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# CHAPTER 1: GLOBALIZATION

## LEARNING OBJECTIVES

1. Describe the process of globalization and how it affects markets and production.
2. Identify the two forces causing globalization to increase.
3. Summarize the evidence for each main argument in the globalization debate.
4. Identify the types of companies that participate in international business.
5. Describe the global business environment and identify its four main elements.

## QUICK STUDY QUESTIONS

### Quick Study 1 (p. 5)

1. Q: *Define the term international business, and explain how it affects each of us.*

A: *International business* is any commercial transaction that crosses the borders of two or more nations. International business involves each of us every day. We consume goods that originate outside our borders or that contain components made abroad. We also consume services, such as a news broadcast or music entertainment, that are sent to us from abroad.

2. Q: *What do we mean by the terms imports and exports?*

A: *Imports* are goods and services purchased abroad and brought into a country. *Exports* are goods and services sold abroad and sent out of a country.

3. Q: *Explain how e-business (e-commerce) is affecting international business.*

A: *E-business (e-commerce)* is the use of computer networks to purchase, sell, or exchange products; service customers; and collaborate with partners. E-business is making it easier for companies to make their products abroad, not just import and export finished goods. It also helps companies improve efficiency in international operations and boost competitiveness.

**Quick Study 2 (p. 9)**

1. Q: *Define globalization. How does denationalization differ from internationalization?*

A: *Globalization* is the 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), and is different from internationalization (which refers to cooperation between national actors).

2. Q: *List each benefit a company might obtain from the globalization of markets.*

A: Globalization of markets refers to convergence in buyer preferences in markets around the world. Potential benefits for companies include: (1) reduced marketing costs by standardizing activities, (2) market opportunities abroad if home market is small or saturated, and (3) levels an income stream by letting international sales offset domestic sales for a company selling a global seasonal product.

3. Q: *How might a company benefit from the globalization of production?*

A: Globalization of production refers to the dispersal of production activities to locations that help a company minimize costs or maximize quality of a good or service. Potential benefits for companies include: (1) access lower-cost labor to cut production costs, (2) access technical expertise, and (3) access production inputs unavailable or costly at home.

**Quick Study 3 (p. 15)**

1. Q: *What two main forces underlie the expansion of globalization?*

A: The two forces underlying the expansion of globalization are: (1) falling barriers to trade and investment, and (2) technological innovation.

2. Q: *How have global and regional efforts to promote trade and investment advanced globalization?*

A: Global Efforts: The 1947 GATT lowered trade barriers and made it cheaper and easier to ship goods across borders. In 1988 world merchandise trade was 20 times larger than in 1947; average tariffs dropped from 40 percent to 5 percent. A 1994 GATT revision created the WTO, which has the power to

enforce international trade rules. Goals of the WTO are: (1) to help the free flow of trade, (2) help negotiate further opening of markets, and (3) settle trade disputes. WTO agreements are contracts committing members to fair and open trade policies. The WTO dispute settlement system is the spine of the global trading system. Regional Efforts: Smaller groups of nations are banding together in regional trade agreements with similar objectives. Examples are NAFTA and the EU. The combined effect of global and regional efforts: international trade and investment is growing faster than world output.

3. Q: *How does technological innovation propel globalization?*

A: E-mail and videoconferencing speed information flows and ease the tasks of coordination and control. Firms use the Web to sharpen forecasting, lower inventories, and improve communication with suppliers, and to communicate with distant managers quickly, cheaply, and efficiently. The Web also reduces the cost of reaching international customers—important for the competitiveness of small firms. Company intranets allow employees to access information from distant locations to share best practices. Extranets give distributors and suppliers access to a company's database so they can place orders or restock inventories electronically and automatically. Transportation advancements are facilitating globalization by making shipping more efficient and dependable.

4. Q: *What factors make some countries more global than others?*

A: Four factors make a country more global: (1) political engagement, (2) technological connectivity, (3) personal contact, and (4) economic integration. The seven most global countries according to recent data are (beginning with first place): Singapore, Hong Kong, the Netherlands, Switzerland, Ireland, Denmark, and the United States.

**Quick Study 4 (p. 16)**

1. Q: *How does this current period of globalization compare with the first age of globalization?*

A: Whereas the first age of globalization (mid-1800s to 1920s) encompassed mostly rich nations, this second age reaches into developing and emerging economies. Like today, migration levels were very high, domestic workers faced competition from cheaper labor abroad, and trade and capital flowed freely. Drivers of that first age of globalization were the steamship, telegraph, railroad, telephone, and airplane. Drivers of this second age include communication satellites, fiber optics, microchips, and the Internet.

2. Q: *Explain the original purpose of the World Bank and its mandate today.*

A: The *World Bank* is an agency created to provide financing for national economic development efforts. Its initial purpose was to finance European reconstruction following the Second World War. It later shifted its focus to the general financial needs of developing countries. Today it finances many economic development projects in Africa, South America, and Southeast Asia.

3. Q: *What are the main purposes of the International Monetary Fund?*

A: The *International Monetary Fund* is an agency created to regulate fixed exchange rates and enforce the rules of the international monetary system. Some of the purposes of the IMF include: promoting international monetary cooperation; facilitating expansion and balanced growth of international trade; avoiding competitive exchange devaluation; and making financial resources temporarily available to members.

### **Quick Study 5 (p. 20)**

1. Q: *What are the claims of those who say globalization eliminates jobs, lowers wages, and exploits workers?*

A: (1) Globalization eliminates manufacturing jobs in developed nations as jobs are sent to nations with lower wages. Also, the new jobs that globalization creates pay less than manufacturing jobs lost. And reduced prices for imported goods are little consolation for workers who have lost their jobs. (2) Globalization lowers wages in developed nations as jobs move abroad and competition increases for the remaining jobs, gradually depressing wages. (3) Globalization exploits workers in developing nations because multinationals operate where labor standards are low by comparison. People in developing nations have few employment options and no power to counter manipulative employment practices.

2. Q: *Identify the arguments of those who say globalization creates jobs and boosts wages.*

A: (1) Globalization raises overall wealth in developed and developing nations because trade openness raises the output of a nation. It also allows firms to become more efficient and pass savings on to consumers. (2) Globalization generates labor market flexibility that allows an economy to rapidly deploy labor where demand is relatively great, which lets workers leave jobs and find new work fairly quickly. (3) Globalization advances developing nations' economies by injecting capital that creates higher-paying jobs than would

otherwise be available, which expands the middle class and raises standards of living.

