1. Globalization

Globalization is a trend toward greater economic, cultural, political, and technological interdependence among national institutions and economies. It is a trend characterized by denationalization, in which national boundaries are becoming less relevant. It is also a process of increasing integration and connections among individuals, NGOs, businesses, and governments.

The forces driving globalization are:
1. Falling barriers to trade and investment
2. Changes in communication, information, and transportation technologies.

Globalization can be measured by looking at:
1. Political engagement—membership in international organizations such as WTO, UN, Regional Trade Associations, etc.
2. Technological connectivity—Internet users, etc.
3. Personal contact—international travel and tourism, etc.
4. Economic Integration—trade, foreign direct investment, etc.

The globalization debate focuses on the impact of globalization on:
1. Jobs, wages, and working conditions
2. The environment
3. National sovereignty
4. Local cultures

2. Differences in Culture and Impact on Business

Culture is a set of values (abstract ideals about right and wrong), norms (social guidelines that prescribe appropriate behavior in particular situations), beliefs, rules, rituals, traditions, art, morals, law, customs and other elements held by a specific group of people.

The two key dimensions of difference in social the structure of a culture are:
1. Individual-group dimension: Societies can emphasize either individual achievement, or group achievement.
2. **Stratification dimension:** Depending on the way social classes are determined, societies may have a high degree of stratification with low social mobility or a low degree of stratification with high social mobility.

*Cultural Diffusion* is the process by which cultural change occurs when a people integrate into their culture the elements and concepts of another culture. The pace of cultural diffusion has increased through globalization and technology.

Cultures affect business practices in terms of management styles, work scheduling, reward systems, language, religious norms and ethical values. Adapting to local cultures is the key for success in international business. This *Cross-Cultural Literacy* can best be achieved by:

1. Employing host-country nationals.
2. Building a cadre of cosmopolitan executives.
3. Guarding against the dangers of ethnocentric behavior.

Hofstede’s method of identifying differences among cultures is based on the following 4 primary dimensions:

1. Power distance
2. Individualism versus collectivism
3. Uncertainty avoidance
4. Masculinity versus femininity

3. **International Trade Theory and the Political Economy of International Trade**

*International Trade* is the purchase, sale, or exchange of goods and services across national borders. Some of the key trade theories are:

1. **Mercantilism:** It claims that nations should accumulate financial wealth by encouraging exports and discouraging imports.
2. **Theory of Absolute Advantage:** A country should specialize in producing goods in areas where it has an absolute advantage (in terms of production efficiency) and import goods in areas where other countries have absolute advantages.
3. **Theory of Comparative Advantage:** Trade is still beneficial between two countries, even if one country is less efficient in the production (in absolute terms, i.e. absolute cost) of all traded goods, so long as it is more efficient (in relative terms, i.e. opportunity cost) in the production of at least one of those goods. It basically says that unrestricted free trade is a positive-sum game (good for all participants).
4. **Factor Proportions Theory** (also known as the *Heckscher-Ohlin Theory*): It proposes that countries will produce and export goods that require resources (factors) that they have in abundance and import goods that require resources that they are in short supply. The apparent paradox between predictions of this theory and actual trade flows is called the *Leontief Paradox.*
5. **Product Life-Cycle Theory:** It suggests that trade patterns are influenced by where a new product is introduced and that the patterns will change during the product life cycle.
6. **New Trade Theory:** Trade allows a nation to specialize in the production of certain goods, attaining scale economies and lowering the cost of producing these goods, while buying goods that it does not produce from other countries that are similarly specialized.
7. **Porter’s theory of National Competitive Advantage** also called *Porter’s Diamond:* It states that a nation’s pattern of trade is influenced by:
   1. Factor endowments
   2. Domestic demand conditions
   3. Related and Supporting industries
   4. Firm strategy, structure and rivalry within the country
Despite the advantages of free trade, governments intervene for the following reasons:

1. Political motives
   1.1 Protecting jobs
   1.2 Preserving national security
   1.3 Responding to other nations’ unfair trade practices
   1.4 Gaining influence over other nations

2. Economic Reasons:
   2.1 Protection of young industries (infant industry argument)
   2.2 Promotion of a strategic trade policy

The methods that governments use to promote international trade are:
1. Subsidies
2. Export financing
3. Loan guarantees
4. Establishment of a Foreign Trade Zone (FTZ) also known as Free Trade Zone.
5. Establishment of special government agencies to promote exports.

