PC business); Vale of Brazil (the world's largest iron ore producer); CNOOC of China (the Chinese national oil company, which was unsuccessful in its bid for Unocal of the US); Tata and Mahindra & Mahindra of India (both manufacturing conglomerates which are now internationalized).

3. *Which companies mentioned in these chapters have focused on stakeholder, ethical and/or environmental considerations in their international strategies?*
- *Chapter 1:* PepsiCo (recognition of all three areas of consideration in its strategy); Volkswagen (stakeholder role in corporate governance, in the form of trade unions, and also the role of the government of Lower Saxony).
 - *Chapter 2:* Puma (independent monitoring of outsourced manufacturing); Nike (for its CSR policies in outsourced manufacturing); Nokia (CSR web page).

CHAPTER 3

The Economic Environment

Strategic crossroads

3.1: Samsung (page 84)

- ◆ *Why is Samsung the target of criticism from both public opinion and regulators in South Korea?*
Although South Koreans are proud of Samsung, they are uneasy about this family empire having so many businesses in so many areas of consumer life. The South Korean government has attempted to introduce market reforms, reducing the influence of the chaebol. However, they are so entrenched in the business culture that, despite regulation of practices such as cross-shareholdings, the families are reluctant to give up power.
- ◆ *How does Samsung exemplify the disjointedness between society and the economy?*
South Korea's period of rapid economic growth saw it achieve status as a leading country in key industries such as electronics and car manufacturing. It built global brands and also a reputation for high levels of R&D and innovation. South Korea also prides itself on the achievement of its education system, particularly in science and engineering (see Country focus 7.2). However, its companies, such as Samsung, are rooted in the family-dominated culture of earlier generations, which suggest more inward-looking perspectives and also less openness and transparency in corporate governance than might be expected in these global companies.

3.2: Aviation Valley (page 104)

- ◆ *What are the specific benefits of the industrial cluster in the Polish context?*
First define the industrial cluster. Businesses tend to be isolated in this remote region, where transport links have been slow to develop. WSK had to produce its own components, for example. The grouping of a number of companies in the sector, including components suppliers and R&D help the firms to benefit from each other's expertise. These companies in isolation would find it difficult to compete in global markets.
- ◆ *In what ways can Aviation Valley benefit Poland's economy?*
Poland is a post-communist transition economy. Market reforms and privatizations have taken place, but changes in management and culture are needed to shake off the legacy of communism and bureaucracy, so that firms can compete in global markets. Foreign investors have played a role, and, indeed, WSK is owned by a US company, UTC. But there is a need for domestic businesses to play a role in economic growth and job creation, to ensure

sustainable economic growth. Aviation Valley has provided jobs and prospects for R&D, helping to train engineers and researchers who might otherwise have gone to other countries in search of better career prospects.

Case studies

3.1: Heineken (page 99)

1. *What changes are taking place in global drinking habits?*

The greatest growth is in emerging markets, such as China and Russia. Drinkers in North America and Western Europe are shifting away from beer towards wine and spirits. As consumers' lifestyles become more affluent, they tend to move up to more premium products, including low-alcohol beers.

2. *Looking at the quotation in the first paragraph, in what ways have changes in Heineken's management made it more 'Anglo-Saxon'?*

Heineken is a private company, just over 50% owned by the Heineken family. This type of company is traditionally conservative and inward-looking, recruiting managers from within and maintaining a closely-knit culture based on cultural homogeneity. The 'Anglo-Saxon' model is more individualist, relying less on consensual decision-making. The new executive committee and regional executives are now able to take decisions more quickly, based on market trends which are rapidly unfolding. This is especially true of decisions on mergers and acquisitions. After this case study was written, Inbev acquired Anheuser-Busch of America, bringing further consolidation in the global brewing industry.

3. *To what extent are the changes at Heineken giving it a competitive edge on its larger rivals?*

The new approach at Heineken has led it to emphasize innovation. It has launched a low-alcohol beer as an extension of its flagship Heineken brand. It has been at the forefront of innovation in packaging and the use of aluminium. New slim aluminium bottles are designed for nightclubs and bars. At the same time, it pursues cost savings relentlessly, unafraid to close breweries if necessary. Both innovation and cost savings enhance its competitiveness, which it needs to compete against larger rivals.

4. *Why does the future look sparkling for the global brewing companies in emerging markets?*

Beer consumption is still rising in emerging markets. Heineken has a 14% share in the Russian market and has bought a number of Russian breweries. As numbers of middle-class consumers grow, these markets have potential for growth. The more affluent consumers in these (as well as mature markets) are turning more to speciality beers. Beer has had an image problem in the past in the mature markets, but this is less true in emerging markets, where new lifestyles and beer consumption are both rising.

3.2: Wal-Mart (page 113)

1. *Assess Wal-Mart's strategy and organizational changes in its US operations.*

Wal-Mart's business model was to run a high-volume, centralized operation, offering mass-produced goods to lower income groups, especially in rural areas. Its origins are in America, where this formula proved very successful. It expanded from food retailing to non-food ranges. It has attempted to broaden its appeal in the US beyond its core customers, to more affluent and urban consumers, in the hope of generating greater profits. This change has involved gaining a better grasp of changes in consumer tastes. This process was accompanied by decentralization in its organization, to allow for local differences in preferences.

2. *Wal-Mart's international expansion, to date, has not been an unqualified success. Are its prospects better for its great leap into China, and why?*

Wal-Mart executives in the international division have learned from previous international retail experience that adaptation to local conditions and norms is needed. This has entailed some radical shifts in policy. For example, despite its anti-union stance in the US, it has allowed trade unions (Communist Party affiliated) in China, and also a branch of the Communist Party to be set up in one of its stores. China's growing market has attracted other major hypermarkets, making this sector highly competitive. Wal-Mart has considerable experience in sourcing products in China, as it is one of China's biggest customers for low-cost textiles and appliances.

3. *In what ways does Wal-Mart epitomize twenty-first-century capitalism, including its good and bad aspects?*

A number of points could be raised by students, partly dependent on how they view 21st-century capitalism. Many in Europe might have little direct experience of shopping at a Wal-Mart store (Asda in the UK is indicative, and those who have been in both could say how they are different.) Some points from the case study:

- Global supply chains – Wal-Mart has maximized its use of low-cost imports from China.
- Employee relations in the large organization with over a million lowly paid workers – it has been strongly anti-union, and has had a poor reputation in employment practices. It has been the defendant in the largest sex discrimination case in US history.
- Wal-Mart has been the target of environmentalists, and has faced legal action for breaches of environmental protection laws in the US.
- In efforts to clean up its act, Wal-Mart has introduced new policies on the environment and labour conditions in the Chinese factories which produce its goods (see Part 5 of this book).
- In China, as noted above, it is co-operating with the Communist Party.

Country focus

3.1: The UK (page 92)

- ◆ *Why has the regional divide persisted, despite the targeting of public spending and public sector jobs in the poorer areas?*

It is helpful to begin by describing the regional divide and its causes. In the north, older industrial jobs have diminished, while new jobs in finance and the ‘new’ economy have been created mainly in the south. The public spending and increased public sector jobs in the north, although they have provided jobs, have not led to new business activities such as start-ups, which create wealth and lead to economic growth.

- ◆ *What have been the effects of globalization on the British economy?*

Globalization has benefited London and the south, which have attracted global financial services. London is one of the world’s leading financial centres. Those in these industries have seen growing incomes, leading to buoyant activity in housing, consumer goods and leisure activities. These sectors are all at risk from crises in global finance, as happened in 2008.

Also mentioned in the case study is the rise in back-office service jobs, such as call centres, which have located in poorer regions. These jobs risk being offshored to cheaper locations such as India.

- ◆ *In your view, what policies would be needed to reduce inequality and boost regional employment?*

This question assumes that these are desirable policies – some students might question this assumption. They could be asked to explain why they feel such policies are not necessary. The three major political parties are concerned about widening inequality and rising poverty. In 2008, steep rises in energy costs were set to lead to rising poverty.

Some of the policies

- Spending more public money on social policies, such as fuel subsidies for the poor, housing benefits and benefits to low-income families. These are costly, and given the UK government’s huge national debt, increases in public spending would entail even more borrowing. Raising taxes, although unpalatable, is a way of raising money. Economic downturn in 2008 has led to reduction in tax revenues, just in a period when needs for payments such as unemployment benefits are rising.
- Introducing steep tax rates for the very rich. The very rich are often skilful at shifting assets to locations which reduce their liabilities. Governments have been reluctant to introduce punitive tax rates: they may not yield greatly increased revenues, and they are perceived as possibly counterproductive, as these individuals and their companies are the source of considerable wealth creation.

- Policies to encourage businesses to set up in regional locations, along with the activities of regional development organizations, have succeeded in bringing enterprises and jobs to the UK's regions. FDI in the regions has been successful in creating jobs, for example, in car manufacturing. A risk is that foreign investors are constantly assessing differing locations, and if costs are lower elsewhere, they can shift manufacturing away from the UK.
- Policies to encourage entrepreneurs and start-up businesses. As the case study showed, many people gravitate naturally towards seemingly secure public sector jobs in preference to starting businesses. Dyson, featured in SX 2.2, argued that the culture and education system have tended to undervalue engineering courses and jobs. Yet, these jobs are at the heart of a country's innovation system.

3.2: Romania (page 108)

◆ *How successful is Romania's economic transition to date?*

Romania has been slow to make strides in economic transition, largely because of corrupt governments throughout the 1990s. Since then, economic reforms have proceeded rapidly, and the country entered the EU in 2007. However, surface reforms tell only part of the story. The legacy of corrupt political and business ties of the 1990s remain a problem.

◆ *How can Romania prevent the emigration of its workers?*

The attractiveness of the country to foreign investors has led Romanians to hope that FDI will help to provide the new jobs which the country needs to sustain economic growth. Romania's education system has emphasized science subjects, which, if combined with IT training, provide the skilled workers which foreign investors are seeking. Lower wages and Romania's flat tax of 16% also attract foreign investors. There could be spillover effects from FDI, offering opportunities for local firms. This can help to provide the jobs at home which will encourage people to stay in the country rather than emigrate. Entrepreneurs such as Dan Ostahie have found that the growing domestic consumer market offers abundant opportunities.

◆ *Why is there still cause to be sceptical about Romania's economic prospects for the future?*

The World Bank has praised Romania's progress as a business environment. However, the EU lists nine critical areas, including corruption and judicial independence and state aid. Many powerful interests from the earlier era remain influential, and impede progress towards cleaning up corrupt political, business and judicial links. With large sums of EU funding due to come to Romania, the need to ensure accountability and transparency are crucial. The European Commission has monitored the continuing corruption, and in August 2008, the EU suspended rural development funds for Romania temporarily. Economic

prospects may still be good, for reasons cited above, but the corruption remains a problem.

Pause to reflect

Beyond the boom (page 84)

Many of today's developing economies have grown rapidly, wishing to catch up as quickly as possible with the developed world. China is the leading example. The risks they face in terms of their sustained growth:

- *Rising expectations* on the part of their populations for improvements in lifestyles, including housing and consumer goods, risk disappointment if there is fall in global demand for the manufactured products on which export-oriented economies such as China are built.
- Rapid industrialization has led to *environmental degradation* (such as air pollution) and depletion of national resources such as water. For ordinary Chinese, problems of air pollution and poor water supplies have risen up the agenda, linked as they are to health. They naturally expect human well-being generally to be enhanced by the country's economic development, but it has deteriorated in these respects.
- Demand from industries in rapidly developing countries for raw materials (such as metals) and energy has led to a *global surge in commodity prices*. This has benefited producers, but for non-renewable resources (such as oil), there are concerns. These concerns are raised in developed as well as developing countries.
- Industrialization and power generation (especially coal-fired power stations) are contributing to *climate change*. The most rapid growth in greenhouse gas emissions is taking place in the developing countries – China is now the largest emitter (see Chapter 13). Climate change is a global issue, implying that all countries should bear responsibility for reducing emissions. However, the large developing countries have been reluctant to go along with this view.

Tackling unemployment (page 89)

- *Country A* – Policy-makers here face a situation which has been attributed to globalization. The government could invest in education and training for these semi-skilled workers in their 30s and 40s, but there would need to be employment prospects in other businesses to get them back into employment. Some could well start their own businesses, but only a few would be likely to do so. The government could aim to attract new businesses to the region, by incentives for start-ups. Redundant workers could be encouraged to seek work in other regions of the country, but this may not look appealing to these workers, given their age range and likelihood that they have families; it would probably appeal more to younger workers.
- *Country B* – This is a very high level of unemployment, and these rural areas could well suffer from social unrest. Workers in the 18-24 age group would probably be willing to go to the cities where jobs are available, but not if jobs are becoming

scarcer. Policymakers could encourage businesses to move to rural areas, where these workers would probably work for less than their urban counterparts. They could also live at home, rather than in dormitory accommodation near urban factories. Businesses could reduce costs in terms of wages, but the costs of transport would probably rise, as would delivery times. This situation has occurred in China, where industrial development has been concentrated in the coastal areas.

Some more equal than others (page 94)

First define what is meant by equality of opportunity. Equal access to education is often difficult to achieve for policymakers. In all countries, richer regions are likely to have better schools than poorer ones. In developed countries, the numbers of students going to university is greater in the richer areas than in the poorer, even though, in theory, all have equal access to schooling. In developing countries, poor families which struggle to survive are often unable to send children to school, even for the few years of primary education provided by the state.

Define the distinction between equality of opportunity and equality of outcomes. Most would probably argue that policymakers can realistically hope to achieve equality of opportunity. An issue which arises in today's societies is possible discrimination against some groups in society – these may be the very poor, ethnic minorities, religious minorities or immigrants. Is 'positive discrimination' necessary to give them equal opportunity?

The market model for all? (page 100)

This is a highly relevant issue in light of state intervention in financial markets in late 2008. Interventions in the US, UK and other European countries, to shore up banks and keep financial flows moving suggested to some that faith in the liberal market model is perhaps misplaced. Students are more likely now to agree with the statement that, in practice, markets are not very good at serving public welfare goals. Their reasons could include the following: Risk taking in financial markets has been facilitated in an atmosphere of light regulation, which, with hindsight looks to have been a mistake. Indeed, sectors such as derivatives trading, hedge fund activities and private equity buyouts have been essentially unregulated (see Chapter 11). It has been assumed that the benefits of economic growth would 'trickle down' to all in society, but this has not happened. Vast wealth has been accumulated by senior executives, especially in financial sectors, which is producing a backlash from ordinary working people. Many would argue, however, that the market model is essentially better than the alternatives, but that better regulation is needed.

A good place to do business? (page 102)

What should the foreign investor look for in the economic environment of possible locations? Note that the question asks which factors the foreign investor *should* look for.

- Summarize what foreign investors tend to look for: government policies which do not discriminate against foreign firms, and possibly offer incentives such as tax

holidays; light regulatory systems; relatively low social costs; low taxes; public investment in education, health, infrastructure and other public goods. Some of the items on this list are contradictory, which is why businesses are accused of wanting the best of all worlds. The foreign investor should look for regulatory systems which are not necessarily the lightest, but are fair, transparent and relatively easy to follow. Similarly, the investor should not necessarily be deterred by high social costs, as the social benefits such as education and health indirectly benefit the business.

- Students are invited to choose which developed market economy is the best for doing business of the ones described in the section, and why. Those favouring the liberal market model can point to the freedom of enterprise in the US, but those favouring the social market model will point to the problems of paying for social welfare in the US, and suggest that the Nordic or European models are fairer, making them better places to do business.

FDI flows to Central and Eastern Europe (page 105)

- *Poland:* Drawing on the strategic crossroads feature, an advantage is the availability of skilled workers at a fraction of the cost in Germany. Another advantage is that Poland's economy is enjoying reasonable growth, and has attracted a number of foreign investors. It has been in the EU since 2004. Disadvantages are poor infrastructure, burdensome bureaucracy and high levels of corruption.
- *Romania:* Romania has had slower economic development than Poland, and has lower GDP per capita. It is a transition economy, but its industries have lagged behind those of Poland. It joined the EU in 2007, creating expectations of modernization and stable growth. However, corruption and bureaucracy remain drawbacks for foreign investors.
- *Russia:* (see CF5.1) Russia is probably the riskiest of the three countries for foreign investors. Its government remains authoritarian despite outward market reforms. Foreign investors have been attracted to its growing numbers of middle-class consumers, but the heavy-handed state is a disadvantage. Russia's economy suffered a financial crisis in the late 1990s, adversely affecting foreign investors.

China's capitalism (page 107)

China has liberalized its economy, welcoming capitalist enterprises and allowing private businesses to operate. However, it remains dominated by the Communist Party, in contrast to the post-communist countries, most have which have brought in at least some minimal democratic government. In addition, China's state-owned companies remain influential players in the economy, again in contrast to the transition economies which have privatized many state-owned companies. Many of China's state-owned companies have listed on domestic stock exchanges, but remain under state/party control.

The Communist Party has resisted any voices asking for civil and political freedoms. Chinese citizens/consumers are becoming more vocal on matters such as health and safety and the environment. The tainted milk scandal of 2008, which

reached widespread proportions before being acknowledged, showed a stark contrast between lax regulation in terms of quality controls and highly sophisticated systems of state controls in areas of freedom of information and the internet.

Global versus national (page 113)

Students are likely to agree with this view, at least initially. The reasons: Companies look for location advantages for FDI, which has meant that some countries are favoured over others. Governments which are keen to attract FDI stress their location advantages, in a kind of competition to attract investors. On the other hand, some countries have pursued policies of economic development which have stressed the nurturing of domestic businesses instead of FDI – India is an example. Of course, India has benefited from globalization, its IT and computing services companies becoming global players. Countries therefore benefit from national economic differences whether they are looking to attract FDI and outsourcing or are pursuing a more national path of economic development.

On the other side of the argument, it should be pointed out that most countries are pursuing market reforms, liberalizing and opening their economies. These reforms attract investors, encourage local firms and promote consumer markets. In this sense, therefore, they are tending to converge along capitalist lines. This chapter has highlighted differing models of capitalism. Students can consider whether these are converging or remaining distinct.

Part B review questions (page 113)

1. *Looking at two countries which have high growth rates at present, explain why they are growing strongly, and what their prospects are for continued growth. Next, look at two countries with low growth rates, explaining why growth is weak and what their prospects of upturn are.*

Students are likely to choose emerging economies or resource-rich economies for the first two examples. Their growth rates are largely dependent on continued demand both within their economies and from exports, both of which are at risk in a slowdown. Countries with low growth rates include the developed economies, such as the US and Western Europe. They have suffered from waning competitiveness, high costs and weakening consumer demand. Their prospects of upturn depend partly on the extent that restructuring takes place and their innovative capacity to regain competitiveness. These countries' exports, such as heavy machinery from Germany, have found eager buyers in China, but if China's economy slows, those exporters will see falling order books.

2. *How have businesses benefited from economic integration within the EU? Contrast those in the EU 15 with those in the 12 recent accession states.*

It is appropriate to begin with the aims of the EU in the single market, allowing free movement of goods, people, capital and services. Not all have been realized. The benefits for businesses: greater ease in doing business across national borders; ease in building markets in other member states; harmonized regulatory

frameworks in many areas, such as product safety; for eurozone members, the single currency, which eliminates exchange risk. For the EU 15, the accession of Central and Eastern European states has opened up opportunities for FDI, producing goods for consumers in the EU 15 states at lower costs. This movement of FDI has helped the newer member states to maintain healthy economic growth. At the same time, it has benefited businesses in the high-cost environments of the EU 15, in accessing low-cost production near to their main markets.

3. *Assess the priorities of the EU's budget. What is the justification for richer countries subsidizing development in the poorer countries? Do you agree with this policy, and why?*

See Figure 3.13. Agriculture accounts for a large proportion of the EU budget under the CAP. Agriculture has been a sensitive sector in the EU, and has been long perceived as meriting protection. It is also politically sensitive and is associated with national strategic interests. The EU spends large sums on aid to poorer member states (regional 'cohesion' funds). The aim is to assist recipient countries to raise living standards and prosperity, but transfer of funds from the richer to the poorer states is criticized by some, especially those who look to markets as the best way forward. The fact that the newcomers have higher growth rates than the countries which are the largest contributors to the EU budget has caused some disenchantment at grassroots level, as indicated by the 'no' votes to the new EU constitution.

4. *Assess the impact of globalization on differing national economies: a developed economy; a developing economy; and a transition economy.*

Some general points only are offered here. The student should choose a particular country in each category. Both sides of FDI, outflows and inflows, should be considered, as well as differing perspectives.

- *The developed economy* – Its companies pursuing outward FDI have prospered; its economy has probably also benefited from inward FDI, serving domestic consumers (the US is an example); its manufacturing jobs in some sectors, however, have contracted.
- *The developing economy* – For a country which has attracted FDI, economic growth has brought benefits, although much FDI is in low-skill manufacturing such as textiles. The poorer developing countries tend to have few companies which become outward investors. Developing countries which are dependent on primary commodities such as agriculture have seen few benefits from globalization, as they have been poorly placed to compete against the large agricultural exporters in global trade. They have also faced tariff barriers in rich-country markets.
- *The transition economy* – This could be an Asian economy or a Central or Eastern European economy. These countries have benefited from globalization, in that they have brought in market reforms, privatized large and inefficient state-owned industries and welcomed FDI in many cases.

Their outward investors, often state-owned companies in the case of China, are now becoming important forces in global markets.

**Web-based
assignment (online)**

Promoting enterprise and small businesses in the UK

This would be an appropriate exercise for an individual assignment. Although it focuses on the UK, the issues and policies are relevant to all countries. A seminar discussion could look at whether the analysis (such as the fear of failure factor) and policies would transfer to other countries.

CHAPTER 4

The Cultural Environment

Strategic crossroads

4.1: Chugai-Roche (page 138)

- ◆ *Why has the alliance between Chugai and Roche been successful?*
 - The identity and culture of Chugai were preserved.
 - The 'hands-off' approach of the new owners to Chugai's activities, within the broad goals of Roche's international research programme.
 - Good personal relations between the two CEOs.

- ◆ *What lessons can be learned by other Western companies seeking Japanese alliances?*

This was a takeover, as it involved acquiring 50% of Chugai's shares, but the lessons would apply to other types of alliance. The lessons:

 - Work on building open relations based on trust with the other partner.
 - 'Saving face' is important in the Japanese context. The Japanese company should not be perceived as being taken over or being the subordinate partner.
 - Leaving the existing management in place helps to reinforce the sense of partnership and trust.

4.2: Arab media (page 150)

- ◆ *What factors have contributed to Al Jazeera's success?*
 - Editorial independence from its financial backers in Qatar, which was unusual among Arab media providers when it was formed.
 - Policy of presenting both sides on important issues.
 - Appeal to the ordinary Arab viewer.
 - In-depth coverage of how ordinary people are affected by events.
 - Expansion of its range of channels.

- ◆ *In what ways is Al Jazeera's new English service noteworthy from a cultural and business point of view?*

The new English channel aims to reach a mainstream English-speaking audience, rather than simply Arab viewers, with its characteristic approach of balanced and diverse perspectives. From a business point of view, it has faced challenges, as the large US cable operators refused to carry it. However, it has been accessible online, and has online subscribers. As a business, Al Jazeera has become one of the most well known Arab brands.

- ◆ *What factors will be significant in Arabic Google's attempt to be as successful as Al Jazeera?*
Arabic Google depends on the growing popularity of the internet in Arab states. Its offering of an Arabic Google News aspires to emulate Al Jazeera's success in satellite TV. However, Google has been criticized for complying with Chinese authorities in self-censorship of its Chinese website, and sceptics question its stated policy of remaining independent of governments in its Arab service. Google faces stiff competition as local Arab websites are proliferating, and these rivals are well attuned to online users' needs and tastes.

Case studies

4.1: Citigroup in South Korea (page 140)

1. *What difficulties has Citigroup faced in building market share in South Korea?*
Acquiring a South Korean bank was the route chosen by Citigroup, in order to gain market share quickly. The target bank, Koram Bank, had 238 branches, and with the might of the Citigroup behind it, had potential to gain market share in this large market. The new Citibank Korea became Korea's sixth largest lender. However, there were difficulties in integrating the two banks, which could delay its expansion plans.
2. *What issues within the two organizations have held up the integration process?*
 - Integrating the IT systems.
 - Deciding on the policies and practices to follow. The reward system was changed, and the bank managers' roles were changed, indicating that local practices were giving way to the parent company's way of doing things.
 - Cultural hurdles. These two companies are culturally very different, and South Korean employees were uncertain of their jobs and wages in the aftermath of the takeover. Poor labour relations are common in South Korea - a well-known factor which should have been taken into account.
3. *In your view, what mistakes has Citigroup made in integrating the two organizations?*
Answers depend partly on the student's point of view, but most would feel that:
 - Citigroup did not adapt sufficiently to the cultural sensitivities of the new environment.
 - Policies and practices should have been adapted more to the South Korean bank's existing ways of doing things.
 - HR roles and responsibilities should have been handled more by consensus.
 - When workers showed dissatisfaction and came out on strike, the rather confrontational approach adopted by the American owners was unhelpful.
4. *What recommendations would you give to Citigroup for any future acquisition in Asia?*
Some possible recommendations:
 - Study both the market and the target company carefully, to assess how well they fit in with the parent company's policies and ways of doing things.

- When the acquisition takes place, re-assure the new staff that the new owners will not make radical changes quickly, but any changes will come about by consensus. This is true in any country with high uncertainty avoidance.
- Adopt more flexible labour relations policies, emphasizing dialogue rather than confrontation.

4.2: DIY goes global (page 152)

1. *What aspects of the cultural environment in China are relevant to the DIY sector?*
 - New prosperity of China's middle classes.
 - Rabid urbanization, in which new apartment blocks are springing up, due to large investment in the private sector.
 - The practice of building housing with little in the way of fittings (such as lights and kitchen units), allows customers to choose all their own fittings and furnishings to suit their taste.
2. *How successful has B&Q been in adapting to the tastes and needs of local consumers in China?*
 - B&Q's UK format is the warehouse, but this has been adapted in China, to allow shoppers to touch and examine the products closely.
 - B&Q found that Chinese customers preferred more ornate furnishings than they would normally stock, and they altered the style of furnishings to suit local tastes.
 - Chinese consumers, who have little background in DIY, prefer to hire other people to do the installation. B&Q therefore provides installation services in China to a far greater extent than they would in the UK.
 - For people moving into new apartments, B&Q offers furnishing packages suited to their budgets. In the second-tier cities, this means offering a basic furnishing service at a much lower cost than the equivalent in an upmarket apartment.
3. *What challenges await Home Depot in its Chinese market entry?*
 - Home Depot is entering a market in which there are experienced competitors, both foreign (B&Q) and local.
 - In America, its business model based the DIY warehouse is highly successful, but attempts to transplant it outside its home market have been unsuccessful (except in Canada and Mexico).
 - Building supply chain links will be a challenge for Home Depot, in light of its limited international experience and little experience of sourcing products in China.
4. *Compare B&Q and Home Depot in terms of their approaches to internationalization.*
 - B&Q have been more international for longer; experience in different cultures, such as Poland, had been gained before entering China.

- B&Q opts for greenfield sites, whereas Home Depot has acquired a local chain of DIY stores, Home Way. This is a suitable entry mode for Home Depot, which is playing catch-up, as Home Way already has market share and its staff are more familiar with the market than those from Home Depot.

Country focus

4.1: Turkey (page 125)

- ◆ *What cultural influences continue to be important in Turkey?*
Conservative Muslim values continue to be influential. At the same time, the strong secular tradition in the state is also important. Turkey has a vibrant westernized urban culture, creating tension with more conservative sections of society. In addition, the Kurdish minority has its own separate culture and identity. Kurdish separatists are a source of conflict.
- ◆ *What social and cultural changes are taking place in Turkey?*
There is a growing urban business community with western secular values. The rural areas, where agriculture has predominated, are mainly conservative Muslim. Turkey has a large population of poor inhabitants, large numbers of whom have moved to the cities in search of work. These migrants tend to live in poor areas on the outskirts of the cities, retaining their traditional values.
Turkey's prime minister is from the Muslim political party, the AKP, and his conservative Muslim background has brought him into conflict with the country's secular institutions.
- ◆ *Assess the positive and negative factors in Turkey's case for EU membership.*
Turkey would stand to benefit from EU membership, which would enhance its attractiveness as a destination for FDI. It has high unemployment, and further manufacturing jobs in car production and textiles would be welcome. The Turkish business community would stand to gain. Exporters already find it attractive for FDI because of its proximity to European markets. However, Turkey's poor educational system needs improvement in order to provide the skills necessary to encourage higher technology investment. In industries such as textiles, it faces tough competition from China, even allowing for the added costs of transport.
Member states of the EU have wavered on whether Turkey should be admitted. Its huge population of mainly poor, mainly Muslim, inhabitants has been an issue. Feelings within Turkey have also wavered. Its modernization has been rapid, but there are still divisions within the country, with risks of social and political instability.

4.2: Mexico (page 146)

- ◆ *Summarize the grievances of Mexico's indigenous peoples against the Mexican authorities.*
 - They have criticized the policy of assimilation with the dominant Spanish culture, as it stifles their identities and cultures.
 - They have lagged behind in development, income, education and living conditions.
 - They also suffer from discrimination, further widening the gap between indigenous and non-indigenous groups.

- ◆ *Why has Mexico made so little progress in creating jobs and prosperity, despite benefiting from globalization?*

The jobs which have been created have been concentrated in the free-trade zones in the north of the country, where manufacturing for export to the US is clustered, especially following the Nafta agreement. These largely low-skilled and low-paid jobs have not brought the prosperity hoped for, and they are vulnerable to competition from China. The higher-tech industries are also vulnerable, as they are dependent on the US market and feel the impact of US economic downturn.

Development in the rest of Mexico is uneven, and rural unemployment is high. Mexico's farmers have not been able to compete with imported maize from the US (part of the Nafta agreement).

- ◆ *Is Mexico on the way to achieving social stability through recognition of cultural diversity, or creating potentially divisive forces, as in the past?*

As the results of the presidential election show, divisive forces are still powerful. Fox and Calderón emphasized social welfare policies. Fox introduced policies of multiculturalism, but the indigenous community still lags behind, with a large proportion living in absolute poverty. A concern is that, as many Mexicans leave to work in the US, remittances have become important to local Mexican communities. Falling remittances due to the downturn in the US adversely impacts on the Mexican communities which are dependent on them.

- ◆ *Assess the advantages and drawbacks of Mexico as a location for an FDI investor.*

Mexico's greatest attraction is proximity to the US market. The free-trade zones, in particular, have attracted investors. Costs, including wages, are low in Mexico. FDI investors from Spain might find Mexico an advantageous location because of the language and cultural affinity between the two countries.

Disadvantages of Mexico are the social and political instability; poor infrastructure; low levels of education and skills in the workforce.

Pause to reflect**Who am I? (page 122)**

Students should give their individual answers to this question, perhaps by writing their responses down on paper. This avoids students simply answering along the lines of the previous speaker. The tutor can collect all the responses and read at least some of them out; there should be variety, which can generate discussion.

Discussion of the second question follows logically. Self-identification indicates the values which are paramount in a person's culture. If the person identifies above all with his/her company rather than family, it suggests the company is more important (which is often true for Japanese people). If the person identifies him/herself as a Christian or Muslim, then religion is the most important value in his/her life.

Diverse societies (page 127)

Answers to the three questions depend on the student's home country. Interesting comparisons can be made in groups with students from a variety of countries. The last question, regarding social cohesion, is likely to produce disagreement. Those that favour cultural pluralism would argue that a degree of subculture identity is beneficial for social cohesion among, for example, immigrant groups. Attempted assimilation is now often criticized as akin to suppression of minority cultures. Rights of minority cultures are recognized in international human rights law, but national governments tend to be concerned about the risks to cohesion and unity within the state.

Intercultural communication (page 129)

The student could give reasons for adopting any of these three policies. The first policy is probably the least desirable, and also unrealistic. Agency interpreters brought in for specific transactions move from job to job and will not be familiar with the business background. The second policy is possibly the best, although there are limited numbers of genuinely bilingual people. To justify hiring them as employees, they would probably need to have functional roles in addition to their linguistic skills.

The third policy is more realistic. Polish people familiar with how things are done are essential to the enterprise. Their English language skills in relation to the business, even if limited, are helpful. A combination of the second and third policies would probably be the best solution.

Applying cultural theories (page 133)

The answers to the first two questions depend on the student's national culture. The third question invites critical discussion. Some of the limitations:

- Hofstede's theory is based on research which is now dated.
- The use of dimensions or categories is somewhat artificial – cultures cannot be dissected so cleanly, as each facet is interdependent with the others.
- Analysing national cultures according to a theory assumes it is static, when in fact cultures are constantly changing.

- Conclusions about cultures based on quantifying responses to questionnaires is problematic in the context of data which are essentially more qualitative than quantitative.

Organizational cultures with national roots (page 135)

- All procedures governed strictly by the rule book. Western individualist cultures, such as the US, would have this characteristic, but mainly in large bureaucratic organizations.
- Open, relaxed communication among employees of all levels. This characterizes national cultures with low power distance. The Scandinavian countries are examples.
- Emphasis on strong corporate identity, reinforced with highly visible symbols. More collectivist cultures are likely to have organizations which subsume the individual in a strong corporate identity. Japanese companies are an example. Company rituals reinforce the feeling of identity.
- Hierarchical, with detailed job descriptions. The job-oriented culture is more likely to be found in the individualist, low-context cultures, such as the US and UK, in which contractual relationships predominate over social relationships. Hierarchies define each position precisely, so that there is continuity in the performance of the tasks even when the people change.

The urban-rural divide (page 142)

This is a problem in many developing and emerging economies. What governments can do:

- Encourage businesses to set up in rural areas, both local firms and those from outside the region. Much of the labour in cities is provided by migrant workers from the countryside. If there is work available near to home, this is a viable alternative. A drawback is that roads and other infrastructure are poor in rural areas – hence the next recommendation.
- Invest in infrastructure such as roads in rural areas.
- Invest in education and training in rural areas, so that workers from these areas are able to take jobs in other sectors.

Cultural diversity (page 148)

Minority communities often lag behind in economic development and suffer from high unemployment. The high levels of unemployment do not reflect unwillingness to work but few opportunities. Employment in small family businesses, in which the native language is the main medium of communication, is typical in such communities, but these offer few jobs (mainly to the family) and little prospect of moving on to careers in the society.

Businesses which invest in these communities can offer regular salaried employment, training and career development. They will be sensitive to the cultural needs of workers – for example, Muslim workers. In immigrant communities, they can offer language classes at modest expense for both workers and their families – these

can be helpful for the business, and also help families to become more able to cope in the new country. We tend to think of government social programmes in connection with helping to build cohesion, but this pause to reflect turns our attention to the role of businesses, which can combine economic with social benefits.

Culture and globalization (page 151)

The globalization argument: As consumer society spreads, lifestyles among the world's people, especially the new urban middle classes, are converging. Their spending power makes them influential in consumer markets which MNEs are targeting for future growth. The rise of global brands, global products and worldwide distribution networks reinforce the convergence in consumer markets. As lifestyles become similar, national differences and the influence of family background gradually fade away. The rise of the English language globally is indicative of this cultural globalization.

The argument against cultural globalization: Although industrialization and the rise of urban lifestyles are held up as indicative of cultural globalization, in many ways the world is becoming more fragmented in terms of cultural identity. Societal groups in developed, developing and emerging economies assert distinctive cultures from a variety of perspectives – ethnic, religious, immigrant and indigenous groups are among them. Separatist groups and movements proliferate, claiming to represent the legitimate aspirations of their members. A new assertiveness of cultural identity could be seen as a reaction against perceived threats from globalization. MNEs in consumer markets, which offer distinctive products, brands and marketing communications designed for local markets, are indicative of the cultural diversity which persists.

Part B review questions (page 152)

1. *Global companies and brands can claim considerable success in diverse markets. Is national culture becoming more, or less, important in the international environment, in terms of markets for consumer products?*

First define what is meant by 'national culture', noting that this term, used by Hofstede, can be misleading. In most countries, there is a mixture of differing cultures, often based on regions or language groups. The entirely homogeneous national culture is unusual – Japan is sometimes pointed to, but even here, there is a Korean minority which is culturally different, as well as indigenous peoples. The large emerging markets, China and India, are home to numerous different cultures and cultural identities (students will be aware of the 'free Tibet' activists).

Although global companies and brands can claim success, the success is often based on adapting products to national markets. Therefore, national culture remains important, but its influence varies according to the product: in food and media content, which are culturally sensitive, national markets matter more than in markets for TVs, for example.

2. *The polycentric company would seem to be better adapted to international expansion than the ethnocentric one, yet most of the world's largest companies seem to be ethnocentric. How do you explain this apparent inconsistency?*

Start by defining each of these categories, and giving some examples. There are large MNEs which are polycentric, such as Nestlé of Switzerland, but the ones which come to mind are the likes of Coca-Cola, Microsoft, Ford and Toyota.

Possible reasons:

- The company with a strong corporate culture which is associated with a strong national culture (as well as strong economy) is in an advantageous position to launch international expansion.
- The ethnocentric company may take a variety of approaches. Some stay at home, content with operating within the culture they are familiar with.
- Some ethnocentric companies have a kind of missionary zeal, convinced that they are the best at what they do, and wish to prove it by conquering other markets, or even the world! It is not surprising that the ethnocentric company is sometimes accused of arrogance.

3. *Which organizations with distinctive cultures have featured in this chapter? Has their culture been a benefit or a drawback in terms of achieving organizational goals?*

- *Chugai of Japan* – corporate culture was probably a drawback, and the takeover had to be managed sensitively.
- *Citigroup* – corporate culture was probably a drawback; the CEO admitted the company was too US-centric.
- *Al Jazeera* – distinctive culture of the firm was a benefit, aiding expansion and building the brand.
- *B&Q* – corporate culture was probably a benefit. B&Q was formed in the UK, but managers have adapted to local conditions as it has expanded internationally. It has built up relations with local suppliers, installers and authorities.
- *Home Depot* – corporate culture was originally entrepreneurial, but became more cautious and planning-oriented under Nardelli. The culture, which was also US-centric, was a drawback for expanding in China.

4. *Give advice to a Western business hoping to enter a joint venture with an Asian partner in an Asian country. Advise on negotiating the terms of the agreement, management arrangements and day-to-day decision-making.*

First, the firm must do research on possible partners (recall the example of Roche). Negotiating must emphasize relationships rather than contractual terms; it must not be rushed, and time spent getting to know the people on the other side is well spent. Although the Western business would be tempted to introduce its own management system, this is probably too radical a shift for the local staff (recall Citigroup). Management arrangements should combine local practices with Western principles.

Day-to-day decision-making is often best left to the local partner, within the broad strategy agreed when the joint venture company was set up. Trust between the partners, and willingness to let the new 'offspring' evolve its own way of doing things, can help the project to succeed, although partners sometimes wish to keep a tight rein on the new business.

Web-based assignment (online)

Comparing organizational cultures

This exercise could be carried out by dividing a group of students into two smaller groups, each researching one of the companies. Their answers could be compared the following week, followed by a general discussion.

CHAPTER 5

The Political and Legal Environment

Strategic crossroads

5.1: ABC Learning (page 179)

- ◆ *Weigh up which factors you feel are more important in the rise of ABC Learning: entrepreneurial flair or favourable government policies. Explain your reasoning.*

A summary of the role played by both is a good starting point. The rise of ABC Learning coincides almost exactly to the shifts in policy of the Australian government: first, the shift to provide subsidies to private providers, and then the end of the system of subsidies to community providers. The rise in subsidies has been so dramatic that private childcare centres are now dominant. Students could well feel that subsidies played a bigger role in the rise of ABC Learning than entrepreneurial flair. The money generated by subsidies helped Groves to acquire businesses rapidly. ABC's growth was based largely on acquisition. Growth in the US, where subsidies are lower, was a test for Groves. By way of update, ABC Learning ran into financial difficulties in the US in late 2008, and had to sell its US operations to raise money.

- ◆ *In what ways has the domination of ABC Learning in the childcare sector been a benefit or detriment to consumers?*

ABC became a vertically integrated organization, owning training colleges and an equipment company in addition to the childcare centres. Its domination of the market has reduced choice for consumers. However, it would argue that it offers a high-quality service based on substantial investment, which could not be matched by the local community providers. On the other hand, the large company can be accused of offering a standardized one-size-fits-all service, whereas the community centres were more locally responsive.

5.2: YouTube (page 182)

- ◆ *What opportunities does YouTube offer for television and media companies?*

Television and media companies can use YouTube to air content and reach a wide range of consumers.

They can also benefit from revenue sharing with YouTube, as they share the revenue from advertising shown alongside their copyright video material.

- ◆ *What copyright issues does YouTube have to deal with, and what has been their approach?*

First, state what the implications for copyright are. Any file-sharing site risks copyright infringement, as copyright law requires permission to be granted by

copyright owners for copies to be legal. Unlicensed copying has been a problem for the file-sharing websites. YouTube's solution has been to secure agreement from the major companies which own copyright of music, television, film and other video content. This does not eliminate the risk of lawsuits over copyright infringement altogether. Google was aware of the risks when it bought YouTube. The development of technology which would filter clips which infringe copyright would help reduce the risk.

Case studies

5.1: Online gambling (page 172)

1. *In what ways did the political and legal environment in the US present risks to the offshore online gambling businesses, even before 2006?*
 - The US Justice Department has maintained that a 1961 statute bans any betting over phone lines, which would include the internet.
 - The large casino companies in the US form a significant lobby group which has been influential with Congressional lawmakers and has lobbied for a ban on US banks processing internet gambling transactions.
 - Conservative Christian groups are opposed to gambling in any form. These groups are influential, especially within the Republican Party.

2. *It is arguable that the fragmented and inconsistent legal position of gambling in the US does little to enhance respect for the law in general. Do you agree and why?*
 Those who agree can point to the following evidence:
 - Most of the individual states do not allow gambling on their territory strictly defined, but allow it on Indian reservations or waterways, which are legally declared to be outside the state's jurisdiction. This might seem to be hypocritical. Native Indian tribes operate 350 casinos in 28 states.
 - The US allowed remote gambling on horse races within the country, but banned online gambling from offshore internet sites. This was the subject of a WTO trade dispute brought by Antigua and Barbuda, which the US lost.
 - US legislation in 2006 banned businesses operating online gambling, but continued to allow the casinos (including those on reservations), and online betting on horses. The ban was enacted as an attachment to a bill on port security, which assured it would be passed, given the importance of preventing terrorist weapons entering the country in shipping containers.

3. *Contrast the different governmental approaches to gambling highlighted in the case study.*
 - The US – The approach seems to be protectionist, aiming to protect existing domestic operations, but banning offshore centres. It is also influenced by lobby groups in Congress, mainly the casino companies.
 - France – Online gambling companies met government resistance here. Legal betting is in casinos, in the state-owned lottery and under the auspices of the

state horse racing authority. The EU has stated that this approach is contrary to the free movement of services.

- the UK – A regulatory approach. The Gambling Act 2005 provides for a system of licensing regulated by the Gambling Commission. The aims are to protect children and other vulnerable people; to prevent gambling from leading to crime or disorder; and to ensure that gambling is open and fair. See the Gambling Act at www.opsi.gov.uk

4. *In your view, which governmental approach to gambling would be the best and most practicable?*
- The answer partly depends on the student's personal perspective. Some might wish to see a total ban, but this is a popular leisure activity, and most governments are inclined to allow it in some form (except strict religious regimes). Governments also make a good deal of money out of national lotteries. Regulation might seem to be the best way, but weak regulation would not satisfy those who feel that gambling is morally wrong and a cause of social problems. Note the example of prohibition, mentioned at the end of the case study.

5.2: Royal Dutch Shell (page 190)

1. *What were the causes of Shell's falling behind rival oil companies?*
- Shell's dual system of corporate governance was cumbersome compared to rivals.
 - Its management structure, also cumbersome, reflected its dual governance structure.
 - Shell fell behind in acquisitions and in exploration.
 - Shell has long invested in Nigeria, which has been a particularly difficult environment.
2. *Contrast the problems Shell encounters in Nigeria with those in Russia, in terms of the political and legal environments.*
- *Nigeria:* Ethnic and political strife disrupt production, and armed militia are active. The central government has little control over key authorities in individual states. Extreme poverty in the Niger Delta area adds to the social instability, as these inhabitants have seen little of the oil wealth generated within the area.
 - *Russia:* Here the political environment is very different from the Nigerian situation, as the government is in a strong position to exert control. The Sakhalin project, which started as one run by foreign oil companies with Shell in the lead, has been re-organized by the government to give Gazprom majority ownership and control. Shell's CEO acknowledged that the assertiveness of governments over natural resources in their territory is a fact of life.

3. *How will Royal Dutch Shell's restructuring lead to better performance?*

The structure has been rationalized, with a single board and CEO. It should be able to act more quickly and decisively. Still, it retains some of the legacy of the dual structure: the new company is registered in London, but with the head office in The Netherlands. The quotation from the Shell executive could be cited (near the end of the first column). The consensus-driven culture has given way to a more 'Anglo-Saxon' one similar to its competitors. It is this change which is key to improving performance.