3. Q: *Why do critics say globalization adversely affects labor standards, environmental regulations, and future markets?*

A: The major complaint of those opposed to globalization is that multinational firms contribute to slack labor and environmental protection laws. They say that because multinationals are in constant pursuit of lower costs, they seek out locales with less strict labor and environmental regulation to reduce the cost of operating in those environments. They argue that multinationals thus put downward pressure on labor and environmental standards worldwide.

4. Q: *How do supporters of globalization argue that it does not harm labor standards, environmental regulations, and future markets?*

A: First, research shows that pollution-intensive U.S. firms tend to invest in countries having stricter environmental standards. In fact, many developing nations liberalized their foreign investment environment while simultaneously enacting *stricter* environmental legislation. If multinationals were eager to seek out nations with the worst environmental protection laws, they would have avoided that group of nations instead of pouring enormous sums of investment into them over decades.

Second, when analyzing a country prior to investing, multinationals today often search for a future market for its goods as well as a production base. In such a scenario, any rational management team would not enter a market with draconian labor and environmental regulations, depressed local wages, and an awful environment, where the locals cannot hope to one day afford to purchase the very items they produce.

### **Quick Study 6 (p. 23)**

1. Q: *What does the evidence suggest for each branch of the debate over globalization and income inequality?*

A: First, regarding the debate over inequality within nations, studies suggest that developing nations can boost incomes of their poorest members of society by integrating them into the global economy. Second, in the debate over inequality between nations, it appears that more nations open to trade and investment grow faster than wealthy nations, whereas sheltered economies are worse off. Thus, countries advance their economies by being open, not closed, to global business. Third, the global inequality debate has generally concluded

that global poverty has fallen in recent decades, though there is disagreement on the extent of the drop. Standardized sources and methods are needed.

2. Q: *What are each side's arguments in the debate over globalization's impact on national sovereignty?*

A: Those *opposed* to globalization claim that supranational institutions, including the WTO, IMF, and UN, consist of appointed, not democratically elected, representatives who impose their will upon citizens of nations. They argue that ceding political authority to such organizations undercuts the legal authority of national, regional, and even local governments, and undercuts democracy itself.

Those *favoring* globalization argue that an amazing consequence of globalization has been the spread of democracy worldwide. People in democracies are better educated, better informed, more assertive, and are challenging elites and the old ways of doing things. Supporters of globalization also argue that national sovereignty must be viewed in the long run, and that consideration must be made of the positive outcomes of international cooperation. UN accords made significant progress in important areas such as women's rights and racial discrimination.

3. Q: *Summarize the claims of each side in the debate over globalization's influence on cultures.*

A: (1) Globalization *critics* fear it is homogenizing the world and destroying its rich diversity of cultures. In some drab, new world we all will wear the same clothes bought at the same brand-name shops, eat the same foods at the same brand-name restaurants, and watch the same movies made by the same production companies. (2) It is also feared that cultural diversity will be reduced through universal products, as local businesses cannot compete with large MNCs.

(1) Globalization *supporters* counter that it allows each nation to profit from differing circumstances and skills. Trade allows a country to specialize in producing those goods and services in which it is most efficient. It can then trade those products to other nations in exchange for goods and services it desires but does not produce. (2) Focusing only on consumer goods examines only the most superficial aspects of culture. (3) Throughout the past century, the music, art, and literature of developing countries has thrived and gained international attention through globalization.

### Quick Study 7 (p. 27)

1. Q: *Why do large multinational corporations dominate international business?*

A: (1) The economic and political muscle of large firms makes them highly visible in the eyes of the media. Large companies generate significant jobs, investment, and tax revenue for the regions and nations they enter. Likewise, they can leave many hundreds, perhaps thousands of people, out of work when they close or scale back operations. (2) Their dealings typically involve huge sums of money. It is common for the income and deals of large firms, such as M&As, to be valued in the billions.

2. Q: *Explain why small companies and born global firms are increasingly involved in international business.*

A: Small firms are increasingly international because traditional distribution channels are more accessible and technology makes it easier to communicate and transport products. Born global firms tend to be innovative and knowledge based and often rise to the level of international competition in a very short period of time.

3. Q: *Describe the global business environment and how its main elements interact.*

A: It is helpful to view international business as occurring within an integrated, *global business environment*. Four elements comprise the global business environment: (1) *Globalization* is a potent force transforming our societies and commercial activities. Globalization increases competition and produces significant changes in how a society operates. (2) Separate *national business environments*, which include elements related to culture and systems of politics, law, and economics, can vary greatly across nations. Companies must be aware of such differences and adapt products and processes as needed. (3) The *international business environment*, which is where the actions of consumers, workers, companies, financial institutions, and governments from different nations converge. As globalization continues, flows of trade, investment, and capital are becoming more entwined—often causing firms to look simultaneously for production bases *and* markets. (4) *International business management* differs from management of a domestic firm in nearly all respects. When a firm ventures into international business, environmental forces present it with many challenges and opportunities. Thus, the context of international business management is defined by the characteristics of each of the other three factors presented here.

## TALK IT OVER

1. *Q:* Today, international businesspeople must think globally about production and sales opportunities. Many global managers will eventually find themselves living and working in cultures altogether different from their own. Many entrepreneurs will find themselves booking flights to places they had never heard of. What do you think companies can do now to prepare their managers for these new markets? What can entrepreneurs and small businesses with limited resources do?

*A:* Large companies can keep a watchful eye on such markets by conducting preliminary studies periodically on each potential market it is considering. Companies can conduct such studies in-house or commission them from independent organizations. They can also send key managers that would oversee such new investments to the market to familiarize themselves with the local culture and begin making contacts.

However, entrepreneurs and small companies often do not have the money for expensive studies. But they can afford to follow events in potential markets through the international media—especially the international business press. They can also purchase existing surveys of potential markets from international research agencies—usually available for a reasonable fee. They can also seek out the advice and counsel of local retired businesspeople with international experience and contact their local Small Business Administration office (or similar agency outside the United States). The Web is a valuable tool for obtaining a great deal of free information.

2. *Q:* *In the past, national governments greatly affected the pace of globalization through agreements to lower barriers to international trade and investment. Is the pace of change now outpacing the capability of governments to manage the global economy? Will national governments become more or less important to international business in the future? Explain your answer.*

*A:* The first part of the question addresses the fact that the GATT was initially very successful but lost much of its relevance in the mid-1980s with regard to services and erupting trade disputes. Governments then tried to update institutions to suit the changed business environment. In answering, students should identify the Internet as an evolving international business tool which governments are finding difficult to regulate and establish jurisdiction over. Students may also mention the inability of supranational agencies to forecast many recent economic crises worldwide.