The methods that governments use to restrict in international trade are:
1. Tariffs: A tariff is a tax levied on a product that enters or leaves the country. Tariffs can be export, import, or transit tariffs.
2. Quotas: A quota is a restriction on the amount of a good that can enter or leave the country. Quotas can be export or import quotas.
3. Embargo: It is a complete ban on trade for certain products.
4. Local content requirements
5. Administrative delays
6. Currency controls

The General Agreement on Tariffs and Trade (GATT) was a treaty designed to promote free trade by reducing both tariffs and non-tariff barriers to international trade. It was replaced in 1994 by the World Trade Organization’s (WTO) more encompassing pact.

The main goals of the WTO are:
1. To help the free flow of trade
2. To help negotiate further opening of markets
3. To settle trade disputes between its members

When a company exports a product at a price lower than the cost of production, it is said to be dumping. The WTO allows a nation to retaliate against dumping under certain conditions.

4. Differences in Political, Legal, and Economic Systems
A Political System consists of the structures, processes, and activities by which a nation governs itself. They can be classified based on two dimensions:

1. Emphasis on collectivism (the needs of the group are more important than the needs of the individual) or individualism (emphasis on the individual’s freedom in the realms of politics, economics and culture).
2. Representative Democracy or Totalitarianism
In a totalitarian system, the rulers govern without the people’s support, maintain control over most aspects of people’s lives, and do not allow any opposition. Totalitarian systems come up in the following types:

1. Theocratic totalitarianism (based on religious beliefs and practices)
2. Secular totalitarianism where the leaders depend on military and bureaucratic power.
   The three types of secular totalitarianism are:
   2.1 Communist totalitarianism (government controls all economic activities)
   2.2 Tribal totalitarianism (one tribe imposes its will on all others)
   2.3 Right-wing totalitarianism (capitalist economics without political freedom)

*Political Risk* is the likelihood that a government’s activities or change of government will negatively affect business activity. The main forms of political risk are:

1. Conflict and violence
2. Terrorism and kidnapping
3. Property seizure (confiscation, expropriation, or nationalization)
4. Policy changes
5. Local content requirements

A **Legal System** is a country’s set of laws and regulations, including the processes by which its laws are enacted and enforced and the ways in which its courts hold parties accountable for their actions. The three main categories of legal systems are:

1. *Common Law*: The justice system decides cases by interpreting the law on the basis of tradition (legal history), precedent (past cases), and usage (application of laws in specific situations).
2. *Civil Law*: It is based on a detailed set of written rules and statutes that constitute a legal code.
3. *Theocratic Law*: It is based on religious teachings and traditions.

An **Economic System** consists of the structure and processes that a country uses to allocate its resources and conduct its commercial activities. The three major economic systems are:

1. *Centrally Planned Economy*: The government owns land, factories, and other economic resources, and plans nearly all economic-related activities.
2. *Mixed Economy*: Land, factories and other economic resources are split between private and government ownership, with the government tending to control the economic factors crucial to national security and long-term stability.
3. *Market Economy*: Private individuals or businesses own the majority of land, factories, and other economic resources. Economic decisions are influenced by the interplay between supply and demand in the marketplace.