Country focus

5.1: Russia (page 163)

◆ *In what ways has democracy gone backwards in Russia?*

Russia embarked on democratic transition and economic liberalization in the 1990s, but the rise of the oligarchs and political instability brought turmoil. From 2000, the Putin government restored stability, but democracy has suffered. Some of the weaknesses of Russia's 'managed democracy':

- Elections criticized by Western observers as neither free nor fair; the government has now curtailed monitoring by any observers not approved by the government.
- Limitations and intimidation of opposition parties.
- Regional governors have been replaced by presidential appointees.
- The constitution has been overridden by the executive.
- The state controls the three main television channels.
- The government has clamped down on NGOs, one of the elements which should be able to function freely in civil society.

◆ *In your view, how stable is the political system in Russia in the long term?*

The sting is in the tail in this question, as it invites the student to think about the long term. Authoritarian systems which rely on the consolidated power of one person, with no clear means of succession (except infighting) are unstable long-term, as new potential leaders seek to supplant the existing one, who finds it harder and harder to keep the whole system under control. Russia now has a new president, Mr Medvedev, a protégé of Putin (who has become prime minister). It is possible that Medvedev will assert power and gather support within the party and state apparatus.

A factor to consider is that governments, including authoritarian ones, can enjoy public support for long periods if people feel their economic and social well-being is in good shape. If economic hardship were to recur, political unrest could follow. If that were to happen, the calls of Russians dismayed by the lack of democracy could grow louder.

◆ *Assess the advantages and risks for foreign investors in Russia.*

Russia has become one of the leading emerging markets (the group known as the BRIC countries – Brazil, Russia, India and China). The global boom in oil and gas industries has greatly benefited Russia, which is rich in these natural resources. IPOs of Russian companies, including listings on the London Stock Exchange, are indicative of their growing confidence. However, these companies are still state-dominated (see CS15.1 on Gazprom). Western MNEs which invest in Russia have become accustomed to interference by the government (especially in the oil and gas industries).

Investors in sectors such as retailing have been attracted by potential market of Russia's rising middle classes. For these companies, bureaucracy and corruption have been seen as elements which add to the cost of doing business, which they feel is worth it. However, these elements pose other risks which are more difficult to quantify. They are part of an authoritarian system in a country with recent history of economic volatility, and where political instability is a potential risk.

5.2: France (page 175)

◆ *Assess the differing approaches in French political discourse on how best to solve the country's problems.*

It is helpful to begin by highlighting what problems are being referred to: lacklustre economic performance; lack of competitiveness; high unemployment; budget deficits combined with generous public spending; labour market rigidities; aggressive trade unions; activist farmers.

- *Centre-right UMP* – Somewhat statist and nationalist, but with currents of economic liberalism. Sarkozy has argued that 'neoliberal' ideas would help to make the country more competitive. He would also aim to boost entrepreneurship and try to bring flexibility in labour markets.
- *The socialists* – Favour social priorities and would resist economic liberalization. The large public sector and state-owned companies, with their privileges, have been championed by the socialists and trade unions. The UMP would have difficulty in dismantling these national champions, even though the country cannot afford the costs of sustaining them.

◆ *What indicators of France's unease with liberal economic values can be derived from the example of EDF?*

EDF was compelled by the EU to privatize, and a portion of its shares has been sold to private investors. However, public sector employees and trade unions have been unhappy with these moves, and the government has taken over EDF's pension system, indicating its sensitivity to these interests.

Liberal reforms are perceived as weakening social protections, and are therefore resisted by workers and their representatives. Formerly, these workers received widespread support from across the population, but many in the private sector now feel that the preferential treatment of these public-sector workers is no

longer justified. The election of Sarkozy on a platform calling for economic change is some indication of changing public opinion.

◆ *How does the issue of globalization divide French political allegiance?*

See the Table. The UMP saw widespread benefits from globalization – MNEs and financial markets most of all, but also consumers. The socialists saw essentially no benefits except to MNEs and financial markets.

◆ *Describe the political influences on the business culture in France.*

- The state-owned companies viewed as national champions.
- The large public-sector workforce.
- Strong trade unions.
- Outspoken farming sector.
- Nationalist sentiment, which can be found on both the left and right in the political spectrum in France.

Pause to reflect

Quality of democracy (page 161)

Students are invited to compare two countries. A stable Western-style democracy is a good choice for one, and most will have some acquaintance with this type of system. An authoritarian country such as Russia or China would represent the extreme opposite. Note that, in looking at all the criteria in Figure 5.1, some of the democracies are weak in some of the criteria (See Figure 5.2).

Right, left and centre (page 166)

It is helpful to begin by describing briefly each of these political positions, noting that generalizations have limitations when looking at individual countries. Students could be invited to write down their views briefly on each of these topics – 10 minutes would suffice. They could then take an overview and decide whether their views represent a coherent philosophy which would fit one of these labels. The role of religion is perhaps one that will elicit discussion. Political parties with strong religious beliefs tend to be of the right, and support close state and church ties in society, such as the imposition of religious teaching in schools. This might seem illiberal, but these parties in many countries also support a liberal economic agenda, advocating markets and limited welfare state provisions.

Is it worth the risk? (page 172)

Begin by summarizing both internal and external risks. Students will be inclined to agree that companies should focus on the internal risks. Their reasons would be:

- These are the risks which immediately impact on the business.
- They are identifiable, and companies can take reasonable steps to manage them, such as keeping relations with officials as transparent as possible.

However, in today's world, these come intermingled with external risks, and overlooking the latter will perhaps give a misleading overall picture. The reasons:

- A deterioration in relations with other countries directly impacts on the dynamics of internal politics, and could lead to instability in a country thought to be internally stable.
- Countries which must import fuel, food and other vital resources suffer from prices rises or shortages in global markets, which could impact on the country's internal political stability. An example is food riots in some states over price rises (the World Bank estimates that these have taken place in some 30 countries).
- The threat of terrorism can be both internal or external. Some terrorists operate at both levels, and it could be difficult to distinguish between home-grown and international causes.
- A country which is relatively stable may be destabilized by an influx of refugees from a conflict between two other countries in its region. This has been a recurring phenomenon in Africa.

Regulation: who benefits? (page 180)

Both these perspectives represent genuine positions which will have advocates, both within government and in the business community. Developing and emerging countries have tended to favour the first view, as economic growth is their top priority. However, the second view, which benefits from the sustainability perspective, would probably have more backers. It should be possible to debate these positions, dividing students into two groups: each group can be given a chance to state the case for or against. A short general discussion at the end could decide whether one side won.

Legal risks in perspective (page 184)

The firm in this situation cannot eliminate legal risks, but it can take steps which reduce them, such as:

- Abide by all local laws, and keep records of dealings with other businesses and officials. This will strengthen the firm's case in the event of litigation even in countries where the judiciary is not independent.
- Deal only with officials whose status can be confirmed. Transparency in any official dealings will help to avoid entanglement in corruption.
- Take steps to protect intellectual property, such as through patents. Be on the lookout for infringers, and launch legal proceedings if persuasion fails. These lawsuits often fail in environments with weak rule of law, but some do succeed.
- Do not use the fact that the country has weak law enforcement and regulatory standards to let your own standards slip.
- Remember that when there are industrial accidents and faulty products which cause harm, the victims can take legal action not just locally, but in your home country.
- When dealing with subcontractors to carry out operations, remember that you cannot wash your hands of liability for their operations. Although they are legally

independent, you could be held liable for any wrongdoing, possibly legally, but almost certainly morally in the eyes of the public, both at home and in the host country.

EU enlargement at the crossroads? (page 186)

Arguments for enlargement

- These states can legitimately claim to be part of Europe
- Both the existing members and new states would benefit from greater economic integration.
- EU membership would probably aid these countries in consolidating democratic institutions and working markets.

Arguments against enlargement

- The EU is already too large and unwieldy.
- Admission of new states which are poor and have large populations will entail too great a financial burden on the EU.
- The admission of Turkey is resisted by some, because of its large size, predominantly Muslim culture and geographic location at the crossroads of East and West, rather than within Europe.

A globalized political and legal environment? (page 189)

Trends towards integration

- Growing international co-operation among states.
- Growing regional integration.
- Role of international law is increasingly recognized.
- National political systems are being increasingly judged by democratic standards; those which are undemocratic and fail to recognize political dissent are held up for international criticism.
- Recognition of the role of the UN in international peace and security.

Trends towards political and legal autonomy

- National law predominates in most spheres of the legal environment for businesses.
- National political systems are not being superseded by global government, despite increased co-operation (see Chapter 15 on global governance).
- Nationalism seems to be on the rise in terms of 'economic nationalism', by which countries assert legal and political control over natural resources.

**Part B review
questions (page 189)**

1. *Authoritarian countries are often seen as more stable than democratic ones, and may thus be viewed favourably as business environments, especially if, like China, they are pursuing market policies. What are the drawbacks of doing business in an authoritarian country?*
 - Unpredictability of policies, as leaders are not constrained by constitutional checks and balances.
 - Potential instability caused by regime change, as new leaders emerge through infighting, often with the involvement of the military.
 - If those in power turn against a foreign business, there is often little a foreign firm can do through institutional means (such as the courts) to seek legal redress.
 - The lack of an independent judiciary is a common feature of the authoritarian state. In this weak institutional environment, foreign firms are at a disadvantage.
 - Restrictions on the media and internet are common. This is particularly difficult for firms in these sectors.
 - Firms whose products are essentially characterized by copyright or other intellectual property rights, are in a weak position where these rights are not enforced in law. The Disney Corporation in China is an example.

2. *How do governments wield power directly in economic activities through state control? Are they a force for public good, or are they acting contrary to consumer welfare?*

Governments may run an industry simply as a limb of government. They may also choose to create a state-owned entity separate from government, but this is not like an ordinary registered company – it probably has no share capital, and the employees are civil servants. Governments have commonly registered a state-owned enterprise as a public company (as a prelude to privatization). They then launch an IPO and sell a portion of the shares to the public. This may be only a small portion of the shares, not essentially altering the state's control.

In some political thinking, there is a belief that the best way to assure that organizations are providing public goods is for them to be accountable directly to public authorities; otherwise, those who run them will think only of their own personal gain and not the public interest. The state-owned industry in a key sector reflects this belief: it is deemed to be too important to be left to private enterprise.

An opposing view is that state-owned companies, especially those with monopolies, tend to become bloated and inefficient in the absence of any competitors. In these situations, consumers are not necessarily getting good services.

3. *A weak national legal system is sometimes perceived as a positive factor by firms, as they can feel assured that their activities will face little scrutiny from national law enforcement agencies. This is particularly the case in developing countries. What are the risks of entering countries with this motive?*

The political leaders could decide at any time, possibly as a result of international pressure, to tighten the law and its enforcement. This will adversely affect firms which do not comply. If they are unwilling to comply, they will probably move on to another country with weak standards. When it introduced new employment laws which gave workers greater rights, the Chinese government faced some criticism from foreign investors, who complained that the moves would adversely affect their competitiveness.

For a Western company which carries out operations in developing countries through FDI and outsourcing, reputational damage is a risk, as home consumers will perceive it to be operating double standards.

4. *National political and legal systems still remain distinctive within the EU. Is political union a viable goal, or should member states retain more sovereign power?*

It is helpful to begin with the competing concepts: one sees the EU as an overriding entity, in which national points of view are gradually replaced by EU citizenship and identity. The other sees the EU as an aggregate of different nation-states, each with its own identity, which are prepared to co-operate for common ends, but with the proviso that they serve national self-interest

Political union now looks less realistic a possibility than was once thought by EU leaders who drafted the new constitutional treaty. A feature of the EU which students might raise is the gap between the EU as envisaged by its leaders and the views of individual citizens, who are sceptical about giving too much power to Brussels and also perceive that leaders should be more responsive to grassroots views. On the other hand, institutions and procedures designed when there was only a handful of states are clearly too cumbersome to operate when there are 25 or more. Streamlining is needed, but moves to do so inevitably tread on perceived national interests.

Web-based assignment (online)

Spotlight on China: the Olympics and beyond

This exercise is designed to encourage students to reflect on the significance of the Olympics in China's transition, and to look forward to political implications in the future. It is probably best as a written exercise, either individual or in small groups. Another possibility is for the students to present findings in short PowerPoint presentations, with one or two slides per answer.

Synthesis and Reflection (online)

Part 2: The environment of IB

1. *Give examples from the chapters which show the role of government in the national economy. Comparing these examples, which do you feel is the best 'model'?*
 - *Chapter 3:* Hungary (opening vignette – poor management of public spending); UK (initiatives to alleviate poverty, improve national health service and improve education – Public sector money on initiatives, but not sustained and improvements disappointing); Romania (authoritarian and statist governments gave way to reformist governments and market liberalization, but corruption remains); China (Government liberalization has facilitated growing private sector, which has been beneficial to the economy; state-owned industries, however, have not been as efficient).
 - *Chapter 4:* Turkey (secular state brought economic development); Mexico (State-owned industries, especially the national oil company, inefficient and lagging behind in expertise).
 - *Chapter 5:* Russia (no longer a planned economy since the collapse of the USSR, but government in Moscow is a very 'visible hand'. An example is Gazprom, which is now a listed company and pursuing outward expansion); France (State-owned companies viewed as national champions; many of these are active internationally).

2. *Cite examples of MNEs encountering cultural hurdles in foreign environments. Which do you feel have been the most successful, and which the least successful?*
 - *Chapter 3:* Wal-Mart.
 - *Chapter 4:* Roche; Citigroup; B&Q; Home Depot
 - *Chapter 5:* Royal Dutch Shell
 - Roche and B&Q successful; Citigroup less successful.

3. *Cite examples of companies which have encountered legal and political obstacles in either home or foreign environments, and state how they dealt with them.*
 - *Chapter 3:* Wal-Mart (has had a range of legal difficulties in its home market, the US, including employment practices, discrimination and environmental protection cases; in China, it has complied with Chinese authorities).
 - *Chapter 4:* Al Jazeera (has encountered political objections from both the Saudi and US governments. It has got round the limitations on satellite broadcasting in the US by transmitting on the internet); B&Q (has had to work with housing authorities in China).
 - *Chapter 5:* ABC Learning (has benefited from Australian government policies on subsidizing childcare, but it encountered difficulties when it became so dominant in the sector that it possibly infringed competition laws); YouTube (has had to deal with the inherent risk of copyright infringement; it has pursued a policy of reaching agreements with content owners); Online

gambling companies (these firms use offshore locations, but national laws in the locations of most of their customers can change, adversely affecting their operations); Royal Dutch Shell (has encountered political problems in Nigeria, due to political instability; it has evolved a policy of co-operation within local communities. In Russia, it has submitted to re-negotiation of the Sakhalin project's ownership, under pressure from the Russian government).

CHAPTER 6**International trade and regional integration****Strategic crossroads****6.1: China turns to Africa (page 204)**

- ◆ *Assess the benefits to each side in trade between China and Africa*
See Figures 2 and 3. China imports fuel and other natural resources from African countries. Its exports to Africa are manufactured goods. These include vehicles for infrastructure projects, which are typically part of the trade deals which China negotiates with African governments.

- ◆ *Why is there cause for concern about the long-term impacts of China-Africa trade relations on economic development in Africa?*
 - The trade deals negotiated between China and African governments are said by China's leaders to focus only on the trade terms, without any interference in other countries' internal affairs. Hence, they take no account of issues such as poverty, democracy, transparency, human rights and social welfare. Many of these are major issues in poor African countries, and western experts fear that efforts to alleviate suffering and promote economic growth will falter as political leaders turn their attention towards China.
 - Chinese companies typically bring in their own workers to carry out projects, rather than hire local workers, despite the low costs of local labour. The concern is that the need to raise levels of employment for local people will be unmet in Chinese-sponsored projects, setting back economic development, rather than promoting it.

6.2: Precarious future for Kenya's export processing zones (page 224)

- ◆ *Are Kenya's EPZs good examples of the benefits of EPZs? Give your reasons.*
First, define the EPZ and state the way the EPZs work in Kenya. In Kenya's case, the US Africa Growth and Opportunity Act (Agoa) has been a driver. Those who have benefited have been the firms in the EPZs which export textiles to the US. An issue with EPZs is whether they generate economic activity in the wider economy, benefiting local firms. In this case, the results have been disappointing. The businesses in Kenya's EPZs are foreign-owned, and Kenya's cotton industry has not revived as had been hoped, as the businesses import fabric from third countries.

◆ *What are the prospects for Kenya's EPZs in the future?*

With the phasing out of the WTO import quota system, Kenya was in a weak position compared to the large-scale textile producers of China and India. The foreign firms will not remain if their businesses cannot compete, and Kenyans themselves have not developed the skills and facilities needed to sustain the textile sector. The EPZs hope to broaden their activities into economic zones and technology parks, attracting local entrepreneurs. In this way, the zones would contribute to development goals, which the EPZs have failed to achieve.

Case studies

6.1: Boeing and Airbus on a collision course (page 216)

1. *Why has a trade dispute erupted between the EU and US over civil aircraft?*

Boeing is accused of taking state aid from the US, and Airbus is accused of taking state aid from the EU – both in contravention of WTO rules against subsidies.

2. *Assess the competitive positions of Boeing and Airbus in global markets.*

These are the two largest manufacturers of civil aircraft. Both have new aircraft in the pipeline, and compete to win orders from the major airlines. They compete directly in the market for medium-sized, long-haul aircraft, and both companies have suffered setbacks. Boeing's new plane in this category is the 787 Dreamliner, which is highly fuel-efficient, incorporating innovative new light materials. Delays in production have pushed back delivery times, and a strike in the autumn of 2008 caused further delays. Airbus has suffered delays in producing its competitor in this category, the new A350. However, Airbus is launching a new superjumbo, the A380, capable of carrying 550 passengers. This is a category in which Boeing decided it would not compete. The A380 has also suffered delays.

3. *To what extent is the notion of 'national champions' outdated?*

Both these large companies rely on an array of suppliers from different countries. Airbus planes have much US-produced content, and Boeing planes use UK-manufactured engines. Neither is therefore a strictly national producer.

4. *Is the WTO's role enhanced or damaged by disputes such as this? Give your reasons.*

- Most will probably agree that this particular dispute seems rather futile. The two parties, the US and EU, are only indirectly involved. The process is protracted and costly, and the panel is likely to find that both companies took state aid. It would be better for the two parties to reach a settlement.
- The WTO's role in other types of trade dispute is probably more positive. For example, disputes between developed and developing countries over trade barriers are a means of dealing with trade distortions and protectionism. The fact that the WTO is getting many disputes of this type suggests that it has an important role to play.

6.2: Piecemeal liberalization of world trade in textiles and clothing (page 233)

1. *What protectionist barriers are common in textiles and clothing; what purposes do they serve?*
 Quota restrictions on imports are common, to protect domestic producers. Almost every country has a textiles and clothing sector, even though many are not competitive in global markets. In particular, textile production in rich countries cannot compete with the low-cost manufacturers in mass-produced products, but some governments (such as the US) adopt policies to protect their domestic industry.
2. *The Agreement on Textiles and Clothing (ATC) 1995-2004 was intended to liberalize world trade. To what extent has it succeeded?*
 - The ATC was intended to bring a gradual end the quota system, which had limited large producers such as China and India. Although quotas were meant to be phased out gradually, this did not happen, and quotas remained in place until 2004. An effect of the ATC was the shift of production to countries unrestricted by import quotas. For the US market, production in Mexico (benefiting from Nafta) and in the Caribbean (benefiting from Cafta's predecessor) led to a decline in US textile employment and also to decreasing prices for US consumers.
 - China and India have increased their exports to the EU and US, but so too have smaller countries (see Figure 2). However, under the WTO rules, there are means by which governments can continue to curtail imports, such as anti-dumping rules.
3. *In your view, how effective have protectionist measures been in keeping out low-cost imported clothes in rich countries?*
 Textile and clothing companies have been adroit at shifting production to low-cost locations which enjoy favourable access to developed-country markets, either due to being outside the quota system or being party to free-trade agreements. The larger companies have become highly efficient, working with global retailers to keep prices down. Students might suggest that governments could take a stronger line on the working conditions in some of these locations (such as Vietnam, see CF9.1), although business interests might consider this policy backdoor protectionism.
4. *Summarize the position of each of the following in relation to this case study:*
 - *A sewing machine worker in a sub-Saharan African country* – This worker was protected to some extent when the quota system was in place, as these countries had unfilled quotas. Following the end of quotas, this worker is vulnerable to global competition from large-scale, more efficient producers.
 - *A consumer in an EU country* – This consumer has seen prices of clothing and textiles falling as imports from the low-cost producers have increased. Increased choice has been another benefit. There are now discount retailers

who source mass-produced goods from low-cost countries, while domestic manufacturers often tend to focus on high-quality and design.

- *A shareholder in Wal-Mart* – This shareholder has seen Wal-Mart make bumper profits as it has become the largest buyer of textiles and clothes made in China. The shareholder may or may not be concerned about labour, human rights and environmental issues in Wal-Mart's supply-chain in China. However, Wal-Mart is now taking greater interest in these issues.

Country focus

6.1: Germany (page 200)

- ◆ *Explain the reasons behind German companies' export success, including the ways in which they have adapted to the changing environment.*

Begin by summarizing the nature of German export success. The following reasons can be highlighted:

- German companies of all sizes have become adept at producing industrial and high-tech products, based on depth of engineering skills. Rising demand for these products globally has led to growth and internationalization of these companies.
- Although Germany is a high-cost environment, companies have restructured and improved flexibility, and have shifted production to low-cost countries where this is feasible. This is an example of adapting to the changing environment.
- German companies have an admirable history of innovation, as well as the ability to adapt to customers' needs in a variety of different markets. Specialized companies in niche markets are an example.

- ◆ *Explain the two sides of globalization evident in Germany.*

The German economy has rather stagnated domestically. Weak growth, high unemployment and budget deficits have proved difficult to control. Germany's companies have been successful in international markets, benefiting from globalization. However, among ordinary Germans, there are fears over job insecurity, rising prices and possible curtailment of social benefits, as the government tries to rein in public spending.

- ◆ *Why is German corporate success slow to kindle economic growth at home?*

Much of Germany's corporate success has consisted in overseas investment, rather than investment in the home country. Domestic demand is weak largely because consumers are reluctant to spend when they feel insecure in their jobs and living standards.

6.2: Brazil (page 221)

- ◆ *What are Brazil's comparative advantages in agriculture?*
Brazil engages in large-scale, industrialized agriculture, which is considerably more efficient than the small-scale operations which are typical of the agricultural sector in many other countries. Its low-cost land and low-cost labour help to keep costs down. It also has abundant water (unlike China, for example).
- ◆ *How is Brazil using its new status to press for liberalization in world trade?*
Brazil has become a leading negotiator on behalf of developing countries in world trade. It argues for the opening of markets and lowering of tariffs in rich countries. It negotiates from a position of strength, as it is a major exporter, but also accepts that developing countries must themselves be willing to lower barriers to imports from developed countries (see newsletter of 20 November 2008, on the collapse of the Doha round). Brazil has also used the dispute settlement procedure of the WTO to bring complaints against US subsidies in large commodity markets, such as cotton.
- ◆ *What are the concerns hanging over Brazil's future agricultural expansion?*
 - Agricultural expansion depends heavily on making incursions into the Amazon rainforests. As agribusiness moves in, the environment suffers. There are also a number of indigenous peoples in the Amazon rainforests, many still 'uncontacted' by outsiders, whose way of life would be threatened.
 - Brazil's agribusiness has had a detrimental impact on the country's small farmers, who cannot compete, and on landless workers, who provide the essential agricultural labour. There are thus negative impacts from environmental, social and cultural points of view.

Pause to reflect

Responding to trends in global trade (page 205)

Developing and transitional countries are the new emerging forces in global trade. Countries rich in natural resources are benefiting from global demand. The countries of the developed world, traditionally the major traders, are now becoming relatively less influential as a more diverse picture emerges. In response to the three examples:

- *An MNE from Europe* – This company is likely to find that it is exporting more to emerging markets, but its home environment is high-cost. Because of globalized production, this company is under pressures to reduce costs and improve efficiency. It will be considering production in a low-cost country, in order to export from here to all markets.
- *The government of a developing country* – This answer depends on the trade profile of the country. If it is a poor sub-Saharan African country dependent on agricultural commodities, the government will try to encourage exports to rich countries, although they face trade barriers. If it is rich in natural resources such as oil or gold, exports can bring wealth to aid development, although in many African

countries, resource wealth has not yielded the development that leaders had hoped for. Given appropriate conditions and available workers, the government can attract export-oriented FDI, in the hope that this will bring jobs and prosperity.

- *An MNE in a developing country* – The MNE may take advantage of the increasing integration of developing countries in global trade. If it is a manufacturer and its location is reasonably near good port facilities, it can export to countries worldwide. It might also consider FDI in another developing country, or a developed one, from where it can serve new markets.

Trade and globalization (page 209)

- Early theories of trade emphasized the importance of location. This is true of the theory of comparative advantage and the theory of factor endowments. These theories envisaged countries engaging in trade to export goods in which they are more efficient producers, and importing those in which they are less efficient. This view of how countries behave is reflected in analysis of globalization, as firms seek locations which allow them to produce most efficiently. Vernon's product life cycle similarly takes this view of country-specific factors, with the added consideration of where FDI should be located. Newer trade theories come to terms directly with globalized production and economies of scale.
- Trade theories highlight national gains from trade and the effects of trade on different groups in society. Those who warn of the detrimental impacts of globalization will find evidence to support their views in these theories.
- Low-cost countries which have built up manufacturing of mass-market goods have benefited, and workers in those industries, in particular, have seen wage rises. China is an example. Losers have been workers in high-cost countries employed in these same industries.
- Poor developing countries which have neither globally competitive industries nor natural resource wealth struggle to maintain economic growth and prosperity. They are globalization's losers. They lack sufficient wealth to import the goods and services they need, and risk falling behind in human development indicators.
- Critics of globalization point to the widening inequality in societies as well as the gap between the wealthier emerging economies and the least-developed countries.

Assessing the theory of competitive advantage (page 211)

First, summarize Porter's theory. Porter's theory looks at four specific aspects of a country's environment, as well as two other variables, including the role of governments. This is more comprehensive than earlier theories, and therefore the theory of competitive advantage presents a richer picture of the country. Still, critics argue that Porter's theory is too limited, citing the following points:

- It concerns export performance rather than FDI.
- It underestimates the role of the MNE in globalized production.
- The diamond of the company's home country is not as influential a determinant as Porter portrays. The national diamonds of other countries where the MNE does business are equally influential.

- The role of government is underestimated.
- Cultural environment is underestimated.

It is probable that students will agree with these criticisms, but the theory is still highly influential and, with modifications, is useful for cross-country comparisons.

Do countries or firms compete? (page 212)

How do countries compete?

Countries compete in terms of their business environment. The cultural, political and legal environments of a country can be perceived as favourable for business or disadvantageous. Government policies can influence these aspects of the environment, for example, by fostering an independent legal system. Often, a country presents a mixture of some aspects which are advantageous and some which are potentially detrimental. Choosing a location for FDI involves assessing these country differences. In a world of footloose MNEs, governments typically offer incentives to attract FDI.

Why is China ranked comparatively low in the competitiveness rankings?

Note the criteria used by the organizations which publish rankings. China is ranked lower in the WEF ranking than in the IMD one, although even in the IMD one it is only 15th. Looking at the criteria, government efficiency and economic prosperity are two in which China is weaker than the more developed economies. The still-vast rural population has enjoyed less of the prosperity and improved well-being of the urban areas (and people here often rely on remittances from migrant workers in urban areas). See text on p. 212 for WEF's reasons for ranking China only 34th: weak institutions, bureaucracy and low educational levels.

Bilateralism rules, but who gains? (page 220)

Why do bilateral agreements pose a threat to the WTO and multilateralism?

Countries which perceive that their interests are better served by reaching bilateral trade agreements with trading partners are not as motivated to devote effort towards multilateral agreements. As the main international body promoting multilateralism, the WTO could be weakened as a result. The piecemeal approach of both bilateral and regional agreements represents a retreat from aims of the WTO, which were to liberalize world trade. The WTO is a descendent of the post-war global financial institutions - products of the aspiration towards global governance mechanisms. This aspiration would be weakened by setbacks to the WTO.

If the countries entering these preferential agreements are happy to do so in their national interest, why should there be any wider cause for concern?

Many in the powerful countries such as the US would probably argue that the proliferation of preferential trading agreements is beneficial. However, there are causes for wider concern:

- The spaghetti bowl of cross-cutting trade agreements adversely affects MNEs, as legal complexities abound in these agreements, and there may be several different

relevant agreements in cross-border activities.

- These agreements are almost always lopsided, favouring the stronger partner. The poorer country is likely to feel pressurized into agreeing terms which are disadvantageous, in order to gain some access to the richer country's market. Some of these terms may well impose other restrictions unrelated to trade.

Beyond Nafta (page 228)

Why is the Nafta model criticized within the US and in the other member countries?

The Nafta model is a free-trade area, with the removal of barriers to trade and cross-border investment between members. Of the three members, the US is the regional superpower. After 15 years of Nafta, Mexico remains a poor developing country. Both Mexico and Canada rely heavily on exports to the US, but for the US, Nafta exports are half those to other Nafta members. There is much criticism of Nafta in the US, as US jobs are alleged to have migrated to Mexico.

What are the prospects for future regional integration of the Americas?

The US has aspired to lead a free trade area of the Americas, but this has encountered obstacles, in that Venezuela and Brazil, both significant exporters, have articulated their own interests and goals, which would cause potential friction with US interests. The US has looked to the Central American and Caribbean countries to form a free trade area (Cafta). This is based on a hub-and-spoke pattern, with the US at the hub. Cafta has been criticized within the US by businesses fearful of cheap imports, and the six poor countries which make up the 'spokes' are also fearful that they will be vulnerable to agricultural imports from US agribusiness.

European economic integration (page 230)

In which respects has regional integration progressed significantly, bringing benefits to EU citizens?

The free movement of people among EU states has been beneficial, although there have been some restrictions on people in the newer member states who wish to work in EU 15 countries. Economic integration is most marked in the eurozone countries, as the single currency has facilitated cross-border business. EU member states' trade is dominated by other member states (see Figure 6.13).

In which respects has integration been weak and why?

Integration has been weaker in services across borders (e.g. financial services) as regulation remains with national authorities.

Trade liberalization: the wider picture (page 232)

Students are invited to choose a country and make the case for liberalized trade.

Whatever the country, points to be made include:

- Protected industries tend to have less incentive to develop competitively and innovate. Competition promotes entrepreneurship and innovation, which will ultimately benefit the country.
- Protectionism can be costly. Subsidies to producers, once started, are difficult to

withdraw, as recipients become dependent on them. The imposition of barriers against imports which are cheaper are a kind of market distortion which disadvantages domestic consumers. Faced with freedom to buy cheaper imported goods, consumers may well decide to buy more expensive domestic products (as is common in Japan): wider choice benefits retail sales generally, benefiting the national economy.

Part B review questions (page 233)

1. *Assess the trends now occurring in the pattern of world trade, which is seeing the developing and emerging economies, including the resource-rich countries, become more prominent. What are the implications for international business?*

World trade is no longer dominated by the triad countries. The share of developing and emerging economies in trade flows is growing, but to assess the trends, students need to look behind them. China has become a trading superpower in a relatively short time (see Figure 6.2), but is dependent on key sectors of consumer goods, such as clothes and electrical appliances, which are exported to Western markets. A result has been huge trade surplus with the US, making China's exporters vulnerable to economic downturn in the US. It should be noted that China's growth as an exporter owes much to FDI, much of it from western companies taking advantage of China's low costs to manufacture for export.

Germany remains an export leader, with strengths in more high-value industrial goods. The resource-rich countries have seen gains from rising prices of oil, and these countries, especially the Middle Eastern oil producers, have become more prominent in the global economy, not just in oil-related industries, but in wider investment (see Chapter 11). A fall in oil prices, as occurred in the autumn of 2008, affects these countries' economic role globally – they are likely to import less and invest less abroad.

Another trend is the growing involvement of governments, directly and indirectly. Governments can use trade policy to promote national business interests, as is evidenced by the use of bilateral trade agreements. Also, note that many state-owned companies, notably those from China, are now active in trade.

Some of the implications for international business:

- Growing competition from emerging MNEs in global markets
- Growing consumer markets in emerging and developing economies, including resource-rich countries.
- The need to target a number of different markets. Weakening demand in developed-country markets is being compensated for by growing demand in the emerging markets.
- Suppliers and customers are becoming highly diverse, ranging from SMEs (both in developed and developing countries) to state-controlled companies. Managers now have to adapt to differing cultural backgrounds and organizational backgrounds.

2. *To what extent does Porter's 'diamond' model help to explain the developments currently taking place in world trade?*

First, explain the main elements of Porter's theory. The theory aims to be helpful in analysing national competitive advantage, and the four aspects he highlights are relevant. However, the theory's focus on export performance overlooks some of the trends, such as the growth in FDI, the role of the MNE and globalization. It also underestimates the role of governments and the cultural environment, both of which are crucial in today's complex trade relations.

3. *Why did the Doha Round of trade talks prove to be disappointing in achieving its aims? Assess the prospects for future multilateral trade agreements.*

Doha talks broke up in failure in the summer of 2008, due to the gap between the rich countries, especially the US and the developing countries, among which India was the most vocal. The disappointment was essentially that short-term national self-interest seemed to prevail, with countries playing to their own domestic political pressures. The future looks bleak for multilateralism, but more talks are possible via the G20 initiative (see newsletter feature of 20 November 2008).

4. *Compare Nafta with the EU in terms of trade, economic integration and political aims.*

Begin by summarizing the elements of each of these regional groupings. In their conception and organization, they differ markedly. Nafta has only three members; the EU has 27 and is anticipating further enlargement. Nafta is dominated by the US, whereas the EU, although it has a core of major economies which date from its inception, is more pluralistic. In terms of trade, Mexico and Canada are more dependent on the US than vice versa. For EU countries, inter-EU trade is highly important for all member states. This has helped to foster economic integration, notably FDI. Nafta is more lopsided. Canada and Mexico have attracted FDI for setting up export-oriented operations targeted at US markets. These lesser Nafta members are vulnerable to economic downturn in the US.

In terms of political aims, the EU has evolved a complex governance structure – probably too complex – although it has not taken the step of setting up a supranational government with sovereign powers over member states. Nafta has no permanent organization. Nafta as an issue is prominent in the politics of all three countries, and sceptics in all three have questioned its role.

5. *Assess the factors affecting further regional initiatives in Latin America. What are the prospects for further regional trade areas among these countries?*

Begin by summarizing the extent of regional integration, such as Mercosur. There are efforts to bring about a regional organization: one is a South American initiative and the other is that sponsored by the US. The factors affecting these developments are:

- Political trends in key countries, such as Venezuela, Argentina and Brazil. These are all volatile countries politically, with large populations of poor

- people. Populist and nationalist politics are influential.
- Markets in oil, minerals and agriculture. These economies rely heavily on primary industries, and are affected by price volatilities in commodities. Low world prices mean reduced government revenues and less money to spend on social welfare.
 - The role of the US. US policies are likely to change with the election of a Democrat, Barack Obama, as president, taking over from the Republican administration of George W. Bush. If the US becomes more protectionist, this will impact on policies in countries south of its border.

Web-based Assignment (online)

The EU and preferential trade

This exercise can be done by students individually or in small groups. Students will gain insight into the EU's trade policies and practices in doing this exercise. The contrast with China's trade policies should generate discussion in seminar groups. In addition, the questions posed in the Reflection section should encourage students to look more deeply into trade issues, contrasting the benefits (or detriments) to businesses, governments and societies.

CHAPTER 7

Strategy and organizations

Strategic crossroads

7.1: Weg Electric (page 250)

- ◆ *Describe and assess Weg's international strategy in terms of competitive advantage.*
Weg Electric is competing in an industry, electric motors, in which there are large, well-established global companies. As a Brazilian company, it is an emerging MNE. Its main source of competitive advantage is in its focus on customized products to suit customers' needs. Also, it is able to respond quickly to customers because it carries out most of its own operations, including producing components. This strategy is one of differentiation, offering a product and service which engenders customer loyalty, making it less vulnerable to competition. Nonetheless, Weg has internationalized, not so much to reduce costs as to be near to customers.
- ◆ *Which of Weg's firm-based resources are most advantageous, and why?*
Its strength in R&D and training is possibly its most important firm-based resource, because they feed directly into innovation and product development. The company has not relied on outsourcing, and therefore has greater control over manufacturing and sourcing than rival companies, which are often caught up in disputes arising in managing these relationships. Weg's sense of self-reliance, part of its German cultural heritage, is a firm-based resource and source of competitive advantage.

7.2: ABB (page 256)

- ◆ *What were the main features of the matrix structure adopted by Barnevik, and why was it eventually scrapped?*
Decentralization was central to Barnevik's vision of the matrix structure. The many separate companies which made up ABB were largely autonomous. The head office hierarchy had a reduced role. The rationale was that local ownership would foster technological innovation in the units and adapt to customer needs. This system was changed in 1997, because the complicated lines of authority and decentralized units proved to be unwieldy, holding back growth.
- ◆ *In what ways did the changing organizational structure reflect the changing strategy at ABB?*
ABB's more recent CEOs have urged that the company needs to refocus its global strategy on technological innovation across the company. This would entail more conformity in management and processes across its operations. The re-organization into customer segments and product segments represented an

attempt to reflect a new customer focus. This organization has now been simplified into five divisions, each representing a core business. This return to what is essentially product divisions reflects ABB's re-focusing on global strategy as the driver of future growth.

Case studies

7.1: Slimmer Unilever seeks renewed growth (page 259)

1. *Describe Unilever's organizational heritage in terms of its structure and culture.*

Unilever was founded through the merger of two companies, Lever Brothers of the UK and the Dutch company, Margarine Unie. It has maintained a dual organizational structure, reflecting this heritage. It became highly diversified and decentralized. It has been multicultural and run along principles of consensual decision-making. Although these attributes could be considered advantageous, they led to slowness in adapting to changing markets while more focused rivals were forging ahead.

2. *What changes were made in the 2000 and 2005 restructuring exercises, and what were their aims?*

The main changes which can be highlighted were:

- Slimming down the number of brands.
- Selling over a third of its manufacturing sites and shedding 10% of the workforce.
- The introduction of two new product divisions: foods, and home and personal care. There remained three regional divisions.
- A sole CEO to replace the two co-chairmen, with a streamlined executive team. However, it remained two separate companies.

The aims were to speed up decision-making, streamline the structure, and be able to respond quickly to changing markets. The company hoped to balance global and local strategies. New brands and products could now be launched globally.

3. *Why has Unilever continued to struggle competitively in its markets?*

Reasons mentioned in the case study:

- Unilever has been less innovative than its rivals.
- It has insufficiently differentiated its products, resulting in weak consumer loyalty.
- Many of its brands have lost ground to supermarket 'own-label' products.
- Weaker growth in European markets has meant that Unilever must concentrate more on developing and emerging markets, but this shift has significant implications for new products and marketing – areas in which its competitors have been strong.
- The company's traditional consensual culture has probably been disadvantageous, as has its dual corporate structure.

4. *What recommendations would you make to Unilever's senior management for further structural change, and why?*

Some students might recommend keeping the 2-company structure, but most would probably recommend that Unilever should convert into a single company. This would imply that shares of either the British or Dutch company would be converted or the shareholders bought out. Shareholder resistance has been a reason for holding back from this radical step.

Unilever could also sell off the plantations, to focus more on brands and products.

7.2: Nissan looks beyond the turnaround (page 272)

1. *What aspects of Japan's corporate culture had adversely affected Nissan's competitiveness?*

- The system of lifetime employment for full-time staff, which made it difficult to slim down the company.
- The practice of observing seniority in appointments, rather than appointing the best person for the job.
- The preference for dealing with established supply-chain partners, with whom the company has built relations, even though these firms had ceased to be competitive.

2. *What were the main elements of Nissan's revival, and what was the role of Carlos Ghosn?*

- Closure of non-competitive factories and reduction in staff numbers.
- Selling non-core assets.
- Introducing competition in supply contracts.
- Introducing new models.
- Cutting costs in every possible way.
- Improving sales in key markets.

The role of Carlos Ghosn was crucial. As an outsider, he proposed measures which a traditional Japanese manager would have found unthinkable. His considerable powers of persuasion convinced workers that these painful changes were necessary for survival.

3. *What are the challenges facing Nissan in global markets?*

The challenges are immense. Nissan has targeted the US, but here, it is behind Toyota and Honda. Its new luxury Infiniti range is facing an uphill struggle as the US goes into recession. Nissan has also targeted emerging markets, such as China, but it was later than its rivals in entering China. It has moved quickly, however, with its Dongfeng joint venture. Nissan continues to be under pressure to reduce costs. It is now more integrated with Renault, its main shareholder, and Ghosn is the CEO of both companies. The two have not merged, but are benefiting from close integration, which helps to reduce costs.

4. *What lessons can be learned from Nissan's case for turnaround strategy in general?*
- Forceful charismatic leadership can provide the guidance and vision that the ailing company needs.
 - An outsider can be more effective if a radical shake-up is needed.
 - It is crucial to build confidence among the workforce that the measures proposed are necessary and will succeed if all play their roles. Nissan staff clearly had faith that Ghosn was doing the right things, even though they were unpalatable.
 - Provide clear targets in terms of improvements, as in the 1-8-0 plan.

Country focus

7.1: Poland (page 245)

- ◆ *What are the reasons behind the success of Poland's emerging MNEs since 1990?*
First, highlight the significance of Poland as a transition economy, including liberalization, privatization and democracy. The changes have encouraged business, including FDI. The reasons behind the success of Poland's MNEs since 1990:
 - Reduction in red tape, bureaucracy and excessive regulation.
 - Growth in numbers of entrepreneurs, as new opportunities emerged.
 - Desire of start-ups to internationalize, attracted particularly by other post-communist countries.
- ◆ *What tensions exist in the Polish social and political environment?*
Some which are highlighted in the case study:
 - Divide between regions which have prospered from market reforms and those which have not.
 - Large number of unemployed people, and also a large number of people on state benefits, including disability, unemployment and early retirement. The generous system of welfare payments is a communist legacy, and recipients are fearful that market reforms will cut back these programmes.
 - Cultural tension between traditional, nation-based values (associated with strong Roman Catholic tradition) and more modern, secular values associated with consumer market society.
 - Fragmented political landscape, reflected in a wide range of parties. Shaky coalition governments have become the norm, reflecting tensions between parties which favour market reforms and conservative parties which are sceptical of market reforms.
- ◆ *Assess the attractiveness of Poland as a destination for FDI.*
Poland is an attractive destination for FDI despite significant drawbacks. The drawbacks include bureaucracy and red tape. Poor infrastructure is also a problem. Poland is a large country, and poor road and rail transport are obstacles for investors. These drawbacks add to the costs of investing in Poland, but if the

attractions are overwhelming, they can compensate for the frustration with procedures and infrastructure.

Poland's attractiveness stems from a number of features:

- A strategic location, well placed for serving Western European markets as well as Central and Eastern European markets.
- Large population and rapidly-growing market for consumer goods and services.
- Relative political stability, despite political turmoil at party level.
- GDP growth rate has remained steady.
- EU membership from 2004 helped to encourage FDI (see Figure), and also promised funding for infrastructure.
- Government led by the liberal Civic Platform Party under Donald Tusk is taking steps to join the eurozone.

Assessing the overall picture, the potential investor would probably agree that the advantages outweigh the drawbacks. But the advantages depend partly on how future developments shape up, and how competitive the location is in terms of costs for the potential investor. Reducing bureaucratic red tape is urgent, as delays and administrative costs reduce Poland's attractiveness.

7.2: South Korea (page 265)

- ◆ *What structural and cultural features of the South Korean chaebol have raised doubts about their long-term viability?*

First, identify the main characteristics of the chaebol, and the role they play in South Korea. These are family-dominated conglomerates consisting of large numbers of companies, many of which exist more for exerting family control than for independent enterprise purposes. In global markets, this type of company is unlikely to be competitive in the long term as its hands are tied by family concerns. Governance of these companies is opaque, as families seek devices, such as cross-shareholdings, to maintain control. The government has sought to reform the chaebol system, to reduce cross-shareholdings and improve corporate governance. These reforms would result in constituent companies becoming more competitive globally, as they would be free to take decisions based on the best interests of the enterprise (see the example of LG).

- ◆ *How has Jimmy Kim managed to succeed in the South Korean environment?*

Jimmy Kim's business, Innotive, operates in a specialist niche, multimedia software. In this market, the large corporations own no competing businesses, and he was able to bypass the chaebol. However, he still had difficulty in finding investors willing to back him, as the few venture capitalists who existed were reluctant to back an independent entrepreneur. Innotive succeeded largely because of Kim's drive and determination, and despite the business climate in South Korea.