The second part of this question gets students to consider the power of large multinational and global companies relative to national governments. Students might identify political lobbying that companies undertake to get favorable legislation passed. On the other hand, students might identify the power of



governments to control their own national business environment—albeit perhaps with an attached cost.

3. *Q: Information technologies are developing at a faster rate than ever before. How have these technologies influenced globalization? Give specific examples. Do you think globalization will continue until we all live in one “global village”? Why or why not?*

A: Information and communication technologies are facilitating the process of globalization in many ways. Through e-mail and videoconferencing, companies are better able than ever before to keep in touch with far-flung subsidiaries, suppliers, and customers. Intranets and extranets are facilitating the timely restocking of inventories by suppliers and the ordering of merchandise by buyers. The effect of these technologies has been to remove some of the pain associated with conducting day-to-day operations for international companies—causing them to look more favorably on new international ventures.

Students should first question what a “global village” is, and give answers depending upon their definition. Are we talking about an “economic village” or a “true village” that entails cultural homogenization? We are currently witnessing an era of increasing interaction among nations (despite the recent global recession), but it is not certain this will continue. Such times have occurred at other points in history only to result in war and division. Students’ experiences of contact with the people and cultural products (such as movies and music) of other nations (and perhaps living abroad) will affect their answers.

4. *Q: Consider the following statement: “Globalization and the resulting increase in competition harm people, as international companies play one government against another to get the best deal possible. Meanwhile, governments continually ask for greater concessions from their citizens, demanding that they work harder and longer for less pay.” Do you agree? Why or why not?*

A: This question gets students thinking about the interrelationships among consumers, workers, international companies, and governments. Consumers tend to win from a purchasing standpoint as companies’ cost structures tend to be lower and retail prices should fall along with increasing competition. However, these consumers are also employees in the economy. The power of corporations to get concessions from governments and workers affects wages. On the other hand, if citizens are not satisfied with their government’s stance on trade and investment issues, they can change the government at the ballot box. However, not every nation gives its citizens such powers.

This question may cause debate as students take the side of international companies or workers, and delve into the validity of such statements. This question might even be assigned as a debate. Students could be divided into groups, assigned a position, and given until the next class period to develop their arguments.

## TEAMING UP

1. *Q: Research Project. Imagine that you and a group of your fellow classmates own a company that manufactures cheap sunglasses. To lower production costs, you want to move your factory from your developed country to a more cost-effective nation. Choose a prospective country to which you will move production. What elements of the national business environment might affect your move? Are there obstacles to overcome in the international business environment? How will managing your company be different when you undertake international activities? What challenges will you face in managing your new employees?*

A: This project gets students to begin pondering the types of elements that must be considered when selecting a country for investment. At a minimum, students' responses should consider: (1) the presence of investment barriers in the country; (2) resources needed to carry out production, as well as their availability and cost; (3) availability of modern telecommunications to facilitate communication with the home office; and (4) how the expansion might be financed.

2. *Q: Market Entry Strategy Project. This exercise corresponds to the MESP online simulation. With a group of classmates, select a country that interests you. Describe its national flag: what do its colors and any symbols represent? Identify neighbors with which it shares borders. Give some important facts about the country, including its population, population density, land area, topography, climate, natural resources, and the locations of main industries. What does the nation produce? Do any aspects of the natural environment help explain why it produces what it does? Integrate your findings into your completed MESP report.*

A: This may be a good time to get students working on their Market Entry Strategy Project. This exercise gets students to learn more about a country, and to generate interest in countries other than their own. The project focuses on important aspects of each country and the process can begin to develop teamwork in the course.

## ETHICAL CHALLENGES

1. *Q: You are a U.S. citizen recently assigned as the manager of distribution in a European country where bribery is relatively acceptable. Your job description includes responsibility for accepting shipments as they enter the local port authority. On your first trip down to the docks to sign for a shipment, the customs agent in charge asks for a “tip” to clear the goods for pickup. The value of the incoming shipment is around \$150,000. Knowing that the government has recently launched an initiative to reduce corruption, how do you react? If additional information would be helpful to you, what would it be?*

A: This question forces an examination of both personal ethical principles as well as company ethical guidelines. The situation also has a legal issue that must be addressed. U.S. citizens are covered by the Foreign Corrupt Practices Act, which prohibits paying bribes to foreign officials. The “tip” may be legal under the FCPA if it is a small amount and paid to the official to do what he or she would already be doing. The fact that the local government began a campaign to reduce corruption must also be considered. Additional information that would be helpful includes the amount of the “tip,” company policy on such matters, and the potential of the local government in helping to reduce corruption.

2. *Q: You are the CEO of a major U.S. apparel company that contracts work to garment manufacturers abroad. Employees of the contractors report 20-hour workdays, pay lower than the minimum wage, overcrowded living conditions, physically abusive supervisors, and confiscation of their passports. Contractors and government officials say local labor laws are adhered to and enforced, though abuses appear widespread. You send inspectors to the factories abroad but they uncover no labor violations. A labor-advocacy group claims that supervisors coached workers to lie to your inspectors about conditions and threatened workers with time in makeshift jails without food if they talked. How do you handle this situation? Do you help the factories improve conditions, withdraw your business, or do nothing? How might your actions affect your relations with the factory owners and your ability to do business in the country?*

A: It’s extremely important that your company be thorough and transparent throughout the monitoring process. The monitoring process could seem more impartial by contracting an independent organization to conduct the investigation, rather than employ someone with whom the company might be suspected as having social or political connections. You could also have the report made public to all parties simultaneously to eliminate the perception of the report being adjusted. To implement and maintain rapid, sustainable improvements: monitor and verify codes of conduct regarding labor practices, disseminate information to workers explaining their rights, appeal to government agencies on effective ways to raise labor standards, explain how their reputation as being “good guys” in the labor standards arena can create a

useful marketing tool and opportunities for firms and countries by differentiating themselves when competing in the apparel export market.

3. *Q: You are the mayor of a midsize U.S. town on the Colorado River between Mexico and Arizona. Pollution from factories on both sides of the U.S.–Mexico border has contaminated your community and the Colorado River. The North American Free Trade Agreement (NAFTA) requires the U.S. government to pay for environmental cleanup in the United States. Yet critics accuse both the U.S. and Mexican governments of not doing enough to safeguard the environment along the border. As mayor, what can you do to persuade business leaders and governmental officials to adhere to environmental standards? Which body do you think presents your biggest challenge: the Arizona state legislature, the U.S. government, or the Mexican government? What can business leaders do if governments ignore their environmental responsibilities?*

A: As mayor, you must fight for your local community. Certainly, dealing with the Arizona and U.S. governments should be much easier than negotiating with Mexican officials. Another strategy would be to get the media involved and they could put some pressure on businesses involved. Because this dilemma involves ethical and social responsibilities regarding the environment, this question might polarize the discussion rather quickly. Students should delineate between legal and ethical responsibilities in their answers, and consider the environment's impact on the living standards of a company's workforce. They should also explore briefly the impact of regulation on business performance and the issue of having the right amount of regulation versus over-regulation.