**5. Foreign Direct Investment**

**Foreign Direct Investment (FDI)** is the purchase of physical assets or a significant amount of ownership (stock) of a company in another country to gain a measure of management control. The theories trying to explain why it occurs are:

1. *International Product Life Cycle (Vernon’s Theory)*: As the product moves through the stages, companies start with exports and continue later with FDI.
2. *Market Imperfections*: FDI is a better strategy when the market makes transactions such as exports less efficient
3. *The Eclectic Theory (Dunning’s Theory)*: The combination of a particular location with ownership makes for a good investment opportunity.
5. *Knickerbocker’s Theory*: Most of FDI can be explained by imitative behavior by rival firms in an oligopolistic industry.
From a company’s perspective, FDI raises the following management issues:

1. Controlling activities in the local market
2. Whether to purchase an existing local company or built a subsidiary from the ground up.

Governments interfere by either promoting or restricting FDIs. Some of the methods are:

1. Ownership restrictions on non-domestic companies
2. Performance demands
3. Tax incentives
4. Low-interest loans
5. Infrastructure improvements

6. Regional Economic Integration

Regional Economic Integration is the process whereby countries in a geographic region cooperate with one another to reduce or eliminate barriers to the flow of products, services, factors of production, people, and capital among them.

There are five potential levels of integration. Each level incorporates the properties of those preceding it:

1. A Free-Trade Area: The member countries seek to remove all barriers to trade between themselves, but each country determines its own barriers against non-members.
2. A Customs Union: As in (1), but the members erect a common trade policy against non-members.
3. A Common Market: As in (2), with the addition that all barriers to the movement of labor and capital are eliminated among members.
4. An Economic Union: As in (3), but the member countries also coordinate their economic policies.
5. A Political Union: As in (4), but the member countries coordinate aspects of their political systems.

Regional integration will not increase economic welfare if the trade creation effects in the free trade area are outweighed by the trade diversion effects.

Some of the major regional trade areas today are:

1. The European Union (EU)
2. The North American Free Trade Agreement (NAFTA)
3. The Southern Common Market (MERCOSUR)
4. The Association of Asia Pacific economic Cooperation (APEC)
5. The Association of Southeast Asian Nations (ASEAN)
6. The Central American Common Market (CACM)
7. The Andean Community

7. Foreign Exchange Markets

The Foreign Exchange Market is a market for converting the currency of one country into that of another country. It has four primary functions:

1. Individuals, companies, and governments use it to convert one currency into another.
2. It provides tools that investors can use to insure against adverse changes in exchange rates (currency hedging).
3. It is used to earn profits from instantaneous purchase or sale of a currency in different markets (currency arbitrage).
4. It can be used to speculate about a change in the value of a currency.
The **Spot Exchange Rate** is the exchange rate at which a dealer converts one currency into another currency on a particular day. The spot rate requires delivery of the traded currency within two business days.

The **Forward Rate** is the rate at which two parties agree to exchange currencies on a specified future date.

Foreign exchange risk can be reduced using:

1. **A Forward Contract**: It is the agreement to exchange an agreed-upon amount of a currency on an agreed-upon date at a specific exchange rate.
2. **A Currency Swap**: It is the simultaneous purchase and sale of foreign exchange for two different dates.
3. **A Currency Option**: It is the right to exchange a specific amount of a currency on a specific date at a specific rate.
4. **A Currency Futures Contract**: It requires the exchange of a specific amount of a currency at a specific date at a specific exchange rate. The difference from a forward contract is that none of the terms is negotiable.

The key economic theories in explaining the changes in the exchange rate between two currencies are:

1. **The Purchasing Power Parity (PPP) Theory**: If the market is efficient, changes in relative prices of a basket of goods in the two countries should be reflected in changes in the exchange rate between their currencies.
2. **The Fisher Effect**: It states that a country’s “nominal” interest rate is the sum of the required “real” rate of interest plus the expected rate of inflation. Differences in the nominal interest rates between two countries should affect the exchange rate between the two countries in equal amount but in the opposite direction.

Both theories fail the empirical test of predicting short-term changes in the spot rate of currencies. Governments often intervene and restrict currency convertibility. The reasons are:

1. The government may want to preserve the country’s hard currency reserves.
2. To protect the currency from speculators
3. To keep the currency invested in the domestic market

The methods to restrict currency convertibility are:

1. Government approval for currency exchange
2. Imposed import licenses
3. A system of multiple exchange rates
4. Imposed quantity restrictions.