- ◆ *What reforms of South Korea's organizations would you recommend, in terms of structure and strategy?*
 - Students might make the radical recommendation of breaking up the chaebol, letting each separate company fend for itself, headed by professional managers, with accountability to the full range of shareholders, rather than dominant families. Companies could thus focus on global strategy. The difficulty is that the chaebol are engrained in the country's business culture. Perhaps public opinion towards the families is changing, however. Although these companies are held up as having led the country's economic development, corruption scandals and criminal trials have tainted the families' reputations. Should South Korea enter a period of economic downturn, public opinion could well turn more strongly against these family empires.
 - The government could encourage SMEs by making funding more easily available to those outside the chaebol, such as Jimmy Kim. As most of the workforce work for SMEs, fostering these companies would act as a counterbalance to the chaebol, and contribute to the competitiveness of South Korea's firms.

Pause to reflect

Attractions of developing countries (page 247)

Students may choose any developing country for the manufacture of a product such as mobile phones. Whatever the country, the following points should be touched on:

Potential market for your products

- Is there a growing middle class and increasing demand for consumer products?
- What competitors are in the country already, serving the local market? Are these local or global?
- What hurdles are there at regulatory level for the entry of new products?
- Are perceptions of foreign-branded goods likely to be favourable, or is there potential negative perception of foreign-branded products?

Potential location for manufacturing your products

- Are there sufficient skilled workers available for work in manufacturing?
- Are transport and port facilities adequate for your purposes?
- Is economic development being managed effectively, bringing a general rise in well-being in the country?
- Is there political stability in the country? This need not imply that it is a democratic state, but if there is an authoritarian government, is it one you feel comfortable working with?
- Is there an independent legal system and rule of law, including the protection of intellectual property rights?

Porter and globalization (page 249)

First, summarize how Porter views competitive strategy globally. The MNE must choose the best location for each aspect of its operations, depending on the attributes of each country. Is he acknowledging the importance of comparative advantage of differing countries? Porter takes the view that the parent company determines global strategy, and that subsidiaries in foreign locations exist to serve the parent company's goals, which include a fostering of the company's national identity.

Many would probably disagree with this view of parent-subsidiary relations, arguing that this is not the best way to design a global corporate strategy. Possible reasons are:

- Operations in a number of countries are bound to be different in each, as each has its own cultural environment. The parent company would be advised to accommodate and work within the local culture, rather than impose its own culture, which might be resented by local people.
- The view of foreign subsidiaries looks rather dated, as local subsidiaries are now more likely to be managed by local people, rather than those sent from the parent company. Their knowledge and skills in operating in the local environment equip them to play a positive role in strategy formation, which can ultimately aid the MNE parent's executives.

Management implications of strategic approaches (page 252)

Porter's model envisages dominance of the parent company, both organizationally and culturally. Managers rely on a strong corporate culture as a source of unity, binding the parent with subsidiaries in different countries. Local managers carry out instructions of the head office. The resource-based models view the parent company's role more as one of co-ordination. For Prahalad and Hamel, technologies and skills exist across the company, in different locations and business units. Management's role is to co-ordinate them, building the company's competencies. They stress the crucial role of central management in maintaining the core competencies.

An ideal model? (page 257)

Assess the advantages of the global organization compared to the transnational organization described by Bartlett and Ghoshal

The advantages of the global organization rest with its centralized organization and control. This type of company is not as vulnerable as decentralized companies to risks in extended supply chains made up of different organizations, as it is in a stronger position to control quality at each stage of production. It is particularly suitable for mass-produced products with few local variations.

Which model is best suited to specific MNEs?

Each of these MNEs is assumed to have a presence in Europe, the Americas and Asia. There is probably no one best model for each of these businesses. Much depends on cultural factors of the national environment of the firm, and its historical background. However, some recommendations can be made:

- *An oil company* – This company is likely to adopt the global model. Integration of operations is needed, as is a global strategy. However, it should be noted that oil companies operate in some difficult environments, such as unstable developing countries, where managers must adapt to local ways of doing things. Shell (featured in CS5.2) streamlined its cumbersome organization in order to become more competitive. It has also adapted to working in the difficult conditions in Nigeria.
- *A hypermarket retailer* – The multinational model would probably be most appropriate. This is a sector where local factors are important, and decentralized organizations can respond to local needs and tastes. Distribution, which is crucial in this sector, is typically handled by national distribution networks, with which the retailer must work. It is notable that Wal-Mart, which is closer to the global model, has suffered setbacks in its internationalization from its strong American base.
- *A television manufacturer* – This company is likely to manufacture a range of consumer products in addition to televisions. The transnational model is probably the best model. This company is in a highly competitive sector, where the location of production is crucial: companies seek proximity to large markets, scale economies and cost reductions. Global strategy is needed, but units bear considerable responsibility for management of operations.
- *A brewer* – Much consolidation has occurred in the brewing industry. A few large companies, such as AmBev, have grown by acquiring smaller brewers. The international model or multinational model would be appropriate. The international model is similar to a co-ordinated federation, with control from the centre, but latitude for independent subsidiaries. The multinational model is more decentralized, with more local autonomy and less direction from the centre. Brewing is traditionally localized as a business, emphasizing local brands and tastes. Although now dominated by global companies, local markets remain important.

The flexible giant? (Page 262)

Inter-organizational networks can operate informally, cutting through the procedural hurdles which are common in the large organization. Interactions with other firms are central to managing supply-chain links. The concept of the value chain has transformed international production. The MNE becomes a co-ordinating organization, dealing with firms in all stages of the supply chain. These links offer flexibility. As they typically involve subcontractors, their services may be designed for specific purposes and limited in time. The SME can play a role in networks, offering specific specialist inputs which the large MNE may lack. The networking approach is therefore flexible and adaptive. However, the co-ordinating MNE must be vigilant to maintain core competencies in-house.

Pop loses its fizz (page 271)

Strategy recommendations

- Examine Pop's portfolio of brands and products critically. Which are the most successful in which markets? Concentrate on the most successful and sell off the rest.
- Examine the company's markets. Which are growing and which are stagnating? Emerging markets are now the fastest growing, but they differ from country to country. In each, local competitors will have established brands. Pop therefore needs to target countries where its products and brands have the greatest potential. Targeting individual markets implies adapting to local preferences and designing marketing strategy accordingly.
- Pop should evaluate its position in respect to healthier alternatives to both its drinks and snacks, as these are growing segments in all markets. Healthier snacks, with less salt and fat, is a differentiation strategy which has potential and offers consumers added value.

Organization recommendations

- The global product divisions are proving inflexible and unable to adapt to changing markets. The company should consider regional divisions, with managers who can maximize the potential of the products and brands in specific markets.
- The company should probably decentralize decision-making processes, to enable it to adapt to local differences. The head office would maintain a co-ordinating role, but responsibilities would be more shared than top-down.

How to go about implementing these changes

These changes involve restructuring and changes in roles and responsibilities. Such radical changes need to be managed from the formal point of view, but they must be carried out with co-operation of staff. This company has become accustomed to highly centralized decision-making, and it will take time for staff to adjust to decentralized responsibilities. Importantly, internal communication needs to be more open, and communication with customers and other stakeholders also needs to be improved. The centralized company tends to be inward focused, which is partly why Pop has lost touch with markets.

Part B review questions (page 271)

1. *Why have acquisitions been gaining over greenfield investments in popularity as an entry mode? Assess the role of the national environment in choosing the mode of entry, giving examples.*
Acquisitions have become popular because:
 - They are quicker than greenfield investment, as the acquired business is already a going concern.
 - The acquired company often already has a customer base on which to build.
 - The acquired company has existing expertise in the local market.

The national environment influences entry mode in many ways (see Figure 7.2). The following can be highlighted:

- For firms seeking markets for their products, the numbers of potential consumers and their income levels are important. The rising middle class in China has attracted numerous foreign companies. This is true whether the firm wishes to export or invest in production in the foreign country. A fast-growing emerging market will justify investing in production for the local market, especially if labour costs are low. The greenfield site or production under licence are alternatives. Level of relevant skills in the local workforce is a factor in deciding where to locate production.
- The political and legal environment affects foreign entrants in a number of ways. All foreign entrants will be involved in legal relations, and a sound, independent legal system is therefore beneficial. Unfortunately, this is rare in developing countries. The foreign company considering production under licence is taking some risk in a country with a weak legal system, as there could be leakage of intellectual property rights (such as patents). The foreign firm may therefore decide on a greenfield site, in order to keep closer control on the design and operations. In this case, the entry mode entails considerable interaction with local administrative authorities. These processes can be frustrating and may be tainted with corruption.
- The company which sets up a subsidiary or engages in a joint venture in the foreign country takes an ownership stake, suggesting a long-term commitment. These foreign interests can be at risk from government interference or even takeover in some environments, especially in the oil and gas industries.

2. *Critically assess the validity of Porter's five forces model, highlighting aspects which have attracted criticism. How could the model be improved upon?*

First, explain the elements of the model. This model is designed to assess the competitive environment in particular industries, encompassing producers, consumers and products. Using this model, the company contemplating its strategy will form a picture of how difficult it will be to enter a market, which groups have the greatest influence, and which substitute products will pose competitive threats. The company can then formulate strategy to deal with these three forces.

A shortcoming of the model is its focus on external environmental factors. It also takes a rather static approach, assuming that the characteristics of an industry are enduring, although industries change over time. It takes little account of the role of innovation to 'shake up' an industry, altering the competitive landscape. Porter suggests that competitive strategy should have both offensive and defensive aspects, identifying three generic strategies. In particular, he notes that cost leadership is a good defence to all five competitive forces. In fact, the firm focusing exclusively on low costs is vulnerable in the modern environment, as lower-cost producers are constantly entering the market, creating a 'race to the

bottom'. Companies now tend to take a broader view of strategy, and a sharper focus on the consumer, offering a multi-pronged approach. This would include elements of cost leadership, added value and customization, but they are likely to be blended, rather than viewed in isolation.

3. *MNEs from developing countries are increasing their international presence. What are their sources of competitive advantage, and what are their weaknesses in comparison with established companies from developed countries? Give examples.*

MNEs from development countries potentially have the following sources of competitive advantage:

- They are entrepreneurial and able to take decisions quickly. This is often because they are run by a charismatic owner/founder with global ambitions. An example is Lakshmi Mittal's businesses.
- The national environment of the MNE's home country can be advantageous in its global ambitions. It is likely to be one where labour is relatively cheap and the national institutional environment is relatively weak. The MNE in this environment learns how to cope where legal and regulatory frameworks are weak, and is thus well experienced when it embarks on international expansion in similar countries. Recall the Lenovo (CS1.2), which benefited from its experience in the low-cost environment in China, before taking over IBM's PC unit.
- MNEs from developing countries are often from cultural environments where personal relations are paramount in business, whereas MNEs from Western countries are more accustomed to legal, arm's-length relations. In most of the world's newer markets, these emerging MNEs find that their approach is more in keeping with the ways in which local businesses operate.

Weaknesses of MNEs from developing countries:

- Many have limited international experience among executives.
- Expertise in production and quality management is limited.
- These companies are still developing the management skills in which developed-country competitors have depth of experience.
- Corporate governance systems tend to be weak and lacking in transparency.

4. *Discuss the advantages and disadvantages of the network organization in international business. To what extent is it fair to describe it as attractive in theory, especially for its flexibility, but difficult to apply effectively in practice?*

First, recall the definition of the network organization. Its advantages include:

- Ability to maximize the benefits of information and resources flows across the organization, and with outside organizations.
- From a management perspective, openness and the ability to involve all staff in decision-making, even those in dispersed locations. The openness of the network organization leads to an outward-looking perspective, enabling the firm to interact more meaningfully with stakeholders, both those directly involved in the business and those in the community.

The student would probably agree with the proposition that the network organization is an attractive theory in terms of flexibility, but difficult to apply effectively in practice. Applying these principles in practice requires having staff with the skills and outlook to realize the potential benefits. This implies cross-cultural communication skills, leadership skills and an understanding of all aspects of the organization's activities, not just a particular department. This is a tall order!

5. *Distinguish between the 'particularistic', the 'collaborative', and the 'arm's-length' national environments. What types of firm are associated with each, and how are their foreign entry strategies likely to reflect their cultures?*

- *Particularistic environment* – weak formal regulatory framework, and paternalistic organizations. China is an example.
- *Collaborative environment* – strong institutions and co-operative behaviour; associated with the strong state. Germany and Japan are examples, although the state role is rather different in each of these.
- *Arm's-length environment* – strong institutions and strong regulatory culture, emphasizing procedural frameworks. The US is an example.

Foreign entry strategies reflect both the company's own history and the national culture of its home environment. Some generalizations can be suggested, based on Whitley's theory:

- In the particularistic firm, the owner has strong control. This type of firm is likely to view acquisition as an attractive entry mode, as it involves ownership and control. Greenfield projects are also attractive. The investor from a developing country is experienced in dealing with administrative hurdles and the need to develop the necessary social and political ties common in developing countries.
- For companies from collaborative environments, internationalization presents challenges, as much of their strength lies in their strong sense of homogeneous culture (as in Japan and German). Japanese car companies opted for greenfield investment in Western markets such as the US and UK, in which they attempted to replicate the Japanese corporate culture. In practice, they adapted to local environments, aided partly by the Japanese cultural preference for consensus-based management. The alternative is to keep a subsidiary entirely independent, which was in practice the approach of Daimler to the Chrysler acquisition.
- For companies from the market-oriented environment, contractual arrangements are paramount. These can be acquisitions, subsidiaries or outsourced production. In each case, the company tends to see the foreign operations as contributing to the wealth creation of the parent company. Strategy is determined by the parent company's head office, which exerts control over operations in foreign locations.

**Web-based
Assignment (online)****Nissan as a global and local company**

Students will be more familiar with car manufacturers' product websites than their corporate websites. Nissan is one which gives an overview of global operations, updated frequently. There are certain to be many new announcements and developments since the writing of this exercise. It is helpful to highlight these, using the new information in answering the questions. The four questions can be answered by students in small groups, perhaps with each group preparing a few slides for presentation. The reflection questions are more suitable for individual responses and general discussion.

CHAPTER 8**Marketing****Strategic crossroads****8.1: Excitement mounts as Hispanic media take to a wider stage (page 290)**◆ *Assess the reasons behind Univision's growth?*

The company is credited with bringing the the 'telenovela' to US audiences. The growth of Hispanic TV audiences in the US reflected the growing numbers of Hispanic immigrants. The rising spending power of Hispanic consumers helped Hispanic TV to attract advertisers. Univision was also able to enter mainstream TV, persuading advertisers that the audience size would justify the expenditure.

◆ *How are the strategies of media firms in Spanish-language output evolving in terms of wider markets?*

Large media companies are now recognizing the opportunities in Spanish-language output. An example is GE, which bought Telemundo. These companies see the benefits of in-house production, in contrast to the imported content used by Univision. Other aspects of strategy are targeting wider global audiences and creating accompanying websites which carry advertising. Owning their own content gives the companies flexibility to exploit a variety of formats. Success in Asia opens up the prospect of much bigger audiences, and these are audiences with considerable spending power as well as widespread internet access.

8.2: Changing attitudes to advertising to the under-12s (page 308)◆ *Why have companies re-examined their policies on advertising junk food to children?*

The main reason is pressure from consumers. Consumers are concerned that junk food leads to obesity in children. These are foods which are high in sugar, salt and fat, such as soft drinks, confectionery and crisps. The large companies which make these products are tempted to design advertising to reach children, and place advertisements where they will be seen by children, for example, on television. This is an area where national regulation is either non-existent or light. Companies would not be in breach of the law, but their practices could be viewed as unethical. Have they responded because of their ethical position or because of consumer pressure?

- ◆ *Assess the range of responses to the issues reflected by companies featured in this discussion.*
Masterfoods (Mars) announced it was halting advertising to under-12s globally. This is the most radical move of the companies discussed here. Kraft announced a similar ban, but only for 'junk' foods and only in the UK.. It would still target advertising of healthy foods to the 6-11 age group. Cadbury has a cut-off line at 8 years of age, but many of its products would be classified as junk foods. Coca-Cola has certainly targeted children, as it places vending machines in schools. Public pressure has compelled it to accept restrictions, such as limited periods when they are switched on. McDonald's has been active in China, where it targets mothers with children. As there is a growing obesity problem in China, this policy could be considered unethical, although not in breach of the law.

Assessing these policies, Masterfoods seems to be acting from an ethical perspective, while the others are responding to consumer pressures where they exist. All are aware that legislation could force them to change their advertising and their products in the future. They have all introduced healthier products, also responding to consumer demand.

- ◆ *Do you approve the Masterfoods initiative, and why?*
Those who approve the Masterfoods initiative are those who recognize that businesses have ethical responsibilities. This could stem from a CSR perspective. It could also reflect a view that legislation is likely to be forthcoming in large markets, and the company could enhance its reputation by being able to say it was first to take this step. Therefore, this could be a differentiation strategy. Those who disagree with the Masterfoods initiative probably feel that the company is forgoing potential growth in some large markets, which will benefit its competitors. They could also argue that the initiative is perhaps less radical than it appears. Children under 12 now access many media sources, including internet, which abound with all types of advertising. Mars is a huge global advertiser, and its advertisements are likely to be viewed by children in any case.

Case studies

8.1: Procter & Gamble (page 300)

1. *How have acquisitions strengthened P&G's brand portfolio ?*
Consumer products cover a wide area. P&G acquired the Clairol and Wella hair care brands in the beauty segment, which has seen strong growth. Gillette has been another notable acquisition, which includes Duracell and Braun. These are all strong brands.
2. *In what ways has P&G dealt with the challenge of supermarket own brands?*
 - It has remained focused on innovation. It has a long history of science and technology research.
 - It has taken legal action against companies when there is an apparent case of trademark infringement or unfair competition. For example, it took legal

action against a producer of shampoo which was sold in containers designed to look like Head & Shoulders.

- It spends heavily on advertising, carefully targeting marketing in particular markets and segments.

3. *How have global product divisions shaped P&G strategy and culture?*

Until the 1990s, P&G had a system of country managers and a highly bureaucratic structure. This was swept away in an innovatory restructuring which brought in global product divisions. These changes enabled the company to focus more on global strategy, while regional and local managers could play a role in marketing and distribution. The aim of the restructuring in terms of culture was to shift P&G from its inward focus to a focus on the needs of the consumer, whatever the market.

4. *What is P&G's product strategy in developing markets?*

P&G has aimed to create products specifically designed for developing countries, rather than simply to export Western products to countries in which only a small proportion of people can afford them. The new products must be suitable to the local conditions and affordable. The company has invested in R&D focused at developing-country markets. It must compete against local products and brands in these markets, but feels it still has the edge in innovation and product development.

8.2: McDonald's (page 312)

1. *What were the reasons for McDonald's losing its way in the new millennium?*

- Weakening sales in its home market, the US, and in European markets.
- Negative publicity, for example, the McJobs image of employment in its outlets.
- Menu perceived as unhealthy.
- Restaurants began looking tired and dated compared to newer chains, such as Starbucks.

2. *Describe McDonald's strategy for transformation.*

The company decided to focus on the customer experience, improving the quality of the menu and the appearance of the restaurants. Healthier food and premium coffee were introduced, bearing in mind the competition from Starbucks. The opening of new restaurants was slowed, in order to concentrate on existing outlets. Following adverse publicity in the film, *Super Size Me*, supersize portions were scrapped.

3. *How has McDonald's combined localization with its global marketing strategy?*

Catering for local tastes has long been a feature of McDonald's, but was extended to design and marketing. The golden arches are identified with McDonald's

globally, but local designers were allowed scope to design for their own locations. In many places, the arches, although present, are less prominent, giving a more localized appearance. The new advertising slogan, 'I'm lovin' it', was rolled out as part of a global strategy. This was the first time all McDonald's had used the same slogan, either in English or the local language.

4. *Assess the image of McDonald's as a brand. To what extent do you feel it has changed?*

Students may have mixed views on McDonald's as a brand image. McDonald's has had such a strong image, associated with American fast food, that changing it was a tall order. The Big Mac is still its quintessential product, despite its unhealthy image. Perceptions of consumers reflect their own experience of the brand in their country. It is possible that perceptions of McDonald's are now more positive in many countries, as the restaurants have been refurbished and menus have been extended. McDonald's has long strived to retain its reputation for high quality ingredients, which has been important in developing and emerging economies. This reputation helps to enhance its image in these markets, even though anti-US sentiment is a factor in many countries.

Country focus

8.1: China (page 286)

- ◆ *Assess China as a potential market in terms of the three levels of analysis presented in the previous section: macro-level factors, consumer markets, and micro-level product markets?*
 - *Macro-level factors:* China enjoys rising GDP per capita and high economic growth rate. Its growing urban middle class is a tempting market. However, these factors are unevenly distributed: rural areas have not participated in the rising incomes and growth to the same extent as urban areas.
 - *Consumer markets:* China's new consumers are eager to acquire the items associated with Western lifestyles, including consumer electronics, cars, holidays, and meals out. Eating habits are changing in the urban areas: people are eating more western-style foods, including meat.
 - *Micro-level product markets:* China is an attractive market for foreign MNEs, but in most product markets, existing domestic firms are active, and the foreign MNE can expect a fierce competitive environment. Retailers such as foreign hypermarkets have entered China. Because of their size and scale economies, they can compete on price with smaller local stores. They also offer a great variety of products under one roof. However, Chinese consumers are highly influenced by price, and local supermarkets are adept at maintaining competitive prices. Similarly, in car manufacturing, Chinese makers, such as Chery, compete successfully alongside the models offered by the foreign joint ventures.

- ◆ *How does China's rich-poor divide impact on the growth in consumer markets?*
It is a mistake to view China as a single market. The rich-poor divide is mainly based on the differences between urban and rural populations. However, regional differences are significant. The developed urban coastal areas are richer than inland cities, although urban areas generally have growing numbers of middle-class consumers. Western entrants have focused on the coastal areas, but future growth in consumer markets is likely to come from the more inland cities. Consumer markets in these cities are diverse, reflecting regional differences in tastes. These consumers cannot be assumed to be attracted to Western consumer goods as they become richer. China's consumers are becoming more affluent, but their location and cultural environment help to determine consumer markets, in addition to their growing incomes.

- ◆ *Why have hypermarket retailers flocked to China?*
 - The size of the Chinese market is the main attraction. Although affluent consumers are still in the minority, the potential for growth makes it worthwhile for Western hypermarket retailers to invest.
 - Hypermarket retailers benefit from economies of scale. Where the market is potentially large, as in China, their advantages become more pronounced.
 - China is still experiencing economic growth rates of about 8%. This is not as high as those of the last two decades, but is still much higher than the more mature markets of the US and Europe.
 - Hypermarket retailers have met resistance in some European markets because of their size and perceived detrimental impact on local competitors. Hence, their scope for growth in these markets has tailed off. In addition, planning permission for the large sites they require often raises objections. Their moves into emerging markets such as China therefore represent opportunities in an environment where the formal retailer sector is less developed.
 - Once one hypermarket retailer has entered China, such as Carrefour, its main rivals feel compelled to follow.

8.2: South Africa (page 293)

- ◆ *In 2005, some criticized Barclays for its acquisition of Absa as being too risky an investment. Assess the pros and cons of the decision. Does the bank now seem to have got it right?*
 - *The pros* – A huge potential retail banking market; growing numbers of middle-class consumers; relative stability in the country following the end of apartheid.
 - *The cons* – As a developing country, South Africa's rate of economic growth is critical, if it is to compete with the fast-growing emerging economies such as China. South Africa must still grapple with uneven development – there is much poverty and poor infrastructure. It has suffered from currency volatility, affecting its export industries. Unemployment is high, and there is a shortage of skilled workers. This latter factor deters foreign investors, whose presence

is needed to maintain good rates of economic growth. Political risk is a factor, as President Mbeki leaves office and hands over to a new president.

- *Has the bank got it right?* The bank has been able to grow the South African business, although early growth in numbers of retail customers might not be sustained. The transition to a new president has is taking place smoothly. South Africa probably now looks as if it was a good choice for Barclays, but global economic downturn will affect all countries.

- ◆ *Assess the entry decision-making process for a company from the EU considering South Africa as a possible location for its call centre.*

BPO in South Africa has been a growth industry, although possibly held back by lack of skilled workers. The location offers the EU company considerable cost savings over its home country, mainly due to lower wages. Tele-communications costs generally are relatively high. The time zone similarity between the EU and South Africa is an advantage over India, and the South African accent is considered 'neutral', adding to the attraction of the country. South Africa does not have the vast pool of qualified workers that India boasts. Much depends on the size and type of call centre envisaged.

- ◆ *Construct a SWOT analysis of a South African company offering upmarket packages for foreign tourists.*

Strengths	Weaknesses
<ul style="list-style-type: none"> • Long tradition of upmarket tourism • High standards of service • Attractive holiday packages 	<ul style="list-style-type: none"> • Dependence on poor infrastructure • Shortages of skilled staff • Use of service providers of varying quality
Opportunities	Threats
<ul style="list-style-type: none"> • Football World Cup 2010 • Variety of attractions for upmarket tourists 	<ul style="list-style-type: none"> • Lower-cost destinations, especially those closer to the EU • Economic downturn affecting tourist numbers and how much they spend • High levels of crime

Pause to reflect

The return of global strategy? (page 280)

It is helpful to begin by identifying different strategic perspectives: multidomestic, regional and global. Localization has been stressed, especially in consumer markets, but global product divisions point more towards global strategy. The student might take the view that global strategy is coming back into its own, but with some provisos. Some relevant points:

- Global product categories and global brands lend themselves to global strategy. However, adaptations must be made for local conditions and preferences.
- Global media, including the internet and satellite TV, are becoming more pervasive. Internet advertising is growing rapidly, thanks largely to the search engines' efforts to increase advertising. This facilitates familiarity with brands, logos and products globally. However, the brand owner is likely to adapt products for local markets, and also tailor marketing to local markets.
- Paradoxically, the internet facilitates the localization referred to in the previous point, as local language websites operated by global companies now abound. Google is available in dozens of languages.

Developing and emerging markets (page 288)

What factors should firms prioritize when contemplating expansion into these exciting new markets?

- *Rate of economic growth and regions/cities in which the growth is concentrated.*
- *Degree of industrialization and where it is happening* – These are areas where consumer spending is going up, in keeping with wages.
- *Levels of education and urbanization* – These are indicators of a growing middle class, whose members are spending along the lines familiar in developed consumer societies.
- *Proportion of the population which can be considered affluent enough to buy the firm's products* – This may be quite low at present, but if it is rapidly growing, market entry is justified.

What are their disadvantages in comparison with developed countries?

- *Political risk* – Many of these economies are politically unstable, and many tend towards authoritarian political systems.
- *Social instability* – Social and ethnic divisions can lead to unrest anywhere, but are a bigger risk where rapid urbanization is taking place, and where poverty is extensive.
- *Infrastructure* – Infrastructure tends to be weaker in developing countries.
- *Sound legal system* – The legal environment is important for the protection of property, including intellectual property rights.

Emerging market entry (page 295)

Strategies suitable for developing and emerging markets depend largely on the industry. Production under licence is appropriate for manufacturers, with the proviso that supervision of quality and working conditions can be maintained. However, leakage of IP is a risk. FDI in a greenfield site would be more attractive if leakage of IP is a risk. This allows greater control over production, and also distribution and marketing, assuming that the local market is targeted. The joint venture is often advocated for emerging markets, for the local partner's knowledge and network ties. This is true of manufacturing as well as retailing. In many countries, such as India, the foreign investor is required to use the joint venture with a local company. Acquisition

is favoured by many retailers. This allows the foreign investor to start gaining a return immediately. However, the target company must be selected with care.

Waning of the global brand (page 300)

Students will have differing views on the answer to this question. Note that it asks about the declining *reputation* of global brands. It is worth considering the elements of a good reputation for a brand, before looking at whether global brands are declining in reputation. Some relevant points:

- The growth of own brands has dented the reputation of some global brands, as consumers feel they are asked to pay a premium just for the brand. This has been true in pharmaceutical products, compared to generic medicines (see CS12.2).
- Some global brands are perceived as too dominant, and in a position to compete unfairly. This is associated with anti-globalization views. Microsoft is an example.
- Some global brands are perceived as essentially American, and become the focus of anti-American sentiment. McDonald's is an example.
- Some global brands have been associated with outsourced production in low-cost countries with poor labour conditions and weak protection of human rights. This association can damage the brand in the eyes of many people.

Price sensitivities (page 306)

Students will have different views on this issue, and should be able to discuss it from their experience in their own country. Some might argue that market forces should have free rein in all products, but, in practice, most governments see pricing of essential goods as an aspect of social policy, although they differ on their willingness to intervene. The following are some relevant points:

- MNEs see pricing in terms of national markets, and set prices according to factors in each market. However, this strategy is becoming undermined as price differentials become widely known. Both individuals and businesses in countries where prices of particular goods are high, are naturally inclined to seek out cheaper locations to buy them. After all, the global company follows a similar strategy, sourcing and producing in the most advantageous location.
- In some products, such as software and DVDs, the trade in counterfeit products is booming in some markets where the official prices are high. It has long been said that in China, there are more people using pirated copies of Windows and Office software than legitimate ones. In this situation, even if Microsoft lowers its prices (as it has done), it is still difficult to sell products, as people are accustomed to paying nothing.
- In essential goods, governments may intervene in various ways. Some control prices in essential products, effectively setting a cap on prices. Governments in emerging and developing countries have applied caps to essential foods and energy prices. This helps to cushion the effects of global price rises in commodities (the consumer in a poor developing country typically pays half or more of his/her income on food). A difficulty is that this policy can lead to

shortages of supplies and the emergence of a black market (the producers cannot make enough money producing for the legitimate market to stay in business).

- Branded medicines are only affordable by the most affluent, mainly those in developed economies. In fact, even in these economies, resistance to high prices is an issue. Where there is a national health service, it can exert pressure for lower prices in its market; it can also threaten to use generic alternatives where possible. In the US, there is now much resistance to the cost of medicines, which is beyond the means of many. The pharmaceutical companies are therefore faced with a dilemma, as is the government. This was an issue in the 2008 presidential election campaign.

Marketing codes of ethics (page 311)

Students are free to design their ten principles as they see fit. They should be encouraged to design their own, not to copy from internet sources! Principles which could figure in the list:

- Comply with the law of the country in which the firm's products are sold and marketed.
- In advertising, accurately and honestly describe products, refraining from any false or misleading claims about their qualities, price, content or performance.
- Where products are particularly designed for children (e.g. toys) adhere to the highest standards of testing components and finished products, even though national law has lower standards.
- Ensure that all involved in marketing directly to consumers adhere to principles of honesty and fairness.
- Where products are potentially harmful if taken in excess (such as alcoholic drinks or even junk foods), emphasize responsible use in advertising.
- Where there are reasonable suspicions that a particular product is harmful (such as contaminated food products), make a public announcement immediately and co-operate with authorities.
- Avoid marking up prices of products excessively.
- Adhere to principles of sustainability in packaging.

Many other principles could be included. The lists of all in the seminar group could be compared. How many principles feature repeatedly? These are likely to be the core principles which participants feel are important.

Part B review questions (page 312)

1. *Why is China now the 'must' market for global companies? What are its drawbacks as a consumer market, and how do they differ between sectors?*

China is the largest potential market for most companies, and also an economy which is still growing strongly. These are its attractions, or 'pull' factors. Its main drawbacks as a consumer market are divergences across regions and between urban and rural inhabitants. These imply differing levels of income, differing lifestyles, differing cultural environments and differing administrative frameworks.

Where levels of economic development are uneven across a country, companies targeting consumers must be careful not to enter the market with products which are not affordable by the majority (see CS8.1 on P&G). Hence, the market for some luxury goods could be confined well-to-do cities such as Shanghai. Here, there is also a market for cars, leisure activities and entertainment. There is less scope in these sectors outside major cities. This growth will take place over time, and early market entrants will have gained experience of Chinese consumers in the process. However, different regions and cultures present new challenges as they expand from the cities.

2. *In what ways can the global brand be described as a 'mixed blessing'? What strategies are available to promote the global brand while cultivating a localized image in consumer perceptions in different countries?*
- The global brand benefits from familiarity in most markets, but a downside is that any adverse publicity rapidly becomes news, potentially damaging the company's reputation. Not all news is good news when it comes to global brands, and the good-news stories do not make headline news in the way that bad-news stories do. Brand owners benefit from the fact that their brand image helps immensely to sell their products. Even if quality is allowed to slip, the image will still generate sales for a time. However, the brand owner must be vigilant to ensure that customer expectations are satisfied – poor-quality goods will do great damage to a brand with a quality reputation.
 - The global brand owner can use the global brand in all markets, but adapt products and marketing messages to local conditions. An alternative strategy is to acquire or build local sub-brands, which have their own image, independent of the owner. For example, Walkers Crisps is a well-known brand in the UK, owned by PepsiCo. It is thought of as a local brand.
3. *In what specific areas do ethical concerns impact on marketing? How does a company's stance in relation to ethical marketing influence its brand image? Give some examples.*

Ethical concerns impact on all aspects of communications with consumers of the company's products. Some areas:

- Description of the product, and claims about its characteristics in advertising
- Pricing
- How the product is sold, for example, with high-pressure selling techniques
- Targeting of specific groups, such as teenagers or children

It could be argued that brand image can be *damaged* by unethical marketing, although ethical marketing does not necessarily *enhance* brand image. The MNE would be advised to see ethical marketing as essential to maintain brand image, in order to avoid the damage which can be caused by cases of unethical behaviour. This is rather a defensive strategy, but possibly a realistic one.

4. *Globalization is associated with increasing inequality. This is one of the arguments often highlighted as a negative impact. Assess the evidence on the basis of current trends, deciding whether this criticism is justified.*

Inequality is discussed further in Chapter 3. It is raised here specifically in conjunction with globalization. It is helpful to state first why globalization and rising inequality are linked, noting that inequality can exist within a country and between countries. A point which students should have grasped is that those countries and companies with the skills, resources and strategies in the sectors which are rapidly becoming globalized (such as manufacturing, telecoms, finance, internet, extraction industries) can potentially make huge financial gains for their owners. China and India now have the most rapid growth in numbers of billionaires. Although ordinary workers have seen rising wages in both developed and emerging economies, the gap between these workers and the richest in their societies has widened. Students may argue that this is not a negative impact, and globalization should not be blamed for these consequences. They might argue that governments should bear responsibility for the social and economic well-being of all in society. Governments have encouraged market reforms and economic integration, seeking the benefits of economic growth, but rising inequality in many countries can lead to social unrest, often as a backlash against globalization.

5. *Should MNEs concern themselves with adverse social impacts of globalization? If so, what should they be doing in terms of changing their global strategy?*

MNEs now generally accept that they are active participants in the communities in which they operate, whatever the location. While they may view their activities chiefly in economic terms, economic activities are increasingly mingled with social, ethical, environmental and political issues. For this reason, it is arguable that companies which manage these interactions with a view to social as well as economic goals will build more sustainable long-term strategies in host countries. The implications for global strategy are that local CSR and stakeholder concerns can bring positive benefits. Moreover, for MNEs, reputational damage in one location can lead to negative perceptions of the company in terms of global reputation.

Web-based Assignment (online)

Unilever brands target all markets

This exercise will vary somewhat according to which videos are available for viewing by students. It will be helpful if all in a seminar group can watch the videos. Answers to the questions can be discussed and compared. Answers to the broader questions about the company's marketing strategy will emerge from both the website and the videos. The reflection section highlights the CSR perspective, including sustainable development. The use of sustainable palm oil was featured on the home page when this exercise was written, indicating the company's desire to headline the issue. A discussion of this topic could round off the seminar.

Synthesis and reflection (online)

Part 3: Competing in the global marketplace

1. *Give examples from these chapters where governments have intervened in business activities to promote national interests.*
 - *Chapter 6* – China (strategy of using trade relations as a means of bolstering national security, such as oil supply contracts with Sudan; Governments' use of trade policy for protectionist purposes (such as protecting national employment); US (use of the VER in relation to Japanese car manufacturers); Japan (companies' decisions to manufacture in the US); EU (Common Agricultural Policy); CS6.1 (Boeing and Airbus, both of which received government support); failure of the Doha Round of multilateral negotiations; Brazil (leadership role in relation to developing countries: it has urged them to open markets, largely in efforts to improve relations with the large Western markets, such as the US, which it targets for its agricultural exports).
 - *Chapter 7* – Poland (opposition to Tesco's entry); South Korea (support for chaebol, which were central to economic development and internationalization, although now, arguably, detrimental to national interests); Japan (state support and guidance for Japanese companies deemed to be national champions).
 - *Chapter 8* – Potential intervention / legislation to control advertising to children.

2. *Cite examples of the tension between global and local considerations in corporate strategy and structures.*
 - *Chapter 6* – CF6.1 (German companies have successfully internationalized, but to the detriment of local jobs in Germany); CS6.1 (both Boeing and Airbus (owned by EADS) have globalized production and sourcing, but are perceived as national champions; boeing has suffered setbacks because of Japanese-supplied materials (see p. 365)); CF 6.2 (Brazil's agribusinesses are global forces, but face local complaints from small farmers and environmental groups; Brazil's exports of some agricultural products, such as sugar, has raised objections from small developing countries – in this case, the EU supported these small countries through the ACP subsidies, which were in breach of WTO rules); the takeover of British Airports Authority (BAA) by Spanish company, Ferrovial.
 - *Chapter 7* – SX7.1 (Weg Electric has become both globalized and localized, guided by proximity to customers); SX7.2 (ABB shifted from a decentralized model to a matrix model, then to global divisions); CS7.1 (Unilever has a global product divisions, but with localized marketing strategy); CS7.2 (Nissan has internationalized, while retaining strong roots in Japan).

- *Chapter 8* – CF8.1 (hypermarket penetration of China: the large hypermarket retailers have had to adapt to local conditions in Chinese operations); CS8.1 (Procter & Gamble’s global brands and strategy have been adapted to local markets); CS8.2 (McDonald’s has adapted menus to local tastes, but now goes further, adapting the appearance of restaurants).
3. *In what ways is corporate strategy changing to reflect the rise of emerging economies? Give examples from the chapters.*
- *Chapter 6* – CF6.1 (German companies, including SMEs, are globalizing production); CS 6.2 (Western textiles and clothing brand owners outsourcing production to China).
 - *Chapter 7* – SX7.1 (Weg Electric began manufacturing in China; Weg is a Brazilian company, itself from an emerging economy); CS7.1 (Unilever is shifting focus to emerging markets, and also other developing economies); CS7.2 (Nissan now manufactures in China, in a joint venture).
 - *Chapter 8* – IKEA (expanded its presence in Russia); CS8.1 (hypermarkets, such as Wal-Mart, have targeted China); CF8.2 (Barclays’ acquisition of Absa in South Africa); CS8.1 (P&G targeting emerging markets); SX8.2 and CS 8.2 (McDonald’s targeting emerging markets, including China).

CHAPTER 9**Human resource management****Strategic crossroads****9.1: GECAD reinvents itself (page 338)**

- ◆ *What are the key elements in GECAD's business success?*

GECAD was a start-up company in the period following the fall of communism in Romania, in the early 1990s. Its entrepreneurial founders were inspired by the opportunities presented by the new market freedoms. They were able to adapt in an environment of weak resources and weak institutional development. Romanian IT experts were encouraged to focus on anti-virus software largely because of the thriving virus industry nextdoor in Bulgaria. This situation led them to specialize in the area, which became highly important in the following years. The global IT companies recognized this expertise, which they were keen to acquire. This is an example of an SME playing a role in innovation, which is then taken up by large MNEs.

- ◆ *Describe the corporate culture of GECAD. How can its employee involvement and commitment be replicated in larger organizations?*

GECAD's founder and CEO takes pride in the fact that his managers were offered jobs with Microsoft, but only 10% took them up. GECAD is highly egalitarian – the CEO sits alongside other workers. All employees are empowered to take initiatives and develop new ideas. This is the company's source of strength and employee motivation.

Replicating this culture is something which large organizations struggle to do. Students might make a number of suggestions, such as flatter organizations, employee empowerment and recruitment policies that prioritize creative talents (see p. 461 on Google, which hires creative people, but leaves many feeling rather directionless in the large organization which Google has now become).

9.2: Austrian banks look eastwards (page 349)

- ◆ *What are the reasons behind the acquisition strategies of the Austrian banks?*

Austria's historical and cultural affinities with Eastern Europe led these banks to look eastwards in their internationalization strategies. Austria itself is a pluralist society, with many Eastern Europeans. These banks had been investing in Central and Eastern Europe since before the fall of communist rule. The post-communist transition gave them new opportunities to expand. For example, they took over formerly state-owned banks. They were able to modernize and restructure these operations, and also attract growing numbers of consumers to banking services.

- ◆ *Describe the Austrian Banks' IHRM policies and practices in integrating acquired banks.*
The Austrian banks are sensitive to local cultures, and value the role of local managers. Changes are introduced gradually, taking into account particular sensitivities among staff, and bringing in only outsiders who local employees will be happy to work with. The banks have built up expertise in this type of takeover and restructuring, and utilize staff who have acquired skills in previous takeovers to manage the integration process in later takeovers.

Case studies

9.1: Look good and feel good with l'Oréal (page 335)

1. *In what ways are l'Oréal's staffing and recruitment policies linked to its IHR strategy?*
L'Oréal's IHR strategy is based on international outlook and cross-cultural competencies. It recruits staff internationally, and is keen to attract people who wish to work in different countries. The company takes the view that moving to new countries and taking on new roles is essential to career development.
2. *How are L'Oréal's IHR policies reflective of its corporate goals?*
L'Oréal's corporate goals focus on its wide portfolio of brands, which are sold in a wide range of markets. The brands include consumer brands, luxury brands and specialist brands, as well as Body Shop, with its emphasis on fair trade policies. Its IHR policies reflect the diversity in its brands and also the diversity in its markets.
3. *Describe L'Oréal's training and development policies. How does it underpin the company's emphasis on multicultural teams?*
L'Oréal views training and development as directed towards taking on new challenges and acquiring new skills, which are linked to a new country, new role or new brand. Managers are moved every 3-4 years to a new location. The result is that in any location, there are people from diverse backgrounds, in terms of culture, job skills, professional experience and experience of different brands. This makes for highly diverse multicultural teams. The company sees this approach as an asset, as such teams generate more ideas than would emerge in a less diverse organization.
4. *How is l'Oréal's global strategy evolving, and how will this affect its IHR policies?*
L'Oréal is now focusing more on emerging markets, which have greater scope for growth than the mature markets of Western Europe and North America. Looking at Figure 2, note that in 2006, these were quite small compared to its established markets. R&D is concentrated in France, and it is possible that, as emerging markets become more significant, R&D activities might be shifted. In general, it is likely that more emphasis on emerging markets will lead to more staff recruitment in emerging countries. Asia is a relatively small market, but this market has scope for considerable growth, and designing distinctive products for Asian consumers

is a possibility. The reward system would probably have to be adapted for Asian staff, along with the training and development policies.

9.2: Shifting centre of gravity for Indian outsourcing companies (page 352)

1. *How are Indian outsourcing companies changing their global strategies?*

First, explain how these companies evolved in outsourcing services. Their main advantage was access to skilled IT workers at low cost. These firms now seek to become global players, offering a wide range of services, designed to suit customers' needs, wherever they are located. TCS set up development centres near its major markets – near-shore outsourcing. In these locations, costs were relatively cheap: Latin American centres could serve the US market, for example. High-volume services are still provided in India (see Figure 2).

2. *What are the HRM implications of TCS's new global strategy?*

TCS now needs to recruit new staff in all locations. To serve customers effectively, staff need language skills. The company has acquired local businesses, which must be integrated. TCS has announced a policy of creating a single unified culture in the global company, but this is difficult in light of the rapid growth in number of employees and their differing locations.

3. *How are recruitment, training and development evolving in the Indian outsourcing companies, to reflect new global strategies?*

These companies have been growing rapidly, recruiting their own new staff and taking on staff in acquired companies. They recruit graduates in major markets. Infosys gives these foreign recruits intensive training at its centres in India. They are then sent back to their home countries and tasked with delivering specialist services. TCS has training centres in major markets as well as near-shore locations. These outsourcing companies now recognize the need to recruit staff with more than just IT skills, and see that interaction with clients in their own languages is needed, in order to devise customized solutions. They are competing against established outsourcing companies, such as IBM, which are also seeking to offer high-value services.

4. *What challenges face TCS and other outsourcers in integrating their rapidly expanding, as well as multicultural, workforce?*

- Aiming to create a unified culture is perhaps optimistic, given the growing diversity of staff and rapid recruitment. On the other hand, the need to stress core values to each and every employee is perceived to be important.
- As these companies rapidly expand, there is a risk that the process will be unwieldy, and HR policies will become fragmented.
- These companies wish to develop services to suit clients' needs over a range of functions, but it is difficult to maintain high standards in all, especially in a rapidly changing environment.

- In any business with large numbers of recently-recruited staff, there is a risk that lack of experience will be a drawback.

Country focus

9.1: Vietnam (page 327)

- ◆ *Describe the main features of Vietnam's institutional environment. How do these factors impact on the work environment and labour relations?*

Vietnam is making the transition from a planned economy to a market-led one, under the guidance of its communist leaders. The state still dominates strategic sectors, and legacies of bureaucratic state machinery remain. Corruption remains a major problem, and progress in eliminating corruption is slow. Market reforms and inward investors have brought prospects of job creation on a large scale. With low wage levels compared to China, Vietnam's plentiful supply of keen workers is a source of comparative advantage. Poor industrial relations have been a problem. Workers in the key export sectors have endured poor conditions and have little voice in labour relations. Labour unions exist, but are state-controlled, and firms in these industries are typically foreign investors, on whom the state is depending for job creation.