## **PRACTICING INTERNATIONAL MANAGEMENT CASE**

### **MTV Goes Global with a Local Beat**

1. *Q: Some say globalization is homogenizing the attitudes and spending habits of young consumers worldwide. As one journalist puts it, "It may still be conventional wisdom to 'think globally and act locally,' but in the youth market, it is increasingly a case of one size fits all." Do you agree or disagree? Why or why not?*

A: Potential problems with the maxim "think globally and act globally" is demonstrated by MTV's experiences in international markets. Although attitudes and spending habits may be converging, there are still many aspects of television programming to which viewers cannot relate for cultural reasons. For example, MTV viewers in the United States once saw young people being specially selected and then given the difficult task of actually going through

basic training for the military at a military base with real drill instructors. But for historical reasons, Japan has a very small military force of its own. Japanese viewers would perhaps rather watch a similar program but where young people are asked to learn what it is like to be a sumo wrestler. In Spain, viewers might want to watch a group of their peers learning what it takes to be a bullfighter, and so on. These types of differences are the key to responding to the needs of local audiences. However, global consumer products are likely easier to market on a global basis with a global theme.

2. Q: *Some people outside the United States say teens exposed to large doses of U.S. youth culture on MTV will identify less with their own societies and teens in developing countries will want Western goods they cannot afford. MTV's response: "It's just fun, it's only TV," says one executive. What do you think? Are there dangers in broadcasting U.S.-style programs and ads to developing countries?*

A: The debate over the impact of U.S. programming beamed to other developed and developing cultures will likely never cease. The U.S. television program *The Simpsons*, which depicts a rather unflattering U.S. family, is seen in more than 90 countries. Such a program is unlikely to want young people outside the United States to grow up to be like Homer Simpson! Generally, this program and others, such as "Married with Children," the "Jerry Springer Show," and "Baywatch," each seen around the world, are watched outside the United States for a glimpse into the humorous or darker aspects of U.S. culture. On the other hand, local programming can lose out to the U.S. programming if it is not as entertaining.

As regards desires among young people for more "Western" goods, this is a sensitive issue involving elements of economic development and materialism. It could be argued that it is not ethical to show U.S. programs that depict wealthy lifestyles in developing countries because they promote discontent in those markets and promote materialism. However, there are wealthy and poor people in every nation and, following this line of reasoning, one could argue that such programs should not be aired in the U.S. market either—incidentally, some groups do make this argument.

3. Q: *Digital compression technology made it possible for MTV to program over a global network. Can you think of other technological innovations that have helped companies to think globally and act locally?*

A: Internet retailers such as Amazon make online books in English available globally. However, Amazon also has online service to accommodate those in French- and Spanish-speaking countries. This is a localized approach. The French version of Amazon can further localize its selections by offering books

tailored to specific Francophone regions such as Africa and Canada, not just France. Clearly, Amazon can continue to localize by selecting other languages where significant numbers of readers are.

4. *Q: Advances in technology often spur evolution in the entertainment industry. How might new products and services, such as the iPhone and YouTube, affect entertainment in years to come?*

*A: There will be innovations to these technologies and future technologies, as one innovation leads to another. The entertainment industries will no doubt continue along with further miniaturization in medium and mobility in delivery.*

## CHAPTER 2: CROSS-CULTURAL BUSINESS

### LEARNING OBJECTIVES

1. Describe culture and explain the significance of both national culture and subcultures.
2. Identify the components of culture and describe their impact on international business.
3. Describe cultural change and explain how companies and culture affect each another.
4. Explain how the physical environment and technology influence culture.
5. Describe the two main frameworks used to classify cultures and explain their practical use.

### QUICK STUDY QUESTIONS

#### Quick Study 1 (p. 47)

1. Q: *Define culture. How does ethnocentricity distort one's view of other cultures?*

A: *Culture* is the set of values, beliefs, rules, and institutions held by a specific group of people. *Ethnocentricity* is the belief that one's own ethnic group or culture is superior to that of others. Ethnocentricity distorts people's views of other cultures because it views other cultures in terms of their own culture. Thus, it causes one to overlook important human and environmental differences among cultures.

2. Q: *What is cultural literacy? Why should businesspeople understand other cultures?*

A: *Cultural literacy* is detailed knowledge about a culture that enables people to live and work within it. Globalization is one force creating the need for cultural literacy because it is knitting business activities in various countries more closely together than ever before. Cultural literacy improves the ability of managers to manage employees, market products, and conduct negotiations in other countries. It also helps managers modify products and management techniques to better suit local markets.

3. Q: *How do nation-states and subcultures influence a nation's cultural image?*

A: First, we are conditioned to think in terms of national culture. Nation-states promote the concept of national culture by building museums and monuments to preserve the legacies of important events and people in their histories. This reaffirms the importance of national culture to citizens and organizations. Nation-states also intervene in business to help preserve their national cultures. Second, a *subculture* is a group of people who share a unique way of life within a larger, dominant culture. Although we often overlook important subcultures in forming our impressions of other national cultures, they are extremely important to conducting business abroad.

### Quick Study 2 (p. 51)

1. Q: *What is meant by a culture's aesthetics? Give several examples.*

A: *Aesthetics* are what a culture considers to be “good taste” in the arts, the imagery evoked by certain expressions, and the symbolism of certain colors. An example of aesthetics with respect to good taste in music is playing polka music in central European nations including the Czech Republic, Poland, and Slovakia. An example with respect to the arts in the Czech Republic is the production of fine glassware through the art of glass blowing. An example of good taste with respect to dance is the ritualistic dancing of the native Australian Aborigines.

2. Q: *How can businesses incorporate aesthetics into their Web sites?*

A: Incorporating aesthetics into Web sites can reap tremendous benefits. When going global on the Internet, the more a firm adapts to local cultural traditions, the better. Some specific tips are to (see Entrepreneur's Toolkit box) choose colors carefully, select numbers with care, watch the clock, avoid slang, wave the flag cautiously, do the math (check local currency), and get feedback.