Governments use one of the following policies in managing the exchange rate of their currency:

1. **Fixed Exchange Rate**: A country pegs its currency to another one (such as the U.S. Dollar, or a basket of other currencies) at a fixed rate.
2. **Floating Exchange Rate**: The country does not intervene and allows the exchange rate of its currency to be determined by the exchange rate market.
3. **Dirty Float**: A variation of a floating exchange rate in which the government intervenes to change the value of the country’s currency.

### 8. The International Monetary System and the Global Capital Markets

The **International Capital Market** is a network of individuals, companies, financial institutions, and governments that invest and borrow across national boundaries. Its three main purposes are:

1. It provides an expanded supply of capital for borrowers.
2. It lowers the cost of money (interest rates).
3. It lowers the risk for lenders.
The growth in the international capital market is due to three factors:
1. Advances in information technology
2. Deregulation of the capital markets
3. Innovation in financial instruments

The **Foreign Bond Market** consists of all bonds sold by issuers outside their own countries and these bonds are denominated in the currency of the country in which they are issued.

The **Eurobond Market** consists of all bonds underwritten by international syndicates of banks and placed in countries other than the one in whose currency the bond is denominated.

The **International Equity Market** consists of all stocks bought and sold outside the home country of the issuing company.

The **Eurocurrency Market** consists of all the world’s currencies that are banked outside their countries of origin.

### 9. The Strategy and Organization of International Business

A *Strategy* can be defined as the actions managers take to attain the goals of the firm. For most firms, the preeminent goal is to maximize shareholder value.

Companies involved in more than one line of business must formulate a corporate level strategy. That encompasses all of the company’s different business units. Some key types of such strategies are:

1. Growth strategy
2. Retrenchment strategy
3. Stability strategy
4. Combination strategy

Managers need to develop business level strategies for each business unit. Some key strategies at this level are:

1. Low-cost Leadership Strategy
2. Differentiation strategy
3. Focus strategy

For companies that operate in multiple countries, the two key strategies are:

1. Multinational (multi-domestic) strategy: It is based on adapting products and their marketing strategies in each national market to suit local preferences.
2. Global strategy: In is based on offering the same products using the same marketing strategy in all national markets.

**Organizational Structure** is the way in which a company divides its activities among separate units and coordinates activities between these units.

There are many different ways in which a company can organize itself to carry out its international business activities. The most common methods are:

1. **International Division Structure**: It separates domestic from international business activities by creating a separate international division with its own manager.
2. **International Area Structure**: It organizes a company’s entire global operations into countries or geographic regions.
3. **Global Product Structure**: It divides worldwide operations according to a company’s product area.
4. **Global Matrix Structure**: It splits the chain of command between product and area divisions.
Forces of globalization demand that companies respond quickly in all their business environments. The formation of teams can be highly useful in improving responsiveness in the global environment. The different types of such work teams are:

1. **Self-Managed Team**: It is a team in which the employees from a single department take on the responsibilities of their former supervisors.
2. **Cross-Functional Team**: It is composed of employees who work at similar levels in different functional departments.
3. **Global Team**: It consists of top managers from headquarters and international subsidiaries who meet to develop solutions to company-wide problems.

10. **Entry Strategies in Foreign Markets**

*Entry Mode* is an institutional arrangement in which a firm gets its products, technologies, human skills, or other resources into a market. The basic entry decisions involve:

1. Which markets to enter
2. When to enter those markets (first mover advantages versus pioneering costs)
3. On what scale to enter them
4. The method of entry

A firm can enter a foreign market in the following ways:

1. **Exporting**: The advantages are: (a) low entry costs, and (b) experience curve and location economies. The disadvantages are: (a) transportation costs, (b) trade barriers, and (c) problems with local marketing agents. *Countertrade* includes a range of barter-like agreements. It is primarily used when a firm exports to a country whose currency is not freely convertible and may lack the foreign exchange reserves to purchase the imports.
2. **Turnkey Projects**: The key advantage is that the company can export its process know-how to countries that prohibit FDIs. The major disadvantage is that the firm may inadvertently create efficient global competitors in the process.
3. **Licensing**: The main advantage is that the licensee bears the costs and risks of opening the foreign market. The major disadvantages include the risk of losing technological know-how to the licensee and also lack of control over the licensee’s activities.
4. **Franchising**: The main advantage is that the franchisee bears the costs and risks of opening a foreign market. The key disadvantage is the problem of quality control of distant franchisees.
5. **Joint Ventures**: The main advantage is that the costs and risks of opening a foreign market are shared as well as the ability to gain local market knowledge and political influence. The main disadvantage is the lack of tight control and the risk of losing technology know-how.
6. **Wholly Owned Subsidiaries**: The main advantage is control over all activities. The key disadvantages are that the firm has to carry all costs and risks of opening a foreign market. Wholly owned subsidiaries can be implemented either by a *Greenfield Venture Strategy*, or by acquiring an established enterprise in the target market.

The key factors in selecting an international entry mode are:

1. The cultural environment
2. The political environment
3. The legal environment
4. The market size
5. The production and shipping costs
6. The company’s international experience
11. Global Production and Logistics

*Logistics* is the activity that controls the transmission of physical materials through the value chain, from procurement through production and into distribution. Production and logistics are closely linked since a firm’s ability to perform its production activities efficiently depends on a timely supply of high quality material inputs, for which logistics is responsible.

The choice of an optimal production location must consider:

1. **Country factors:**
   1.1 Differences in factor costs
   1.2 Differences in political economy
   1.3 Differences in culture
   1.4 Trade barriers
   1.5 Location externalities
   1.6 Exchange rates

2. **Technological factors**
   2.1 Fixed costs
   2.2 Minimum efficient scale
   2.3 Availability of flexible manufacturing technology

3. **Product factors**
   3.1 Value-to-weight ratio
   3.2 Needs served (universal or location specific)

An important decision is which parts and components should be produced in-house and which ones should be outsourced.

The advantages of in-house production are:
1. It facilitates investments in specialized assets
2. It helps the firm protect its proprietary technology

The advantages of outsourcing are:
1. It facilitates strategic flexibility
2. It helps the firm avoid the organizational problems associated with extreme vertical integration

Strategic alliances with suppliers are a way to attain the benefits of vertical integration without the problems. Nevertheless, some drawbacks still exist because the firm that enters such an alliance may find its strategic flexibility limited by commitments to the alliance partners.

Logistics in international business is more complex due to the issues of:
1. Distance
2. Time
3. Exchange rates
4. Legal and political factors

12. Global Marketing

When developing international product strategies, companies must:
1. Undertake mandatory product adaptation in response to a target market’s laws and regulations.
2. Adapt their products to suit cultural differences.
3. Most of the time keep the same brand name, but occasionally create new product names to suit local preferences.
4. Consider the role of the image of a nation in which the company designs and produces its product.
5. Consider the role of shortened product life cycles on the timing of when to introduce and market a product internationally.

In terms of the promotion of their products in international markets, companies can pursue one of the following strategies:

1. Product/Communications extension (dual extension)
2. Product extension/Communications adaptation
3. Product adaptation/Communications extension
4. Product adaptation/Communications adaptation (dual adaptation)
5. Product invention (development of a completely new product)

In terms of developing an international distribution strategy, companies must keep in mind that a nation’s distribution system develops over time and reflects its unique cultural, political, legal, and economic traditions. Most problems in terms of international distribution arise from:

1. Lack of understanding of a country’s unique distribution system
2. Theft
3. Corruption

The key elements that influence international pricing strategies are:

1. **Worldwide pricing** is the practice of selling at the same price in all markets—something very difficult to achieve.
2. **Dual pricing** is when a product has a different price in export markets than in its home market.
3. A **Transfer price** is the price charged for products or parts sold between a company and its subsidiaries.
4. **Price controls** are upper and lower limits placed on the prices of products sold within a country.
5. **Predatory pricing** is the use of profit gained in one market to support aggressive pricing in another market to drive competitors out of that market.
6. **Multipoint pricing** refers to the fact that a firm’s pricing strategy in one market may affect rivals’ pricing strategies in another market.