- ◆ *What are the attractions of Vietnam for foreign investors?*

Some which are highlighted in the case study:

- Low wages.
- Diligent workforce.
- Weak employee rights
- Reasonably stable government. It is communist led, but a National Assembly of elected representatives is a sign of political reform.

- ◆ *What are the prospects for better employment protection and improved labour relations in Vietnam?*

Members of the National Assembly have shown they are willing to criticize officials, and this could be a sign of growing awareness of social and political issues at grassroots level. The government has a weak human rights record and weak stance on employment protection. With considerable labour unrest, the government could decide to follow China's example and strengthen employment rights. However, it would be reluctant to antagonize foreign investors. Thus, the likelihood of improvement is probably slim, especially if foreign investors are on the lookout for more advantageous locations. On the other hand, if social unrest becomes a perceived threat to communist leaders, they might feel that improving workers' rights is necessary simply to maintain political stability and retain power.

9.2: Sweden (page 341)

- ◆ *Describe the main characteristics of Sweden's social model of capitalism.*

They are:

- Generous welfare state.
- Strong state presence in business, including state ownership.
- Consensus between government, business and labour unions.
- Egalitarian values in workplace and society.

Students might also mention the high taxation and social costs which have been needed to pay for benefits. Questioning of this model is now ongoing in Sweden.

- ◆ *Why is Sweden ranked highly in global competitiveness?*

Refer to tables, pages 211-12. Sweden is ranked higher in the WEF table (fourth) than in the IMD one(ninth), but still high in both. WEF criteria include health and primary education, both strong in Sweden. In economic criteria, market efficiency, government efficiency, infrastructure, and both public and private institutions are all strong in Sweden.

- ◆ *What policies and practices designed to foster employee participation traditionally feature in Swedish organizations?*

- Employee orientation, fostering job-related education and training.
- Works councils.
- Co-determination in corporate governance
- Decentralized decision-making – the Volvo approach.

- ◆ *What employment changes are taking place under the centrist government?*

The new government is concerned about the spiralling cost of social benefits. It is seeking to privatize state-owned companies, reducing the size of the state. It is also scaling back the welfare system. These are essentially market reforms. The government is aware that, with slow economic growth, businesses need the flexibility to hire and fire. If social costs are reduced, they should be able to create more jobs.

Pause to reflect

How culture bound is HRM? (page 325)

- *Q1:* Students may well feel that HRM has lost relevance. This reasoning rests on the Western individualist assumptions that underlie HRM theories and practices. It can be pointed out that much attention is devoted to aligning workers' roles and rewards with those of the firm – a process in which managers play a crucial part. For example, the notion of empowerment rests on individual responsibility, and is contrasted with the view of employees as mere units of labour, commonly associated with large organizations.
- *Q2:* Few would claim that a single theory could apply universally. The HRM theories discussed here take account of different types of organization.

International HRM has evolved as firms become more internationalized, and is now recognized as a subject area in its own right. It is arguable that the same issues, such as manager-employee relations, arise in all organizations, and theories are helpful in clarifying the different roles and relations. However, it is now clear that differing environments are central to that discussion – which was perhaps not widely acknowledged in the past.

Race to the bottom? (page 329)

- *Q1*: One of the traditional means of improving working conditions is through independent trade unions, which can represent workers' interests and negotiate on their behalf with management.. They played important roles in both Europe and the US. However, independent trade unions are banned in many developing countries where authoritarian governments see them as vehicles of political dissent. Other possibilities:
 - Democratic political transition, by which pluralism is recognized, along with trade unions.
 - NGO activities which publicize poor working conditions to consumers in Western markets.
 - Government policies in host countries. Governments are in a position to lay down conditions for employment. Some foreign investors, such as those conscious of CSR, would welcome such initiatives rather than be deterred by them.
- *Q2*: Not necessarily. Much depends on the industry – textiles and clothing do seem to suffer from the race to the bottom. However, most investors have multiple reasons for choosing a particular location, and low wages is only one of them. If improving labour standards sends investors rushing for the exit, it could be argued that these were not the type of investors the country should have been attracting.

Vietnam can be cited, having attracted investors when China was becoming more costly. Mexico is another location which has benefited from low costs. It saw investors leave in favour of China, despite the higher costs of transport to reach US markets (see CF 4.2).

Rewarding workers in diverse environments (page 333)

First, summarize what a reward system comprises. The company could have an identical reward system operating in these two locations, but even if it did, it would probably not operate in practice in the same way, as these cultural environments are so different. Some factors in the US subsidiary:

- Workers are likely to be individualistic and competitive. They are task-oriented, and performance-related pay would appeal to them.
- Employees here are very concerned about benefits such as health insurance offered by the employer (note this is mentioned in the benefits offered to McDonald's, as featured in the web assignment for this chapter)..

- Workers in the US tend to see a line between their life in the organization and their personal life. Hence, work-life balance is important to them. They might also appreciate being able to work at home.

Some factors in the Chinese subsidiary:

- Here, workers and managers feel strongly the need for harmony and good personal relations.
- Workers here are less individualistic and less motivated simply by the reward system. Feeling appreciated by the organization is an important factor.
- Performance-related pay might not appeal in this more collectivist environment.

The future of trade unions (page 341)

Arguments in favour of the statement: that trade unions have ceased to be relevant:

- Trade unions were effective in negotiation with managers to improve working conditions when national environments were rather self-contained. In today's era of globalized production, this has ceased to be the case.
- Working conditions and employees' contractual rights have generally improved, especially in the developed countries, and therefore trade unions' reasons for existing no longer hold true. In today's industrializing countries, trade unions are often very restricted, especially by authoritarian governments; therefore they cannot play the role which they played in the earlier industrializing countries.
- Nowadays, employers have numerous means of communication with employees, both direct and indirect, which did not exist during earlier eras, when trade unions provided almost the only means of representation for workers.

Arguments against the statement that trade unions have ceased to be relevant:

- Even when global companies are involved, working conditions and employment terms are negotiated locally, and trade union representatives, independent of management, are legitimate voices of the employees.
- In today's developing and emerging economies, conditions are often poor and workers are exploited, with little knowledge of their legal position. The trade union can perform a function similar to that performed by counterparts during the period of industrialization of Western developed economies.
- Although employers have taken many steps to engage with employees in many organizations, these management initiatives are directed essentially towards the organization's goals, not the workers' rights. The trade union, by contrast, takes the workers' perspective and can negotiate on behalf of members. In addition, many individual workers, either by inclination or fear of losing their jobs, would not be happy about complaining individually to managers (neither would they be very effective on their own). The trade union, as an organization in its own right, can exert greater bargaining power than workers individually.

In a seminar, students could be divided into two groups, one arguing each side. A plenary session could decide which was the more convincing.

Cross-cultural teams (Page 346)

- *Q1*: The challenges of working in a cross-cultural team stem from the differing cultural backgrounds of the team members. They will differ in their attitudes to team work in general and in their expectations of the specific team. Some team members are likely to be from low-context cultures and others will be from high-context cultures. The members will have differing view of the task orientation: some will feel that establishing social relations is just as important as carrying out tasks, while others will be task-oriented. Some will feel more natural in a team environment, whereas others, especially those from individualist cultures, will find it more difficult to adapt to a team way of working.
- *Q2*: Students will probably have experience of working in teams, if only in the context of group assessments or exercises. Seminar participants could be asked to contribute suggestions to the list. They will probably be familiar with groups where one or two people dominate, and the others are turned off, possibly withdrawing from participation. Some possible suggestions:
 - Become acquainted with the cultural backgrounds of members, using informal conversation as an aid.
 - Select a leader who is sensitive to the cultural differences, not necessarily the person who is most inclined to take control of meetings.
 - Make sure all contribute, rather than let one person dominate. The others will soon feel alienated from the project.
 - When differences emerge on the task in hand, allow all to contribute to resolving it, rather than going along with the preference of the strongest member.
 - Tasks can be broken down into smaller elements. It is important that each person is assigned a particular task that he/she is happy with.

Evolving IHRM (page 352)

The changing organizational environment

More networking and decentralized decision-making creates greater roles for local managers, and greater emphasis on cross-cultural management skills. Inter-organizational networks can operate informally, cutting through the procedural hurdles which are common in the large organization. Interactions with other firms are central to managing supply-chain links.

Globalization

The rise of the transnational manager: companies recognize the importance of co-ordination across different locations, which calls on the competencies of the transnational manager.

Changing expectations of employees

Employees in all locations expect their personal needs to be taken into account by employers. This means adapting reward systems, allowing for flexible working

patterns, and providing training and development which focuses on personal development, as well as organizational needs.

Part B review questions (page 352)

1. *In what ways does IHRM contribute to the MNE's overall competitive strategy?*

For the MNE, IHRM has a strategic role and should support overall corporate strategy. Three areas are highlighted in the chapter: labour productivity, organizational flexibility and social legitimacy:

- Cost-effective use of labour is important for any firm, but is critical in industries where low-cost labour is essential to competitiveness. The firms in these sectors often outsource manufacturing in low-cost countries. Although relying on independent contractors, these operations must be aligned with the HR strategies and policies of the brand owner.
- Organizational flexibility in the international context involves IHRM directly, and underpins competitive strategy. The firm seeks to enhance performance in differing locations, involving a number of structural and operational choices. In decentralized organizations, local managers have considerable decision-making authority. However, they must be attuned to overall corporate goals, and their HR policies must be co-ordinated from the centre, even though they have responsibilities for local staffing and recruitment.
- Social legitimacy – This aspect of IHRM recognizes the diversity of social and cultural environments in which the firm operates. Working practices and norms of behaviour differ in each location, but at a deeper level, the view of the individual employee and his/her relationship with the employer differs according to the cultural environment. It is now recognized by MNEs that reward systems and work-life balance must reflect cultural differences.

The MNE seeks to gain maximum benefit from the diverse resources and capabilities which foreign locations offer, and it is now recognized that IHRM plays a crucial role in achieving this goal.

2. *Examine differences in national institutional environment between developed and developing countries, and assess the implications for HRM.*

First, explain what is meant by the 'national institutional environment'. Both public and private institutions are relevant. On the formal level, there are government departments, regulatory bodies and courts. The political and legal systems of the country are linked, in providing a framework for enacting and administering laws and policies. In developed countries, employment law, labour standards and health & safety law tend to be more evolved and better enforced than in developing countries. Employment rights (including the right not to be unfairly dismissed) are usually established in employment protection legislation. We associate such rights with developed countries, but developing countries have

them in varying degrees: for example, India has relatively strong employment protection rights. Health and safety legislation exists in most countries, but enforcement and redress for harmful effects differs markedly between developed and developing countries. The implications for HRM:

- Companies must be aware of local employment laws, including protection from unfair dismissal and redundancy.
- Companies must be aware of local health and safety rules. When there is an accident resulting in injury and damage, they will be liable under local law for the harm if the company was responsible. Similarly, the company may suffer harm from the activities of another firm. In these situations, the workings of the legal system may well be slow, cumbersome and not entirely transparent. These characteristics are more likely to be found in developing than developed countries (see Chapter 5).

3. *The international joint venture is recognized for its potential in achieving competitive advantage in new markets, but poses HRM challenges which are often underestimated. What are the challenges, and how can they be resolved?*

First, define the international joint venture. The two founding companies are usually from different countries. The new company created tends to be in the home country of one of the 'parents'. The challenges include:

- Disagreement between the two parents on the nature or operations of the new business. They will have different HR policies, and must agree on which policies to adopt for the new firm. The new policies could be a blend.
- Management of the new firm often reflects that of the dominant partner in the joint venture. However, in a developing or emerging economy, the company which invests more capital is usually the foreign partner. In this situation, the HR policies should adapt more to the local environment, which gives the local partner a position of relative strength, creating possible conflict with the foreign partner. Agreeing management roles in the early stages can help to avoid conflict.
- The new firm takes on its own identity, culture and policies as it grows, making it different from either of the parent firms. They may wish to retain control, feeling that this is necessary in the interests of the parent company. However, those in the new firm sees its own interests as paramount. In the early stages, therefore, it is helpful to consider how they envisage the new firm in the longer term. It may well thrive to a greater extent if the parents adopt a flexible approach to guiding it.

4. *What IHRM issues arise in the cross-border merger or acquisition? In what circumstances should the acquirer look to integrate, or alternatively, keep distinctive, the acquired organization?*

- *Q1:* The issues which arise in cross-border M&A:
 - Whether to integrate the new company or keep it separate.
 - Whether the acquired company needs to be restructured, and, if so, how.
 - How the acquisition fits in with the strategy of the new owner.

- How to allocate staff to key positions in the acquired firm.
- How to incorporate the differing culture of the acquired company.
- *Q2*: If the acquired company is a well-known brand, it might be appropriate to keep its distinctive qualities, including its structure and staff, who are committed to the brand. If the acquirer takes over a rival company in the same sector as itself (such as the acquisition of one supermarket chain by another), then it is appropriate to assimilate the acquired business, rebranding shops. A middle way is the collaborative partnership, in which the acquired firm retains its identity and culture, but its strategy is directed largely by its new parent (Body Shop, now owned by P&G, is an example of this approach).

Web-based

Assignment (online)

McDonald's: the employer

This exercise is suitable for a seminar group. Small groups of students can answer a question each. Students will probably have preconceived views of McDonald's, based on their own experience or the media reports they have seen. It is preferable, at least initially, to put these views aside and approach this website with an open mind. Perhaps a closing discussion could compare the McDonald's presented on this website with the images students had before they did this exercise.

CHAPTER 10

Supply chains

Strategic crossroads

10.1: Bosch steers a steady course in changing vehicle markets (page 369)

◆ *What changes in global supply chains are exemplified by Bosch?*

Bosch has a long history of innovation. Its expertise is drawn on by customer firms, with whom it works closely. Some of the changes:

- Interaction between components suppliers and car manufacturers is transforming supply chains into networks. Bosch has specialist knowledge which it gains from its own R&D as well as its interactions with customers in a wide variety of networks.
- A trend is to move component manufacturing closer to the customer. Much manufacturing in the motor industry has moved to Central and Eastern Europe, and Bosch has followed.
- A third change is designing for a wide range of customers, with adaptations for each. Bosch supplies components to numerous companies in different countries, making a wide range of vehicles, from the basic, no-frills car to the luxury models.

◆ *What challenges face Bosch in the changing environment?*

A major change highlighted in the case study is the rise of China and India in both vehicle and components manufacturing. These competitors are keen to move up the value chain, challenging Bosch directly. It is notable that Bosch's business is not solely concentrated in motor manufacturing; it makes central heating boilers, household appliances and industrial machinery. The company would like to expand in these sectors, which would help to offset any downturn in the car parts business.

At present, the global market for car manufacturers is rather bleak. There is over-capacity in the industry, and demand is falling. Delphi, the former General Motors subsidiary, is exemplary of the woes of America's car manufacturers, beset by high costs and falling demand. Delphi was unable to build up a diversified business or a broad customer base, while Bosch is better placed in both these respects. Bosch should be better able to meet the challenges of downturn in car manufacturing. Its R&D and innovation capacity can be focused on new developments to come on stream when economic recovery rekindles car sales.

10.2: Maersk encounters bumpy seas (page 386)

- ◆ *Critically assess Maersk's approach to the strategic crossroads it has faced.*

Maersk was a highly diversified company many years ago. It concluded that it should concentrate on its core activities and sell the others. It sold many businesses, but remains diversified. Besides shipping, it has continued with its supermarkets and banking businesses. The decision to focus on shipping was probably wise, as this is where its main expertise lies. Some might say it should have sold the supermarkets and banks.

Maersk's shipping business is itself broad, and it became vertically integrated. It now builds ships, operates terminals and runs logistics companies. This enables it to offer a seamless service to customers. This could be thought a wise strategy, as customers do not have to deal with a number of independent service companies. It also offers economies of scale.

As economic slowdown impacted on the shipping industry, Maersk had to rethink its strategy again. With worrying overcapacity, shipping companies are cancelling orders for new ships and reducing prices for customers. An outsider was brought in as the new CEO. This was a radical step for Maersk, but it was hoped that the new CEO would bring new ideas. The business was restructured, splitting the container business into three divisions. The aim seems to be to focus more on performance in the separate businesses. The company had arguably become too large and unwieldy. (see item on Maersk in update of 20 November 2008).

- ◆ *In your view, is Maersk's ownership structure, which is based on private control, a benefit or a detriment in terms of strategic direction?*

First, outline the company's ownership structure. This is an example of a listed company in which a dominant family has control. It is protected from activist shareholders, who might voice concerns over corporate strategy in companies with more egalitarian structures and voting systems. Poor performance in the container shipping business seems to have compelled the owners to rethink strategy, and they brought in an outsider as the new CEO. Students will have different views on whether the 'insider' dominated structure and culture is a benefit or detriment. Activist shareholders can be a thorn in the side of companies (Cadbury is an example, in CS 11.2), and many observers would question whether some activists have the best interests of the company in mind, or simply their own agenda. In the case of Maersk, the owners did react when financial performance suffered, but it is evident that they saw the need for outside ideas to find solutions. Taking this step is something that many private companies find it difficult to do.

Case studies**10.1: Toyota (page 378)**

1. *Explain the key features of the Toyota Production System, stating the ways in which it was innovative.*

Toyota initially used the assembly line system pioneered by Ford. This system was suitable for mass production of standardized products, but lacked flexibility. Toyota introduced lean production and continuous improvement systems. Lean production relies on just-in-time (JIT) delivery of components, and allows products of different specifications to be built on the same assembly line. Continuous improvement involved staff becoming constantly alert to ways of improving processes and reducing waste. These innovations gave Toyota flexibility and reduced costs.

2. *What have been the challenges faced by Toyota in developing a successful global strategy?*

- Toyota was initially slow to expand manufacturing globally, as its system was firmly based in Japan, where the Japanese culture of co-operation and consensus-building underpinned lean production and continuous improvement techniques. Transplanting these techniques to different cultural environments was a challenge, and the techniques would need to be adapted.
- Lean production involves links with suppliers to be timed with precision. In Japan, suppliers were located near to factories. This would need to be replicated in foreign locations, adding to the complexities of setting up similar systems abroad.
- Toyota relies heavily on training to teach staff both techniques and culture of continuous improvement. This is difficult to replicate abroad. Training centres in Japan are used to train foreign staff. This is a costly and time-consuming process.
- Recalls of millions of cars have dented Toyota's reputation for quality. It has had to build up global operations, but has faced challenges of maintaining high levels of quality in foreign plants.

3. *Why does Toyota risk losing its competitive advantage as it expands globally?*

Toyota's competitive advantage has been built on consistent levels of quality and value. It had difficulty maintaining levels of quality when its production system was adapted in foreign environments. Meanwhile, competitors have successfully introduced lean production and JIT systems. The adoption of this manufacturing model by other companies has eroded Toyota's source of competitive advantage to some extent. The South Korean company, Hyundai, is an example, as it has gained a reputation for quality.

10.2: Dell (page 390)

1. *What were the manufacturing and supply chain innovations which Dell pioneered in PCs?*
 - Dell introduced lean production in the manufacture of PCs, including JIT processes and continuous improvement.
 - Dell adopted a build-to-order model, customizing the product for the individual customer.
 - The direct selling model became a hallmark of Dell. It kept prices low and offered customers direct service. Business customers were particularly attracted to Dell.
2. *How did Dell's competitive advantage become eroded, and how did the company respond?*

Rival manufacturers, such as HP, Acer and Lenovo, improved their own manufacturing and supply chain efficiency, becoming more of a threat to Dell on price. Dell could still claim its superior customer service, but in the 2000s, Dell's customer support weakened. The company moved its manufacturing head to customer services, to rebuild confidence. The company also sought to expand internationally, partly because the fiercely competitive situation in its home market, the US.

3. *Assess the strength of Dell's original business model for global markets in the current environment.*

Dell's business model was based on lean production and direct sales. It was conceived in the US environment, and one could question how well it would translate to global markets. Dell and its suppliers had to build close relations to keep up production and fill orders quickly. Although low stocks were held by Dell, logistics suppliers also held stocks of components. There was always the risk that lack of a component could hold up production; hence, production processes were kept simple. In today's market, consumer choice is even greater, and it would be difficult to replicate this model, especially if cross-border supply chains are contemplated.

The model relied exclusively on direct sales. In the US, customers have long been accustomed to buying products online or by telephone, but in other markets, direct sales are less developed. The Chinese customer who buys directly from a seller expects a relationship with the seller. Dell's model had been used by mainly business customers, who were concerned mainly about the purchase itself, obtaining a machine suitable for their business needs. Catering for personal customers, many of whom would have little idea of what they needed, would imply changes to the direct sales model.

4. *What changes have been made by Dell, and what further changes would you make, to regain competitiveness?*
 - Dell now sells its products through retailers around the world, in addition to its direct sales. It has diversified its product range, to compete more

effectively. It has also started focusing on the provision of computer services for business customers. It is up against stiff competition, as its main rivals are experienced in all these areas. Dell's founder, Michael Dell, returned as CEO in 2007, following the company's spell of waning fortunes (and a misreporting scandal).

- Students might question whether Michael Dell is the right person to inject greater competitiveness in the company. As the founder, he is personally committed to the company, but was possibly too slow to adapt to the changing environment. Perhaps someone with new, innovative ideas would be better.
- As for further changes, business services would be an area where added value is possible. Sales of PCs and laptops can be expected to slow with economic downturn, but other devices, such as netbooks, have potential for growth (Dell does offer netbooks). Dell could also bring in fresh marketing ideas, and look to improve its image, which, for many consumers, is associated with its troubles in the recent past.

Country focus

10.1: Spain (page 362)

◆ *What factors accounted for Spain's attractiveness for foreign investors in the 1990s?*

- Low wages in comparison to northern European countries
- proximity to European markets for manufactured goods
- relative political stability with the introduction of democratic government
- EU membership, which brought EU funding for building infrastructure.

◆ *Why has Spain's competitiveness waned in the new millennium?*

The main factors:

- Costs have risen in Spain, and manufacturing capacity has been expanded in lower cost Central and Eastern European countries, such as Slovakia. Several of these countries have become EU member states. This has enhanced their attraction, convincing many companies to shift from Spain to one of the newer EU members. These countries are now receiving funding for infrastructure from the EU, which has added to their attractiveness in comparison with Spain.
- The rise of China has also threatened Spanish manufacturing. Spanish firms have shifted much manufacturing to China, and low-cost imports from China have grown in sectors such as textiles, clothing and shoes.
- Spain has lagged behind in spending on education, training and R&D. This has meant that Spanish businesses struggled to compete in high-value sectors.

◆ *In what sectors can Spain compete globally, and why?*

Spain has numerous entrepreneurial enterprises which attract skilled workers and creative talent. These resources are being tapped by carmakers, such as VW, which

opened a design centre near Barcelona. Spain's outstanding business success story is Inditex, the group which owns the Zara brand. It has become a global leader in the clothing industry, transforming supply chain management in the sector. Its success is evidence of the ability of talented entrepreneurs to draw on local skills and resources to compete globally. Another is Manuel Torres, featured in the opening vignette in Chapter 12 (p. 434).

◆ *What are the lessons of Spain's experience in sustaining the benefits of globalization?*

Recall the winners and losers from globalization, highlighted in Chapter 2. Spain was a winner, but became a loser as jobs migrated to lower cost locations. The lessons:

- Foreign investors are always on the lookout for more advantageous locations. It is therefore necessary for local firms to be encouraged to develop competitive advantages of their own, such as expertise in high-value activities.
- Remember that industries such as motor manufacturing involve numerous players in different stages of the supply chain. The departure of an assembly plant is likely to imply the departure of components manufacturers as well.
- Investment in education and training will help to give a country the capacity to build R&D skills, which will aid domestic firms in diversifying into areas where the country has competitive advantage.

10.2: Slovakia (page 373)

◆ *What are the reasons for Slovakia's recent surge in FDI?*

Slovakia has enjoyed a surge in FDI due to:

1. Low-cost labour compared to Western European countries
2. Strategic location close to Western European markets
3. Liberalization reforms of the post-communist government.
4. Flat rate of tax, which attracts investors
5. Joining the EU in 2004, and the eurozone on 1 January 2009.

◆ *How sustainable is Slovakia's current economic growth? What are the underlying concerns?*

Slovakia has relied on foreign investors, especially those investing in greenfield projects. While the government is optimistic that these investors will stay, they realize that manufacturing tends to shift to lower cost locations. Wages have risen in Slovakia, but shortages of skilled labour have occurred, as many workers had already moved to other countries for higher wages. There is some concern that Slovakia has grown too rapidly, and that the gap between the prosperous west of the country and the poorer east will widen. Funding social welfare is a potential worry, as government finances would be strained in the event of an economic downturn.

- ◆ *How has Slovakia benefited from globalization, and how well placed is it to capture future benefits from globalization?*

Slovakia benefited from globalization in that the country offered location advantages for foreign investors, such as carmakers and manufacturers of electronics. Its low-wage environment was attractive because of the competitive pressures on companies to reduce costs. Its liberalization reforms reflected a trend towards opening markets, which is associated with globalization. Capturing future benefits will be more difficult, as it is competing against China and India, both of which enjoy lower costs and are greatly improving their manufacturing capabilities. For Slovakia, competitive advantage should probably be sought in producing higher value added products and services. The country has a history of manufacturing, but it needs further investment in education and training. Many domestic companies have benefited from the presence of foreign investors, and such entrepreneurs should be encouraged, as innovation will aid in enhancing the country's competitiveness.

Pause to reflect

Beyond the fragmented supply chain (page 361)

It is helpful to begin by identifying the characteristics of the fragmented supply chain: different organizations operating on a contract-by-contract basis, with little overarching co-ordination (see Figure 10.1). Vertical integration overcomes this fragmented process, in that the organization exerts control over every phase. However, internalization involves huge investment and costs. The Ford Motor Company is often cited as an example. The newer network approach is more streamline than the fragmented supply chain, and benefits from flexibility which the vertically integrated operation cannot match. The network consists of different organizations, but they are working co-operatively, sharing information and maintaining close ties. When circumstances of customer requirements change, the organization can respond with a new network configuration. The internet permits networks to be co-ordinated globally.

Make or buy decisions in context (page 366)

The figure covers 4 broad approaches.

- *Intra-firm (internal)* – This approach is that of the vertically integrated firm. Ford has a history of this approach, although no longer pursues this strategy. US firms in this group are likely to be ethnocentric. Unilever, which is more polycentric, is historically in this category (see CS 7.1)
- *Outsourcing (external)* – This represents the opposite approach to the first one, in that the firm contracts at arm's length with suppliers. Many firms which have a culture of self-sufficiency and internalization see this as the logical alternative – moving from one extreme to the other. Many American companies have gone over to this approach. An example cited is Boeing.
- *Inter-firm alliance* – This is one of the two approaches which rely on relational ties, rather than purely transaction-based ties. Japanese companies are noted for this

approach, but, as has been pointed out, inter-firm alliances have tended to lead to complacency and inefficiency, leading executives to seek more advantageous deals from external suppliers (see CS 7.2 on Nissan).

- *Complex networks* – This is a more recent development. It involves flexible links, by which suppliers and customers can share knowledge, benefiting both. As each is constantly reacting to changing markets, participants are less likely to become complacent, for fear that competitors are waiting to take their place. Car manufacturing is an example, and Bosch is a firm which can be cited as exemplifying this approach.

Sourcing in the era of globalization (page 370)

- *Q1*: Ways in which globalization impacts on sourcing decisions:
 - Firms now look at a range of suppliers globally before deciding on which one to choose. This is indicative of global supply chains, with different stages taking place in different countries.
 - Internet and communications technology make it possible to do business quickly and cheaply with supplier firms across the globe, and to keep in touch continuously, tracking processes.
- *Q2*: Ways in which localization plays a role:
 - Individual countries enjoy location advantages, such as abundant raw materials or low-cost labour, which have benefited from the global scanning of MNEs.
 - FDI has benefited individual countries, but each location presents a distinctive national environment, to which the investor must adapt. The example of Toyota in India is cited.

Consumer-driven manufacturing strategies (page 374)

Innovations have been driven by the need to satisfy consumers in the following ways:

- *Lean production* – First, define lean production. Lean production focuses on reducing waste, including defects. This improves levels of quality, and also reduces costs.
- *Modular strategy* – Modular strategy allows production costs to be reduced, as a component can be used in several different products. This means that products can be customized, while keeping costs low.
- *Agile manufacturing* – This allows the manufacturer to respond quickly to changing demand. It is associated with lean production and JIT systems. The benefits for the consumer are that the company can respond easily to new demand and the consumer is not faced with a long wait for the desired product.

The manufacturing supply chain (page 375)

Many manufacturing processes now envisage the carrying out of different stages of a complex product in different locations, to benefit from specific location advantages. The suppliers of specialist components often have considerable expertise, and can therefore play a part in innovation and design of new products from the manufacturer (see the example of Bosch). However, the extended supply chain has drawbacks, in

that it can be inflexible, and there are risks in delivery and transport over long distances. If a quality problem is spotted in the assembly of a final product, the entire operation could be jeopardized as the firm awaits new components (which could be coming from a company thousands of kilometres away). Lean production systems rely on close collaboration between organizations in the supply chain. Suppliers are often in the immediate vicinity of customer.

As this chapter has shown, Japanese car manufacturers rely on this type of relationship, but it can be difficult to duplicate in other countries. Many manufacturers choose to make high-value products in their home countries, and make low-value products in foreign low-cost locations. Some companies have prioritized the guarding of core competencies, and have been reluctant to outsource. These companies tend to incur high costs if they are located in developed economies, but many feel that their reputation for quality justifies this approach. Germany, a high-cost economy, is still a strong manufacturing country, valuing its high-quality engineering, although many Germany companies now manufacture globally. This is an indication of the need to formulate a global strategy on what activities to carry out where, in seeking competitive advantage.

Quality in the competitive environment (page 382)

Price competition has become fierce, and is a major consideration in many product areas, as products become standardized or 'commoditized'. The basic mobile phone is an example. Although consumers expect quality, they, like manufacturers, are aware that quality is not an absolute concept. Expectations of quality and durability vary according to the price of the product. However, consumers do expect the product to perform as described, to be without defects and to stand up to reasonable use. Quality systems such as Six Sigma focus on cost reductions through the elimination of waste. This approach accords with satisfying consumers that quality is not sacrificed in mass-produced products.

The strongest growing markets at present are in the large emerging economies such as China and India. In both countries, cost is a primary criterion of consumers. China's manufacturing strength is well known, but India is now catching up in manufacturing. Quality management systems are sometimes difficult to operate in developing countries. An issue is the responsibility placed on individual workers, which is entailed in continuous improvement systems. In countries of large power distance, this type of approach is difficult to implement. China manufactures more toys than any other country, mainly through production under licence for Western markets. Chinese toys have suffered many setbacks due to poor quality, and brand owners have been criticized by consumers, concerned about possible harm to children from poor materials, poor design and defects.

Transport and globalization (page 389)

- *Q1*: The single biggest influence on globalization in transport is probably the container ship (pictured on the cover of this book) which reduced costs and improved safety. Globalization is associated with the extended supply chain,

incorporating ports, rail and road. As the IT for managing these movements improved, companies were able to link the different stages in the supply chain together. The costs of transport dropped dramatically, and as a result, shipping mass-produced products from ports in China to Western markets became commonplace.

- *Q2*: Traditional ports must be adapted to take container ships, and the new superships need extra wide berths, which require further substantial investment. China has invested heavily in huge container ports able to handle the new container ships which export its goods. However, China is the exception. Port infrastructure varies enormously around the world: the sums involved in funding are huge; the timescale is long, and in many places, planning issues make it difficult to bring such projects to completion. Importing countries therefore vary widely in their ability to handle container ships. Poor road and rail networks in many countries hamper the movement of goods, and also add to costs. Students might also raise the recent issue of piracy, mainly off the coast of Somalia. In January 2009, the Chinese government sent its own naval vessels to the area to protect shipping. Increased incidence of piracy, along with rising insurance costs, could lead companies to reconsider overland routes.

Rethinking supply chains (page 389)

Rethinking supply chains can be prompted by a number of factors. Indeed, companies should be constantly rethinking supply chains. Some that might be mentioned with relevance to today's environment:

- Changing security situation and political instability in key countries in the supply chain. Also, particular regions in a country may be more volatile than others. India is an example, with considerable variation between regions. Companies contemplating FDI in manufacturing in India must take these risks into account.
- The risk of insurgency and terrorist attacks is more prevalent in some regions than in others. The extraction industries in Africa are examples.
- Financial and exchange risk are growing factors in today's volatile global financial environment (see Chapter 11).
- Economic downturn can mean that supplier and service companies face possible closure. A firm which depends on a particular supplier could find that its future is in jeopardy. Having an alternative supplier in mind is a possibility, but all could be suffering from a generalized downturn. Many MNEs might consider taking some key processes back in-house, which had been outsourced in the past.
- Transport can become problematic. Piracy (mentioned above) can affect shipping, and has become a growing problem of the coast of Somalia. Road and rail links are also subject to change.

Part B review questions (page 390)

1. *How have the internationalization strategies of MNEs influenced the evolution of SCM?*

MNEs have sought to choose the best location for a particular component or stage in production. Increasingly, MNEs began thinking of supply chains in terms of the value chain. Three aspects are highlighted in the text:

- The growth of networks – these are now cross-border. Internationalization has encouraged firms to look for linkages, often with multiple firms, to coordinate global operations.
- The growth of co-operation between firms. Cross-border supply chains have relied on extensive co-operation. The approach of ‘us and them’ in supply chains has evolved to one of shared goals, to the ultimate benefit of all participants.
- The re-examination of resource positioning and competencies – The firm must assess what benefits it can achieve from internationalization, bearing in mind its own resources and competencies. It will be attracted to the supplier who can offer an essential component, together with related expertise. The fact that the supplier is in another country is no longer the obstacle that it once was.

2. *Assess the advantages and disadvantages of lean production strategies in global supply chains.*

The advantages include:

- The need for lower inventory to be held.
- Reduction in waste and the ability to minimize the disruption from defects, as they are spotted early in the relevant process.
- The ability to respond quickly to changing demand and changing products.
- The ability to produce customized products using mass-manufacturing techniques.

The disadvantages include:

- Precise timing is needed in complex manufacturing processes, such as carmaking, and this can be problematic over long distances.
- Suppliers in other countries are less likely to have the same approach to techniques such as continuous improvement, as Toyota found. The training process can therefore be prolonged and costly.

Students are invited to weigh up the advantages against the disadvantages. It is probable that the advantages are perceived to outweigh the disadvantages in the long term. The disadvantages are often technical hurdles which can be overcome.

3. *Assess the benefits to emerging economies from global sourcing and manufacturing strategies of MNEs; and the risks these strategies pose for the parent company.*

China is the best example to date of an emerging economy which has benefited from global sourcing and manufacturing. The benefits include:

- Spillover effects from FDI investors, by which local firms gain knowledge and expertise.

- Benefits to local firms which take on outsourced manufacturing for Western brand owners. These companies learn manufacturing processes, and eventually aim to develop their own brands. This has happened in China. However, much outsourced manufacturing is carried out by firms which are themselves foreign investors (Taiwanese companies in China, for example; and South Korean companies in Vietnam – see CF9.1)
- Manufacturing jobs are created in emerging economies, where employment has traditionally been in agriculture. This industrialization process is, of course, a mixed blessing, but it has brought significant economic growth.

The risks for the parent company include:

- Weak control over manufacturing processes, including quality. Any defects can taint the reputation of the brand owner.
- Poor working conditions in outsourcing factories. Although they are owned by independent companies, the brand owner is often thought of as having ultimate responsibility.
- Leakage of intellectual property rights. An example is joint venture partners in China, who independently produce similar products to those which are made by their joint venture enterprises.

4. *What challenges are posed by differing cultural environments in quality management? Give examples.*

As manufacturing and supply chains spread to a wider range of developing and transitional economies, differing levels of economic and technological development become issues. These are linked to the cultural environment in each case: a country in the early stages of industrialization, where most people are still engaged in agriculture, differs from a more industrialized economy, in that family ties and kinship values are likely to be stronger than in industrial economies. In addition, every national culture has its own historical roots, sense of identity and important symbols which bind members together. It should also be noted that regions within countries have distinctive cultures. India is an example: some areas of the country have become more industrialized than others.

In individualist cultures, employees more readily accept responsibility for quality systems than in collectivist cultures. In the latter cultures, which often have large power distance, managers are seen as the authority figures, and workers in subordinate roles. Workers are not accustomed to thinking independently about ways to improve quality or looking critically at processes to see how they can be improved. In many developing and emerging economies, large power distance is the norm, and paternalistic management prevails.

A second challenge faced by companies is that of weak institutional environment, especially in developing countries. Much of the impetus for quality improvement has come from government or industry-based regulation in the developed economies. Where these frameworks are weak, harmful and dangerous products are more likely to enter consumer markets. Quality problems in China persuaded McDonald's to take control of its entire supply chain. The tainted milk

scandal in China is another example. In this case, a New Zealand company found its reputation damaged by association with a Chinese firm found to be producing contaminated milk.

5. *Assess the challenges and risks currently facing logistics management in international operations.*

Students will probably highlight the threat of piracy on the high seas, as this is now a major worry for shippers and their customers. Consumers have come to expect an array of imported goods, including food and durable goods such as electronics, constantly available at reasonable prices. A number of factors affect supply chains, which pose risk. This is particularly true in a period of economic downturn. Some of the challenges:

- *Cost and availability of raw materials.* Raw materials, especially those dependent on only a few sources, can never be guaranteed. Government action, terrorist activities, natural disasters (such as earthquakes and flooding), can halt supply and can also halt traffic on roads and rail.
- *Trade barriers imposed by governments.* Many governments are under domestic pressure to increase trade barriers for imported goods. Protectionist measures can adversely impact on importers. On the other hand, multilateral, regional and bilateral trade agreements offer opportunities to benefit from liberalized trade.
- *Logistics* depend on maintaining and improving infrastructure, helping to clear bottlenecks and improving efficiency of transport systems. As the text highlighted, both governments and private-sector companies are reluctant to fund big projects, which assume constantly rising demand. When there is a downturn, and governments are concerned about increased public spending, projects such as transport infrastructure may not seem very high priorities.

Web-based assignment (online)

Finding out about logistics with DHL

This is an interactive tool for teaching logistics, which students should find enjoyable. It is best to try doing some of the tests yourself, to see how it works, if you plan to use this as a classroom exercise. Its function is mainly to acquire information and test knowledge. However, as the reflection questions suggest, it is interesting for students to ask themselves what DHL is hoping to achieve through this interactive exercise.

CHAPTER 11

Finance and accounting

Strategic crossroads

11.1: Has APP learned the lessons of Asia's financial crisis? (page 403)

- ◆ *In what ways is APP illustrative of the structural weaknesses in Indonesia that contributed to the financial crisis?*

APP grew as a family empire of businesses, in paper, real estate and banking. It has used family links to build these separate businesses, but benefited from the opening of capital markets in Indonesia. The family was alert to the potential of markets, and listed its companies in the 1990s. It was perceived as more market oriented than other family companies, and was able to take advantage of the capital flows into Indonesia. It accumulated huge debts, which led to a \$14 billion default on corporate bonds. It was exonerated in the Indonesian courts, however, and resumed its growth strategy following the Asian crisis. The structural weaknesses in Indonesia which can be highlighted are: the business environment which favours family conglomerates; the openness of Indonesia's financial system in the 1990s, combined with weak regulation; the weak legal institutions; and corruption.

- ◆ *How has APP been able to rebuild its businesses despite its record-breaking debt default? What lessons are there in the APP story so far for would-be investors in the future?*
 - *Q1:* The 2006 court judgment, which relieved the company of its debt, paved the way for rebuilding. The family's links with China have been fruitful, and it has been able to extend activities there. The opaque institutional environment in China, which is not dissimilar to that in Indonesia, seems to have been helpful to the family. It has also enjoyed a successful listing on the Singapore stock exchange, where its structure and culture would not be perceived as drawbacks, as they might be in western financial centres.
 - *Q2:* Would-be investors in APP shares or bonds should probably be wary, following the losses many suffered in APP investments in the past. However, the prospect of good returns and a growing business in China could seem to have much potential, attracting investors again. Would the company now be more cautious? Students might have differing views, but it would seem that the company is still run in essentially the same ways, with a combination of family control and market listings, which proved successful in the past.

11.2: Cultural revolution in Chinese accounting (page 428)

- ◆ *Why has the legacy of the old accounting system proved an obstacle in learning modern accounting principles in China?*

The principles of performance, assets and liabilities had to be learned from scratch, as they did not exist in the old system. The cultural change involves learning the basic concepts and how to use them, to reflect the actual performance of the business, rather than simply what was being produced. Another cultural hurdle has been to appreciate the importance of transparency in disclosure of financial performance. Lack of transparency is a drawback in many aspects of Chinese business, and in the enforcement of accounting standards, failure to disclose can be so serious as to constitute breach of legal requirements.

- ◆ *Even with the adoption of international accounting standards, what challenges remain in Chinese accounting practices?*

China's new accounting rules exempt state-controlled entities from the requirements of disclosure on transactions with 'related parties'. This affects a large swathe of Chinese business. The standards being adopted in China are not IFRS standards, but aligned with them. Weaknesses in disclosure and governance generally are a concern in China. China has a regulatory authority. However, there are concerns that it will not play an independent role, but one subservient to government wishes. Confidence in China as a place to do business depends on both observance of accounting standards and on regulation to ensure compliance.

Case studies

11.1: Sparks fly in Mittal Steel's takeover of Arcelor (page 417)

1. *What were the hurdles Mittal had to overcome in his hostile bid for Arcelor?*

Arcelor was viewed as a European champion. Its shareholders, managers and other stakeholders resisted a takeover. Mittal's first bid was rejected, and a consequence was to send the share price upwards. Mittal was an outsider, and had a reputation of being autocratic. The close control he kept over companies he owned, together with weak corporate governance, did not appeal to Arcelor shareholders. Arcelor directors sought a rival bidder, but this attempt failed. Raising the bid price was Mittal's main means of gaining shareholder consent. His promise to reduce his control also influenced them to accept his bid.

2. *Assess the shareholder and stakeholder perspectives in the takeover battle and in the new company.*

Shareholders will generally be won over if a takeover offer is high. The offer made by Mittal included shares in the new company as well as cash. Two-thirds of the price was paid in shares. This meant that shareholders became members of the new ArcelorMittal. Mittal himself, however, held over 43% of the new company,

making him the dominant shareholder. In this situation, minority shareholders can well feel worried that they have little influence.

Other stakeholders include managers and employees. For them, the management control exerted by Mittal constituted a concern. Mittal said he would step down as CEO, but after a few months, he resumed being CEO. The authoritarian style with which he had become associated was at odds with the more consensual style of Arcelor. Mittal's Indian background, based in a developing country with weak institutional environment, was very different from the European context. There was some concern that mining disasters which had resulted in numerous deaths in Mittal-owned mines in Kazakhstan were indicative of little heed of CSR.

3. *What competitive advantage is now enjoyed by ArcelorMittal in global markets?*

ArcelorMittal is dominant in the global steel industry. It is larger than the next three largest companies combined. Mittal is now in a position to buy even more competitors, enhancing his ability to control supply and prices. He sees this as an advantage, as he has suffered financially in the past from the volatilities in the steel market. However, if global demand falls, as is happening at present, the company will be vulnerable, despite its huge size.

11.2: A sweet future for Cadbury Schweppes? (page 431)

1. *In what respects is Cadbury Schweppes' complex structure impairing its competitiveness?*

Cadbury Schweppes has had both regional and product divisions. It has grown by acquisition, its sprawling empire split between beverages and confectionary. The company has traditionally been decentralized, allowing acquired businesses local autonomy in finance and the management of brands. Its executives have been concerned that the company's complex operating structure was inefficient. Cadbury Schweppes has used independent bottling companies, which manufacture beverages under licence. The sectors in which it operates are highly competitive. In particular, it faces competition from Coca-Cola and PepsiCo in the beverages business. It sold its European beverages business to private equity groups in 2006, but retained American beverages and American confectionary.

2. *What are the main risks faced by the company in its international operations?*

- It must carry out transactions in many different currencies.
- It is a huge purchaser of commodities, the prices of which are subject to market volatility. These include cocoa, sugar and aluminium.
- Its many subsidiaries are in numerous countries. Its borrowings in these locations can be risky, but it aims to balance borrowings with trade in these markets.

3. *How has it reduced risk in foreign exchange activities?*

Cadbury relies on various hedging strategies, such as forward exchange contracts. It also uses forward contracts in commodities markets. Borrowings in different locations are structured to be hedged naturally, through business activities in each location.