3. Q: *Compare and contrast values and attitudes. How do cultures differ in their attitudes toward time, work, and cultural change?*

A: *Values* are ideas, beliefs, and customs to which people are emotionally attached. People hold as values only those ideas, beliefs, and customs extremely important to them. *Attitudes* are positive or negative evaluations, feelings, and tendencies that individuals harbor toward objects or concepts. People harbor attitudes toward things that are important and unimportant to them.

Certain cultures are more relaxed in their attitudes toward time whereas others are more rigid. For example, Latin American and Mediterranean cultures tend



to be relaxed toward the use of time whereas Northern Europe and the United States tend to keep far tighter schedules.

Some cultures see work strictly as a means to an end whereas others see work as an end in itself. Attitudes toward work also then influence people's attitudes toward time. For example, in France where people tend to take a relaxed attitude toward work, attitudes toward time are quite flexible. The opposite is true in Japan.

Some cultures readily accept the cultural traits of other nations, whereas others are more wary. Yet globalization and technological advancements are increasing the pace of cultural change.

4. Q: Describe the process of cultural diffusion. Why should international businesses be sensitive to charges of cultural imperialism?

A: A *cultural trait* is anything that represents a culture's way of life, including gestures, material objects, traditions, and concepts. The process whereby cultural traits spread from one culture to another is called *cultural diffusion*. This process is natural, yet gradual.

Cultures not open to the cultural traits of other nations typically fear that those traits will harm their own values. *Cultural imperialism* is the replacement of one culture's traditions, folk heroes, and artifacts with substitutes from another. Companies must be sensitive to charges of cultural imperialism because they can result in laws designed to protect the local culture. Such laws can render a market opportunity infeasible.

### Quick Study 3 (p. 55)

1. Q: How do manners and customs differ? Give examples of each.

A: *Manners* are appropriate ways of behaving, speaking, and dressing in a culture. *Customs* are habits or ways of behaving in specific circumstances that are passed down through generations in a culture. They differ from each other in that manners apply generally in a culture whereas customs apply to specific situations.

An example of good manners is behaving in a modest manner and dressing conservatively in Japan. An example of a custom is the practice of arranging marriages on the behalf of children in India—just as it was a widespread custom across Europe several or more generations ago. Another custom is the playing of cricket in Britain and its former colonies including India and Australia.

2. Q: *List several manners that managers should keep in mind when doing business abroad.*

A: Several tips include (See Global Manager's Briefcase box): don't rush familiarity, adapt to personal space, respect religious values, give and receive business cards respectfully, use comedy sparingly, and maintain good posture.

3. Q: *Define folk and popular customs. How can a folk custom become a popular custom?*

A: A *folk custom* is behavior often dating back several generations that is practiced within a homogeneous group of people. A *popular custom* is behavior shared by a heterogeneous group or by several groups. Folk customs can become popular customs through the process of cultural diffusion.

4. Q: *Define social structure. How do social rank and social mobility affect business?*

A: *Social structure* is a culture's fundamental organization, including its groups and institutions, its system of social positions and their relationships, and the process by which its resources are distributed. *Social status* (or rank) refers to the social layers or classes into which people are classified. Social rank affects business in that the type of occupation a person has often determines or heavily influences their social standing.

*Social mobility* is the ease with which individuals can move up or down a culture's social ladder. Social mobility is severely restrained in a caste system but quite free in most class systems. Social mobility can influence business activities in caste cultures because certain occupations can be off-limits for certain groups of people. Also, someone from a lower caste generally cannot supervise a member from a higher caste because personal conflict will likely occur. Systems that do not allow a great deal of social mobility tend to be characterized by greater labor-management conflict because workers often consider them unfair. Also, people can be hesitant to work hard in systems that do not reward hard-working individuals with social mobility. On the other hand, increased productivity and economic development often characterize systems that reward hard work with social mobility.

#### **Quick Study 4 (p. 60)**

1. Q: *What are the main beliefs of each of the seven religions presented above?*

A: The Roman Catholic faith asks its followers to refrain from placing material possessions above God and others. Protestants believe that salvation comes from faith in God and that hard work gives glory to God—a tenet known widely as the “Protestant work ethic.”

Religion strongly affects the kinds of goods and services acceptable to Muslim consumers. Islam, for example, prohibits the consumption of alcohol and pork. Popular alcohol substitutes are soda pop, coffee, and tea. Substitutes for pork include lamb, beef, and poultry (all of which must be slaughtered in a prescribed way so as to meet *halal* requirements).

Hindus believe in reincarnation—the rebirth of the human soul at the time of death. For many Hindus the highest goal of life is *moksha*—escaping from the cycle of reincarnation and entering a state of eternal happiness called *nirvana*. Strict Hindus do not eat or willfully harm any living creature because it may be a reincarnated human soul.

Buddhists also seek *nirvana* (escape from reincarnation) through charity, modesty, compassion for others, restraint from violence, and general self-control.

Confucian thought is based partly upon rigid organizational structure and unswerving reverence for authority.

Judaism is the oldest religion to believe in one God and foods that are banned among strict Jews include pork and shellfish (such as lobster and crab). Meat is stored and served separately from milk. Other meats must be slaughtered according to a practice called *shehitah*. Meals prepared according to Jewish dietary traditions are called *kosher*.

Shinto teaches sincere and ethical behavior, loyalty and respect toward others, and enjoyment of life.

2. Q: *In what ways does religion affect international business activities?*

A: Knowing the principles of each religion wherever a firm operates can help reduce cultural conflict. Different religions take different views of work, savings, and material goods. Understanding why they do so may help us to understand why companies from certain cultures are more competitive in the global marketplace. It also may help us understand why some countries develop more slowly than others. Knowing how religion affects business practices is especially important in countries with religious governments.

3. Q: *Identify the dominant religion in each of the following countries: (a) Brazil, (b) China, (c) India, (d) Ireland, (e) Mexico, (f) Russia, and (g) Thailand.*

A: (a) Christianity—Roman Catholic; (b) Chinese—Buddhist, Taoist, and Confucian; (c) Hinduism; (d) Christianity—Roman Catholic; (e) Christianity—Roman Catholic; (f) Christianity—Eastern Orthodox; and (g) Buddhism—Southern Buddhist.

### Quick Study 5 (p. 63)

1. Q: *Define communication. Why is knowledge of a culture's spoken language important for international business?*

A: *Communication* is a system of conveying thoughts, feelings, knowledge, and information through speech, writing, and actions. Gaining knowledge of a culture's spoken language is important for international managers because this knowledge provides insight into why people think and act the way they do.