*Human Resource Management* refers to the activities an organization carries out to use its human resources effectively.

*Staffing policy* is concerned with the selection of employees for particular jobs.

*Corporate Culture* consists of an organization’s norms and values systems.

The types of staffing policy are:

1. **Ethnocentric Staffing Policy**: Operations outside the home country are staffed and managed by home country nationals.
2. **Polycentric Staffing Policy**: International operations are staffed and managed by host-country natives.
3. **Geocentric Staffing Policy**: It seeks the best people for key jobs throughout the organization regardless of nationality.
4. **Regiocentric Staffing Policy**: The staff may move outside their country but remain within a particular geographic region.

*Cultural training* is often effective in reducing both culture shock (the difficulties in adapting into a new culture) and reverse culture shock (the psychological process of readapting to one’s home culture). *Expatriate Failure* is the premature return of an expatriate manager to his or her own country.
Expatriate failure can be reduced by:
1. Selection procedures that screen out inappropriate candidates
2. Cultural training, including language training

The most common approach to expatriate pay is the balance sheet approach, which aims to equalize purchasing power so employees can enjoy the same standard of living.

14. Accounting and Financial Management in International Business
National differences in accounting and auditing standards have become a problem for multinational companies as transnational financing and investments have grown.

The most significant push for harmonization has come from:
1. The International Standards Committee (IASC), and its successor,
2. The International Accounting Standards Board (IASB)

Consolidated financial statements which provide financial accounting information about a group of companies that recognizes the companies’ economic interdependence is one way to deal with this problem. Transactions among the members of a corporate family are not included in the consolidated financial statements; only assets, liabilities, revenues and expenses generated with external third parties are shown. One of the key issues is what exchange rate to use for these statements when the subsidiaries operate in countries with different currencies than the home country of the corporation. The key methods are:

1. The Current Rate Translation method: The exchange rate at the balance sheet date is used to translate the financial statements of a foreign subsidiary into the home country.
2. The Temporal method: Assets valued in a foreign currency are translated into the home currency using the exchange rate that existed when the assets were purchased.

When using capital budgeting techniques to evaluate a potential foreign project, the company must account for economic and political risks by:
1. Using a higher discount rate
2. Forecasting lower cash flows

Given that the cost of capital tends to be lower in the global capital market than in domestic markets, companies should try (other things being equal) to finance their global investments by raising capital in the global capital market.

Multinational corporations use a number of techniques to transfer funds across borders including:
1. Dividend remittances
2. Royalty payments and fees
3. Transfer prices
4. Fronting loans

Firms often manipulate transfer prices to:
1. Move funds out of a country by circumventing government restrictions of capital flows,
2. Minimize tax liabilities
3. Hedge against foreign exchange risk
4. Reduce tariff payments.

Fronting loans involves channeling funds from a parent company to a foreign subsidiary through a third party, normally an international bank. Fronting loans can:
1. Circumvent host-government restrictions on the remittance of funds
2. Provide certain tax advantages
15. Ethics in International Business

Ethics refers to accepted principles of right or wrong that govern the conduct of a person, the members of a profession, or the actions of an organization.

Ethical issues and dilemmas in international business are rooted in the variations among:

1. Political systems
2. Legal systems
3. Economic development
4. Culture

The most common ethical issues in international business involve:

1. Employment practices
2. Human rights
3. Environmental issues
4. Corruption

Unethical behavior is rooted in:

1. Poor personal ethics
2. The psychological and geographical distances of a foreign subsidiary from the home office
3. A failure to incorporate ethical issues into strategic and operational decision making
4. A dysfunctional culture
5. Failure of the leaders to act in an ethical manner

References