4. *Why did Cadbury Schweppes become a possible takeover target?*

Any company which is perceived to be inefficient in its management and organization is likely to become a takeover target, as would-be acquirers can see where restructuring and efficiency gains can be made. The attraction of the company is enhanced if it has a strong brand or brands, as Cadbury Schweppes does. Where a company's share price is languishing, and clear strategy seems to be lacking, would-be acquirers see opportunities to launch a bid. An added factor in the Cadbury case was the presence of an activist shareholder, a hedge fund manager who felt the company was underperforming and needed stirring up. One of his complaints was that the company was too stretched, and needed to focus on its core activity, which was confectionary. The selling off of the beverages business has now taken place.

Country focus

11.1: Hong Kong (page 409)

◆ *How has Hong Kong benefited as a financial centre from its links to mainland China?*

First, summarize Hong Kong's status, its background and current position. Because Hong Kong has long had an active stock exchange with links to Western finance, it is respected and considered sound. This gives it a good position as a gateway to Western finance for mainland companies. These companies have been keen to list on the Hong Kong exchange, enhancing their status in eyes of Western markets.

◆ *What are Hong Kong's competitive advantages as a financial centre? Are these likely to be eroded?*

Its competitive advantage derives from:

- Strategic position close to mainland China
- Market economy and institutions dating from colonial rule
- Reputation for transparency and adhering to the rule of law
- Long links with Western capital markets
- Free press
- Fully convertible currency.

Hong Kong's competitive advantages are at risk of erosion if the mainland authorities decide to impose stricter controls in Hong Kong. Hong Kong's stock exchange is becoming more integrated with the mainland economy as so many mainland companies are listing there (including state-owned ones). Possibly

paradoxically, if the mainland regime becomes more open and transparent, Hong Kong's competitive advantages could be eroded.

- ◆ *Are further democratic reforms necessary for Hong Kong's open economy to continue to flourish?*
As a SAR (special administrative region), Hong Kong was assured some autonomy at the time of handover by the British to China in 1997. However, there is only limited democratic participation in the election of the Legislative Council, and Beijing is essentially in control of the process. There has been an active pro-democracy movement in Hong Kong. The question touched on in the case study is whether Hong Kong needs democracy to protect the rule of law. Most students would probably say that it does, and that control from Beijing jeopardizes the rule of law. The rule of law has been a key element in Hong Kong's open economy. Tightening control by Beijing would probably weaken the attractiveness of the SAR for international investors.

11.2: Dubai (page 421)

- ◆ *What are Dubai's strengths as a regional financial centre?*
Dubai has a strategic location, close to oil-rich states of the Middle East. It has cultivated an outward-looking approach, desiring to establish itself as an international centre. It has a vibrant business climate, a currency pegged to the dollar, and no capital controls.
- ◆ *In what ways do environmental factors impact on potential issuers and investors in Dubai's stock exchange?*
Dubai has enjoyed strong economic growth. Although it has had oil wealth, its oil is now running out, and it is concentrating on services, mainly financial services aimed at its oil-rich neighbours. It is a trading hub with a strategic location. Transport and construction are thriving. Property and tourism sectors are also being developed, making its economy more diverse. For potential issuers and investors, the western-oriented business environment is an attraction. The cultural environment is a distinct factor. It is a centre of Islamic finance, which is Sharia compliant. Both Islamic equities and bonds are traded on Dubai's stock exchange.
On the negative side, the authoritarian government dominates not only political life but also the economy. The main companies and centres are state-owned, owned by agencies which are offshoots of the government or owned by the ruler himself, Sheikh Mohammed. Traditional values and social structure exist alongside the different cultures of foreign residents and the market orientation of the economy. The society is only 15% made up of local people, and the bulk of inhabitants are foreign residents. Many foreigners work in the construction industry, which has a poor reputation for living and working conditions. The Middle East is generally an unstable region, and this regional factor might influence some investors.

◆ *How is private equity as a model being used by Dubai funds?*

Dubai's funds find the private equity model attractive, allowing them to invest in a range of companies. Located in a region with many wealthy investors looking for possible international investments, the Dubai funds have sought to attract these investors. They then invest in a range of companies, taking only small stakes in some, looking to see the companies grow. This is a more patient approach than western private equity groups. A factor to consider is that Dubai investors are viewed with some apprehension in some countries (such as the US). They therefore take minority stakes. On the other hand, buying Tussauds Group was more akin to the western private equity buyout.

Pause to reflect

Impacts of exchange rate policies (page 401)

It is helpful first to summarize different exchange rate policies operated by governments. A country's exchange rate policy impacts on these different interests as follows:

- *Businesses within its borders which carry out international transactions* – The fixed exchange rate offers certainty to these businesses, but it might be set at a rate which is not particularly favourable for the individual business. If it is set low, exporters benefit, but if it is set high in relation to market perceptions, exporters will feel disadvantaged. A floating exchange rate subjects it to market forces. This could seem preferable, but much depends on market perceptions: if the currency is strong, exporters may not be so happy.
- *Foreign trading partners* – Foreign trading partners are sensitive to the possibility that a government may wish to see its currency undervalued, and this may create trade tensions. Governments can use the policy of devaluing the currency, which helps domestic businesses, but disadvantages foreign trading partners.
- *Investors, both foreign and domestic* – Investors committing themselves to FDI projects wish for stability in exchange rates, so that they can plan ahead with confidence. However, portfolio investors may be short-term in their outlooks, and may simply look for financial gains. The opening of capital markets around the world has left many countries vulnerable to speculative activity, which can affect their currencies. Those pegged to the dollar were vulnerable in the Asian financial crisis. Where the currency is allowed to float, volatility is especially a risk in a small, open economy. Governments do intervene to prop up the currency, but this is seldom effective.

Globalization and stock markets (page 410)

Stock markets become internationalized as more foreign companies list on them through IPOs. Investors also indicate international appeal if they invest in stocks listed on exchanges other than their own. The extent of internationalization of an exchange depends heavily on the regulatory framework of the exchange. Exchanges are all overseen by regulators associated more or less closely with their national governments. The law in some countries does not allow foreign investors or foreign companies to list. In Figure 11.7, the Chinese exchanges do not allow foreign

companies to list. The most internationalized are American and European exchanges. Japan attracts few foreign listings.

The stock market is indicative of the extent of globalization in the country's financial system. London as a financial centre has become highly globalized, attracting listings from companies in large emerging markets, such as Kazakhstan and Russia. Some exchanges, such as the Dubai one featured in CF 11.2, aim specifically to attract foreigners. One means has been to set up a regulatory framework similar to that in the UK. This has not been entirely successful: local companies, accustomed to rather opaque governance, were reluctant to sign up to a system which did not accord with their way of doing things, and foreign companies were perhaps dissuaded by the local cultural and political environment (as well as the newness of the exchange). Thus, both local and global factors play a part. Some of the exchanges in emerging markets, such as India, China and Russia, have been very volatile. They have risen dramatically, only to fall equally dramatically, suggesting that they have not yet reached the maturity which would assure foreign investors.

Corporate finance alternatives (page 415)

- *The SME owned by a single family, which is a private company* – This company has limited means of raising money. It is funded by the insiders who are its shareholders. It can seek bank loans, but these are sometimes difficult to obtain, especially during a credit crunch. Raising finance could therefore be difficult. This type of company often seeks help from venture capitalists who recognize the potential in the business.
- *The large public company with subsidiaries in many countries* – This company probably has numerous shareholders. At least a portion of its shares are freely traded. It could be the major shareholder in its subsidiary companies, which are registered in the countries where they are located. The parent company can raise capital by equity issuance, and by loan capital (the issuing of debentures).

Winners and losers in battles for corporate control (page 418)

Winners and losers in takeover situations:

- *Shareholders* – Shareholders are concerned about the value of their shares, their voting power, and their voice in the company. Shareholders of the acquiring company can expect to see their shares fall in value as a rule, and shareholders of the company being acquired see theirs rise. The reasons for the fall in the acquirer's shares are that the shares will be diluted with the influx of new shareholders, and the risks involved could well impair performance, at least in the short term.
- *Managers* – Managers are concerned about changes of strategy and structure, which are often entailed in a takeover. Those in the acquiring company may see opportunities for themselves, but this would mainly be in takeovers where the new business is in the same sector as the acquirer's business. Managers in the acquired company are likely to be fearful of losing their jobs – only the best might be kept on. They might also be concerned about the change of direction. Many managers

in takeover target companies will leave, unhappy about the uncertainties or simply because they do not want to work for a company which is owned by another.

- *Employees* – Employees are concerned about their jobs, any new roles, and place of work. Those in the acquiring company are generally thought to be safer in their jobs than those in the acquired company. Employees in the acquired company might be offered a new job in a new location, but might not be happy with the upheaval. Employees in the company taken over are usually vulnerable in this situation. Their employment rights are protected in the EU by the Transfer of Undertakings Regulations.

The good, the bad and the risky (Page 423)

Begin by discussing the good aspects as mentioned in the box. The bad ones depend on one's point of view.

Aspects that might be considered 'bad'

- Hedge funds and private equity groups tend to have short-term perspectives. They are mainly interested in gains for their investors, rather than the interests of target companies.
- The tactics of hedge funds are sometimes considered dubious. They deal in derivatives such as share options, and can build up positions without the company's knowledge. They also have a poor reputation for going 'short' on shares, in the hope they will fall in value.
- Private equity groups typically use debt financing to finance their buyout activities, building up the debt burden on target companies.. This creates a huge burden, as the Debenhams example shows.
- Restructuring often entails job losses in the target company. This could be seen as good, but not from the point of view of the person who has lost a job. By contrast, the private equity buyout partners reap huge rewards from their activities, many of which have successfully exploited tax loopholes.

Aspects that might be considered 'risky'

- Hedge funds and private equity groups have relied on the availability of loans at advantageous rates. Any rise in interest rates or reduced availability of loans (the credit crunch) dramatically affects their business model.
- Weak accountability and lack of regulation creates risks in the operations of hedge funds and private equity groups. Financial crisis in late 2008 seriously affected both. Existing investors wanted their money back, and new investors were in short supply.

IFRS and beyond (page 430)

IFRS rules are designed to harmonize accounting standards, and also to make firms present a more accurate and informative picture. For companies which have in the past used practices which give a rosier picture than would be presented under the new rules, the new standards represent a constraint. An example is the treatment of

financial instruments, including derivatives. These must be measured at fair value and included in the profit and loss account. The treatment of leases, which involve long-term debt, must now reflect this reality, rather than be treated simply as assets. The cost of employees' benefits, including share options, must be disclosed, and treated as operating expenses.

Following the collapse of Enron, the US legislature passed the Sarbanes-Oxley Act. One of the concerns which arose in the Enron case was the extent of special-purpose entities, which were kept off-balance sheet. The new law did not ban their use, but revised the rules for disclosing off-balance sheet debt. Much of the new law concerns compliance requirements for certifying accounts. CEOs and chief financial officers became liable for certifying the company's accounts. Criminal penalties for reckless certification were increased. The impacts on MNEs included increased costs of compliance with Sarbanes-Oxley rules, which also applied to foreign companies listed in the US. The US trend was to increase legal formalities, but many might question whether this is effective: some companies will simply find ways of getting round the law.

Part B review questions (page 430)

1. *To what extent has the rise in derivatives trading, combined with the securitization of debt, led to an uncertain international financial environment?*

Derivatives trading is largely unregulated, as these products are sold privately, rather than through stock exchanges. Define what is meant by the securitization of debt. The problem with these products is that, although they represent value in that the debt instruments (such as mortgages) have value, it is not clear what their value is. Therefore, uncertainty creeps into these markets. See update feature of 20 November 2008, for a discussion of the global financial crisis.

2. *What are the differences between a friendly takeover and a hostile takeover of a company? What risks are associated with a hostile takeover?*

First, explain what is involved in a takeover by one company of another. Taking over a private company is essentially friendly, as the acquirer buys out the owners. Taking over a public company is more complicated, especially if the acquirer and the acquired companies are in different countries. The would-be acquirer makes an offer to the board of the target company. If the directors disapprove or want better terms, the acquirer may well come back with a revised offer until they are happy. This would still be a friendly offer. If the board disapproves in principle or rejects every offer made, the acquirer may then go directly to the shareholders, making them an offer. This is the hostile takeover bid. Directors and shareholders may be won over by an improved offer. The risks include:

- Splitting the board, between those who favour the offer and those who reject it. Whatever the outcome, there will be tension among directors, which can affect their ability to work together in future.

- If the hostile takeover bid becomes a protracted battle, the costs mount, and the shares in the acquirer usually fall. The best managers of the target company could well decide to look for employment elsewhere.
- If the hostile takeover bid ultimately fails, many shareholders in the targeted company will feel unhappy if they thought the deal was a good one. They will be critical of the board. On the other hand, many shareholders will be relieved that the board fended off the predator company.

3. *Assess the impact of differing national regulatory environments for international financial flows.*

This is a broad question, which could constitute a written assignment. The student could begin by summarizing the differences between regulatory environments in contrasting countries. These would include an advanced economy, an emerging economy and a developing economy. The advanced economy will have a sounder, independent institutional environment. Regulation in financial systems aims to assure those who carry out transactions, and the investing public generally, that the system is fair and transparent. If there is a financial scandal involving fraud and false accounting, people blame not just the parties, but the regulators, for failing to catch what was going on. Note that the Sarbanes-Oxley Act introduced heavier criminal penalties. However, scandals can occur in any country, shaking confidence in regulators.

If the cultural environment is one in which the rule of law is widely respected, regulation is more effective than in an environment in which players are constantly striving to get round the regulatory requirements. A portion of players in any market will be in the latter category. The section on this subject in the chapter highlights the weakness of the legalistic approach to regulation, and suggests that a CSR approach, which touches on values as well as forms, might help in the reform of the regulatory environment.

A concern in emerging and developing economies is that notions of independent regulators, not influenced by political and personal ties, are not well established. Here, there is more scope for corruption, even though the regulatory bodies and enforcement methods look, on the surface, similar to those in countries with more robust institutions. The strategic crossroads box on Indonesia highlighted that investors had been welcome, but many suffered losses in the financial crisis, mainly due to the weak financial and legal frameworks. Investing in Russia would entail similar risks, with the addition of political intervention.

4. *Examine the ways in which private equity groups invest and manage companies. Compare the positive and negative aspects of a private equity buyout.*

Private equity groups have raised controversy in the ways they acquire and manage companies. They seek to make money for their investors and managers. They look for companies to buy, in which they feel they can extract greater value than the current managers. Often this means taking a public company private.

The positive aspects:

- The new owners and managers seek efficiency gains and a strategy more focused on financial performance. Profits may well rise.
- The new owners may well shed some activities which were not performing well, to focus on the core business.
- If the business becomes more successful as a result of the buyout, jobs are created in the long run.

The negative aspects:

- High levels of debt are typical, as debt is used to finance the buyout.
- Job losses in the short term, as the business is restructured.
- Taking a company private removes it from much of the regulatory oversight of public companies.
- Corporate governance is problematic: the owners are looking to make a profit from the sale of the company after a few years. Their focus tends not to be on the long-term interests of the firm.

Web-based**Assignment (online)****Financial markets at risk**

This exercise helps students to understand market turmoil. It could serve as an individual assignment or a group exercise. If done in a seminar, Question 4 could be the basis of a closing discussion.

CHAPTER 12**Innovation and strategy****Strategic crossroads****12.1: Martek Marine rides the waves of innovation (page 439)**

- ◆ *What are the key elements of Martek's approach to innovation, and in what ways is its innovation strategy linked to entrepreneurship?*

Martek Marine operates in an internationally regulated industry, which is safety and other equipment for the shipping industry. In safety and environmental monitoring, regulations are constantly changing the standards, and new products are constantly needed. The company is highly attuned to the changes in international conventions (instruments of international law) which affect the industry, aiming to have products available which anticipate future changes. This strategy stems from the founders' entrepreneurial approach to the business. As a start-up, they linked technological expertise with marketing strategy designed to suit customers' needs.

- ◆ *What are the core competencies of Martek, and what are its sources of competitive advantage?*
- Students should first recall these theories from Chapter 7. Martek's core competencies would be their technological expertise in their specialist area, including design and operational know-how. Drawing on the resource-based view of the firm, this company has physical resources (its plant and machinery); human resources (its skills and expertise) and organizational resources (its corporate culture and networks of relations). Its CSR policy and close links with customers and other stakeholders are also sources of competitive advantage.

12.2: Amadeus strikes a new chord with customers (page 449)

- ◆ *How is Amadeus responding to the rapidly changing travel industry?*

First, describe how the travel industry is changing, with the rise of low-cost carriers and online booking. Amadeus's traditional core business was serving travel agents, which are increasingly being bypassed by online booking. Rather than exit its core business, it decided to turn the new developments to its advantage. It broadened its services in online travel, and turned to technological innovation to improve its products. It also expanded into new geographical areas, focusing on emerging markets such as India.

- ◆ *Assess the benefits of the new internet-based system to the two Western companies and to the host society.*

The host society: Amadeus was able to offer a package of services to Indian travel agents, allowing them to offer customized package holidays. The travel agents could offer personalized contact with customers, which was highly valued, and also provide the added benefits of online services. The travel agents were able to reduce costs and offer a more comprehensive service through the new system.

The two Western companies (Amadeus and BT Global Services): Amadeus's plans to bring online services to all of India's individual travel agents posed technological challenges. BT Global Services had to familiarize itself with both the needs of travel agents and the patchiness of local infrastructure. In the end, the Amadeus project offered scope for more technological innovation, through the virtual call centre. Amadeus is also using open technology, to develop innovative solutions more quickly. Amadeus is prioritizing technology development to better meet changing customer needs.

Case studies

12.1: Kodak (page 462)

1. *What were Kodak's failings in innovation strategy which led to it being left behind?*

Kodak realized that it would have to adapt to the new digital age, but failed to anticipate how quickly digital cameras would replace traditional photography. Even when the price of digital cameras started to fall dramatically, Kodak was still manufacturing huge quantities of film. The new CEO who took over in 2005 immediately called for reduction in manufacturing capacity by two-thirds, but by then, the company was in crisis.

2. *In what ways does its new strategy stem from its long-standing business strengths, and in what ways is it breaking with its past?*

Kodak had an active R&D department, which had been researching digital technology for years, acquiring IP rights along the way. It had long supplied X-ray laboratories and film studios. Its expertise in imaging is now a platform for further expansion.

Kodak faced an uphill task in lower-end digital cameras, as its rivals were well established. The new CEO guided its development of printing products, spotting a gap in the market. The digital printing business was thus central to its new strategy. The company is seeking further innovation in the sharing and display of images in different media, such as mobile phones and internet. A partnership with Motorola, the mobile phone company, has been formed to foster these developments.

The new products, such as easy-to-use home printers, would be considered a break with its past, but Kodak as a brand has long been had a reputation for catering for family and holiday photo-taking. Its sound reputation, especially in

the US, would transfer to the printer activities, which are largely targeted at this same market.

3. *How would you assess Kodak's core competencies as sources of competitive advantage in the future?*

Kodak's experience and research in imaging can be a source of competitive advantage in the future. Much of this expertise is in specialist applications, and the company would also need to maintain its competitive position in mass-market products such as low-end cameras. The link with Motorola in technology for sharing images over different media can be a source of competitive advantage in the future.

12.2: Is innovation under threat in the pharmaceutical industry? (page 468)

1. *What challenges are intensifying for the research-based pharmaceutical companies?*

The main challenges:

- *Medical science* is forging ahead as a result of mapping of the human genome. As people live longer and medicines become more widely accessible, the expectations are raised for medical advances to treat a wide range of illnesses.
- *Costs* of bringing new medicines from the laboratory to the marketplace are rising. A new product may stumble at any stage along the way, some falling in the later stages of testing as side effects emerge.
- The *regulatory environment* is becoming more stringent globally, with the effect that medicines must pass many hurdles in gaining approvals. National health authorities are boosting their own assessment processes before treatments meet with their approval.
- The *generic drug manufacturers* have become more aggressive in pursuing cases against patents held by the large research-based pharmaceutical companies. The generic companies are gaining increasing market share, and enjoy the advantage of lower costs and lower prices to customers, who include national health services and insurance providers as well as individual consumers.

2. *To what extent are the challenges unfair, in your view, and why?*

Students will have differing perspectives on this issue, depending on what they consider fair or unfair. Some issues which emerge are:

- *The regulatory hurdles.* Although a medicine might pass its clinical trials and be approved as safe, a national health authority can carry out its own assessment, which will include a cost/benefit analysis. It might weigh the possible lives saved from a drug against the costs, and, especially if the drug is very expensive, decide not to authorize it for use in the national health service. For many sufferers, this will seem an injustice.
- *The behaviour of the generic drug companies.* These companies are keen to whittle down patent protection by mounting legal challenges to the patent holders. Their activities can be seen as obstructive, time-consuming and costly by the

large companies. The generic producers also launch their own products in anticipation of winning legal battles against existing patents, and in anticipation of the expiry of patents.

- The large companies must *spend huge sums on research*, and argue that it is unfair that they should face criticism for their prices.

3. *How are the pharmaceutical companies responding to the more adverse operating environment?*

Some of their responses:

- Pharmaceutical companies are looking for external sources of ideas for new medicines. These often come from SMEs, which have done the basic research, but lack the funds to take the process further.
- Major research-based drug companies are launching their own generics businesses, producing ‘authorized’ generics.
- The patent holders are looking for ways of improving medicines, justifying the application for a new patent, which will effectively extend the patent life of the drug.

4. *Is innovation threatened by the more competitive environment, or has competition actually stimulated innovation?*

Students can be asked to debate this question, as there are arguments on both sides. The large research-based companies argue that innovation is threatened as they are now finding it difficult to spend the money needed to find breakthrough medicines, given the diminished likelihood of being able to recoup their costs. Note the quote from the head of Novartis (p. 469). Those on the other side will argue that competitive pressures are legitimate, compelling the companies to examine their cost structures and strategies. This is not to imply that cutbacks in R&D are necessary, but reducing expenditure in marketing, for example, might be called for. Spending huge sums of money does not guarantee that new drugs are continuously filling up the drug pipeline. Looking for new ideas from SMEs might lead to greater innovation on lower budgets.

Country Focus

12.1: Singapore (page 445)

- ◆ *In what ways has Singapore’s economic development model weakened national innovative capacity? Does a lack of home-grown innovators matter?*

First describe Singapore’s development model, which features a strong government role and FDI. Reliance on skilled foreigners has arguably led to weakened national innovative capacity. Singapore has long prioritized high-quality education, which helped to attract foreign investors. But local staff became accustomed to working for foreign companies, rather than developing their own innovative ideas. A further factor is that the city-state can seem to many local people to have a rather stifling social and political climate, leading many talented people to seek jobs elsewhere in more open environments.

- ◆ *How sustainable is Singapore's combination of a market economy and authoritarian political rule?*

This is an interesting issue in general, relevant in a number of emerging economies, not simply Singapore. Singapore has benefited economically from its openness to foreign investors, and its entrenched political establishment has been able to claim credit for continued prosperity. However, rising inequality is now a cause of concern, and could lead to a breakdown in the consensus which has characterized the society. In addition, the preferential treatment accorded foreign businesses over local ones has led to a rise in political dissent, surfacing on the internet.

It is arguable that the paternalistic state, which has been responsible for Singapore's economic development, is now seen more negatively, as a constraint on society. Any economic downturn, as is now engulfing states globally, can lead to a questioning of the government's policies. The general issue is whether the growth of economic freedom logically leads to calls for greater political freedom. Often, calls for democracy come from the more educated and outward-looking sections of society. However, dissent can also grow among numerous social groups, including, for example, young people who find it hard to get jobs. If prosperity is not evenly spread in the society, this adds to the pressure on authoritarian governments.

- ◆ *What recommendations would you make to the Singapore government to maintain global competitiveness?*
 - The government is seeking to create centres in biotechnology research, which will enhance its competitiveness. However, local spillovers seem to be few, as the policy has been to attract scientists from abroad. Perhaps, the government should look to encouraging local academic research: given the number of academic institutions, it would seem long overdue to encourage local excellence. Perhaps, local firms would then emerge, which could benefit from links with foreign investors.
 - Singapore needs to encourage more entrepreneurs to come forward and start businesses. These would create jobs which could be filled by the highly qualified local workforce. This policy would also raise the city-state's innovation capacity.
 - The Singapore government recognizes the drawbacks of the restrictions on civil society and the perception of intrusive restrictions on social activities. Lifting restrictions would be popular, but the government is concerned about opening up political dissent. If social and political instability were to emerge, this would certainly be a deterrent to would-be foreign investors, whom the government has prioritized. The government is therefore faced with a dilemma. Dissent is likely to spread, whatever it does.

12.2: Switzerland (page 455)

- ◆ *What are the strengths and weaknesses of Switzerland's innovation system?*
 - *The strengths:* strong tradition in science education; research-intensive global companies; priority given by the government and companies to basic scientific research; excellence in pharmaceuticals and electronics; numerous SMEs in biotech research.
 - *The weaknesses:* less funding channelled to applied science; funding in joint business-university research goes entirely to the academic partner. Swiss MNEs are now investing more in R&D abroad than at home. The entrepreneurial environment for Swiss SMEs has not been favourable. Still, there are many Swiss SMEs in biotech research, which are benefiting from incentives in differing cantons.

- ◆ *Why has Switzerland lost momentum in innovation?*

Weakening domestic R&D, especially applied and business-focused research, is largely responsible. Large Swiss MNEs in pharmaceuticals are carrying out much of their R&D in other countries, to be near to customers and also to reduce costs. It should be remembered that competitiveness is relative to other countries. Switzerland has remained at the forefront of innovation for many years, but other countries are now catching up. These include Finland and Sweden (see Figure 3 on patents granted by the US Patent Office).

- ◆ *What reforms are needed within Switzerland to maintain competitiveness in innovation?*

Switzerland is highly decentralized, and innovation policies differ from one canton to another. This fragmented approach is possibly a drawback, as the country needs the guidance of national innovation policies. The federal government is under pressure to use public spending for social welfare programmes, but could re-assess how it spends public money on R&D, looking to fund more applied research, which has tended to fall behind the purer scientific research in funding. The cantons which have taken a lead in encouraging research-intensive SMEs could be rewarded, leading others to emulate them.

- ◆ *Comment on the view that Switzerland represents the paradox of an inward-looking domestic economy and outward-looking MNEs.*

Switzerland's economy has shown poor growth for a number of years. Innovation has suffered in this time, and the SMEs which might have spurred innovation were not encouraged. In many sectors of the domestic economy, there is little competition. In contrast, Switzerland has produced numerous global MNEs. Their success at the forefront of globalization is often attributed to the fact that they come from a small country, where there is little domestic scope to expand.

Pause to reflect**Elements of innovation (page 437)**

Begin by summarizing the elements of innovation featured in the Figure. Then look at the examples:

- *Fast-food chain* – The firm could invent a totally new product through its R&D, but it might be more likely to improve existing products, in taste, quality or production methods. Equipment improvements are important in this sector: new methods could be more efficient or more energy efficient, for example. This firm is likely to innovate through incremental improvements in areas such as marketing. Innovations in the appearance of outlets and services for customers are also important competitively.
- *Aircraft manufacturer* – Competition in this sector depends heavily on innovation, in materials as well as engine design and functions. Patentable inventions and the management of IP rights are crucial.
- *Internet retailer* – This business is dependent on advances in internet technology. It must constantly seek to improve the service to customers, making it easier and quicker to use its site, and also expanding its services. These improvements are mainly incremental. There are also opportunities for marketing innovations. The firm could well use cross-functional co-operation, working with technology providers to improve its service.
- *Pharmaceutical company* – This company is the most reliant on new, patentable inventions of the types of business listed. New medicines may be the result of in-house R&D departments, or they may be acquired from elsewhere. For both, the management of IP rights is critical to success.

How does innovation spearhead prosperity? (page 442)

Begin by summarizing the stage-based view of economic development. In stage 1, most industry is low-tech or craft-based, although there is some inward investment. Spurred by these inward investors, local innovators can seek to shift away from the labour-intensive sectors to those which are more knowledge-intensive. If the country is to move upwards to stage 2, it needs investment in education and technology, to provide the foundation for developing local innovation capacity. In stage 2, the number of foreign investors rises, and more knowledge-intensive products are produced. This stage offers opportunities for local innovation, through spillover effects. Local firms can form networking ties with foreign investors, including joint ventures. China's surge in economic development came at this stage. In stage 3, local firms are maturing to become more service-oriented, able to compete globally. Lenovo of China is an example. Outward MNEs are becoming active internationally. Meanwhile, the country's investment in education and technology will help it to attract high-value investment, such as R&D activities.

Innovation: can policies really make a difference? (page 447)

This discussion can take the form of a debate, in which each side puts forward its arguments. A plenary session at the end can bring together some conclusions. Here are some of the points on both sides.

The pros

- Innovators can emerge any time, anywhere. They emerge both in societies which are oppressive and those which encourage people to pursue new ideas.
- Innovatory capacity does not need a basis in education or technological training. Innovators are self-motivated, equipping themselves with the knowledge they need to pursue their ideas.
- Innovators often thrive in adversity. Perhaps paradoxically, they are motivated by the sense that they are battling their way to success, struggling for funds and finding no one who believes in them. They would be less motivated if government money were too easily available.

The cons

- Although there are always going to be one-off highly motivated individuals in any society, the number will be insignificant unless the conditions are made more congenial for encouraging people to develop their ideas.
- Education is a prerequisite, as it kindles the imagination of individuals who wish to pursue new ideas.
- Education needs to encourage students to think independently, not simply learn by rote. As the pool of critically-minded educated people grows, more will pursue innovatory ideas which can be turned into viable businesses.
- Although every country has innovative individuals, the ability to take an idea and develop a successful business requires considerable knowledge and skill in various business areas, not just in the idea for the new product. This knowledge can only come through education and training.
- Finance is often the largest hurdle for entrepreneurs. Government policies to encourage both public and private funding of start-ups can bear fruit.

The technology gap (page 450)

Developing countries must build innovative capacity. See Figure 12.3 for the different elements of a national innovation system. Developing countries often look to technology transfer to help them to build innovative capacity, but much depends on their absorptive capacity. Education, infrastructure and the industrial structure in the particular country influence the extent to which local people and firms can benefit from technology transfer and develop their own technological capacity. FDI and technology licensing offer good opportunities for local people to learn new technology and how to manage it. However, these channels can be a mixed blessing. The risks of over-reliance on FDI include:

- The foreign investor stifles local producers.

- Local people are welcomed in the lower skilled jobs, but are not trained to do the more skilled jobs or take up managerial posts.
- Some FDI investors do not develop ties with local suppliers, preferring to import from their own familiar sources.

In the above situations, FDI provides little benefit to host-country innovation capacity. These effects can be avoided if host-country negotiators reach agreement with foreign investors on issues such as jobs, training and suppliers, to ensure local participation. However, the host country could well fear that doing so will deter the would-be investor.

Innovation strategies adapt to changing markets (page 457)

Technology push strategies are associated with cutting-edge new products invented in research-intensive organizations, whereas customer pull strategies are more likely to be of the incremental variety. Incremental innovation can take place in any organization, not just those with sizeable R&D departments. As Table 12.2 showed, the companies which spend heavily on R&D are mainly in automotive engineering, pharmaceuticals and electronics. Their new products are the result of R&D activities. However, these companies are now focusing on changing customer needs. The 'green' car is an example (see CS 13.2).

The global companies in consumer products, such as P&G (CS8.1), now target emerging markets, where meeting the particular needs of these consumers is spurring innovation.

In mass-produced consumer goods, innovation is taking place in numerous functional areas, such as marketing and distribution. New ways of working can meet consumer needs better and cost less. Wal-Mart, which is a global retailer, also focuses on innovation in supply chains. This is incremental innovation which reduces costs and improves response times.

The innovation culture (page 464)

Aspects of corporate culture which foster innovation include openness to new ideas, informality and minimal bureaucracy. Large organizations tend to be more bureaucratic and procedure-driven, making it difficult to cultivate the sort of atmosphere in which creative people can thrive. Managers can attempt to change the corporate culture by reducing bureaucracy and allowing more informal networking to take place. Creative people can be given more scope to pursue their ideas. Often in a large organization, the person with a new idea can find that the daunting prospect of getting it adopted involves so many procedures that it is not worth the trouble.

Globalization of innovation? (page 467)

This question could be used for a seminar debate or an individual assignment.

If this were set as an assignment, the student would be expected to summarize what is meant by globalization. On the 'yes' side of the debate, organizations are scanning the globe for the best location for every activity, including R&D. R&D has traditionally been an activity which Western MNEs have kept in their home country, as this is

where they would find the most highly skilled researchers. This is now no longer true. As emerging countries are rising up the development ladder, their research and innovation capabilities are also rising. These capabilities are serving both local MNEs (which are themselves becoming internationalized) and also foreign investors. Western companies also see the advantage of locating R&D near customers (recall the example of Swiss MNEs). Innovation is itself now conceptualized as part of a broader-based strategy than merely R&D, involving the whole organization and supply chain. As supply chains become internationalized, innovatory ideas can emerge at any stage in the process.

On the 'no' side of the debate, one could argue that national innovation systems are crucial to innovation capacity. Most innovation still takes place in the large MNEs, which have the largest R&D spending. These companies have benefited from the national conditions in their home countries, which have fostered innovation. The environment in the country, including the education system and cultural environment, is crucial to nurturing innovation. These remain essentially local factors. It is true that more countries are now building innovation capacity, but this does not mean that innovation is itself globalized.

Part B review questions (page 468)

1. *In what ways can government policies help to build innovative capacity, and how do the policy choices differ in relation to different stages of economic development?*

Governments can invest in education, beginning with universal primary education, moving towards higher education. As these institutions are being developed, the government can send promising students to be educated, for example, in science and technology, to foreign institutions, on condition that they return home to take up jobs or train others. China has successfully pursued this policy. The government needs also to promote entrepreneurial activity, making it relatively simple and cheap to start a company, and making funding available in the early stages of the start-up. Governments in developing countries, looking to rise up the development ladder, often see FDI as the favoured means, moving from rather low-skilled to higher skilled manufacturing. However, the spillover effects and encouragement of local firms does not necessarily materialize where the absorptive capacity of the local workforce is limited.

The government should also build a legal framework for the recognition and enforcement of IP rights. This will help to attract foreign investors and will also protect local innovators.

2. *Why is the large, research-intensive MNE, such as a pharmaceutical company, finding the global competitive environment increasingly tough?(Read CS12.2 before answering.)*

The large, research-intensive MNE is compelled to spend huge sums on R&D, as new products are its main source of competitive advantage. For pharmaceutical companies, the costs must include the costs of long periods of testing and the costs of securing and defending patents. A consequence is that the company is

compelled to try and recoup the costs through pricing of its products. In the current climate, however, consumers and health services around the world are exerting downward pressure on prices. In addition, producers of generic medicines (out of patent) are competing against the global brands. These generic competitors, which do not have large R&D budgets, charge much lower prices. Some aggressively pursue legal actions against patentholders, hoping to undermine patent protection and make more products available for generic companies to manufacture.

3. *For the large MNE, assess the relative merits of keeping R&D in-house or acquiring new ideas from external sources.*

Recall the theory of core competencies from Chapter 7. The large MNE must consider to what extent R&D represents a core competency, and whether acquisition of ideas from external sources would have a detrimental effect on its in-house research.

Merits of keeping R&D in-house:

- Maintain core competencies
- Maintain control of IP rights
- Nurture the research skills to produce winning products in the future
- Maintain quality control over research processes.

Case for using external sources:

- The company cannot pursue in-house research in depth in all relevant areas. The outside specialist can complement in-house strengths.
- Buying in can be cheaper. The company may obtain a licence to produce the product or take over the company, which in many cases is an SME.
- Working with outsiders can help to nurture new ideas.

4. *What role is played by SMEs in breakthrough innovations, and how does it differ in differing national environments (give examples from this chapter)?*

Any company can be innovative, and the small, entrepreneurial company often attracts creative people who come up with breakthrough innovations. Many of these companies are born-globals, set on a global presence from the outset. SMEs with rather more modest aspirations often seek to get their ideas taken up by large companies with greater resources to market them. The large company gains from this relationship, as in the pharmaceutical industry. National environments differ in their encouragement of SMEs. The chapter has featured two countries with high research profiles (Singapore and Switzerland), but both have been faltering in their encouragement of SMEs. In the case of Switzerland, we saw that the biotech SMEs are flourishing in some cantons.

5. *Explain why managing IPR is becoming more multifaceted in the internationalized competitive environment.*

Intellectual property rights (IPR) have become quite complex, and are subject to differing national regimes. Every product represents a bundle of rights: the product itself might be subject to patent; the trademark can be registered; media content is copyright. Managing these rights involves the company, not simply the legal department. As product life cycles become shorter, the company might have only a short space of time in which to exploit its new product (in practice, it will be a shorter time than the legal duration of a patent). If the product is successful, there are sure to be competitors on the scene with similar products, raising the possibility of action for infringement of IPR. Ensuring that the company's products are well protected legally in the relevant markets will deter possible infringing activities. IP infringing activities are huge businesses in themselves, affecting all sectors, but particularly media products, including software (which is copyright). Pursuing infringers is one of the many facets of managing IPR in international markets.

Web-based assignment (online)

Research and innovation at GlaxoSmithKline (GSK)

This exercise provides students with a glimpse of GSK's strategy and worldwide operations. This comes at a time when pharmaceutical companies are rethinking how they can generate new ideas on smaller budgets, and how they can use external sources of innovation. These are the points which students should pick up. At the time I accessed the site, one of the collaborations featured was with Ranbaxy, the Indian company known for its generics, but which also carries out its own R&D. This exercise can be used for a seminar activity, with a final discussion along the lines highlighted in the Reflection section above.

Synthesis and reflection (online)

Part 4: Managing in the global environment

1. *In what ways do these chapters show the need for MNEs to draw on external links as well as internal resources?*
 - *Chapter 9* – In IHRM, companies draw on host-country nationals and third-country nationals. Other examples: cross-cultural teams and networking with other organizations; greater focus on IHRM in international alliances, especially cross-border acquisitions of firms.
 - *Chapter 10* – Expansion of supply chains into global networks, demanding maximum collaboration with partner firms. An example is Wal-Mart's consumer response system (p. 383). Outsourcing examples: Boeing (p. 365); Bosch (SX 10.1).
 - *Chapter 11* – In corporate finance, companies seek listings in foreign stock exchanges; they also seek loan capital internationally (through bonds).

- *Chapter 12* – Companies seek to buy in new ideas from other companies, often SMEs, either through licensing or outright purchase of the company. An example is P&G. There is also the example of co-operative R&D agreements.
2. *Give examples of successful adaptation of products and operations in differing national environments.*
- *Chapter 9* – The rise of IHRM indicates the recognition of the need to adapt HR policies and practices to differing cultural environments. Reward systems are particularly sensitive to cultural differences, with distinctions between individualist and collectivist cultures, as well as differing power distance. In acquisitions, adaptation to the culture of the acquired company is an example (see SX 9.2 on Austrian banks). Adaptation is evident in employee relations; an example is Wal-Mart's recognition of Chinese trade unions, despite hostility to trade unions in its home country.
 - *Chapter 10* – Toyota's experience of manufacturing in India (p. 368). MNE strategy of outsourcing low-end products in low-cost environments and high-end products at home. Adaptation of quality management in differing environments, including those with weak institutional frameworks.
 - *Chapter 11* – Finance and accounting adapt to differing environments. National regulatory systems differ markedly (for example, in taxation), and companies can manage their finances where possible to avoid some countries and focus on others. The MNE can manage its subsidiaries in different countries in ways which benefit from local equity and debt financing (for example, by registering the subsidiary as a local company). An example is VW issuing peso bonds in Mexico.
 - *Chapter 12* – Much innovation involves adaptation of products for different countries. Examples are Amadeus in SX 12.2, P&G, and Cemex. Note that examples of adaptation of products for different cultures are discussed in Chapter 8, on marketing (see CS 8.1 on P&G and the example of Lifebuoy soap, produced by Unilever in developing countries (p. 299). Students should be able to give other examples which are not in the book.
3. *In what ways do these chapters show the risks associated with globalization? Cite examples which you feel show successful management of these risks.*
- *Chapter 9* – The MNE which rapidly expands through acquisitions in different countries can encounter difficulties in integrating HRM systems, which can be detrimental to performance. Outsourcing of manufacturing to low-cost countries raises HR issues for the brand owner, even though this firm is not legally the employer of the the workers (see CF9.1 on Vietnam). These situations raise CSR issues.
 - *Chapter 10* – Extended global supply chains involved in the manufacturing of complex products such as cars are exposed to risk at any stage. A defective component, a transport failure or a natural disaster can affect a global operations.

- *Chapter 11* – A risk of global capital markets is volatility leading to financial crisis in one or more key countries. This can have knock-on effects, ultimately becoming global in its impacts. The Asian financial crisis of 1997 is an example. In 2007, the US financial crisis caused by the boom in unsound mortgage-backed securities is widely held to have been a main cause of global downturn the following year. The growth in hedge funds and private equity funds was facilitated by globalization of finance. These funds benefit from open markets and instantaneous internet dealing. However, their opaque activities and reliance on derivative products in largely unregulated markets created risks.
- *Chapter 12* – The innovative company which launches a new product used to be able to rely on first-mover advantages to capture market share ahead of rivals. The global competitive environment makes this more unlikely: a competing product will soon emerge, making it necessary for the original creator to have improvements in the pipeline from the earliest possible stages. Research-intensive pharmaceutical companies have benefited from globalization, but these same processes pose risks. The rise of global generics companies can be cited, along with their propensity to launch legal actions against patent holders.

Examples of successful management of the risks above

Students will have their own views on how successful companies have been, and can be asked to explain why they cite particular companies. Some examples:

- *SX 9.2* – The Austrian banks have successfully managed integration in their acquisitions. Wal-Mart's success is perhaps more problematic.
- *SX10.1* – Bosch has successfully managed global sourcing and manufacturing.
- *SX 10.2* – Maersk presents a mixed picture: successful growth in integrated global operations, but exposure to risks of slowing demand in container shipping.
- *CF11.1* – Hong Kong has so far succeeded in managing the risks of globalization.
- *CF11.2* – Dubai is a more mixed picture, with successful growth in some sectors, but not yet entirely successful in its aim of establishing itself as a global financial centre.
- *CS11.2* – on Cadbury, showing successful management of foreign exchange risk.
- *SX12.1* – on Martek Marine. This company has successfully managed in an internationally regulated environment.
- *Google*, the global search-engine leader, has been successful, despite difficulties over copyright and privacy (see further discussion in Chapter 15)

CHAPTER 13

Ecological challenges for business and society

Strategic crossroads

13.1: Whole Foods Market: more than a niche player (page 502)

- ◆ *Assess Whole Foods Market's business strategy in light of its ethical principles, in particular discussing whether its size and values are compatible.*

Whole Foods Market has pursued a more aggressive expansionist strategy than is customary in this specialist sector, which is mainly organic produce. Students will vary in their views about this sector and this company in particular. The CEO has been somewhat controversial, having encountered objections from competition authorities for his acquisition strategy. The stores are highly profitable, consumers in this segment seemingly willing to pay premium prices.

Possible objections which might be raised against the company's strategy are:

1. The business strategy seems to jar somewhat with CSR principles, as these emphasize fair business practices generally.
2. The takeover of rival outlets reduces diversity in a sector in which diversity is a major concern.
3. As the company now contracts with suppliers on a large scale, many local and regional foods, as well as retail outlets, are threatened.

- ◆ *Why has Whole Foods Market grown so popular with consumers? What are its prospects in international markets?*

Its growth can be attributed largely to consumer concerns about health and environmental aspects of food. There are no GM products, artificial colours or flavourings. Products are produced from sustainable sources. In addition, the stores have considerable eye appeal. The natural wood interiors and gleaming produce are a marked contrast with average supermarket shelves. Its prospects in international markets, however, might not be so rosy. The offering caters for the affluent American consumer. In most markets, this type of consumer is in the minority, and this would be considered a niche market. In times of economic downturn, consumers tend to trade down. The market for premium-priced goods is likely to shrink, while lower-priced products see a resurgence in these situations.

7.2: Customer-led packaging innovation from Huhtamaki (page 507)

- ◆ *What are the challenges posed for designing packaging to suit modern lifestyles and protect the environment?*

The use of packaging is growing in all markets. Consumers with busy lifestyles consume more food and beverages on the go, and the packaging used for single-use containers is a growing contributor to municipal waste. The challenges are to produce packaging which is safe and convenient, while being environmentally friendly, which implies that it is recyclable and involves minimal environmental impact in production as well as disposal.

- ◆ *Huhtamaki's fastest growing markets are in emerging economies, where cost is likely to be a bigger factor than environmental concerns. How should its environmental strategy be framed in these markets?*

Much packaging is based on plastics, which is petroleum derived and therefore from a non-renewable resource. Plastics do not decompose in landfill sites, and the manufacturing process involves harmful emissions. These issues are not seen as crucial in many emerging markets *at present*. However, Huhtamaki would take the view that these issues are rising up the agenda everywhere, and it is concerned with environmental impacts in all its markets. Taking the lead in environmental strategy in these markets could be source of competitive advantage as these issues become more important. Note that these markets are growing at a much quicker rate than those in the developed countries.