2. Q: *Describe the threat faced by endangered languages. What is being done to help them survive?*

A: There are about 6,000 languages in the world, of which about 90 percent have fewer than 100,000 speakers. By the end of this century, more than half of the world's languages may be lost, and perhaps fewer than 1,000 will survive. To help combat this trend, linguists are creating videotapes, audiotapes, and written records of endangered tongues before they disappear. Communities are also taking action. In New Zealand, Maori communities set up nursery schools called "language nests," that are staffed by elders and lessons are conducted entirely in Maori.

3. Q: *What is a lingua franca? Describe its implications for conducting international business.*

A: A *lingua franca* is a link language that is understood by two parties who speak different native languages. English is the *lingua franca* of global business, higher education, diplomacy, science, popular music, entertainment, and international travel. More than 70 nations give a special status to English (including India, Nigeria, and Singapore) and roughly one quarter of the world's population is fluent or competent in it.

4. Q: *Why is body language important for international business? Give several examples of how it differs across cultures.*

A: Body language is important because it reflects cultural communication styles through unspoken movements. It communicates through hand gestures,

facial expressions, physical greetings, eye contact, and the manipulation of personal space. Like spoken language, it communicates both information and feelings and differs greatly from one culture to another. Italians, for example, animate conversations with lively hand gestures and other body motions. Japanese and Koreans, although more reserved, communicate just as much information through their own body languages; a look of the eye can carry as much or more meaning as two flailing arms.

### Quick Study 6 (p. 66)

1. Q: *Why is the education level of a country's people important to international companies?*

A: Multinational firms often rely on education statistics to determine whether a culture represents a good market for their products or a good location for production or assembly facilities. Such statistics also help companies determine how to promote products to potential customers after the decision is made to enter a market. Finally, a highly educated workforce typically attracts high-paying jobs in many high-tech industries.

2. Q: *What is meant by the terms brain drain and reverse brain drain?*

A: *Brain drain* is the departure of highly educated people from one profession, geographic region, or nation to another. *Reverse brain drain* occurs when a profession, region, or nation lures back these highly educated professionals.

3. Q: *How are a people's culture and physical environment related?*

A: Two aspects of the physical environment (topography and climate) influence a people's culture. *Topography* is all the physical features that characterize the surface of a geographic region. Topography such as treacherous mountain ranges, large bodies of water, and deserts can increase cultural dissimilarity and hinder cultural diffusion.

*Climate* can influence a people's work patterns, such as when people in hot climates take breaks of one or two hours in the middle of the day to rest and then return to work in the cooler hours of late afternoon. People in cultures with hot and humid tropical climates wear little clothing to stay as cool as possible. People in cultures with hot and dry sunny climates often wear long, loose-fitting clothing to protect them from intense sunshine and blowing sand. Climate also affects the types of vegetation and animals living in a specific region and therefore influences a people's diet.

4. Q: *What is the significance of material culture for international business?*

A: All the technology employed in a culture to manufacture goods and provide services is called *material culture*. Changes in material culture often cause changes in other aspects of a people's culture. An increasingly sophisticated material culture dictates rising incomes and a greater emphasis on material goods and, even, the development of a consumer culture. Material culture is often uneven across a culture and can result in different regions developing at far different paces.

### Quick Study 7 (p. 70)

1. Q: *What six dimensions comprise the Kluckhohn–Strodtbeck framework for classifying cultures?*

A: This framework captures the essence of a culture by answering six questions:

- Do people believe that their environment controls them, that they control the environment, or that they are part of nature?
- Do people focus on past events, on the present, or on the future implications of their actions?
- Are people easily controlled and not to be trusted, or can they be trusted to act freely and responsibly?
- Do people desire accomplishments in life, carefree lives, or spiritual and contemplative lives?
- Do people believe that individuals or groups are responsible for each person's welfare?
- Do people prefer to conduct most activities in private or in public?

2. Q: *What are the five dimensions of the Hofstede framework for classifying cultures?*

A: The *Hofstede framework* applies the following five dimensions to analyze cultures:

- *Individualism versus collectivism*: Identifies whether a culture holds individuals or the group responsible for each member's welfare.

- *Power distance*: Describes the degree of inequality between a culture's people in different occupations.
  - *Uncertainty avoidance*: Identifies a culture's willingness to accept uncertainty about the future.
  - *Achievement versus nurturing (quantity versus quality of life)*: Cultures focused on quantity of life emphasize accomplishments such as power, wealth, and status. Cultures that stress quality of life generally have more relaxed lifestyles and people are more concerned with cultivating relationships and the general welfare of others.
  - *Long-term orientation*: Indicates a society's time perspective and an attitude of overcoming obstacles with time. It attempts to capture the differences between Eastern and Western cultures.
3. Q: *Briefly explain how each framework can be used to analyze a culture.*

A: Both the Kluckhohn–Strodtbeck and Hofstede frameworks can be employed to analyze a culture by assessing each dimension on an individual basis. After determining how the selected culture scores along each cultural dimension, a more comprehensive determination of the compatibility with the foreign culture with your own cultural values can be analyzed. It is important to understand the specific cultural differences between two cultures, such as the difference in individualism between the United States and Japan, prior to establishing a relationship with a foreign firm or establishing a policy for a joint venture agreement.

## TALK IT OVER

1. Q: *Two students are discussing the various reasons why they are not studying international business. "International business doesn't affect me," declares the first student. "I'm going to stay here, not work in some foreign country." "Yeah, me neither," agrees the second. "Besides, some cultures are real strange. The sooner other countries start doing business our way, the better." What counterarguments can you present to these students' perceptions?*

A: First, students should present a counterargument to the statement that international business does not affect them if they do not work in another country. Today, international business reaches deep into nearly every domestic economy. It affects the foods we consume, the movies we watch, the cars we drive, the computers we use, the clothing we wear, and so on. Chapter 1 explains how every national business environment is affected by events occurring in other nations. Second, students should recognize the emphasis on

the words “foreign” and “strange.” This betrays an ethnocentric bias in which anyone or anything from other countries is considered “foreign” and different ways of thinking or acting is considered “strange.”