Case studies

13.1: BP's green strategy takes a battering (page 495)

1. *To what extent was BP to blame for each of the disasters?*

- *Texas City explosion* – BP was considered largely to blame for this. The refinery was old and suffered from mechanical failures and safety risks, but BP saw cost-cutting opportunities here. Staffing and training budgets had been cut, when they probably should have been increased.
- *Prudhoe Bay, Alaska* – BP was responsible for maintenance here, in an area of ecological sensitivity and very harsh conditions. Inadequate monitoring by BP was found to have contributed to corrosion which caused the pipeline leakage.
- *Thunder Horse platform* – This was in an area of probable hurricanes, one of which caused the platform to list. While the hurricane was the cause, it is arguable that the infrastructure was possibly not adequate in the first place. This was probably not a good location to build the world's largest floating platform. The difficulty and slowness of repairs, delaying the start of production, suggest that some of the blame lies with BP.

2. *What regulatory failures are highlighted in the case study?*

Regulatory failures highlighted:

- The failure to follow up 10 incidents at Texas City.
- Failure to monitor environmental impacts at Texas City.
- BP was found to have lobbied successfully against environmental monitoring, indicating that large companies were in powerful positions to circumvent the law.
- Prudhoe Bay – Both the Alaskan regulator and the US Department of Transport pursued criminal actions which were punishable by fines. However, it is arguable that regulation should have focused on prevention.

3. *What lessons should MNEs learn from BP's environmental strategy of the late 1990s, which was criticized as a mere marketing device?*

BP set itself high ideals in 1997, ahead of other oil companies. It aspired to both environmental and social responsibility. This was a high-risk strategy, as the attention it drew to the company could turn into adverse publicity if the principles were not fulfilled in practice. This is a major lesson for other MNEs. Another lesson is that all members of the organization must be committed to these goals, and have the training and resources to implement them. The failings of BP staff owed much to these organizational weaknesses. BP's fundamental rethinking concluded that greater centralization was needed, following the example of ExxonMobil. This would make it easier for safety policies and procedures to be implemented in the same manner across the whole company. Is the need for centralization a lesson for other MNEs? BP seemed to be looking for a structural answer to what were cultural and operational problems. It is arguable that the decentralized organization can still maintain high levels of safety and monitoring, following rules laid down by the centre. If BP failed to transmit the rules to local subsidiaries adequately, then the need to improve communications is one of the lessons.

4. *What recommendations would you make to BP executives for a new strategy which will regain public confidence?*

Students should offer a range of recommendations, to do with staffing, training, management, budgets and even acquisition strategy. Many have to do with CSR, but most are simply about sound management strategy. Some possible recommendations:

- Recruit adequate numbers of qualified people for key jobs with safety implications.
- Prioritize training and safety procedures.
- Insert adequate procedures and protection for whistleblowers in the staff handbooks in all locations.
- Alter the company's ethical code to disallow lobbying of politicians to bypass environmental monitoring.
- When acquisitions are made, take into account the need to raise old facilities to modern standards. If the time and expense look large, do not acquire the facility.

- If the company pursues a CSR programme, it must be carried out throughout the organization.

Many students would suggest that only a considered CSR strategy will win back public confidence. The company must convince the public that it now takes the goals seriously, including investigating failings.

7.2: Who's driving the green car (page 511)

1. *What factors are influencing the move towards greener cars?*

- Government pressures on manufacturers to reduce emissions.
- Public concerns of rising emissions from transport, and detrimental impacts on health and the environment.
- The need to improve fuel efficiency, in light of rising fuel prices in recent years.
- Strides made in new technology, including plug-in batteries.

2. *Of the alternative technologies in the development process, which in your view holds out the greatest long-term prospect, and why?*

Opinions differ on this issue, and much depends on comparisons of efficiency and costs. Improvements in the plug-in battery could make it possible to travel longer distances. Ethanol is no longer viewed as favourably as it was: it is less fuel-efficient than petrol; sources may compete with crops for food; and recent falls in the price of petrol have appeared to reduce the urgency. Hybrids and clean diesel reduce reliance on fossil fuel, but are nonetheless dependent on it, making these alternatives look less desirable in the long term.

3. *Would you agree that there is a conflict between manufacturers' desire to go green and their desire to sell more cars?*

Most would probably agree with this statement. The main reason is that some of the most popular lines, such as the SUVs, are the least fuel efficient and biggest emitters. The models with the best environmental credentials tend to be small cars and those in the hybrid ranges. The latter cars, such as the Prius by Toyota, have premium prices, and are not hugely popular with ordinary motorists who have few views on the environment. The manufacturer who focuses only on the greenest models would court financial disaster in the present market. However, this situation could be slowly changing. Toyota is now producing greener SUVs, indicating that popularity and green credentials can co-exist. Note the quote from BMW in the second column of page 512, suggesting that CO₂ emissions are becoming more of a selling point as time goes on.

4. *Toyota has brandished its green credentials, but is criticized by other manufacturers. Why?*

Toyota has become the market leader in hybrid vehicles. Launched in 1997, hybrids still only accounted for 4% of their total sales by 2006. Toyota is criticized because its green credentials are not as laudable as they are portrayed. The hybrid

Lexus, for example, which is a luxury vehicle, has relatively high fuel consumption. Toyota remains committed to SUVs and pick-up trucks, both popular in the US. Even though it has introduced greener versions of these vehicles, they are inherently less fuel efficient than smaller cars. Toyota is a member of the Alliance of Automobile Manufacturers, which lobbies against restrictions on emissions. American car companies are also members, but Honda and Nissan, both working to build up their market share in green vehicles, are not.

Country focus

13.1: Egypt (page 480)

◆ *What are the main factors in the environmental deterioration of Cairo?*

The main factors:

- Huge, and growing, urban population
- Unregulated growth of slums
- Little attention to air and water pollution
- Unregulated urban industrial operations
- Effects of desert dust which form clouds and trap pollutants

◆ *In what ways do Egypt's environmental problems impact on its economic ambitions?*

Egypt has extensive oil and gas, attracting foreign energy companies. The government is looking to these companies to generate much-needed revenues, but the high costs of reaching deposits is a deterrent. In addition, The Egyptian government subsidizes energy prices for local consumers due to widespread poverty and risk of social unrest. Egypt has tried to attract non-energy FDI, in the hope of creating jobs. Some of these are in textiles and furniture. The jobs are most needed in Upper Egypt, where the poverty is the worst. Egypt is also seeking to expand its tourism sector, but environmental concerns are a factor which could limit development. Many tourist attractions are threatened by degradation from pollution. Furthermore, emissions are rising.

◆ *What recommendations would you make to the Egyptian government to develop the tourism sector while protecting the environment?*

Students should put forward a number of recommendations. Egypt has diversified tourist attractions, including ancient monuments, coral reefs, golf and beach resorts. Improving airports and roads increases pollution, but these are necessary to serve tourists. Egypt could promote eco-tourism, designed to minimize environmental impacts. This would not necessarily attract mainstream tourists, however. Cleaning and protecting ancient monuments is needed to preserve them for future generations, for both local people and tourists. The government could introduce stringent planning regulations for developments such as golf courses, to make sure that they do not adversely affect the ecology or consume excessive water or energy. The country might be advised to concentrate more on upmarket tourism, rather than lower end tourism.

- ◆ *How do Egypt's urban problems, including poverty as well as poor living conditions, take on a political dimension which could threaten the government?*

Egypt has an elected parliament, but political power is concentrated in the president and ruling party. The activities of opposition parties and groups are curtailed, but one, the Muslim Brotherhood, has gained much public support. This is largely because of the widespread poverty, which has led to considerable discontent with the ruling government. The Muslim Brotherhood acts as a social and well as political force, garnering much of its support in poor urban areas. Although economic development has benefited Egypt's economy, the gap between the wealthy, living in gated communities, and the urban poor, has become more evident, and could lead to unrest, especially if living conditions deteriorate further. It was thought that economic development would protect political stability, but Egypt's social and economic problems have persisted.

13.2: Australia (page 490)

- ◆ *Why is Australia's mining sector, although highly profitable at present, considered precarious in terms of long-term growth?*

Australia's mining sector has profited from growing exports to China, fuelling its rapid growth. Coal has been its largest export. This sector has suffered a downturn as China's industrial production has been affected by economic downturn. BHP Billiton enjoyed huge growth in profits as a result of exports to China, but these levels were problematic in the long term. Another factor is that any international agreement on climate change could affect Australia's huge coal exports, as emissions from coal-fired power stations are some of the biggest emitters of CO₂.

- ◆ *Assess Australia's current problems of water scarcity and the measures being taken to solve them.*

(Note that there is a mistake in this country focus feature on page 491, which refers to the Murray-Darwin basin. This should be the Murray-Darling basin.) Australia is the world's driest inhabited continent. Droughts have been exacerbated by the effects of climate change. These are taking their toll on the country's agricultural sector in particular. Australians' per capita water use is high, especially in the context of water scarcity. Australia has restrictions on water use for farming, distinguishing between dryland and irrigated farming. However, agriculture is beginning to look unsustainable due to water shortages. Trade in water rights is a government policy, and is one of the main ways to manage water use. Recycling and desalination plants are being built.

- ◆ *Why has Australia been unwilling to sign the Kyoto Protocol, and what are the prospects for the country joining in future international mandatory emissions reduction targets?*

The new Labour government elected in 2007 has expressed willingness to sign up to emissions reduction targets. As of 2 January 2009, it has indicated that it would sign up to reductions of only 15% from 1990 levels by 2020. (This is discussed in an update feature in May 2009). This is less than the EU's proposed reduction of 20% by that date. Among the developed countries, therefore, although there is now more outward expression of willingness to accept targets for reductions, there is no overall agreement on the extent of proposed reductions.

◆ *In your view, what are the prospects for Australia diversifying its economy, and shifting to a more environmentally sustainable strategy?*

Students will have differing views on this question, and will need to reflect on various points made in the case study. It is arguable that policymakers have rather taken for granted continued prosperity from the boom in exports of mining products and other commodities. However, services have been growing in importance, and these sectors would be the main area of diversification. Education and tourism are growing, and high-tech innovation presents opportunities. Recall that Australia ranks highly in entrepreneurship (see Figure 1.3, p. 9). SMEs in high-tech industries offer a good prospect for diversification. These would be considered more environmentally friendly, whereas a sector such as tourism could potentially damage the environment, if it involved development in ecologically sensitive areas or heavy use of scarce water resources. There is much potential for tourism from Asia, but developments in tourism would need to be managed in a sustainable way.

Pause to reflect

The right to development? (page 478)

Begin by describing the environmental impacts of industrialization, which has been a driver of economic development. Students will have differing views on this question. Discussion could be organized as debate between those agreeing with developing countries' arguments that they should not curtail economic development for the sake of the environment.

Some of the 'pro' points:

- As sovereign states, they have every right to pursue their own growth strategies.
- They are merely following in the footsteps of the early industrializers, who recognized no need to cap pollution in their own development phase.
- Per capita emissions of the developing world are still much lower than those of the developed world.

Some of the 'con' points:

- The mounting scientific evidence on climate change indicates that without dramatic reductions in CO₂ emissions by all countries, the continuing development of all is in jeopardy.

- Pollution is not merely a national issue for governments, as the effects cross boundaries and even have global consequences. The sovereignty argument is no longer tenable.
- It is a global concern that populations in developing countries are subjected to dangerously high levels of pollution in air, soil and water, causing large areas of population to suffer impaired health and diseases.

Accountability for pollution (page 479)

Countries tend to deny that their activities are the cause of pollution in another country. They argue that damage in another country could have been caused by numerous other factors which are prevalent in that country. In response, it can be pointed out that scientists can demonstrate causation in cases of acid rain, which can travel long distance, carried by wind. In cases of polluted water, such as the dumping of waste into waterways or the sea, causation is relatively easy to show. There is international law on transboundary pollution, holding the polluter liable. The solutions, however, should probably begin with negotiation between governments rather than the launch of legal proceedings. Co-operation is usually more successful as a means to resolve this type of issue, and legal action should be seen as a last resort.

Mitigating climate change impacts (page 485)

Q1: The world's poor countries are vulnerable to the effects of climate change. Some examples are given (p. 483). Coastal regions prone to flooding are a characteristic of many. Some suffer from the risks of desertification, which can ruin agriculture. Food and water scarcity can occur in both these situations. Students should put forward a number of suggestions, for both local action by governments and international help. Actions which can help include:

- Moving people from low-lying to safer ground in coastal areas, although in some situations, the areas at risk is so large as to make this impossible in practice.
- Investing in technology to prevent inundations of low-lying land.
- Where desertification is a risk, the development of crops which require minimum water is a possibility.
- Alternatives to drawing on underground water are available (such as desalination plants).
- Deforestation and clearing of vegetation generally raise the risks of damage from flooding. Governments can control these activities, but it is often the case that in developing countries, businesses which carry out these activities have links with the political establishment.

Q2: Most would probably say that the big emitters should bear some responsibility. Certainly, funding is needed, and poor countries lack the resources to carry out major infrastructure projects. Development aid by rich countries is a possibility (see discussion in Chapter 15). Both governments and businesses in rich countries are in a position to help, through both funding and technology.

Setting an example or stifling competitiveness? (page 487)

Differing policy approaches stem partly from the view taken of the role of the state. In some countries, the state has taken a lead role in industrialization and economic development. China is an example. Governments holding this view are reluctant to do anything that might hold back growth. In other countries, the state has played a mainly indirect role in economic development: the US is usually highlighted as an example, although, as we have seen, the state has played a greater role than is sometimes suggested (e.g. subsidies to farmers, discussed in Chapter 6).

- *Developed v. developing countries* – Developed countries have led in legislating to protect the environment. Areas of legislation include emissions, waste disposal, planning regulation, taxation policies. They utilize the civil and criminal law, so that those who suffer damage can sue (in civil courts) and those who violate criminal environmental protection laws can be prosecuted and fined. Developing countries tend to have weaker legal institutional frameworks. They have less legislation in place and fewer enforcement mechanisms. These processes are also likely to be tainted by corruption.
- *Differing approaches among developed countries* – Many developed countries, such as Germany, have taken a lead in mandatory legislation to control pollution. The EU has also taken a legislative lead. These countries appreciate that their own national initiatives are not likely to be followed in many other countries, causing their businesses to lose competitive advantage. They therefore urge that international co-operation, through treaties such as the Kyoto Protocol, must complement national legislation. An alternative approach has been that of the US, which has taken the view that its industries would suffer from environmental controls such as controls on emissions (although some individual states have taken leads). The US also refused to ratify the Kyoto Protocol for the same reason. (A further discussion of international co-operation is in Chapter 15.)

Students could be encouraged to discuss the merits of each of these viewpoints.

Benefiting from international divergence? (Page 489)

Advice to businesses in these different environments depends partly on the nature of the business and the corporate culture of the company. This question raises CSR issues. Business strategy can take a strong environmental line at one extreme, or, at the other extreme, exploit the lack of regulation. Factors to consider:

- If national environmental laws are weak, this can be a source of competitive advantage. Companies can be legally liable for breaches of national environmental protection law, whether they are domestic or foreign. Furthermore, there have been cases where an MNE has been sued in its home country for environmental failings in a foreign one. Any cases involving breaches of environmental laws involve reputational damage for MNEs.
- The company which takes a strong line on the environment as integral to its strategy in any country stands to enhance its reputation, assuming its practices live up to its principles.

- Long-term planning for any company must now include the possibility of international environmental accords, which could impact on its operations and those of its subsidiaries, especially in they are in industries which are heavy polluters or heavy users of energy or water.
- As resources become constrained, the forward-thinking company is probably looking to become more efficient in use of energy and water, simply on the basis of self-interest, without necessarily subscribing to principles of CSR. In fact, most companies now do seem to accept CSR principles in theory, although interpretations vary.

Economic and ethical strategies coming together? (page 495)

First, explain what the business case is. The business case converges with the ethical stance in that it recognizes the principle of sustainability, accepting that changes are needed in use of scarce resources and in reduction of emissions, in order to survive in the long term. Carbon neutrality and carbon offsetting are examples. The business case diverges from the ethical one in that environmentalists would urge that more needs to be done to stem global warming, even when it entails extra costs for the business and going beyond the requirements of national law. The ethical case is associated with CSR principles.

Driving competitive advantage from environmental goals (page 498)

Benefits of a competitive strategy based on environmental performance:

- Innovations in clean technology can be resource efficient and save costs. An example is 3M.
- In the resource-based theory of the firm, core competencies based on natural resources and environmental protection, such as waste recycling, can be a source of competitive advantage. Firms which introduce these measures ahead of government regulation gain valuable experience ahead of competitors and might also be able to tap government funding.
- In sectors where consumer pressure is strong, environmental credentials helps to win over customers. Whole Food Markets is an example.

Risks of a strategy based on environmental performance:

- The company which embarks early on an environmental strategy commits to extra expenditure, which, on the face of it, makes its products less competitive. The firm hopes to recoup its investment from higher prices, but this might be difficult to achieve, especially if there is downward pressure on prices in periods of economic downturn.
- Some companies which develop new technology, such as Vestas Wind Systems, have done so in anticipation of government funding. If this funding fails to materialize, they face losses.
- Some companies implement greener strategies ahead of government regulation, in order to be prepared for the changes to come it. However, if the government changes its policy or retreats from environmental targets, the company could well

conclude the extra expense was unnecessary. This is assuming the company's only reason for making the changes was future legislation, rather than CSR motives.

Environmental reporting from the investors' perspective (page 503)

Investors have various reasons for taking an interest in environmental impacts. One is simply out of ethical concern. Another is that sustainability of the company's business model is an issue for long-term investors. Another reason is that investors can become jittery if the company encounters adverse publicity and suffers reputational damage for its operations which have damaging environmental impacts. The types of business listed bring out these issues:

- *Global brand of sportswear manufactured from outsourced manufacturing* – Ethical issues arise in connection with this company, as workers in outsourced factories may be subjected to poor working conditions and human rights abuses. The company may well subscribe to international labour standards in principle, but national laws are notoriously weaker, especially in developing countries. Adverse publicity and reputational damage also apply. Disclosure about conditions in the factories are important for investors.
- *Food retailer which sources fresh produce from many countries* – The food retailer is often poorly placed to know what conditions are operating in the farms and plantations where food is produced. The connection with these workers is even more remote than that between the global brand owner and the manufacturer which produces the branded goods in a developing country. However, investors are concerned about the issues. As the chapter pointed out, some retailers, such as Marks & Spencer, have a 'look behind the label' policy, but stress that they cannot be sure what happens on the 10,000 farms which produce their fresh food.
- *Global steel-making company* – Investors are concerned about environmental impacts in the various locations, including adherence to national law and international conventions, for example, on pollution and waste management. Investors will also wish to see that the company has prioritized local communities in which it operates, where environmental impacts are most immediate.

Energy security (page 506)

Energy security has become a major priority for governments, as non-renewable sources of energy become depleted. There has seemed to be a trend of nationalism emerging, as governments of energy-importing countries are no longer content to leave it to the markets for their future energy supplies. Similarly, governments of some energy-rich countries have nationalized their resources (Venezuela, Bolivia and Russia are examples, although these actions were not simply in the interests of energy security, but to control the production and generate revenues.) In designing energy policies, governments consider:

- Natural energy resources, including their accessibility and ease of exploitation.
- Environmental impacts of existing and alternative sources, including climate change.

- Availability of resources and technology to exploit renewable sources, such as wind and solar energy.
- For countries which import oil, governments are sensitive to issues of supply from unstable regions of the world, or those where there is a risk of nationalization.
- International agreements, both the Kyoto Protocol and possible successors, which could limit emissions, restricting use of fossil fuels.

Reality check for the consumer (page 510)

- *Q1*: Governments are reluctant to introduce mandatory restrictions on consumer behaviour, such as the drastic one mentioned here. The airline industry has enjoyed favourable treatment, such as exemptions of tax on aircraft fuel. Consumers have become accustomed to low-cost air travel, and such a move would be politically unpopular. Governments are conscious of the contribution of travel and tourism to national economies. The same argument applies to green cars (see the following case study). Governments are more inclined to give incentives to encourage consumers to change their behaviour rather than compel them to do so. In democratic countries, in particular, the notion of government interfering in consumer lifestyle decisions is perceived negatively, although countries differ in this respect, and the degree of environmentalism differs from country to country.
- *Q2*: Most students would probably say that changes in lifestyle are needed by consumers in all countries, not just the developed world. However, sustainable consumption is not a big issue in most developing countries, as lifestyles generally are not sufficiently westernized, and per capita emissions are low. Governments in these countries feel justified in arguing that the major changes in behaviour are therefore called for in the developed world.

Part B review questions (page 510)

1. *Environmentalists are sometimes accused of advocating turning the clock back on economic development. Is this a fair or unfair depiction, and why?*

Many would consider this a fair depiction, but environmentalists are highly varied in the extent of change they consider necessary. Industrialization and its associated developments, such as the building of infrastructure and power stations, is perceived as central to economic development. These processes are largely responsible for environmental degradation and the acceleration of global warming. Probably only those on the extreme side would advocate a reversal in industrialization. This radical position would find little support from governments and societies, which are dependent on industrial products and on the employment which industries provide. This viewpoint probably envisages a rather idealistic view of self-sufficient communities from the pre-industrial era, with low levels of trade.

Most environmentalists would accept that it is not possible or desirable to turn the clock back, but it is possible to maintain the benefits of industrialization while seeking to put it on a sustainable footing. Those who argue against changes such as reducing emissions have tended to cast all environmentalists as wishing to destroy the lifestyles that people enjoy. This is perhaps an unfair generalization. Environmentalists generally take a more realistic approach, realizing that people and governments are willing to make small changes which, cumulatively, can add up to significant shift – in both attitudes and behaviour.

2. *Pollution in some regions, in particular in urban areas of developing countries, is at such high levels that people's well-being is impaired and ecosystems are being destroyed. How, if at all, can national governments, who have contributed to the pollution by their industrialization policies, be persuaded to change their policies?*

A factor is the extent to which a government is accountable to the people, say, through democratic elections. Developing countries tend to have weak governance and accountability, tending towards authoritarian regimes with only weak democratic accountability. Poverty is a major feature of these urban areas, contributing to the risks to quality of life. Governments, whether tending towards the authoritarian or democratic, are sensitive to the economic and social environment, which, if it deteriorates, can cause social unrest. Taking steps to relieve urban pollution and regulate industries can be seen as positive, both for inhabitants and in terms of political stability. Mexico is an example. New programmes to improve urban living conditions in Mexico City should serve to reduce the likelihood of unrest.

3. *Climate change is usually referred to as an example of a global environmental issue, but countries tend to take a national perspective on impacts. What changes in thinking are needed, in order for national authorities to co-operate in, for example, reducing emissions?*

This question raises the issue of whether changes in thinking are needed. Some would argue that government policymakers must change their ways of thinking, but these changes tend to come about as a result of pressure from people outside government – consumers, NGOs, influential campaigners and others who point out the urgency of the situation and the possible catastrophes which lie ahead if nothing is done. Some of the changes are:

- *Climate change* should be seen as impacting on everyone and demanding co-ordinated action on a global basis. Although this is difficult for some national governments to accept, they are perhaps becoming persuaded by the devastation that can strike in their own territories.
- Schemes such as *emissions trading* are beneficial, but in the long run, are insufficient, as significant reductions in emissions are needed.
- *Technology* will not magically provide all the solutions. Clean technology and technology associated with renewable energy are making progress, but they are not the total answer. Some governments and commentators argue that technology will always find solutions, eliminating the need for individuals and

firms to change their behaviour. However, much irreparable damage is already done.

4. *How is the competitive landscape changing, favouring companies which seek to gain competitive advantage from environmental policies?*

Many MNEs are now seeking to distinguish themselves from competitors on the basis of environmental policies. In each sector, there might be only a minority of companies taking this approach, but as the number grows, and as stakeholders respond favourably, competitors feel compelled to respond. Some examples of sectors cited in the text:

- *Retailers* such as Wal-Mart and Marks & Spencer, which involve global sourcing and supply chains.
- *Mining and energy* – These companies are among those most noted for environmental degradation and pollution. Most now have environmental policies and profess a commitment to sustainable development.
- *Agri-business* – Some of these companies have a poor environmental reputation, but they are now aware of the need to revise policies. Chiquita is an example.
- *Innovatory companies* in clean technology can gain competitive advantage.
- *Waste management and recycling companies* have benefited from increased interest in greener methods. Some of these changes are being driven by legislators, as in the EU.

5. *Environmental monitoring for companies is still in the early stages, but the perceived need for transparency and disclosure is growing. How should companies in the following industries respond?*

- *Car manufacturing* – This is the subject of the next case study. Monitoring of emissions and other pollution in the manufacturing process is needed. The global supply chain, which entails long road journeys for parts and finished vehicles, should be highlighted. These companies now produce a range of vehicles, and must make clear the level of emissions of each model, as well as the recyclability of their cars.
- *The passenger airline industry* – The airlines can disclose the emissions data and noise data for the aircraft they use. Those with newer fleets are likely to be lower overall in emissions and noise. Fuel efficiency is another issue for these companies. This is a sensitive sector, which has enjoyed favourable taxation policies from governments, but could face restrictions in future.
- *Banking* – This sector is less directly involved in environmentally sensitive activities than the others. The bank can monitor its carbon footprint, and set itself targets to reduce emissions. It can introduce a policy of carbon neutrality (note example of HSBC).

**Web-based
Assignment (online)****Spotlight on BHP Billiton's sustainable development performance**

This exercise is designed to help students sharpen their critical abilities in looking at corporate environmental presentations. As the exercise shows, the reality of the company's performance is sometimes less favourable than the impression given by the material on the web pages as initially presented. This exercise would be appropriate as an individual assignment.

CHAPTER 14

Corporate social responsibility

Strategic crossroads

14.1: Accenture's corporate citizenship profile (page 528)

- ◆ *Which of the theories of CSR and stakeholder management best fits Accenture, and why?*
Accenture is an example of bolted-on CSR. For this company, CSR is essentially philanthropy. The company has given charitable donations through its foundation, Accenture Foundation, and it has been active in charitable activities. The secondment of staff for voluntary development work is an aspect that would potentially help these volunteers to form a broader idea of the firm in society. However, these ideas do not seem to impact on the ways in which the firm conducts its business. It has a rather narrow view of stakeholders, identifying them in terms of contribution to shareholder return.
- ◆ *Summarize Accenture's approach to corporate citizenship*
First, define the concept of corporate citizenship. See the list of contexts on page 517. For Accenture, which is a global company, corporate citizenship seems mainly to fall into the third of these, philanthropic activities. Accenture does not seem to see itself under the first of these headings, which involves the legal and moral duties of the good citizen, as it has encountered difficulties in its use of tax havens and offshoring.
- ◆ *In your view, is Accenture a good corporate citizen, and why?*
Students will have differing views on this question. If corporate citizenship is defined as philanthropy only, then Accenture's philanthropic activities would make it a good corporate citizen. Most would probably feel this is too narrow a definition, however. Re-registering a company in a tax haven is common practice, but is increasingly being criticized as unethical. The company with expert advice on tax avoidance can reduce the amount it pays in taxes, but ordinary citizens cannot. Money raised by taxes goes to fund many essential services for both citizens and companies. Finding clever and often complex ways of avoiding tax liabilities can be seen as unethical.

14.2: Anglo American's CSR principles under fire (page 544)

- ◆ *Describe Anglo American's approach to CSR in terms of its policies.*
Anglo American has a set of CSR policies which address major issues in mining, including safety and environmental damage. Their toolbox is called the Socio-Economic Assessment Toolbox (SEAT), and was launched in 2003. It is designed

to deal with impacts in host communities and other stakeholders, and to take into account development issues.

- ◆ *In what ways do Anglo American's operations in practice depart from its CSR principles and the OECD's guidelines for MNEs?*

Anglo American is a UK-listed company, which is South African in origin. A large proportion of its mining operations is in Africa. A series of fatal accidents in South African operations in 2006 led to questioning of the company's lapses in safety. It also has a chequered history of dealings with local communities, where allegations of failure to consult have been made. Its most difficult environment has probably been in the Democratic Republic of Congo (DRC). The subsidiary, Anglo Gold Ashanti (AGA), has been active here. Armed groups control areas of this country, including those rich in gold.

How should foreign mining companies respond? Dealing with the groups and their warlords can be risky, as the company can be implicated in their crimes, especially if money is handed over. The UN has found numerous companies dealing with these groups, despite their breaching the OECD's guidelines. Anglo American now seems to have divested the AGA subsidiary. This move could be seen as an attempt to distance itself from these activities. It could be argued, however, that this is only a partially satisfactory response: as the company has prided itself on its CSR principles, one would expect it to meet the CSR issues head-on. If AGA were still under the parent company's control during the period of engagement with warlords, it could still be implicated.

- ◆ *What recommendations would you make to Anglo American to deal with human rights and other allegations associated with its African operations?*

A number of recommendations can be made. Some are:

- Investigate internally what dealings the company has had which might raise implications of association with human rights offences.
- If dealings were thought to be in breach of OECD principles, find out why, and take steps to put matters right for the future. It is possible that staff on the ground were carrying out company policy, but it is also possible that they were acting from their own initiative.
- All staff in sensitive regions need to be informed and trained in the inherent difficulties and risks in dealing with ad hoc groups, especially armed ones.
- The company should co-operate with the authorities investigating war crimes and human rights abuses. Otherwise, there is a lingering impression that it is trying to hide its activities in the area.
- This company is at risk of suffering from the criticism that its practices diverge markedly from its professed principles in respect of CSR. This can cause reputational damage.
- The company probably needs to seize the initiative and explain publicly why it is in these sensitive areas and how it goes about gaining access, both legally and in practice.

Case studies

14.1: GrupoNueva (page 530)

1. *In what ways does GrupoNueva combine CSR with goals of maximizing profitability?*

The company's philosophy is that CSR is the best approach to ensure profitability in the long term. See the quote in the first column. Its business principles are legal compliance, ethical conduct, workers' rights and respect for the natural and social environment. Its stance against corruption arguably enhances its profitability, as corrupt practices usually end in financial woes for businesses involved. The company sees itself as better placed to meet changing consumer demands because of its CSR policies. Its focus on workers' rights probably contributes to better working conditions and smoother industrial relations. These policies can aid in achieving high performance, in contrast to companies with antagonistic industrial relations.

2. *How does the company's focus on poor communities fit in a CSR strategy?*

These are the people at the bottom of the pyramid. Countries in Latin America generally have high levels of inequality, with a consequence that millions live in poor communities, often based on indigenous cultures, which have long suffered from economic and social disadvantages. GrupoNueva believes that the socially responsible company should focus on these groups, from a sense of duty to these poor sections of society. Development needs are a particular focus of the company's efforts. These groups also form a potentially large market for the company's products.

3. *In what ways do GrupoNueva's HR policies enhance its reputation for corporate responsibility?*

First, note that GrupoNueva considers itself responsible for all workers in its operations, both direct and indirect (employed by contractors). Its HR policies emphasize the company's corporate culture and business principles. Among the priorities are human rights, ethics and ecological responsibility. The company recognizes that training and development of all of its employees is important to achieving its goals. It is notable that its policy is to appoint multifunctional people, and to align incentives with the company's priorities. Working for this company would be challenging and also rewarding for people committed to its principles. Its strong values and strongly motivated staff could be considered a source of competitive advantage.

14.2: Nike's evolving CSR strategy (page 548)

1. *How has Nike's CSR approach changed over the years?*

The code of practice for contract factories, introduced in 1992, is probably a starting point. It says that factories should abide by local law. However, local law tends to be weak in developing countries, and enforcement can be problematic. Nike faced critical reports in the 1990s, and introduced third-party monitoring. A long-running legal case beginning in 1998 did little to help the company's CSR profile,

and the adverse publicity led to the company attempting to withdraw from the limelight. It appointed a corporate responsibility committee in 2001, and presented a CSR report on 2004. This report focused on the monitoring in the factories. A report in 2005 suggested that a 'systemic change' was needed. This suggests a more rigorous approach, perhaps in recognition of consumer concerns, which have risen up the agenda.

2. *Assess Nike's current approach to CSR and stakeholder management. Has it undergone 'systemic change', or less radical changes?*

Nike's approach to CSR is certainly an aspect of the company that it wishes to emphasize. It does still seem to be based on the use of the code of practice, coupled with monitoring. It could be argued that this is essentially a stakeholder type of approach, as the focus is the workers in the outsourced factories. Note the elements of the Strategy document in 2005, for example, the wish to ban excessive overtime by 2011. The company has operated a code of practice, of which this should have been part, since 1992. Does this lag of nearly 20 years suggest less than whole-hearted commitment? As the factories are faced with sudden increases in orders, even this goal seems optimistic. In respect of stakeholder management, note the statements of stakeholder groups in the CR report of 2004. Are the factory workers direct stakeholders, as 'workers in our supply chain'? This is left ambiguous. One would probably conclude that, although the rhetoric has been strengthened, the mechanisms for CSR and stakeholder management remain essentially the same.

3. *Critically evaluate Nike's corporate governance in terms of CSR.*

First, discuss what corporate governance features one would expect from a company which espouses CSR as its core approach. Elements would be stakeholder voice and democratic processes, including one-share-one-vote. Then, compare Nike. Nike has a share structure which is weighted towards the dominant shareholder (the founder), who effectively controls the board. Ordinary shareholders have no say on executive rewards, which amounted to over \$22 million for the top five executives in 2007. Excessive executive pay is an issue which has aroused much criticism recently, coupled with the lack of checks and balances in the boardroom. One would probably conclude that Nike's corporate governance falls short of CSR principles. However, as the company seems to adopt its CSR approach in management terms only, the company would probably respond that its corporate governance is entirely separate. Do you agree?

Country focus

14.1: Nigeria (page 518)

- ◆ *List the different stakeholders which foreign oil and gas companies in Nigeria must take into account.*

First, explain in general which groups and organizations are stakeholders in any company. In Nigeria, the following can be highlighted:

- The foreign companies' employees in the region.
- The foreign companies' shareholders.
- The foreign companies' customers globally.
- The Nigerian federal government, with whom the companies have agreements. The Nigerian army and police force, responsible for security, are also stakeholders.
- State and regional officials, who have authority in the areas where companies operate.
- Local communities in the delta region, including ethnic groups.
- Militant groups which have caused disruption of operations. These groups operate in quasi-criminal ways, but are also representative of legitimate interests in the communities.
- The environment, on land and offshore.

Students can be invited to discuss the relationship between these diverse stakeholders and possible conflicts which might arise for managers in reconciling these differing interests. However, the next question looks at them in detail.

- ◆ *Summarize the claims of each of the stakeholder interests listed in Question 1, and make recommendations for dealing with each.*
- Internal stakeholders are listed first in the above list. The companies owe a duty of care their own employees in the region, and also probably to the workers working for subcontractors hired by the companies. Their safety and security are paramount, and are difficult to guarantee in unstable locations.
- The companies' shareholders are the group to whom directors are ultimately accountable to deliver performance and profits. A company's executives are aware of the regional risks, but see the possible profits as justifying the risks, although only up to a point: when safety becomes very precarious, the balance tips the other way, and companies might exit a location.
- These companies seek to fulfil obligations to deliver to customers, now and in the future, which entails operations in unstable regions.
- Nigerian federal authorities negotiate the deals with foreign oil companies. This is a sensitive issue as the country is dependent on oil wealth for revenues, but must contend with high levels of poverty. Corruption has been a major problem, and foreign companies must take steps to steer clear of knowingly becoming involved.

- Corruption is also a problem with state and regional officials, but they have considerable power over resources in their areas, posing additional hurdles for oil companies to negotiate.
- Local communities and ethnic groups are directly affected by oil companies' operations. These groups tend to feel that they have seen little of the country's wealth. Social unrest is a potential problem, fuelled by those in the he next group listed.
- Militant groups are often cited as the major problem for oil companies, but they exist in a complex social context. They are not simply criminals, but have links with both communities and officials (although many are corrupt). Dealing with these groups is inevitable, although companies do not wish to get involved in their criminal activities.
- Finally, the environment. Some students might argue that this is not a stakeholder group as such. However, sustainable environmental policies impact directly on the communities and on wider global goals, discussed in the next question.

◆ *Assess Royal Dutch Shell's community policy in terms of CSR.*

Shell and other oil companies saw the return of democratic government as a good development in Nigeria, although in practice, elections have fallen short of democratic ideals. A difficulty for foreign companies is that the federal system is highly decentralized, aiming to devolve power to local ethnic and religious allegiances. For Shell, dealing with local communities is seen as part of their CSR policy, as it helps to reduce the hostility between the foreign companies and local people. Shell has given contracts to local businesses, although this is a risky policy as some are connected with militant groups. The aim of this gesture is to build up relations with local people, a benefit of which would be that militants will give the company full access to oilfields and reduce attacks on their installations. This is an example of business motives driving CSR policies.

14.2: Myanmar (page 524)

◆ *Summarize the CSR case against doing business in Myanmar.*

Myanmar (Burma) is governed by a military dictatorship, which ousted the leaders chosen in democratic elections. The government has been criticized for human rights abuses. The government has huge interests in the country's major business activities, the profits from which keep them in funds. Foreign companies doing business in Myanmar are effectively propping up the generals. Meanwhile, the mass of ordinary people suffer in poverty and inadequate health services. The case against doing business with Myanmar rests mainly on ethical grounds. However, there have been UN-sponsored sanctions against the regime.

- ◆ *What factors would persuade businesses to resume operations in Myanmar?*
Democratic reforms, such as the re-instatement of the elected assembly, would be an obvious trigger for firms to reconsider. However, these seem unlikely. A willingness to open up and co-operate with outside aid agencies, as occurred on a limited scale in May 2008 (for which, see update of November 2008), would also lead some firms to think that steps in the right direction are being taken. Firms will differ in their responses. As the case study states, the violent suppression of demonstrators in 2007 prompted some to withdraw at that time, although the regime had had a poor record for many years.
- ◆ *Do you agree or disagree with Total and Chevron's stance in respect to Myanmar, and why?*
Students could be asked to debate this question. Those who agree would argue:
 - Withdrawal would provide a windfall for the generals.
 - Less scrupulous investors would take up these operations. India and China have had treated the situation in Burma as 'business as usual'.
 - The companies' activities indirectly benefit the Burmese people.
 Those who disagree will argue:
 - Their continued presence is a sign of approval for the generals, and also provides continued revenues and technical expertise.
 - To the CEOs: the possibility that other companies with lower CSR standards will move in does not justify *your* decision to stay.
 - Brutal regimes represent a humanitarian and environmental tragedy, and a strong message needs to be sent by international business that they are not legitimate, either as governments or business partners.

Pause to reflect

CSR and stakeholder interests (page 520)

- *Q1:* Concepts of CSR and stakeholder interests do overlap to a great extent. See Figure 14.2 (Carroll's CSR model). However, the focus of the two concepts is different. CSR is a broad approach to the firm's place in society which takes in multiple dimensions, including the legal and ethical. The stakeholder concept relates to the firm's interactions with groups which impact on its activities. The latter concept therefore represents an array of interests which managers must deal with. *How* they deal with these interests raises the question of whether they have a CSR approach. If they do, then they will take into account legal and ethical considerations in relation to each, in addition to economic considerations. Hence, CSR defines the approach, and the stakeholder approach identifies a number of relevant interactions in which CSR applies.
- *Q2:* Apparently conflicting interests between multiple stakeholders is a major issue for international managers. CSR principles can help with this decision-making. However, it can be difficult where the MNE has operations in numerous countries. Examples can help to illustrate the problems. If the MNE must close operations in some locations, it may decide to keep on operations in a particular location as it is a major employer and part of the community, even though, on

economic grounds, this location should be closed. Another example: In outsourcing of manufacturing of clothing, the western brand owner seeks cost reductions (satisfying shareholders and customers), but a CSR approach would avoid subcontractors in low-cost locations where health and labour standards are low. The workers in these factories are also stakeholders of the brand owner (see CS 14.2 on Nike).

CSR as public relations (page 528)

The risks of reputational backlash are probably increasing in today's world, as public opinion is becoming more sceptical of firms' rhetoric. The media put out a steady stream of information on astronomical executive pay contrasted with that of ordinary workers in outsourcing operations. In addition, there have been some spectacular examples of fraudulent activities on the part of firms and executives with strong records of philanthropic activities. Enron was an example. A more recent example is Bernard Madoff, a New York broker responsible for billions of dollars of losses suffered by clients globally.

Any firm which uses charitable activities to enhance its reputation risks backlash, as people suspect the philanthropy is used as a means to distract attention from negative news about the firm's activities. Enron had a strong corporate philanthropy profile, but its business methods were corrupt. The brand owners who outsource to sweatshops in low-cost countries often carry out charitable activities in these same countries. Is this a sign of good corporate citizenship, or are the charitable activities designed to draw attention away from the poor factory conditions and weak labour standards?

The business case for CSR (page 531)

The business case for CSR is based on an assumption that being socially responsible can actually be beneficial in economic terms, especially if long-term goals are taken into consideration. In the chapter, this approach is aligned with an integrated strategy. The business case for CSR focuses on responsiveness to stakeholders. This focus is less strong than that of a CSR-focused strategy, in which ethical concerns are prioritized. However, the firm which adopts CSR as part of an integrated strategy does take into account ethical as well as economic impacts. From the CSR perspective, this approach is better than the reactive approach which involves responding to stakeholder pressures.

CSR advocates sometimes criticize the business case for CSR, as it seems to view ethical concerns only in economic terms, which negates what CSR is about. As the text suggests, however, businesspeople are more likely to adopt CSR principles if they are couched in business terms. This is the argument based on enlightened self-interest.

Business leaders turn philanthropists (page 533)

Students could well have conflicting views on this issue. If a discussion is organized, rather than simply inviting comments, it would be best to focus first on the statement that ethics seems to be rising up the agenda – true or false? Then, discuss whether a

factor has been the weakness of social welfare. Some points on the first of these questions:

Philanthropy on the part of rich people, often successful, self-made industrialists, has been around a long time. What is new is the changing strategic focus and geographic spread (for example, to African countries), along with the organizational and operational aspects of the new philanthropy. The Gates Foundation demonstrates these points. The plight of poor developing countries is now attracting more attention, largely thanks to the Gates Foundation. Another point that might be made is that the huge sums amassed by CEOs and financiers (such as Warren Buffett) have grown dramatically, due largely to global markets. The urge to give back to society is probably now striking an ethical chord with these billionaires. The growing gap between rich and poor, both within and between countries, is an issue noted in earlier chapters (Chapters 2 and 3). Does capitalism now seem flawed in terms of social welfare? The role of the market and the need for state intervention certainly cast doubt on the capitalist model in 2008 (see update of November 2008). Perhaps the liberal market economy is also questionable on social welfare grounds, as many in Europe have long argued.

How to succeed in a social enterprise (page 535)

Students can be invited to compose their own lists, which can be compared in a seminar discussion. The most important element would be first in the list. Students should be able to list five elements. Some suggestions:

- Commitment to social goals by founder
- Volunteers who are also committed
- Reasonably secure funding, for example, from a donor
- A 'business' model, which provides recognized ways of measuring performance
- Transparent governance
- Financial controls

Many other elements are possible, and the order of priority is has good potential for discussion.

Corporate governance and CSR (page 537)

Opinion among students will be divided on this issue. Some arguments for CSR and stakeholder participation in corporate governance:

- The board(s) is the main body in which executives are accountable. If only shareholders' interests are represented, CSR and stakeholder concerns are inevitably subordinated.
- A legal (as opposed to moral) duty for the board(s) to take account of stakeholder interests and CSR concerns can only be effective if the board includes stakeholder participation.
- Stakeholders should be entitled to participate in management decision-making at the highest level, not simply to have their interests considered once strategy is already determined by the board.

Some arguments against stakeholder participation in governance:

- Conflicting interests from so many different stakeholders would make it difficult for managers to formulate coherent strategy for the business.
- The company should essentially focus on wealth maximization, and stakeholder interests should be a matter for management, not governance (this is the principle of the shareholder model).

One share, no vote (page 539)

- *Q1*: Some of the non-democratic aspects of corporate governance:
 - Many companies have classes of shares, with differing voting rights.
 - Many investors' shares are voted by 'proxies', which effectively gives the management control over their votes.
 - Small investors lack the resources to nominate a candidate for the board. The board is effectively selected by the senior management.
 - Boards now have independent, 'non-executive' directors, but these people often have some informal ties with the company, and are chosen by the senior management.
 - Voting for board members – no right to vote against a candidate in the US, only to abstain, and abstentions do not count. The management's candidate will be elected anyway.
- *Q2*: There is much debate on this issue. Control-enhancing mechanisms are common, and are perceived as ways of ensuring that dominant shareholders retain control, and are protected from the activities of activist investors who wish to 'rock the boat'. However, there is a need for monitoring of management, and the subservient board cannot perform this function effectively.
- *Q3*: The student can make suggestions, which would probably include democratic reforms. It would seem that from both a CSR and stakeholder perspective, democratic reforms would lead to more transparent governance. They might also lead to more diverse boards, and a better check on excessive pay (the next pause to reflect).

Executive pay (page 540)

Those who agree with this statement are of the view that there is now a global market in highly skilled executives who can step into CEO positions in any company anywhere. The assumption is that these individuals are so valuable for their skills and vision that they have become executive superstars. They are analogous to celebrities in other walks of life, who have become global icons. The argument goes that if they are not rewarded handsomely, they will be tempted away to other companies which offer greater rewards. Those who disagree with this analogy might argue that the sporting hero or film celebrity must live up to his or her star status by continually performing well or attracting large audiences. When performance slips, so do the fees. They are ultimately accountable on the pitch or through the box office to the paying consumers. The difficulty with the highly paid executives is that they effectively control their own rewards because of board subservience. Lavish rewards for poor performance now attract criticism from public opinion generally. This criticism is

particularly forceful in the case of companies which use devices such as tax avoidance schemes which are of doubtful legality.

CSR and globalization (page 545)

- *Q1*: Globalized production and supply chains involve relations with numerous other organizations, both direct and indirect. Organizational boundaries become blurred in these situations, and, while this network approach makes good business sense, it poses challenges for CSR and stakeholder relations. A potentially large number of people can be classified as stakeholders, including workers in factories run by subcontractors. But the firm's control over these operations is probably weak, and it might lack much information about the subcontractor's organization. In the international context, the subcontractor is likely to be in another country, often a low-cost location. The brand owner which wishes to portray itself as having exemplary CSR credentials can be challenged about what is happening in these far-flung locations.
- *Q2*: Many would argue that the outsourcing model is inherently at odds with CSR principles. Its focus is almost entirely on cost savings, and the losers are the workers in the factories. Brand owners can establish monitoring in the factories, and use third-party verification to lend greater credibility. However, factories have become adept at satisfying monitors while concealing the everyday occurrences which the monitoring is designed to weed out. See the case study on Nike (CS14.2) for a discussion of the challenges and how to meet them.

The future of CSR (page 547)

Students will vary in how cynically they view companies' public pronouncements, including web materials. Certainly, none will believe that simply extolling CSR principles on the website (which most now seem to do) means that they espouse CSR as a business model. Most would probably agree that competitive strategies are being couched in CSR terminology. How, then, does the company which genuinely pursues CSR strategies stand out from the crowd, and how can it derive competitive advantage by doing so?

Part B review questions (page 548)

1. *Analyse the essential conflict between the CSR approach to corporate strategy and the view that the economic role of the business is all that matters. How are the differences between these two views becoming blurred by the 'business case' for CSR?*

This question would make a good individual written assignment. The CSR approach starts from the premise that the company has a role in society which is broader than that of generating economic wealth. The company is seen not just as an economic entity but in more 'organic' terms, as a member of the society, with social and ethical, as well as economic roles. The company is therefore not simply a vehicle for investment or a place to work, but a vital part of social life. The

economic view of the company takes the opposite approach, assuming that companies are private entities concerned about generating wealth for their owners; *indirectly*, they benefit society through the wealth generated, but they owe no direct duties to society.

These views are becoming blurred in that both are borrowing to some extent from the ideas of the other approach. The CSR approach is often couched in the 'business case', arguing that social concerns make good economic sense in the long term. The wealth-maximizing approach is now being tempered by considerations that responding to stakeholder interests, for example, is essential from the business point of view.

This gives some idea of basic lines of argument, which can be expanded in a written assignment.

2. *Stakeholder management is often praised in principle, but criticized as unworkable in practice. To what extent is this a fair criticism, and how can stakeholder management be made more effective in practice?*

First, explain what stakeholder management is about, listing the major stakeholders. Note that we are mainly considering the international context, which adds complexity to stakeholder concerns. For example, employees are not a single, homogeneous group, but comprise a number of groups of people in different locations, with differing economic and cultural perspectives. It is probable that most would agree with this criticism of stakeholder management, as there are potentially so many diverse interests to consider. Does this nullify the concept? On the face of it, it would seem not, as companies use the term extensively in describing their strategies and CSR principles. But much of this is rhetoric. In practice, dealing with the conflicts is a major challenge, and it could be argued that a clear focus on CSR will help to resolve these issues.

Stakeholder management can usually be made more effective by improving dialogue and channels of communication, both within the company and with outsiders, such as people in host communities (see Pedersen's theory, p. 522). The company needs to install mechanisms for responding to employees and local communities regularly, and to act on the basis of this feedback. When a conflict arises, the channels for airing it from all sides are in place, and a resolution is more likely to be forthcoming than with the 'fire-fighting' approach, which might consist of responding to those who shout the loudest at any particular time.

3. *CSR concepts and theories have evolved mainly in the Anglo-American context. How can they be applied when multiple societies, differing legal frameworks and diverse cultures are involved?* Some of the points which can be made are based on the discussion in the section, 'Internationalizing the theories' (pp 522-3). Social responsibility can be seen both in the context of particular countries and in terms of international standards. CSR policies would respect the social and cultural environment of each country, abiding by national laws. At the same time, the company would adhere to

international labour standards and international human rights conventions. Ethics raises some issues. It could be argued that if a culture sees nothing wrong with child labour, then a company (for example, a foreign investor) is justified in employing local children. This practice, however, would be criticized by those in the company's home country as exemplifying double standards. In most developing countries where child labour is practised, the law now either bans or restricts child labour, although these restrictions are difficult to enforce. Hence, the ethical position is shifting towards zero tolerance. In this situation, a CSR approach is appropriate. It would indicate that the company should probably taken a higher ethical stance, in preference to weaker national institutions.

4. *To what extent do strategic philanthropy and social enterprises represent new directions in CSR, or simply fringe developments?*

Philanthropy is not new, but strategic philanthropy has now moved well beyond simply making donations to charities and letting them use it as they wish. The more managed, organized approach characterizes many US companies, where charitable giving is highly developed. However, it is usually couched in terms of corporate citizenship and seen as voluntary activities. In Carroll's pyramid model, it represents only the top tier, coming after economic, legal and ethical obligations. Social enterprises would possibly be considered more in keeping with CSR principles generally. They could well be seen as fringe enterprises, but this sector is growing, and has a role to play. As these enterprises become more established, they will appear less fringe phenomena and more mainstream.

5. *Managers tend to feel they know best how to run companies and produce the greatest returns for shareholder value. Many shareholders feel that boards, which should represent their interests as owners, are, in practice, biased towards managers. Assess the apparent conflict between managers and shareholders on issues of accountability and corporate control.*

This could form an individual written assignment. There is considerable theory on this subject, derived from agency theory. The student would not be expected to delve deeply into the theory, but should raise the main issues. Managers feel they know best how to run the company, whereas they feel that shareholders lack their expertise. There is thus an inherent divergence in perspectives. In theory, the company's interest as a whole should be paramount, but shareholders are naturally self-interested, wishing to see maximum value, and managers, too, are naturally self-interested, but their self-interest focuses mainly on their own survival in their jobs. Note that in most companies, as the examples in this book have shown, there are dominant shareholders who tend to exert control of the board, and often, of the voting system. They will influence the appointment of senior executives, who are professionals. Aligning these executives' interests with shareholders is held to be enhanced by giving them stakes in the company. Stock options as remuneration are one solution.

Ordinary shareholders in a public company are in a weak position to hold managers accountable or to exert control over them. The board tends to be

dominated by directors responsive to the major shareholders, whose control is exerted through the board. These governance issues are now increasingly becoming part of the CSR and stakeholder debate.

6. *CSR, corporate citizenship and stakeholder interests are now commonly used by companies as a means to enhance their business reputations, featuring especially in public relations materials. In practice, many adopt the terminology without adopting CSR as a strategy and culture. To what extent does this pervasiveness of 'buzz words' detract from genuine changes in strategy on the part of many companies?*

This public relations aspect of CSR probably makes it more difficult for the genuinely socially responsible company to stand out. It can also help to create cynicism about CSR in general. If everyone is using the same terminology, regardless of the firm's actual practices, then the concepts seem to become diluted. Nonetheless, as people are now more sceptical about company pronouncements, they will look behind the rhetoric to what the firm is actually doing to carry out its professed principles. If we find that charitable activities and voluntary community activities are heavily featured on the website, then we are likely to conclude that these activities are strong in public relations rather than corporate strategy.

Web-based assignment (online)

Comparing CSR approaches: Accenture and GrupoNueva

This exercise could be used in a seminar, with small groups focusing on one of the two companies. Each group could give a short presentation of its findings, in 3 to 4 slides. A discussion session at the end could bring together their conclusions.

CHAPTER 15

Global governance

Strategic crossroads

15.1: Product Red: a new business model in the making? (page 556)

- ◆ *What is the basis of Product Red's business model, and what is the role of each of the key organizations involved?*

Product Red is a brand which is licensed to companies for use on consumer products, the proceeds of which go to the Global Fund. Product Red, conceived of mainly by Bobby Shriver and Bono, is a registered company which co-ordinates the licensing activities of the logo. The Global Fund is an organization which funds health programmes in developing countries, focusing on Aids in Africa. It receives money from governmental and non-governmental donors. The companies which sign up to Product Red include many leading global brands. They offer products with the Red logo in addition to their mainstream lines.

- ◆ *In your view, what are the prospects for growth for Product Red as a company? Could its model be copied by other firms?*

It helps if students have looked at some of the products on offer with the Red logo. The brand's prospects for growth depend partly on the strength of the global brands which sign up. Its prospects also depend on the growing awareness of ethical concerns among consumers, and their wish to buy products which help towards funding Aids work in Africa. With economic downturn, especially in America, selling niche products is perhaps more difficult. However, people who are becoming more discriminating in their spending habits could well look at the ethical dimension of products, seeing the connection between Aids and poverty as a global issue.

15.2: China welcomes the internet, but on its own terms (page 586)

- ◆ *In your view, is China's approach to managing the internet justified, and is it sustainable in the long term?*

Views will differ on both these questions. Here are some of the points which should feature in a seminar discussion. Chinese authorities are concerned above all with controlling political criticism and dissent. The internet is a favoured medium in today's world for spreading information and views, and therefore controlling it helps to deter dissent. The authorities go to considerable lengths to block external websites and to curtail any conversations with political implications in internal web activity. Those urging greater freedom of speech and association in China

argue that the authorities are acting in breach of their human rights. These critics of Chinese government controls have expressed disappointment that Western companies have been complicit with the authorities in censorship and other co-operation. Internet controls are seen by many as attempts to hold back the tide, as people inevitably find ways round the censors, making it difficult to sustain in the long term. Critics, both inside and outside China, argue that the restrictions on human rights cause long-term damage, and the authorities would be better advised to become more transparent. This, they would argue, is the best way to ensure political stability in the long term.

- ◆ *Do you agree or disagree with the Western companies which have agreed to comply with China's censors?*
 - Those who agree will argue that in international business, the firm is obliged to comply with national laws, wherever they operate. China is a large market, and the global company is compelled to do business there; complying with the law is an aspect of the national environment. After all, most countries operate some kind of internet controls.
 - Those who disagree will argue that these companies are doing damage to their global reputations, as their ethical positions are being compromised. Are companies such as Google concerned? Reputational damage in some sections of society in some countries is probably not of great concern. However, the company's CSR credentials are compromised.

Case studies

15.1: Gazprom – an ordinary company? (page 578)

1. *In what ways is Gazprom different from a company whose investors are chiefly interested in shareholder returns?*

Gazprom was formed from the old Soviet Ministry of Gas. It was privatized in the 1990s, when powerful oligarchs gained large stakes in the privatized industries. The financial crisis of 1998 led to the restoration of strong central government under Vladimir Putin. The government brought privatized assets under state control and built up a large stake in Gazprom. Gazprom is now effectively controlled by the Russian government. Its owners' main interests are inevitably less on returns for shareholders than on the strengthening of its position as a national champion.

2. *To what extent do you feel Gazprom has become increasingly influenced by Russian political aspirations on the world stage?*

Gazprom has built up export markets to boost profits. Its pipelines carry oil to neighbouring countries, Ukraine and Georgia, but relations with these countries have been coloured by their growing moves towards closer relations with the West. Price rises imposed by Gazprom on Ukraine seem to reflect political policies. Gazprom's acquisition strategy also suggests political influence. It has

invested in Hungary, but this has left the Hungarians in a precarious position, almost entirely dependent on Russian gas pumped through pipelines in Ukraine. These pipelines are at risk of being shut down when Russia and Ukraine clash over pricing of Ukraine's imports. Gazprom has also invested in Nigeria, possibly influenced by China's growing presence in that country.

3. *Why are European governments wary of Gazprom?*

Gazprom's control of pipelines raises concerns across Europe, as it is feared that the company's close association with the Russian government makes it tempting to use gas supply as a political tool. Gazprom has also been treated with caution in its aspirations to acquire energy assets in the EU. The EU has pursued a policy of unbundling the energy market, which it has proposed would apply to outside investors as well as domestic companies. Domestic companies' control of pipelines and power grids has been a cause of concern on competition grounds, and the Commission would be even more reluctant to see Gazprom build up a presence, given its strong links to the Russian government.

15.2: Microsoft versus competition authorities: and the winner is... (page 590)

1. *Why was Microsoft accused of abuse of a dominant market position by competition authorities, and what are the remedies?*

The practices of bundling applications software with the Windows operating system, and limiting the interoperability with other firms' systems and applications – these are the practices which are targeted by competition authorities. The remedies include requiring Microsoft to unbundle the software, by offering Windows without Microsoft applications such as Media Player. It would also be required to offer information to rivals to allow their products to work with Windows.

2. *Who were the winners in the long-running legal battle to date between the EU and Microsoft: the EU, Microsoft, consumers, rival companies or nobody?*

Students could argue any of these alternatives. The rival companies had won the case in theory, but all had settled with Microsoft before the judgment was reached. The EU could claim to have won in a sense, in that the competition commissioner's case against the company was upheld. However, Microsoft remained unbowed, and the huge fines were insignificant in terms of the company's global finances. It could be argued that the decision was a victory for consumers, but consumers had long endured Microsoft's dominance, and it remains in a dominant position. The battle for consumer choice, one could say is partially won. Some sceptics might argue that, to date, there are no clear winners.

3. *In your view, should there be a global competition authority with agreed rules to apply, and why?*

Some will agree with the statement, on the grounds that national regulators are too limited to deal with global monopolists and anti-competitive practices, and

that, in any case, the global position of any company is outside their jurisdiction. A strong argument would be that consumers in many countries suffer from the presence of a dominant player, but governments individually lack the tools to deal with the situation. Those who disagree with this position will take the view that the market should decide, not regulators. If a company has become powerful, it is because it has produced the innovative products that consumers everywhere want. Why clip its wings? New competitors are coming along all the time, and they will inevitably challenge the leader. The advocates of a global competition authority would reply that the dominant player is in a position to use unfair practices, which actually thwart the possible new entrants, reduce consumer choice and distort the very markets which are allegedly being encouraged.

4. *How is the competitive environment shifting in computer and internet technology, and which companies are in the strongest position?*

The desktop PC is giving way to internet-based and mobile applications. This gives internet companies an advantage. It also benefits companies such as Apple, which offers the iPhone. Google is dominant in the search business in many countries, generating profits from advertising. Microsoft's attempt to purchase Yahoo in 2008 suggests that it is now trying to build competitive strength in these areas.

Country focus

15.1: Kazakhstan (page 559)

- ◆ *Explain Kazakhstan's role as 'power broker' in the changing balance of power between the world's large economies.*

Some students might not understand what 'power broker' means. It is best to start with some explanation, indicating that a key strategic country with natural resources can be in a position to tip the balance of power one way or the other among the larger economies and political superpowers. Kazakhstan is strategically located between the Asia and Europe. A former part of the Soviet Union, it still maintains close ties with Russia, but it has also carved out a role as an independent state in the post-Communist era. Its economic power stems largely from its natural resource riches of oil and gas. Russia has been influential in developing these resources, but Kazakhstan's government is looking to FDI from other countries. American company, ExxonMobil, and Eni, an Italian company, have been developing the offshore oilfields in the Caspian Sea. Pipelines can potentially carry oil to Western Europe, and to China.

- ◆ *What global governance organizations and processes are referred to in this country focus feature? Explain the significance of each in global governance.*

Some which are highlighted in the case study:

- *Opec* – the Organization of Petroleum Exporting Countries. This is the cartel of oil-producing countries, which controls 60% of global oil reserves. At

regular meetings, these countries decide on production quotas for members. Many leading producers, however, are outside Opec, including Kazakhstan.

- *OSCE* – Organization for Security and Co-operation in Europe – This is an oversight body for security, democracy and human rights. One of its functions is monitoring national elections, which is particularly apt in countries where elections have tended to fall beneath the criteria of being free and fair.
- *WTO* – The World Trade Organisation (discussed in Chapter 6). Its role in global governance is to oversee the multilateral trading system and its rules. It also provides a system and procedure for settling trade disputes among countries.

◆ *What are Kazakhstan's long-term prospects of pursuing both sustainable economic development and an international political role?*

These two aspects are probably linked. As the country becomes more important as a resource-rich country, and manages its riches in a sustainable way, it will gain in international political status. However, both of these developments are in some doubt. Governments in oil-rich countries often step in to assert a key role as owner in the management of oil wealth. The Kazakh state oil company is working with foreign partners, through multi-party co-operation. If further tensions arise, these projects could be set back. On the political front, Kazakhstan's democratic credentials remain weak. When economic downturn strikes (especially due to a fall in oil prices), social and political unrest are a possibility. There are political tensions in the country, as new contenders for power emerge and many wish to see democratic reforms. If political turmoil occurs and authoritarian measures to stamp it out ensue, this will diminish Kazakhstan's prospects of taking a stronger political role internationally.

15.2: Burkina Faso (page 568)

◆ *What are the factors contributing to Burkina Faso's precarious economic position and extreme poverty?*

The country is landlocked, and has been entangled in regional conflicts which have involved illegal trading in diamonds and arms. The economy is dominated by agriculture, especially cotton. Cotton prices have plummeted, and Burkina Faso's small farmers are poorly placed to compete in global trade. Exports of produce must be transported across neighbouring countries to ports, adding to costs. The country has not benefited from mining in the way that neighbouring countries have. Political instability is a potential problem, given the high levels of poverty.

◆ *What steps are being taken to foster development and reduce poverty in Burkina Faso?*

International donors have ploughed aid into the country, encouraged by market reforms introduced by the government of Compaoré. He is attempting to attract mining companies, to exploit gold and uranium. In the cotton-growing sector, the government hopes to attract investment in processing industries. There is also the

niche market in organic cotton, which offers prospects, although this is only a small portion of the country's output.

- ◆ *In what ways is Burkina Faso indicative of the plight of poor developing countries generally?* Burkina Faso's economy is primarily agricultural, as is that of most poor developing economies. Dependence on volatile markets and the effects of weather and climate make these countries vulnerable. They tend to have high levels of absolute poverty, which pose huge challenges for governments. Most of these countries are in receipt of official development aid. However, they tend to have weak governance structures and corruption, making it difficult to deliver aid effectively to those in need. They also tend to suffer from political instability. In this respect, perhaps Burkina Faso is somewhat better placed than some: its government has guided development through a single-party state, which has brought relative stability. However, the question of Compaoré's successor is looming, and the situation could lead to instability.

Pause to reflect

Governance as networking (page 555)

- *Q1:* Co-operative groupings do not have the top-down rule-making processes that hierarchical structures have. There is no one structure with overarching power to legislate, as is the case with national lawmakers. Governance involves diverse bodies, some more formal than others, with rule-making authority in particular spheres. This authority is recognized by individuals, businesses and governments. Indeed, firms, governments and international organizations often participate in formulating rules.
- *Q2: The advantages* – Participation in the rule-making framework helps to instill a sense of legitimacy in the bodies set up for oversight and enforcement. Rules and norms emerging from co-operative arrangements are, to some extent, self-regulating. Bureaucracy is reduced and, and, as these frameworks are international in scope, cross-border business is facilitated.

The disadvantages – Some businesses and governments fail to comply with regulatory systems in place internationally, viewing the lack of formal police powers as allowing them to ignore the rules. Often these are unscrupulous firms and governments, which can undermine the general level of compliance and legitimacy in global governance mechanisms. Such firms are likely to attempt to evade national laws as well, it should be said.

Assessing the theories (page 562)

First, summarize the three key theories presented. If this is discussed as a seminar, students can be invited to present the 'case' for each of the three approaches. Each will probably have supporters. Note that the question asks about the students' views on global governance, implying that they should discuss not just the situation as it is, but as they feel it ought to be. The second theory, liberal institutionalism, is likely to find supporters, as it recognizes power politics but also the role of international

institutions. Table 15.1, page 557, should be an aid. The third theory is likely to be seen as rather too idealistic. However, in the current global financial crisis, in which national regulators as well as MNEs have been criticized, perhaps strong global institutions now looks a more arguable alternative.

Threats to security (page 564)

- *Q1*: There are differing views on this issue, but the main contenders are: war and other conflicts; terrorism; nuclear disaster, either from a military or civilian source; proliferation of weapons, especially in conflict zones around the world; international crime.
- *Q2*: The mechanisms are listed in Figure 15.3 (page 563). UN peacekeeping activities and attempts to resolve conflicts are generally perceived as weak. UN attempts to control weapons through treaties have met with some success, but have not stopped the proliferation. Diplomatic initiatives, often by third parties, have had success in resolving regional conflicts, but the conflicts can recur as the tensions remain. Where war crimes and human rights abuses occur, the International Criminal Court (ICC) has jurisdiction. Strengthening the UN and the ICC would not be welcome by many states, which would see these moves as threats to their sovereignty. Most people would probably say that the international remedies for state aggression are weak, and the best long-term hope would be that peace is in the interests of all, including the aggressor states.

Making poverty history (page 567)

- *Q1*: Views will differ on this question, but the UN is now pessimistic about the achievement of the MDGs on poverty. Furthermore, the MDGs set targets for poverty *reduction*, rather than elimination. Making poverty history is a catch phrase which has been used by some commentators who argue that it should be possible, but this is an ideal. In the real world, it is unlikely.
- *Q2*: The key players are:
 - National governments of the poor countries
 - National governments of the rich, donor countries, which provide development aid.
 - UN agencies, such as the World Food Programme.
 - The World Bank, which provides aid for development projects.

It is generally thought that simply providing emergency food and money to poor countries is not a long-term solution. Poor people need to be empowered to drive their own development. Therefore, they need development expertise, technical help with growing crops and help with starting local enterprises. Infrastructure projects, such as transport and communications, are also advantageous. Note the 8th MDG, which is technology transfer.

Global citizenship and climate change (Page 570)

Some of the ways by which reluctant governments might be persuaded:

- A case based on *long-term self-interest* will help to influence these governments. It could be argued that the effects of climate change are so devastating they their own GDP will suffer if they take no steps to control emissions.
- A case based on *human well-being* will also weigh with these governments, as the evidence suggests that the effects of climate change take a heavy toll on health and quality of life.
- These governments might also be persuaded by the increasing *likelihood of extreme weather events*, which will have devastating consequences (and also costs) to economic activities and infrastructure, as well as social consequences.
- A more radical possibility is that *responsible governments will insist on changes in domestic policies before doing business with irresponsible governments*. This could lead the irresponsible governments to being isolated by international public opinion. Although some governments would profess not to mind being condemned internationally, most inhabitants of those countries would probably exert pressure on their leaders to come into line.

Do aid and trade work for Africa? (page 574)

Much aid is directed towards poverty alleviation, health and education. Although helpful, they are not necessarily directed towards long-term development. Aid which helps to build economic capacity is most effective for economic development in poor African countries. Some of this is help to build infrastructure. The Aid for Trade initiative of the WTO aims to help countries improve capacity to benefit from trade. Improvements in agriculture are included, and also improvements in services, such as banking.

It is common for donor countries to link aid with trade deals, and insert conditions related to economic liberalization. African countries which rely on agricultural exports are in a weak position in relation to trade negotiations with rich countries, few of which take agricultural imports from the least-developed countries. These countries would benefit from trade deals which open the markets of rich countries to their produce. China has negotiated numerous trade deals in Africa, which do not come linked with the liberal economic reforms favoured by Western aid donors. China's trade deals (see SX6.1, page 204), offer infrastructure projects, which are much needed. However, workers from China are often brought in to do this work, although local workers would benefit from the employment.

As the Doha Round showed, multilateral agreement is very difficult to achieve, as there is a major division between the developed world and the developing world. Producers in the developed world have enjoyed subsidies, which governments are under pressure to protect. These subsidies can distort global commodities markets.

States as new economic forces (page 579)

All states take in money, mainly for spending from the public purse. Some states have pursued deliberate policies of accumulating wealth in the form of foreign exchange reserves as a protection against financial crisis. Asian economies, stung by the financial crisis of 1997, are in this category. Oil-rich countries have also accumulated large sums

in reserves. In addition, state funds may be channelled into sovereign wealth funds, which may be government bodies or separate entities. These funds have become active investors in the global economy. In this way, they take stakes in MNEs and can be in a position to influence strategy. As these funds can be willing to invest large sums, they can be seen by MNEs as beneficial, especially if they take little active interest in running the company. However, they tend to lack transparency, and there is a risk that their government parents will use them as vehicles for political policies. Hence, international business has benefited from their presence as investors, but there are doubts about their strategies.

Global competition rules (page 583)

Arguments in favour of a set of global competition rules:

- As some global companies have grown to become huge empires, their monopolist tendencies and anti-competitive practices have become global phenomena.
- National regulators only look at the national picture, and are in a weak position to exert controls in the area of competition law on huge MNEs. In any case, they have jurisdiction only in their own country.
- Companies which dominate markets are in a position to control prices and supply, and their influence can add 25% or more to the price of goods for the final consumer.

Obstacles which stand in the way of a multilateral agreement:

- The US is at the forefront of opposition to a multilateral agreement.
- For many countries, the export cartel is thought to enhance national competitiveness, and is exempt from national competition laws.
- Some countries also approve of the existence their own national champions which are monopolists (often state-controlled), and would be unlikely to approve multilateral competition laws which might curtail their activities.

The internet untamed? (page 587)

The internet facilitates international business, but there are legal constraints operating at national level which impact strongly on MNEs' activities. Some of these help to protect the firm's property, but some act as constraints. IP law at national level protects the firm's patents, copyright and trademarks. Media companies have enjoyed opportunities presented by the internet, but the very medium which broadens their potential audience also involves them in the risk of copyright infringement. Unlawful copying and counterfeiting are greatly facilitated by the internet.

Data protection and privacy are also issues which impact on international business. In many countries, there are restrictions on the types of goods and services which can be marketed and sold, especially in countries with authoritarian governments.

Governments also attempt to control internet access and content. This is particularly true in authoritarian states. All governments exert some controls, for

example, in the interests of national security. Regulations on advertising to children is another example (see SX8.2, page 308). Most people would probably accept that governments are justified in exerting some controls, but controlling freedom of expression and political dissent is criticized in democratic societies.

CSR merging with global governance? (page 589)

CSR strategies stress the responsibilities of the firm in society, from the legal and ethical points of view. Recall that international labour standards stem from the work of the International Labour Organisation (ILO). Companies which outsource manufacturing usually state that they aspire to these standards as part of their CSR strategies.

CSR strategies involve the firm working with stakeholders such as international governmental organizations (such as UN agencies) and NGOs, in the provision of services, including health and education. The Fair trade initiatives are another example. The UN's Global Compact represents a co-operative approach to achieving the MDGs, in which UN agencies, companies and civil society organizations collaborate.

MNEs are in a strong position to exert influence on governments in the areas of labour standards and the environment. National laws, especially in developing countries, may be weak, and the MNE can offer co-operation, and perhaps technology, to raise standards. In practice, however, MNEs may not be keen to exert pressure, due to the cost implications and the possible reluctance of host governments in these areas. These issues bring out the differences between MNEs which have strong CSR policies and those for which CSR is bolted on. The latter companies are inclined to see their role as mainly economic, leaving issues of social well-being to governments.

Part B review questions (page 589)

1. *Global governance processes are multiplying and encompassing a diverse range of players. However, it could be argued that they are mainly discussion platforms, and that the strong economic players, both companies and nations, are still the dominant forces. Do you agree or disagree with this view, and why?*

This question would make an individual written assignment. It could be especially interesting for the more critically-minded student who can bring in the theories of international relations to support his/her arguments. It is helpful to begin by summarizing the different theories of international relations, highlighting the strength of arguments about national sovereignty in each. Those who are of the realist view tend to see international organizations as forums for dialogue, but those urging a greater role for international institutions take a view that governance involves international bodies and non-governmental bodies. Perhaps the strongest argument in favour of growing global governance is the deepening integration of all players in the global economy. It becomes increasingly difficult – and unrealistic – to argue that in terms of economic and political power, ‘might is

right'. The strength of each player, whether government or business, is dependent on interactions with a range of other players, including international bodies. Co-operation rather than autonomy is perhaps looking to be the rest route to a sustainable future.

2. *To what extent is the dominant position of the US being challenged at present? Which countries and regions represent the greatest challenges, and why?*

First, it is helpful to look at the background of US hegemony, with its economic, military and political aspects. The bipolar world of the cold war era gave way to one of US hegemony. It is now said that this 'unipolar' world is giving way to a 'multipolar' world. The large emerging markets are part of this picture. Asia as a region, and China in particular, is challenging US power economically. China has grown rapidly from its export-oriented manufacturing expansion. The US has facilitated this growth, absorbing imports from China. Imbalances are created, however: China has a huge trade surplus, and the US a huge trade deficit. As consumer spending in the US collapsed in 2008, the effects were felt in Chinese manufacturing, indicating the interdependence of these large economies.

American influence has been strong in the international governmental organizations, such as the IMF and World Bank (it controls the appointment of head of the World Bank). This influence on the world stage is also evident in the US extolling its capitalist economic model (which these international organizations have promoted). As China gains in political influence internationally, its economic and political model (market mechanisms within one-party rule) will challenge that of the US.

Europe represents another challenge to the US, especially through the EU, which, as a single market, is larger than the US. Russia is also challenging the US. One might argue that Russia is a pale shadow of the political force which was the Soviet Union, but Russia has a huge military establishment and control over vital natural resources.

3. *African countries are now seeing growth rates in the region of 6%, largely because of the benefits of natural resource wealth. Although this is beginning to look like a 'success story', what are the factors which suggest that economic prosperity and human development have a long way to go?*

This would be suitable for an individual written assignment, perhaps among a choice of subjects. The student would be expected to explain the reasons behind economic development in Africa, and the role of outside investors. These would include Western donors, Western companies and also Asian countries (such as China and India). African countries have often been said to suffer from the 'resources curse': they have natural resource wealth which can potentially lift whole countries out of poverty, but the wealth is channelled to elites, rather than ordinary people. Some of the negative factors in Africa, which affect economic development prospects:

- Poor governance and corruption.

- Social and ethnic conflict. Many of the African states have been drawn along colonial lines, with little cohesion among different groups and little sense of inherent national legitimacy.
- Conflict both within countries and with neighbouring countries, often fuelled by armed groups which have varying degrees of control over natural resources.
- Precarious agriculture, which is deteriorating due to the effects of climate change.

The student would be expected to explain how improvements in these areas would contribute to sustainable growth in future.

4. *Russia, India and China are all investing in African countries, with packages of aid, trade and infrastructure projects. How does this trend impact on Western governments which give aid and debt relief, usually with conditions attached; and Western MNEs, many of which have long operated in Africa?*

This question raises issues of shifting economic and political power. First, summarize the investment strategies of Russia, India and China. Also consider the motives of each. Each of these countries is wishing to play a bigger global role politically, as well as to make economic investments. China, for example, is looking to secure energy resources, minerals and food from abroad. These developments are in contrast to Western aid and debt relief, which are aimed at benefiting the recipient country above all. However, recipient governments have differing views. When confronted with Western conditions such as reforming economic structures, some African governments have responded that they prefer deals with China which do not include such conditions. However, deals with China often specify use of Chinese labour, and take little heed of the recipient country's development goals. Western MNEs are also being challenged, as new contracts for mining rights are now tending to go to emerging MNEs. The latter companies lack the experience of Western counterparts, and are less scrupulous about CSR and stakeholder concerns (although Western companies are also criticized in this respect). It is arguable that Western interests are being squeezed out in the 'grab' for African resources.

5. *What recommendations would you make as global governance principles to be applied to sovereign wealth funds and state-owned companies which are active foreign investors?*

First, summarize the defining features of these newer economic players, noting their differing types of ownership. These funds and companies are typically based in countries where close insider ownership is the norm, along with opaque structures and little disclosure of financial information or strategy. Students will have varying views on what type of international code the funds might be asked to sign up to. It would need to be voluntary, and these governments and other sovereign players would need to be persuaded that it was in their long-term interest. As this would involve a culture shift, it is possibly difficult to imagine their signing up for the type of disclosure that would be the norm among registered companies. A working group (the International Working Group of

Sovereign Wealth Funds) has devised a set of preliminary principles for a voluntary code, known as the Santiago principles, which are at www.iwgswf.org/pubs/gapplist.htm. Students should be encouraged to come up with their own suggestions first, and then look at this proposed code.

Among the principles are:

- The policy purpose should be made clear.
- There should be clearly disclosed rules and procedures.
- Governance structures should spell out the differing roles and responsibilities.
- There should be an annual report and financial statement.

It would be useful for students to compare their own principles with those which are in the draft Santiago code.

6. *MNEs increasingly see the developing world as their biggest growth markets in the future. How should an MNE with a CSR strategy apply CSR principles to new markets in developing countries such as India, Russia and China? Looking at the two country focus features in this chapter, how would the foreign MNE devise a CSR strategy for entering Kazakhstan or Burkina Faso?*

- *Q1:* Much depends on the nature of the industry in which the particular MNE is involved. In general, the MNE should be focused on stakeholders in each country environment, and on ethical principles. Some of the suggestions which might be made:
 - Workers, both direct and indirect, should be entitled to rights in terms of health, safety, employment and collective bargaining, which adhere to ILO principles.
 - Products which are to be sold in these markets should meet the standards of quality and safety which the MNE operates in its markets in the developed countries.
 - The MNE should refrain from political entanglement and payments, or entanglement with influential individuals in the country.
 - The MNE should follow legal procedures in all its dealings, aiming to keep all its activities in the country transparent and in compliance with the law.
 - The MNE should apply the same principles of environmental protection which it operates in its operations in developed countries.
- *Q2:* A CSR strategy for Kazakhstan: Kazakhstan is keen to diversify its economy and attract outside investor in non-energy sectors. Some of the aspects of a CSR strategy for this country: Dealing with the government is inevitable, and the firm should specify that it is willing to co-operate on a transparent basis, following legal procedures, which it expects will be adhered to by government authorities as well. The firm should be careful not to discriminate or favour any one ethnic group over another.
- *A CSR strategy for Burkina Faso:* The foreign company will comply with national laws and regulation, and also be willing to work with governmental authorities to deliver social welfare and education if possible. The firm can use local workers where the skills exist, and focuses on education and training to add to

the skills in its workforce. It can also co-operate with the government in delivering health. Note that the new mining code requires foreign companies to invest in training local technicians. The foreign firm will engage in dialogue with local communities as stakeholders.

Web-based Assignment (online)

A new global financial order?

The IMF has been in the spotlight as an example of an institution of the Bretton Woods era which has become out of touch with global realities. It has faced much criticism over its policies in the past. This exercise is designed to encourage students to think critically about how it can be reformed. There is a growing body of opinion which recognizes the need for a new global financial regulatory framework, but would this be a revised IMF or an entirely different organization? There will have been developments in this debate since this piece was written. Students can be invited to discuss these developments in a seminar discussion following this exercise.

Synthesis and reflection (online)

1. *What types of measures to improve environmental protection and respond to the threat of climate change are highlighted in these chapters?*
 - *Chapter 13* – National governments' environmental protection measures; EU emissions' reduction targets; negotiations for a follow-up to the Kyoto Protocol; Australia's policy changes towards acceptance of emissions reduction targets; Company initiatives to reduce carbon footprint (such as Marks & Spencer, Reckitt Benckiser); 3M company's energy efficiency; Whole Foods Market's sale of organic produce; Huhtamaki's innovations in packaging; carmakers' innovations in clean technology.
 - *Chapter 14* – Marks & Spencer's Fairtrade initiative; GrupoNueva's environmental strategy; triple bottom line reporting.
 - *Chapter 15* – MDGs 7 and 8 on sustainable development; focus on emerging economies in efforts to set targets for emissions reduction; the production of biofuels; Aid for Trade initiatives which aim for sustainable development.

2. *Give examples of companies' CSR strategies resting on the 'business case' for CSR. How successful would consider their approaches?*
 - *Chapter 13* – BP's CSR strategy; Marks & Spencer's 'look behind the label' campaign; 3M's energy efficiency strategy; Whole Foods Market's philosophy; Wal-Mart's environmental strategy; Huhtamaki's CSR strategy.
 - *Chapter 14* – Royal Dutch Shell's community policies; GrupoNueva; Anglo American; Nike.
 - *Chapter 15* – Product Red; Victoria's Secrets.

A variety of approaches emerges, the success of each depending on delivering both social goals and improved financial performance. Students could be invited

to discuss the relative performance of each of these. Some successes: Grupo Nueva, Whole Foods Market. Nike would also be considered a success on grounds of performance, but some would criticize its CSR. BP and Anglo American have had difficulties. In mining and extraction, high ideals are difficult to follow through in practice.

3. *In what ways are global governance mechanisms impacting on international business? Give examples from the chapters. Looking at the list, which are beneficial, in your view, and which are detrimental to international business?*

- *Chapter 13* – The UN's International Panel on Climate Change, whose reports led to the Kyoto Protocol; UN Environment Programme; The Voluntary Carbon Standard produced by the International Emissions Trading Association – helps to achieve consistency in reporting of emissions; the Marine Stewardship Council (see SX 13.1 on Whole Foods Market), which provides certification of fish; Asian Corporate Governance Association, which monitors environmental reporting by companies.
- *Chapter 14* – Fairtrade Foundation, which certifies fairtrade products; UN Development Programme (Country Focus 14.2 on Myanmar), which monitors human development indicators around the world; International Co-operative Alliance, which lays down principles for co-operatives; OECD (Principles of Corporate Governance, Guidelines for Multinational Enterprises); International Labour Organization (ILO), which sets international labour standards; Human Rights Watch, which monitors human rights around the world; Global Reporting Initiative, which provides guidelines on triple bottom line reporting.
- *Chapter 15* – UN Environment Programme; ILO, WTO, which oversees the multilateral trade framework; Organization for Security and Co-operation (OSCE), which monitors security, democracy and human rights; IMF, which oversees the international monetary system; G8 Summit, bringing together leading economies to design co-ordinated policies on global issues; UN Security Council, which oversees global threats to security; OECD's Anti-Corruption Convention and Financial Action Task Force (aimed to detect money-laundering); credit-rating agencies, such as Moody's, on which businesses and governments rely for financial ratings; World Federation of Exchanges; International Federation of the Phonographic Industry, which attempts to control illegal downloading of copyright material; UN Global Compact, which brings together UN agencies, companies and civil society organizations in the areas of human rights, labour rights, environmental sustainability and anti-corruption.

The second part of this question asks which are beneficial and which are detrimental. Students can be invited to discuss their views. Certainly, many impose constraints, such as the body detecting global money-laundering, but this would probably be viewed as beneficial.

GUIDE TO JOURNAL OF INTERNATIONAL BUSINESS STUDIES MATERIAL

ARTICLE 1

Meyer, K. (2004)

Perspectives on multinational enterprises in emerging economies

Journal of International Business Studies, 35(4): 259-276

<http://www.palgrave-journals.com/jibs/journal/v35/n4/abs/8400084a.html>

Guideline answers

Part A: Grasping key points

- *What positive and negative impacts on host-country industries are highlighted by the article?*

Positive spillovers:

- Local entrepreneurs may be encouraged to imitate FDI initiatives.
- MNEs typically train local employees, who may use the skills to start up their own businesses. Note, however, that local firms need a level of 'absorptive capacity' to recognize and benefit from new knowledge.
- Inter-industry spillovers can be positive, as domestic suppliers can enjoy benefits.
- Supplier relations can be built up in industrial clusters.

Negative spillovers:

- If local firms are far behind in technology (the technology gap), they may be unable to benefit.
- There is a risk that local firms lose market share to foreign competitors, thus inhibiting the growth of local firms.
- There is also the risk that a local firm which develops its own technology and brands will be acquired by the foreign investor, diminishing the gains to the domestically-owned sector.

- *Impacts of MNE operations on the natural environment can be categorized as a 'pollution halo' or 'pollution haven'. Define these terms, and summarize the article's points on existing and future research.*

The 'pollution halo' effect improves environmental standards in the host country, and the 'pollution haven' effect occurs when MNEs transfer outdated or less environmentally-friendly technology to the host country.

MNEs may choose to transfer advanced technology for the benefits gained in global production standards, scale economies and enhanced reputation. Note local community pressure and the role of NGOs in encouraging these positive outcomes. The author notes that using a single indicator as an independent variable in research is 'problematic' for analysing complex impacts. A case-study approach can give a fuller picture.

- *What points does the author make on the relevance of local institutions to FDI?*
Emerging economies, the author notes, often have less developed institutions than developed economies. Local institutions interact with foreign investors, local firms and communities. Local informal institutions may be influenced by the experience of businesses from different cultures in their midst. Similarly, governments may be influenced by FDI considerations, seeking to offer incentives to foreign investors. Note the list of relationships on p. 271: labour markets, capital market institutions, environmental regulation, competition rules, education system and special economic zones (see Chapter 6).

Part B: Building skills in critical thinking

- *In what ways does this article contribute to formulating criteria for assessing the role of MNEs in societies?*

The article

- Looks beyond economic development criteria, to social, institutional and environmental impacts. The latter can be less susceptible to quantitative measures.
 - Urges assessing both positive and negative spillover effects in local economies, to obtain a full picture.
 - Stresses the importance of 'absorptive capacity' in analysing spillover effects.
 - Highlights the role of local entrepreneurs in emerging economies, in relation to MNE activities.
 - Stresses the interdependence of MNEs and local institutions, both formal and informal. This is becoming increasingly relevant as many countries now take a more critical view of foreign investors' impacts (see CF 2.2 on India).
- *How does this article contribute to the debate on the pros and cons of globalization?*
The MNE and FDI have been drivers of globalization. Economic benefits of globalized production have been enjoyed by emerging economies, which have been seen as attractive to foreign investors. International business research has tended to take the MNE perspective, looking at ways of achieving greater

efficiencies, while impacts on host societies have received less attention. The article addresses the range of impacts of MNEs and globalized production on societies.

- *What are the practical implications of the article for international managers?*

Implications for international managers:

- The opportunities for building on positive spillover effects in host countries. This increasingly focuses on R&D and other high-value activities, which benefit both host countries and the MNE.
- The need for building relationships/networks in local operations and communities, including governments, regulatory authorities and NGOs.
- The need for awareness of stakeholder issues, such as labour standards and environment.

ARTICLE 2

Morck, R., Yeung, B., and Zhao, M. (2008)

Perspectives on China's outward foreign investment

Journal of International Business Studies, 39(3): 337-350.

<http://www.palgrave-journals.com/jibs/journal/v39/n3/abs/8400366a.html>

Guideline answers

Part A: Grasping key points

1. *Describe the types of firm which are most likely to pursue outward FDI and their main destinations.*
 - *Types of firm* – Large listed state-owned enterprises (SOEs) are responsible for most Chinese outward FDI. They enjoy officially-sanctioned monopoly status in key industries, such as natural resources and telecommunications.
 - *Destinations of FDI* – The most popular destinations are South and East Asia, especially Hong Kong, and countries offering tax-haven status, such as the Cayman Islands in the Caribbean. Africa is also attracting Chinese FDI. Hong Kong and tax havens offer confidentiality and possible private benefits to SOE insiders. Hong Kong offers trade and financing possibilities for mainland companies in their outward expansion.

2. *Identify the three aspects of the macroeconomic environment highlighted by the authors, which help to explain the nature of Chinese outward FDI, and explain how they impact on FDI.*
 - *High savings rates.* This applies to both personal savings and enterprise savings, whereby firms retain earnings rather than distribute dividends. The accumulation of funds internally provides the means for engaging in FDI projects.
 - *Weak corporate governance.* Many large SOEs are listed companies, but ownership is dominated by non-tradable shares (owned by the state). The state also controls many tradable shares, for example, cross-shareholdings by other SOEs. The state appoints the board, and the firm's Party Committee appoints executives, who report to the Party, rather than shareholders. Although these are listed companies, their corporate structures and high-level decision-making are dominated by state and Communist Party authorities, rather than shareholder concerns. Corporate decision-making in this context is influenced by political concerns, national strategic policies and the perceived need for FDI to be used to foster national prestige abroad.
 - *Distorted capital allocation.* The state-controlled banks are major sources of capital, and SOEs receive the bulk of commercial loans, despite their lack of efficiency compared to private-sector companies. This imbalance tends to encourage wasteful investments, including FDI projects.

3. *Why are China's private-sector firms, despite their economic success, slower than SOEs to invest abroad?*

China's private-sector firms have less access to financing than state-controlled counterparts. These firms are still young, emerging only in the years following the opening of the economy in the 1980s. The most successful enjoy large domestic markets for their products, and have also become successful exporters. Many are manufacturers producing products for western brand owners. They are gradually developing their own brands.