2. *Q: In this exercise, two groups of four students each will debate the benefits and drawbacks of individualist versus collectivist cultures. After the first student from each side has spoken, the second student questions the opponent’s arguments, looking for holes and inconsistencies. A third student attempts to reply to these counterarguments. Then, a fourth student summarizes each side’s arguments. Finally, the class votes on which team presented the more compelling case.*

*A: First, students should question the origins of these terms. Students’ statements may be biased depending on their cultural origins or those of their parents. The culture of Greece is very different from many of those found in Northern and Western Europe, such as Germany. They differ in their attitudes toward the use of time and the pace of work. This is at least somewhat affected by the fact that Greece is extremely warm for nearly one-half of the year. German culture places an emphasis on punctuality and hard work whereas Greek culture places greater emphasis on enjoying as much free time as possible. These differences reflect different underlying values in the two cultures. German culture tends to emphasize quantity of life accomplishments whereas Greek culture focuses on quality of life measures. German culture is also more open to risk-taking (small uncertainty avoidance) than Greece and is characterized by greater individualism that tends to promote entrepreneurial drive. Throughout the debate, students should give specific examples to support their general statements. An instructor may want to point out inaccuracies in students’ statements prior to voting, and note that any statements do not imply the superiority of one culture over another.*

## **TEAMING UP**

1. *Q: Research Project. Select a company in your city or town that does business internationally and make an appointment to interview the owner or a senior manager. Your team’s goal is to learn how cultural differences affect the decisions of this business as it pursues international opportunities. How does the company balance the need for global efficiency and local responsiveness in a cultural sense? Has local culture ever required the company to alter its personnel or corporate practices? Be sure to ask your interviewee for specific examples. Present a brief talk or paper on your group’s interview findings.*

*A: Students may want to use the content of this chapter as a guide to create the questions they will ask the interviewee. Students should include in their report a full account of the cultural elements their interview uncovers. Student teams*



may also enjoy comparing their findings to look for similarities and differences among companies.

2. *Q: Market Entry Strategy Project. This exercise corresponds to the MESP online simulation. For the nation you are studying, list several of its people's manners and customs. What values do people hold dear? Describe their attitude toward time, work, and cultural change. What religions are practiced there? What language(s) are spoken? What ethnicities reside in the nation, and do they form distinct subcultures? Describe the nation's social structure, and its education system. Turn to Figures 2.2 and 2.3 and either (a) explain why you think the nation appears where it does, or (b) identify where you think it belongs on the figure and explain why. Integrate your findings into your completed MESP report.*

A: This may be a good time to get students working on their Market Entry Strategy Project. This exercise gets students to learn more about a country, and to generate interest in countries other than their own. The project focuses on important aspects of each country and the process can begin to develop teamwork in the course.

## **ETHICAL CHALLENGES**

1. *Q: You are the vice president of operations for a U.S.-based software firm. Your firm's board of directors wants you to explore building a software design operation in India. Typically, when international firms enter the Indian market, they quickly learn about the various ways in which a rigid caste system can affect business activities. Do you think it will be possible to uphold a U.S. management style in India? Or should your company be prepared to adjust to the local Indian managerial style and human resource practices?*

A: Students must understand that understanding cultural differences is crucial to developing strong relationships. The question in this vignette poses a real dilemma for international companies operating in India. Local management practices can be very different from the company's practices in its home country. The response by most companies is to implement the home country policies but to adapt them to the local market. This is probably best accomplished by placing as head of the Indian operation an Indian-born employee that has worked for the company in the home country who understands the corporate culture. This manager would know what policies can or cannot be implemented in the Indian subsidiary.

2. *Q: You are the vice president of international operations for a large pharmaceutical firm that manufactures an anti-malarial drug. Your firm is*

*considering opening up a factory in a small Central American nation where malaria is common. The operation will be a cooperative venture between your firm and the local government. The majority of the people in that country cannot afford the medicine because of the high import tariffs. Yet if your plan goes through, more than 200 jobs will be created and the drug's international price will drop by more than 50 percent. In a final meeting with a senior government official, the gentleman informs you that, if you pay him \$500,000 cash, the deal will go through. What issues must you consider? What do you do?*

A: First, there is no guarantee that paying the bribe will secure the deal. Also, this government official may not have the authority to make the deal happen. If the bribe is paid, the behavior may be encouraged and you may have to expect to pay more bribes in the future. The moral trade-off between creating jobs and helping people versus paying bribes and breaking laws is key. The government official, customers, and company (in terms of profits) win. But who loses? Finally, the Foreign Corrupt Practices Act, and its prohibition of U.S. managerial bribe payments to foreign government officials to secure contracts, must be addressed. This bribe is illegal by U.S. law (and probably by local law as well). A discussion of what is legal versus what is moral in this context is worthwhile. An explanation of the moral philosophy, Consequentialism, is ideal at this point.

3. *Q: You are the public relations director for a company that recently announced its decision to close its factory in the United States and outsource the work to manufacturers in Asia and Latin America. Your firm is doing just what many other companies have already done, reducing labor costs by shifting work to low-wage countries such as China, India, Mexico, and Central American nations. Yet the media and disgruntled workers are lambasting your firm's decision. Is there a reasonable response to charges that the companies you will hire frequently exploit child labor, force women to work 75-hour weeks, and destroy family units?*

A: As the head of Public Relations, this will be a challenging ordeal. Emphasis must be placed on the many positive outcomes of the outsourcing decision. Issues such as keeping retail prices low, increasing shareholder wealth, adhering to local laws abroad, and creating foreign jobs can be discussed. Moreover, students should first of all recognize the bias in this statement. Many companies relocate labor-intensive operations to low-wage countries. But they also involve themselves in the local community to better people's lives, not exploit workers at the expense of education and family. They do this because human rights groups are active in every country and closely monitor the activities of multinational firms. If they abuse the rights of local workers, they receive a great deal of bad publicity in the home country—hurting their

reputation and, perhaps, sales. Firms also do it because they recognize how important an educated, healthy, and happy workforce is to productivity.

## PRACTICING INTERNATIONAL MANAGEMENT CASE

### A Tale of Two Cultures

1. *Q: If your international firm were doing business in Asia, would you feel partly responsible for these social trends? Is there anything that your company could do to ease the tensions these cultures are experiencing? Be specific.*

A: This question presents students with an ethical dilemma. Some students will say that their company is in business to earn a profit and that Asian consumers are not being forced to buy Western goods—they make a conscious decision when they make a purchase. Other students will feel a sense of responsibility to those societies in which they market their products. These students will want to suggest ways to lessen tensions in those societies. Some possibilities for this include doing charity work to help people suffering economic difficulties, financially supporting and giving employees time off to do volunteer work for cultural fairs and festivals, and making counselors available in the company to help employees with their troubles.

2. *Q: In your opinion, is globalization among the causes of the increasing incidence of divorce, crime, and drug abuse in Asia? Why or why not?*

A: Many students will agree that the forces of globalization are exposing people in all countries to new ways of thinking and behaving. However, many social ills are not a direct result of globalization, but of other forces causing social change. Drug use is certainly not a new problem in most countries—opium has been used across Asia for centuries. Also, many women in Asian cultures are no longer financially dependent on their spouses because of the growing employment of women in the workforce. Thus when marital problems arise, divorce can be a viable option unlike in the past. This is not a Western phenomenon being spread by globalization, but one tied to economic development and industrialization more generally.