Part B: Building skills in critical thinking

1. *How do the authors argue that internalization theory be modified and applied to Chinese outward FDI? Do you agree with this argument?*

Internalization theory typically envisages a western firm which owns technology, brands or other firm-specific assets, seeking to control the manufacturing of its products. (See section on internalization, Chapter 2.) In the case of China, firm-specific advantages possessed by its outward investors are their experience in dealing with weak institutions, burdensome regulation and political interference. As these characteristics typify many developing countries, Chinese firms may be at an advantage. Asian and African countries targeted by China are examples that can be cited.

2. *In what ways do the authors see a 'role reversal' taking place in the traditional FDI rationale whereby the owner of technology (often from a developed country) invests in manufacturing capacity abroad?*

As products become standardized, manufacturing excellence – including efficiency and quality concerns – become more important than R&D and ownership of technology. In this respect, there can be said to be role reversal which benefits Chinese companies. The commoditization of PCs is an example, indicated by IBM's desire to sell its PC unit.

3. *Is international experience likely to change Chinese companies, and how?*

This depends on the type of firm. SOEs have benefited from abundant funds to pursue FDI, lack of pressures to improve efficiency and the absence of accountability to shareholders. Most investments have been in developing countries with weak institutional and governance frameworks. Investing in developed countries could pose new learning situations, where multiple stakeholders are involved, and greater transparency is needed. For China's private-sector companies, a more market-oriented culture is a benefit, and many are now being lured by investment opportunities closer to large western markets. The example of DVD manufacturing is cited in the article. These companies are becoming attuned to different consumer markets and also differing organizational cultures.

ARTICLE 3

Johnson, J., Lenartowicz, T. and Apud, S. (2006)
Cross-cultural competence in international business:
Toward a definition and a model

Journal of International Business Studies, 37(4): 525-543.

<http://www.palgrave-journals.com/jibs/journal/v37/n4/abs/8400205a.html>

Guideline answers

Part A: Grasping key points

- What are the three antecedents to cross-cultural competence identified by the authors, and how does the authors' definition of cross-cultural competence build on them?*

The three antecedents are: knowledge, including specific, general, tacit; skills, such as language skills; and personal attributes, such as leadership qualities. The authors' definition stresses building on these antecedents to work effectively with people from different cultures. Their stress is on performance rather than on the possession of appropriate knowledge, skills and personal attributes.
- In what ways do institutional ethnocentrism and cultural distance act as negative external moderating factors?*

Institutional ethnocentrism refers to the home-country focus of the organization, which determines the way of doing things both at home and in subsidiaries, wherever the location. The authors highlight US companies as examples. The greater the cultural distance between the home culture and the foreign location, the greater the cultural difference. The authors also stress that other aspects of the foreign country environment, such as economic and political values, are also likely to be very different from home.
- What are the weaknesses of cultural training programmes as highlighted by the authors?*

Cross-cultural training tends to place too much emphasis on culture-specific knowledge, rather than general learning. Tacit knowledge is not as easily tested as factual material, which lends itself to standardized objective tests. The authors refer to the gap between knowing and doing as a challenge in designing training programmes. For cross-cultural competence, performance is key.

Part B: Building skills in critical thinking

- In what ways does the authors' model represent an advance on existing ideas, definitions and conceptual tools?*

The model classifies earlier definitions as representing antecedents of cross-cultural competence, which, though important in helping to identify relevant knowledge and skills, are merely the groundwork on which cross-cultural

competence is built. They seek a model which has more direct practical applications: helping firms to select the people for international assignments; helping to assess strengths and weaknesses in the individual's cross-cultural competence; and helping to appraise expatriate performance.

- *How can the model contribute in practice to reducing the risks of failure in international ventures?*

In the section 'Implications for researchers', the authors discuss how their ideas can be implemented. Many cross-cultural training measures assess skills, knowledge and attitudes, but assessing performance is more challenging. A potential issue is how to define performance or success, as performance should be assessed across several dimensions, both in organizational and social contexts. They suggest that acquisition of tacit knowledge can be tested by the 'triangulation method', using written scenarios and inviting responses: in these situations, there are no 'right' or 'wrong' answers, but cultural intelligence comes into play. A scoring system can be used to assess degrees of cross-cultural competence.

- *The authors highlight poor understanding of the foreign environment (including economic, legal, technological) as causes for failure of international ventures (see Figure 2). Does their model address these issues, or are there deeper educational roots which should also be addressed?*

It could be argued that the article remains focused on the role of cross-cultural training, underestimating the influence of an ethnocentric national culture generally. Transmitted through the education system, national culture is crucial in the early formation of attitudes, values and beliefs. The article highlights 'institutional' ethnocentrism of large companies, particularly American ones, as inhibiting the development of cross-cultural competence by enforcing the company way of doing things. However, this is arguably only one manifestation of ethnocentrism, which is associated with America's national culture generally. An understanding of foreign economic, social and political systems is arguably more a matter of education than training. If the national culture bias is well established in national institutions, it is difficult to design training to compensate for inherent ethnocentrism.

ARTICLE 4

Capelleras, J.-L., Mole, K., Greene, F., and Storey, D. (2008)
Do more heavily regulated economies have poorer performing new ventures? Evidence from Britain and Spain

Journal of International Business Studies, 39(4): 688-704

<http://www.palgrave-journals.com/jibs/journal/v39/n4/abs/8400340a.html>

Guideline answers

Part A: Grasping key points

1. *What points emerge from existing research on the relationship between heavy regulation and entrepreneurial activity?*

Most of the prior research has found that heavy regulation has both discouraged start-ups and hampered their growth. This is the Djankov perspective. High set-up costs and regulatory burdens tend to reduce the potential productive outcomes. Much empirical research on particular countries (such as that on retailers in France) supports this view.

The second perspective, the research by Baumol, distinguished between formal and informal contexts, which differ widely between countries. In heavily regulated economies, entrepreneurs were still likely to emerge, but not be registered officially. Their activities were not as productive of social benefits as those in the formal sector. Separate research (by De Soto) also showed that heavy regulation led potential entrepreneurs to stay away from the 'official' economy, but this reduced their access to capital, and led to weaker growth and fewer spillover effects in the country's economy.

2. *In what ways do the authors' aims and methodology research differ from previous research in the area?*

The authors aim to compare start-up size and subsequent growth in two markedly different economies, Britain and Spain. They point out that a macroeconomic approach has been prevalent. Research in the Djankov vein tends to rely on official data from government-based business registers. Research in the Baumol vein draws on the World Bank ease-of-doing-business rankings and the GEM research (referred to in Chapter 1 of the text). The present research aims to use microeconomic data, acquired through questionnaires of entrepreneurs in both countries, including both those in official statistics and those outside official registers.

3. *In what ways do the results of this research differ from those of previous research?*

On the Djankov view, researchers would have expected to find that registered firms in heavily regulated economies start larger and grow more slowly than in

lightly regulated economies. On the Baumol view, there would be no differences in start-up size and subsequent growth when all new firms, including unregistered ones, are taken into account. Present results showed:

- Registered Spanish firms were larger than registered English counterparts at start-up, but the English firms grew more quickly. When all firms were taken into account, there were no significant differences in size at start-up and growth, reinforcing the Baumol view.
- Three variables showed similar results for Spanish and British firms: firms with prior managerial experience were likely to start larger than those without; firms registered as companies with limited liability were likely to be larger in both countries; and individuals with a business plan were more likely to start bigger businesses in both countries (particularly in Spain).
- Brüderl and Preisdörfer's classification for firm growth since start-up (decliners, statics, slow growers and fast growers) was also applied. English registered firms had faster post-start growth, whereas when all firms were taken into account, there were no differences. For both countries, the largest firms at start-up were decliners. The second largest group was the fast growers, and the third largest, the slow growers. The firms smallest at the start were statics.

Part B: Building skills in critical thinking

1. What methodological challenges were faced by the researchers, and how were they overcome?

The major challenge was conducting surveys in both countries to identify appropriate firms, including both in official statistics and those which were below the threshold for registration. Specific regions of Britain and Spain were selected, on the basis of comparable start-up rates. Researchers constructed databases based on British Telecom directories in Britain, and, in Spain, lists of firms for local tax payments and official new enterprise lists were used. The researchers went through these lists, excluding subsidiaries, not-for-profit firms and those that were not trading.

Devising suitable questionnaires was a further challenge. Although they started with identical questionnaires, they found they had to make changes to accommodate differences between the countries.

2. Assess the selected pre-start variables and at-start variables in terms of the researchers' aims.

Pre-start variables concern characteristics of the individual entrepreneur, and access to resources. They are: age, gender, education, managerial experience, prior employment, external sources of support, whether they had a business plan, and sources of initial capital. At-start variables relate to the firm, including location, legal status and industry sector. These variables can reveal differences in entrepreneurs and their businesses between the two countries. New English firms were likely to be started by older, qualified males, with managerial experience. English firms were more likely to have received support, such as from the public sector, while Spanish firms were more likely to have received bank loans. Data

were analysed for firms registered for VAT (R) and for all firms (A). The results present a richer picture of entrepreneurial activity than previous research, and also a more detailed picture than the authors' initial aims suggested. The results show that the background and skills of the entrepreneur are more relevant than regulatory environment.

3. *What are the political implications for governments and legislators which emerge from this research?*

Despite the fact that businesses in Britain are more lightly regulated than in most other countries, British businesspeople often complain of regulatory burdens (both actual and potential) stifling enterprise. The picture presented here is more complex. Making it easier and cheaper to start up a business and reducing regulation for existing businesses are recognized ways of encouraging entrepreneurship, but the evidence here suggests policymakers are likely to be disappointed if they assume that these measures will automatically lead to an increase in entrepreneurial activity. Many aspects of the business environment, including social networks and access to finance, are influential in starting a business. These may be present in economies that are relatively heavily regulated.

Also influential are characteristics of entrepreneurs themselves, including skills and managerial experience. The implication is that there is a need for a multi-pronged approach by governments, whether in heavily or lightly regulated countries. Investing in education and training, and providing support for entrepreneurs, is likely to be more fruitful than looking narrowly at reducing the amount of regulation. Indeed, government support schemes are themselves a type of enabling regulation which has positive benefits for new businesses.

Entrepreneurs clearly adapt to the regulatory environment in which they operate. In economies which are heavily regulated, the informal route is often preferred. In these countries, reducing regulation could result in more businesses taking the registered route.

ARTICLE 5

Jackson, G. and Deeg, R. (2008)

Comparing capitalisms: Understanding institutional diversity and its implications for international business

Journal of International Business Studies, 39(4): 540-561

<http://www.palgrave-journals.com/jibs/journal/v39/n4/abs/8400375a.html>

Guideline answers

Part A: Grasping key points

- *Describe the main characteristics of the IB approach and the comparative capitalisms approach to institutional diversity.*

The IB approach tends to focus on MNE strategy and see institutions as variables that act as constraints on firms. In particular, this literature highlights transaction costs, differing resource environments, and institutional distance between the home and host country. Each of these is seen as a variable which can be measured from high to low. MNEs can thus 'fit' their strategy to the institutional environment, for example, adapting strategy and structure in the face of large distances between home and host institutions.

- *What are the main approaches within the comparative capitalism literature?*

The comparative capitalisms approach examines how institutions function across several functions, to form a distinct national configuration or national 'case'. It stresses that firms and other economic actors are socially embedded, interacting with institutions to produce diverse patterns of coordination and governance in differing countries.

The comparative capitalisms literature has several strands: (a) types or varieties of capitalism; (b) national business systems; and (c) governance approach. All share certain basic elements: the view of institutions as means of non-market forms of coordination; the view of institutional configurations as national cases; a theory of comparative institutional advantage for different types of economic activity; and a notion of institutional path dependence.

- *How do liberal market economies differ from coordinated market economies in their implications for MNE strategy?*

In liberal market economies (such as the US and UK), the market is the main coordinator of economic behaviour, and the state 'remains an arm's length enforcer of contracts' (p. 546). The role of the market is evident across 4 domains: short-term orientation of corporate finance; deregulated (that is, relatively open) labour markets; general education; strong inter-firm competition. An institutional advantage is radical forms of innovation.

In the coordinated market economy (such as Germany and Sweden), non-market mechanisms play an important coordinating role. In the 4 domains, we see: long-term finance; co-operative industrial relations; high levels of vocational and firm-specific training; and co-operation in technology development. This institutional structure promotes incremental forms of innovation.

MNE strategies can exploit institutional strengths in specific countries. Whereas the IB literature tends to emphasize degrees of difference between home and host countries, this approach sees a variety of home and host country interactions that can help to shape strategy. Institutional complementarities may enhance competitive advantage. An example cited (p. 553) is that strong employment protection, which is usually perceived as raising costs for business, could have different impacts on HR strategies in the context of a country's complementary institutions. A country which invests in industry-specific skills through government training programmes benefits firms in providing skilled labour and enhancing competitiveness. In a country without such programmes, high employment protection can lead to widespread use of casual labour and declining competitiveness.

Part B: Building skills in critical thinking

- *On what grounds do the authors criticize the view of institutions in IB literature? (p. 545)*

Four criticisms are presented:

- 1) The IB approach to institutions is 'thin', that is, viewing institutions simply as constraining strategic choice. Firms are viewed as unitary, self-interested actors. Interactions with a range of stakeholders are thus under-emphasized, despite their impacts on strategy formation.
- 2) The approach based on indicators and variables sees institutions in isolation, neglecting interactions between diverse institutions.
- 3) The approach adopts a narrow notion of 'fit' between firm strategy and institutional environment.
- 4) The IB literature pays little attention to theory or change in institutions, an understanding of which would aid in strategy formation.

- *How can the comparative capitalisms approach overcome the weaknesses referred to in the previous question?*

The comparative capitalisms literature provides frameworks for understanding national systems as complex configurations of institutions. Institutional interdependence and coordination are taken into account. A more fine grained explanation of different systems is therefore possible. Note Whitley's systematic approach to national business systems. His eight comparative dimensions cover ownership and internal relationships of the firm; production chains and external relationships, including alliances with other firms. Internal firm relations are thus linked with national institutional environments. This approach relies on a notion of path dependency, and may tend to underestimate how institutions change over time. Hence, the last of the weaknesses is possibly shared by the two approaches.

- *The authors urge that a more flexible view of how institutions influence MNE strategies can help in understanding the world's emerging and transition economies. Do you agree and why?*

The authors suggest that understanding new types of capitalist economy which are emerging is one of the current challenges. Specifically, transition economies, such as China and economies in Central and Eastern Europe, have grown in an era of MNE expansion, and their institutions have been influenced by the presence of MNEs, impliedly *foreign* MNEs. Understanding institutional change has thus risen on the agenda for both IB and comparative capitalism scholars. The latter are perhaps better placed to assess institutional diversity in these countries, where new capitalist forms are mingling with national institutions shaped in earlier eras. IB scholars' emphasis on firm-level IB strategy, as in globalized production chains, reminds us of the importance of location-specific advantages. However, a weakness has been a tendency to see capitalist market institutions as evolving in similar ways everywhere. Certainly the formal systems may look similar in emerging markets (stock exchanges are an example), but their institutional context differs considerably from western models. The comparative capitalisms approach offers conceptual tools to analyse these developments.

ARTICLE 6

Buckley, P. and Ghauri, P. (2004)

Globalisation, economic geography and the strategy of multinational enterprises*Journal of International Business Studies*, 35(2): 81-98<http://www.palgrave-journals.com/jibs/journal/v35/n2/abs/8400076a.html>**Guideline answers****Part A: Grasping key points**

1. *In what ways are there clashes between globalizing markets and national policies?*

The authors look at three levels of markets: financial markets, markets in goods and services, and labour markets. These become globally integrated at differing rates, and national factors, such as protectionist policies, remain influential.

- Financial globalization has moved quickly. Although national markets have lost some autonomy, there have been huge economic benefits in the opening of national financial markets.
- Markets for goods and services experience both global and local characteristics. In consumption, local factors remain important.
- Labour markets, however, function separately at national level. Large MNEs are in a position to exploit differences between countries in all levels of markets. Domestic markets still determine prices and wages.

The authors cite research which shows policy barriers, differing local cultures and geography contribute to differences. They state that the contrasting paradigms of self-contained national economies and a borderless world are both flawed. MNEs are faced with complex situations, in which both global and local factors remain important. Regional integration is another factor which affects national autonomy.

2. *What are the main points the authors make about the impact of globalization on MNE strategies?*

They highlight location and ownership strategies. Their main points are:

- The vertically integrated company proved costly and inflexible. As globalization progressed, firms saw the benefits of subcontracting production, which allowed for greater flexibility.
- Networks represent challenges to the traditional company. The growth of networks and clusters allowed for flexible management. Networks have even become 'virtual'.
- The use of the joint venture has combined the benefits of the network with the retention of some proprietary control over new technologies.
- Modern sourcing strategies depend on both location factors and knowledge management.

- Outsourcing is a major development linked with globalization. Contract manufacturers have become supply chain managers themselves, gaining specialist expertise.
- Mass customization reconciles scale and differentiation, and is associated with lean retailing.
- The global factory – These are the flexible factories of the future, which are able to shift to different products in the firm's portfolio. They can be located near to the customer, able to respond to consumer demand. This is the antithesis of the large-scale plant with high fixed costs. The brand owner can control design, engineering and marketing, while the production is outsourced.

3. *What has been the contribution of economic geography to the analysis of globalization?*

Economic geography has long pointed out the links between physical geography and economic development. The authors highlight climate, coastline, river transport, soil quality and terrain, all which impact on economic activities. These factors influence MNE strategy, and geographical models can aid MNEs in their strategy formulation. The authors point to Michael Porter, who stressed a strong spatial element in competitive advantage. Clusters or industrial districts are examples. Foreign MNEs are able to tap into these clusters, and theories of innovation rely on both national systems of innovation and clusters of innovation.

Part B: Building skills in critical thinking

- *To what extent are flexibility and volatility important considerations in market entry strategies?*
These two concepts are linked. Flexibility implies the ability to respond quickly to changing markets, and volatility refers to changes taking place rapidly, which are difficult to anticipate. The authors point to the 'hub and spoke' model for reconciling global and local factors. A regional hub can offer flexibility. It is relatively near to each separate market, which is advantageous in terms of transport costs and information gathering. At the same time, because it serves several markets, it is not exclusively dedicated to any single one of them. If one suffers a setback, the company can shift to another. This is assuming the setback in the national market is free-standing. The authors go on to point out that this strategy can be successfully implemented via a joint venture. This allows flexibility, in that a company can expand in tandem with the joint venture partner, or withdraw from the market by selling out to the partner.

Flexibility and volatility are considerations in expansion strategy, and also in a low-growth environment. If production is subcontracted and demand falls, the MNE is better placed than would be the case where it owns production facilities itself. These considerations are relevant in the current environment, although the authors would not have anticipated that falling demand would affect all markets, as happened in 2008-9.

- *What developments are leading to the global division of labour?*

The globalization of production by MNEs has combined with changing ownership policies. The authors highlight three approaches:

- *The new international division of labour* – The MNE breaks down the production process into segments, each of which can be carried out in the most favourable location. A result is that higher value activities are carried out in the advanced countries, and lower value activities in less developed countries.
- *Global commodity chains* – These are production networks which are typically driven by large buyers or large producers.
- *Regional networks* – Regional integration is associated with regional production networks, as in Asia.

As MNEs become more adept at dividing their activities among differing locations, the spatial division of labour becomes more complex.

- *What are the challenges to market capitalism highlighted by the authors? Are they being addressed in today's global economy?*

A list of complaints against globalization appears on p. 92. These complaints were raised at the turbulent WTO meeting in Seattle in 1999. Although dating from some years ago, this list raises central issues which continue to challenge policy makers. Many of these issues represent challenges to capitalism itself, as the authors point out. These include job insecurity (which can arise from the changing geography of production and also from technological changes) and income inequalities. The authors stress that low-wage workers in developing countries have benefited greatly from capitalism. However, they also point out problems linked to negative externalities such as environmental damage. They express concern that underlying capitalism is 'selfish profit-seeking behaviour' (p. 93), an issue which has recently captured much public attention in an environment of economic downturn. Statutory regulation operates at national level, but at international level, there would need to be considerable inter-governmental co-operation, which can cause tension among sovereign states. MNEs have become adept at seeking advantageous locations for financial arrangements as well as production, and onerous national regulation in an MNE's home country can be bypassed, as the book has highlighted. The authors point out that relying on individuals' sense of self-regulation is perhaps unrealistic, as the 'moral infrastructure' must exist. This is unlikely in the low-trust culture in which capitalism thrives.

In today's world, ethical issues have risen up the agenda. Excessive executive pay, currently attracting extensive media attention, is an example. Other issues mentioned by the authors are unethical marketing practices (p. 94). These issues are being addressed, albeit in piecemeal ways. Government policy makers are currently looking at greater regulation of corporate finance, including excessive executive pay. However, they have in the past been reluctant to legislate in this area, due largely to the prevailing capitalist view that governments should keep intervention in markets to a minimum. Market capitalism is now under the

spotlight, and we would probably agree with the authors that moral weakness, as much as regulatory shortcomings, are issues to be addressed. They do not suggest that CSR could provide the ethical and legal framework to deal with these issues, but this would surely be arguable.

ARTICLE 7

Chen, S. (2005)

Extending internalization theory: a new perspective on international technology transfer and its generalization*Journal of International Business Studies*, 36(2): 231-245<http://www.palgrave-journals.com/jibs/journal/v36/n2/abs/8400124a.html>**Guideline answers****Part A: Grasping key points**

- *What is the difference between 'arm's length' and 'contractual' co-marketing? In what situations are they appropriate?*

The technology owner and the (indigenous) product manufacturer can each market to end consumers, emphasizing the benefits which they contribute. The author uses the example of DuPont, which makes non-stick coatings, and Tefal, which manufactures pans coated in DuPont's Teflon coatings. The two companies can organize their marketing separately, in arm's length co-marketing. In this case, DuPont transfers its coating technology to Tefal for a market price, and Tefal sets its prices according to what customers are willing to pay. Each operates separately: there are no licensing contracts governing the developer-manufacturer relationship. Arm's length co-marketing depends on the ability of the end consumers to assess the value of each of the complementary assets separately. In many cases, however, this is not possible. This situation may give rise to 'positive performance inseparability', in which the consumer does not know whether it is the superior coating or the excellent production process of the pans which is responsible for good performance. Similarly, in 'negative performance inseparability', where the end product fails, consumers do not know who to blame – the coating or the pan. Therefore, the final products market alone will not give the separate parties incentives to improve the value of the co-marketed product. In these situations, contractual co-marketing is a solution.

Contractual co-marketing involves contractual restraints to control the behaviour of each partner. DuPont can specify the essential manufacturing procedures, and Tefal can specify the quality standards of the non-stick coating. When these terms are breached, the other party can be compelled to reimburse the party responsible for the failure. This arrangement is based on the fact that there is an intermediate input market, as there is a market for the technology and a market for the manufacture.

- *In what circumstances is licensing advantageous?*

Note the weaknesses of licensing, described from the bottom of the second column on p. 233. It is difficult for MNEs to price their technology; the transfer

of tacit knowledge is problematic, and there is a risk that the indigenous firm might leak the technology, especially in an environment of weak IP rights enforcement. Licensing is discussed on p. 236. MNEs sell the right to exploit their technology to indigenous firms, which use the technology to manufacture products. The final product and the price represent the efforts of the two partners. In this case, DuPont would take full responsibility for the quality of the technology, but the marketing of the product (which is the technology-cum-manufacture bundle) lies with the indigenous manufacturer.

Licensing can solve the quality-cheating problem identified in negative performance inseparability. Tefal, which bears full responsibility for the marketing, will be motivated to maintain the quality of coating procedures. DuPont, which is anonymous in the final products market, need not worry that Tefal might shirk, as Tefal will be motivated to invest in improved processes, to garner the full reputational value. The author notes, however, the risks highlighted above. Licensing is the optimal solution where the market for technology is efficient, and the market for manufacture is inefficient.

- *What are the benefits of OEM to the MNE and to the indigenous firm?*

This arrangement relies on the fact that there are two markets which MNEs and indigenous firms can use. The MNE can contract with an indigenous firm to have a product manufactured, which is based on the MNE's technology and for which the MNE accepts the full marketing role. The MNE is able to enter new markets, building brand recognition, while the manufacturing arrangements are in the hands of the local firm. There are cost advantages for the MNE, especially if manufacturing takes place in a low-cost country. This is the basis of OEM. Traditionally, MNEs use licensing to serve the host economy, and OEM to outsource production of products for its home market. However, from a conceptual perspective, these arrangements could be the other way around. In OEM, which is a mirror image of licensing, the local manufacturer is anonymous in the final products market. The full marketing right rests with the MNE, which is motivated to control the quality and enhance the product's performance. The MNE also has strong incentives to improve its technology. A disadvantage, however, is that the indigenous firm may lack incentives to improve its production processes, as it sees to benefit in the final products market.

A benefit of OEM for indigenous firms is the availability of design and technology of the MNE, often for free. The MNE must be careful to impose terms which restrain these firms from misusing the technology. In cost terms, OEM represents the situation where the cost of using the market for manufacture is low (the market is efficient), but the market for technology is high. For the indigenous firm, OEM offers a route to expand into international markets, and to build technological capacity, often in industrializing countries. A benefit stressed by the author is that OEM allows both the MNE and the indigenous firm to avoid the high costs of using the market for technology. It also allows the MNE to avoid the high costs of FDI. The author notes the prevalence of OEM in

consumer goods industries, such as clothing, and the prevalence of licensing in medicines.

Part B: Building skills in critical thinking

4. *What are the limitations in internalization theory as perceived by the author, and how does this new model overcome them?*

Internalization theory focuses on the relative efficiency of hierarchy in contrast to external markets. The author addresses the investment *vs* licensing trade-off as the cornerstone of internalization theory. The limitations of this focus are:

- It overlooks the use of market institutions in situations where technologies developed in one country can be more efficiently exploited in another.
- It takes a unilateral perspective, assuming that the MNE either licenses its technology to the local product manufacturer or invests in production (which internalizes the exploitation of the technology, as through wholly-owned subsidiaries). This overlooks the fact that the final product consists of two elements: the technology development and the manufacturing.
- It assumes a one-dimensional continuum which concentrates on the efficiency of the technology market.

This new model:

- Extends internalization theory to two dimensions, bringing in the efficiency of the manufacturing market. It thus looks at the relative efficiency of two markets, technology and manufacturing.
- Opens up an analysis of the relative costs and benefits of alternative manufacturing arrangements.
- Offers five structures which can govern international technology transfer (shown in Figure 2).

5. *What is the significance of the three implications for transaction cost economics research highlighted by the author?*

These implications are on p. 243. The three implications:

- 1) Co-marketing can apply to separately identifiable elements. Inter-firm co-operation can apply through arm's length market transactions.
- 2) Arm's length co-marketing will fail where there is performance inseparability.
- 3) The two specialists can agree who should market their joint output. This economizes on the cost of business-to-business transactions. The author recommends that the party best suited to serve the final products market should take on this task, buying out the value created by the other party.

The significance of these implications is in extending internationalization theory beyond the licensing *vs* investment trade-off. The new theory offers a transaction cost explanation for OEM.

6. *How does this analysis aid management decision-making for an MNE which owns technology?*

This analysis clarifies the roles of the two partners in cross-border technology transfer and manufacturing. It enables them to reach a satisfactory governance

structure, taking into account the technology market and the manufacturing market, to agree on a division of labour between them. The MNE gains from OEM, as a solution to rising production costs at home, but there are risks that the local manufacturer may one day become technologically strong enough to constitute a formidable competitor. For the local manufacturer with an OEM business, the situation can be somewhat frustrating. The firm relies on the MNE for the technology, and licensing deals may be too costly to contemplate in practice. Still, these companies do successfully make the transition to become forces in their own right, although conflicts with the MNE are likely along the way.

ARTICLE 8

Mathews, J. and Zander, I. (2007)
The international entrepreneurial dynamics of accelerated internationalisation

Journal of International Business Studies, 38 (3): 387-403

<http://www.palgrave-journals.com/jibs/journal/v38/n3/abs/8400271a.html>

Guideline answers

Part A: Grasping key points

- *What are the new types of MNEs which the authors discuss, and what are their key characteristics?*

The authors refer to a 'new species of MNEs' (p. 390). Born globals and international new ventures are highlighted. Many SMEs from advanced economies embark on accelerated internationalization from the outset. The authors also refer to 'latecomer MNEs', which originate from later developing economies, such as the Asian tiger economies. Many of these companies have rapidly become global, shaking up established MNEs in a number of markets.

The characteristics of these firms include:

- Accelerated internationalization
 - Greater geographical mobility than established MNEs
 - Willingness to seize new opportunities anywhere in the global economy
 - Ability to harness internationally dispersed knowledge and resources
- *How does the IED framework explain the creation and development of these new entrepreneurial firms?*

The IED framework focuses on the very early stages of entrepreneurial initiatives, when individuals are exploring business opportunities. These activities will begin before they have formed a company as a legal entity, and can involve forays into diverse geographical locations, examining opportunities and potential resources. The theory distinguishes three aspects (or milestones) of this wide-ranging process: the discovery of opportunities, deployment of resources and engagement with international competitors. The authors argue that, while internationalization theory has tended to focus on 'push' factors which drive the firm to pursue competitive advantage in outward expansion, this new theory focuses on 'pull' factors. New possible resources and opportunities attract these widely travelled entrepreneurs, who are likely to pursue networking strategies to gain competitive advantage. These firms can thus become quickly integrated into the global economy.

- *What are the three organizing principles of the internationalization process highlighted by the authors?*

The three organizing principles:

- 1) *Discovery of opportunities* – This covers innovation in a broad sense. The individual entrepreneur can match a variety of resources to differing customer needs. The firm can also take existing business concepts and apply them in new contexts. The authors refer to a disequilibrium setting, in which the entrepreneur is able to shake up existing markets, spotting new opportunities unseen by others. The international context is crucial in this theory: the fact that the entrepreneur is widely travelled and acquainted with different locations means that he/she can bring together geographically dispersed skills, knowledge and resources.
- 2) *Resource deployment* – This refers to the actions taken to pursue the opportunity which the entrepreneur has identified. The geographical movements, network contacts and business contacts will influence the type of organization formed and its strategy. Both internal and external resources and activities are involved. In this respect, the new firm diverges from the established MNE in that the new firm will seek to use international co-operative agreements more, including partnerships, alliances and joint ventures, to tap into resource capabilities of others.
- 3) *Engagement with international competitors* – Competitive interaction differs according to the specific ways in which firms perceive and develop their potential, in terms of skills and resources.

Part B: Building skills in critical thinking

1. *In what ways does the IED framework differ from the OLI paradigm, and to what extent is it an improvement?*

The OLI or eclectic paradigm, devised by Dunning, has been highly influential since the 1970s. It stresses ownership, location and internalization advantages of the MNE. Mathews and Zander argue that the OLI paradigm focuses on the large company, already well established in its home country, which has acquired ownership advantages in that context. It does not consider the new firm early in its development process. This latter type of firm seeks to build its competitive position internationally from the beginning, and may have little in the way of ownership advantages linked to a strong position in its home market. It is likely to build its competitive position through the use of networks and collaborative agreements. The network approach is captured in the new theory, and contrasts with the traditional view of ownership and location in the OLI paradigm. As for the third element, internalization, the authors argue that this is rather a static approach, with origins in transaction cost economics. Comparing relative transaction costs is only one consideration for the firm, and the new MNEs have multiple motivations and pathways, as well as various sources of competitive advantage.

The ability of firms to derive competitive advantage from building international networks rather than from exploiting internalized resources is a distinguishing feature of the IED theory. This could be said to be an improvement on the OLI paradigm, and to accommodate the emergence of the new born-global MNEs.

2. *How can the IED theory aid our understanding of internationalization in the new and uncertain environments of today's world?*

The discovery of new ideas and opportunities takes place in a global environment which has become highly diverse, and in which knowledge is highly dispersed. As new ideas can emerge from anywhere, there is underlying uncertainty as to what innovations will emerge, and from where. Entrepreneurial discovery has thus become internationalized, and the authors stress the fact that the new entrepreneurial firms are able to bring together resources and knowledge from a variety of international sources to develop their strategies. Business opportunities emerge in a setting of disequilibrium, where some individuals are able to see opportunities where others do not. For new and established MNEs alike, strategy must be formulated in a context of uncertainty.

The theory is presented as an aid to strategizing in an uncertain environment. It illuminates the role of networks, the processes of recognizing opportunities and differing pathways in the deployment of resources. It also addresses the new competitive landscape, in which competitive interaction takes place among a wide variety of organizational forms. The issue of the boundaries of the MNE, which is also highlighted, is discussed in the context of dynamic processes.

3. *As new firms grow older and become established, will this theory cease to apply to them? What are the implications for MNEs and internationalization theory in general?*

The authors state (p. 393) that the IED framework is less relevant in mature industry conditions. They thus seem to see their theory as relevant only to early-stage entrepreneurial processes, although they suggest that entrepreneurship and adaptation are relevant to *all* firms (p. 393). We might suggest that their claims about its relevance are rather understated. It is arguable that the IED framework, while directly applicable to new MNEs, does contribute to internationalization theory in relation to all MNEs. Global competitive pressures are now likely to be driven by the types of firm which the authors cite in their examples, such as Acer. This article was published in 2007, and we could probably now add Lenovo and Asus (founded by engineers who had worked for Acer) as further examples. Established MNEs must now respond, and are finding these new companies formidable competitors.

It could be concluded that the IED framework marks a shift in internationalization theory from the concepts and assumptions associated with the OLI paradigm to a more strategic approach. The authors point out the opportunities for further theoretical contributions and empirical research in entrepreneurial dynamics with an international dimension.

ARTICLE 9

Elango, B. and Pattnaik, C. (2007)
Building capabilities for international operations through networks: a study of Indian firms

Journal of International Business Studies, 38(4): 541-555

<http://www.palgrave-journals.com/jibs/journal/v38/n4/abs/8400280a.html>

Guideline answers

Part A: Grasping key points

- *Explain the Uppsala model of internationalization used in this research, and why the authors chose it.*

The Uppsala model holds that the firm internationalizes gradually, increasing its international involvement as it gains knowledge and experience in foreign markets. The current authors stress two core aspects: the development of knowledge of international operations and the increasing inclination of firms to undertake these operations. Relevant knowledge consists of objective knowledge and also experiential knowledge.

The authors chose this model for the following reasons: It applies to any size of firm and to firms which are in the early stages of internationalization. Most emerging market firms are smaller than the large MNEs from developed countries. They lack experience internationally and are in the early stages of international expansion. These firms often lack the resources and technologies of established firms in developed countries.

- *In what ways does the parental network aid in internationalization for Indian firms?*

These firms use the resources, knowledge and experience of parental networks to help them build capabilities to operate in foreign markets. Internationalization knowledge will exist among the various members of the network, and can be acquired by other firms linked in the network. The networking approach thus blends with the Uppsala approach, in that learning through network contacts is part of the process of gaining in internationalization knowledge. In India, as in other emerging markets, the business group performs key functions for member firms, in resource sharing, information sharing and relational ties through which experience can be shared. The network can also provide the contacts which firms need to facilitate market entry and operations. Note the summary on p. 546, which highlights reductions in search costs, transaction costs, contracting costs, etc. These benefits can help to make up for the institutional weaknesses typical in developing countries, in relation to markets, regulation and the legal environment.

- *Why do firms from emerging markets choose a cost-based strategy?*
Firms from emerging economies typically lack the competitive advantages of leading technology and product differentiation. Partly this is due to the environment in their home countries, in which policies of market protection and limited incentives to develop new technologies for the domestic market were key features. The firms which are the focus of this research are manufacturing firms. They tend to focus on low-cost products, and therefore are more likely to succeed using a cost-based strategy when embarking on internationalization. Liberalization in the firms' home countries has introduced greater market competition from foreign entrants, especially developed-country MNEs. Many domestic manufacturers now seek market opportunities abroad, in which cost-based advantages are critical.

Part B: Building skills in critical thinking

- *In what ways does the Indian environmental context make it suitable for generalizing about other emerging markets, and in which ways is it distinctive?*

The authors see two distinct phases in Indian economic history. The post-independence phase lasted from 1947 to 1991. This period was characterized by a rather statist approach to modernization and industrialization. Self-sufficiency was promoted through state-guided development, in which state-owned companies were the drivers. Protectionism and subsidies benefited local firms, and small firms were able to benefit. Foreign firms were restricted in the sectors they could operate in. A result was that local firms faced limited competition, having a large captive market for their products. They were not incentivized to develop new products and technologies. The liberalization phase, from 1991 onwards, has opened up the country, reducing restrictions on foreign firms. The emphasis shifted from import substitution to export-led growth.

In these respects, India is similar to other emerging markets. However, India is distinctive in some respects:

- For much of the liberalization phase, India's policymakers have seen software and outsourcing as the drivers of growth, rather than manufacturing. Manufacturing has been a focus only in the last several years.
- India has developed technological expertise in various areas, such as pharmaceuticals and engineering. Its firms aspire to competitive advantage based on competencies, not simply on lower costs.
- India's institutional environment has been distinctive. It has had a democratic government, civil society institutions and a developed legal system since independence, unlike many developing countries which have had more authoritarian legacies (such as Asian and Eastern European countries).

- *Explain which hypotheses were confirmed by the research, and which were not.*

Key findings were as follows:

- *Hypothesis 1* was confirmed, in that marketing and research intensity were found to have insignificant bearing on these firms' internationalization.
 - *Hypotheses 2a* and *2b* were upheld, confirming the importance of cost-based advantages.
 - *Hypothesis 3*, suggesting the importance of international experience of the parental network, was confirmed.
 - *Hypothesis 4* suggested a positive relationship between network scope and internationalization. In fact, a negative relationship was found. Further analysis showed partial support for Hypothesis 4 if group size is taken into account: network scope has a positive effect for small and mid-sized groups, and a negative effect for large groups.
 - *Hypothesis 5*, on the positive effects of foreign partner ties, was confirmed in that foreign partners were found to be important to firms lacking market power.
- *What are the implications of the research for managers from emerging markets?*

These are summarized on p. 552, and students can be expected to expand on these with further comment. The four main implications:

- These firms' lack of R&D and marketing resources affects their approaches to internationalization, but does not create as much of a handicap as previous internationalization research might suggest. For these firms, the authors feel that incremental internationalization is the key strategy. Entering other emerging markets in the early stages is an opportunity for learning, although the focus would be on lower-cost sectors. Based on this experience, firms could move on to more developed markets.
- Firms from emerging markets need to integrate their own resources with those of business groups to which they belong. This will help to reduce the liability of foreignness.
- For firms lacking the support of a network group, they can seek foreign partners with requisite resources. The foreign partner can help them tap into new markets.
- Managers in large groups do not necessarily benefit from the network scope of the group in their own internationalization. These managers are advised to adapt their organizational structures to expand internationally. This seems a rather vague recommendation, which can be explored in further discussion. As smaller groups are better for increasing foreign exposure, the firm might seek foreign partners or choose to enter markets where the size of the group will bring positive benefits.

ARTICLE 10

Kolk, A., and Pinkse, J. (2008)

A perspective on multinational enterprises and climate change: Learning from “an inconvenient truth”*Journal of International Business Studies*, 39(8): 1359-1378<http://www.palgrave-journals.com/jibs/journal/v39/n8/abs/jibs200861a.html>

Guideline answers

Part A: Grasping key points

- *What are the alternative patterns highlighted in the framework on the nature and development of climate change induced FSAs?*

The authors cite the terms used by Lavie (2006), in respect of capability reconfiguration mechanisms. These are evolution, transformation and substitution.

In the case of capability evolution, existing FSAs are retained, and the firm builds on them and modifies them. The second mechanism is capability transformation, in which existing FSAs are not discarded, but changes are made as new knowledge and skills are acquired. This is a more forward-looking approach. The MNE might, for example, embark on new R&D activities that could lead to alterations in the production process. The third mechanism is capability substitution. In this scenario, competence-destroying technological changes make the firm's FSAs worthless. It must acquire a whole new set of FSAs.

The framework presented in Figure 1 looks at FSAs in different stages of the value chain. The impacts on upstream and downstream activities are quite different. The MNE might focus on developing FSAs in its upstream activities if climate change is impacting on its production processes. Changes in downstream activities which would affect it arise from customers, for example, green marketing. Each cell in Figure 1 represents a different type of development. Cell 1 represents minimal change: FSA evolution impacting on downstream activities. The launch of a fuel cell for motor manufacturers would be positioned in Cell 4: upstream and transformational.

- *What are the main factors which determine climate change CSAs?*

Government, geographical, societal and market factors are involved. The MNE is strongly affected in its home country, which might influence it to pursue climate-induced FSAs, but it is also affected by the CSAs in the countries in which it operates. The authors refer to the MNE as needing to ‘optimize their FSA-CSA configurations’ (p. 1368).

Some of the CSAs generally highlighted:

- Availability of natural resources

- Access to markets for products and services
- Costs of labour, capital and land
- Technological assets

Other CSAs directly relevant to climate change:

- Government policy and regulation – This differs from country to country. The EU has taken a lead in regulation, supporting the Kyoto Protocol, whereas the US has not. The election of a new president in 2008 in the US, however, is expected to lead the way for new policies focused on climate change.
- Subsidies to stimulate new investment.
- Consumer awareness of climate change.
- An emissions trading scheme.

It should be noted that, as climate change is a global issue, the MNE might perceive that global strategies are appropriate, stemming from the MNE's headquarters. On the other hand, the authors note that climate change policies are quite fragmented. If a climate change issue is specific to a single country, the MNE is unlikely to respond unless it can transfer any FSAs to other locations.

- *In what respects does the oil and gas industry provide examples of climate-induced changes in FSAs?*

Oil and gas industry MNEs fall in Cells 5 and 6. They will have to totally change their FSAs in both upstream and downstream activities. The new technologies are not yet clear. All the major companies are investing in renewable energy sources. These resources are very different from their existing businesses. Although oil companies are investing in wind power, the main FSAs are in companies such as GE, which produce wind turbines. In downstream activities, renewable energy emphasizes decentralized distribution, while the key FSA of the oil industry is in centralized energy distribution. The authors find that most oil companies see renewable technologies as marginal for them. However, transition technologies are attracting interest from these companies. These fall in the category of competence-enhancing technologies, representing an evolutionary path. Transition technologies can build on the production of natural gas (which is clean burning). Companies (such as BHP Billiton) which are large coal producers are investing in clean coal technology. Statoil and BP have invested in carbon capture and storage co-operatively, thus spreading the risk.

Part B: Building skills in critical thinking

1. *In what circumstances and why will firms develop climate-induced FSAs?*

Firms gain competitive advantage through FSAs. The authors assume that firms develop FSAs (and modify or abandon them) on business grounds. The business context is constantly changing, and firms change their FSAs accordingly.

However, firms differ in the extent to which they are willing to go in tackling climate change, and the extent to which they perceive this will bring competitive advantage.

Some points which emerge in the article:

- Regulation by governments can render a firm's FSAs obsolete, implying that they must change. Regulation, however, is mainly on a country basis (or regional basis, such as the EU), and a firm which has invested in old technology can shift to a country in which it is still relevant.
- Climate change offers opportunities for innovation. However, investment in R&D is costly, and the results may not lead to commercially exploitable products or services which yield competitive advantages.
- If MNEs can adapt and develop both upstream and downstream FSAs, this will lead to competitive advantage which is likely to be sustainable, as competitors will have difficulty imitating them.
- MNEs need market signals to change their FSAs towards climate-induced FSAs. Most efforts are still evolutionary. Many focus on downstream activities, such as green marketing.
- Bolder steps towards upstream transformation carry greater risks, as shown in the car industry, where MNEs want to maintain flexibility in their FSAs, rather than commit totally to new technology. There are uncertainties about the viability of new technologies as well as regulatory changes.

2. *Why are radical, competence-destroying FSAs limited to only a few industries and only over the long term, although climate change is an urgent issue?*

Climate change as a source of competitive advantage is most likely in firms directly affected by climate, that is, in which climate change affects their main source of profits. In only a few industries is radical FSA reconfiguration likely. The oil and gas and automotive industries are examples, but even here, change will come only slowly. This is partly because of lack of consensus on what new technologies will win out. The firms in these industries are investing in transition technologies, which rest on their existing FSAs.

Apart from firms which make specialized products that help to mitigate climate change or meet public policy needs, for most firms climate change is not directly a source of profits.

3. *In your view, would a CSR strategy help to reconfigure FSAs to promote more urgent responses to climate change?*

Climate change is a global issue with environmental, ethical, legal and stakeholder dimensions. Most MNEs (including the ones cited in this article) state that climate change responses are part of their CSR strategy. The authors, however, do not mention CSR, even as a consideration which they could then give reasons for rejecting. Furthermore, CSR is the first research/teaching/publication interest of the first-named author. In the absence of a CSR strategy, the two frameworks presented here are rather reactive in strategic perspective on climate change, and focus almost entirely on economic considerations. The authors state that the two frameworks are aimed at aiding firms in 'exercising *leadership* [my emphasis] that

reckons with strategic and societal concerns' (p. 1374). However, a recurring theme is MNE unwillingness to commit resources to changes in an environment of regulatory uncertainty in the future. A CSR strategy would arguably supply such incentives and encourage leadership.