3. *Q: Broadly defined, Asia comprises more than 60 percent of the world's population—a population that practices Buddhism, Confucianism, Hinduism, Islam, and numerous other religions. Thus, do you think it is possible to carry on a valid discussion of "Asian" values? Why or why not?*

A: Clearly, there are important and significant differences between Asian societies. But some values tend to be Pan-Asian, including the extended family

concept—in contrast to the nuclear family concept in Western cultures. Also, respect for community elders is deeply ingrained throughout Asia—unlike the Western emphasis on youth and vitality (most pronounced in the United States). Thus, certain cultural elements can be discussed as “Asian” just as we identify certain concepts and behaviors as “Western.” But the validity of generalizing about “Asian values” depends on the depth of the discussion. The deeper we explore Asian cultures, the more differences we uncover.

4. Q: Consider the following statement: “Economic development and capitalism require a certain style of doing business in the twenty-first century. The sooner Asian cultures adapt the better.” Do you agree or disagree? Explain.

A: The statement is clearly biased toward Western management practices. But it is true that many companies worldwide are learning Western business principles. Companies are trying to instill a drive toward greater efficiency and are showing a greater appetite for trying new management techniques. The shift toward Western management principles in Asia was seen during the Asian economic crisis: Governments passed laws forcing greater transparency among companies and banks, and U.S. and other Western companies bought bankrupt Asian companies and radically altered how they were run. But no matter how rapid the pace of change, Asian companies will always retain practices that make them unique.

## CHAPTER 3: POLITICS, LAW, AND BUSINESS ETHICS

### LEARNING OBJECTIVES

1. Describe each main type of political system.
2. Identify the origins of political risk and how managers can reduce its effects.
3. Describe each main type of legal system and the important global legal issues.
4. Explain ethics and social responsibility and key issues facing international companies.
5. Explain how international relations affect international business activities.

### QUICK STUDY QUESTIONS

#### Quick Study 1 (p. 82)

1. Q: *What is a political system? Explain the relation between political systems and culture.*

A: A *political system* includes the structures, processes, and activities by which a nation governs itself. A people's political system derives from their history and culture. Factors such as current population, age and race composition, and per capita income influence a country's political system.

2. Q: *Identify the three main features of totalitarianism.*

A: *Totalitarianism* is a political system in which individuals govern without the support of the people, tightly control people's lives, and do not tolerate opposing viewpoints. *Imposed authority* means that an individual or group forms the political system without the explicit or implicit approval of the people. A *lack of constitutional guarantees* means that a totalitarian system denies its citizens the constitutional guarantees of democracies. *Restricted participation* means that political representation is limited either to parties that are sympathetic to the government or to those that pose no credible threat.

3. Q: *Briefly explain each form of totalitarianism.*

A: *Theocratic totalitarianism* is a political system that is under the control of totalitarian religious leaders. Historically, theocratic totalitarianism has badly damaged the economies of those nations implementing it.

*Secular totalitarianism* is a political system in which leaders rely on military and bureaucratic power. *Communist totalitarianism* is when a government has sweeping political and economic powers. In this type of system, private business is virtually or totally nonexistent. These types of political systems often do not allow inward investment or do so selectively. They make investing in a country less appealing because governments can act as they wish and can destroy the profitability of an operation.

*Tribal totalitarianism* is where one tribe (ethnic group) imposes its will on others with whom it shares a national identity. Nations with this type of political system typically discourage investment because they are often characterized by a great deal of civil unrest, ethnic conflict, or even war.

*Right-wing totalitarianism* is where the government endorses private ownership of property and a market-based economy but grants few (if any) political freedoms. Countries with this type of political system are typically very attractive to international companies as a location for investment. The government wants financial returns to pay for better education, infrastructure, and so on for their people but creates stability through suppression of free political expression.

4. Q: *How might a totalitarian government affect business activities?*

A: Doing business in a totalitarian country can be a risky proposition. Many facets of business law pertain to contractual disputes. In a country such as the United States, laws regarding the resolution of such disputes are quite specific. In totalitarian nations, the law can be either vague or nonexistent, and people in powerful government positions can interpret laws largely as they please. For instance, in China it may not matter so much what the law states as it does how individual bureaucrats interpret the law. The sometimes arbitrary nature of totalitarian governments makes it hard for companies to know how laws will be interpreted and applied to their particular business dealings.

### **Quick Study 2 (p. 84)**

1. Q: *What is democracy? Explain the difference between democracy and totalitarianism.*

A: *Democracy* is a political system in which government leaders are elected directly by the wide participation of the people or by their representatives. In a democracy, the views and opinions of the people are incorporated into the national decision-making process. Democracies, in general, represent more stable business environments than do totalitarian systems because laws protecting individual property rights are enforced. Democracies also tend to

have a greater portion of the country's factors of production under private ownership. Totalitarian systems tend to have a greater portion of the factors of production under government ownership.

2. Q: *What five freedoms does a representative democracy strive to provide its people?*

A: (1) Freedom of expression, (2) periodic elections, (3) full civil and property rights, (4) minority rights, and (5) nonpolitical bureaucracies.

3. Q: *How might a democratic government affect business activities in a nation?*

A: Democracies maintain stable business environments primarily through laws that protect individual property rights. In theory, commerce prospers when the private sector includes independently owned firms that exist to make profits. Bear in mind that although participative democracy, property rights, and free markets tend to encourage economic growth, they do not always do so. India, for example, is the world's largest democracy; but it experienced slow economic growth for decades. Meanwhile, some countries achieved rapid economic growth under nondemocratic political systems. Asia's four tigers—Hong Kong, Singapore, South Korea, and Taiwan—built strong market economies absent of truly democratic practices.

### Quick Study 3 (p. 90)

1. Q: *What are the five main types of political risk? How might each affect international business activities?*

A: *Conflict and violence* can arise from people's resentment toward their government or over territorial disputes between countries. Violent disturbances impair a company's ability to manufacture and distribute products, obtain materials and equipment, and recruit talented personnel.

*Terrorism* aims to create fear and force change through the sudden and unpredictable destruction of life or property. *Kidnapping* and the taking of hostages may be used to fund a terrorist group's activities. Each of these increases risks for international companies because expatriate executives are prime targets because their companies can afford large ransoms.

*Property seizure* also increases the risks for international firms and can cause them to avoid investing in nations implementing such tactics.

*Policy changes* can result from civil or social unrest or might represent the views of newly empowered political parties. They can cause managers to regard a nation's business environment as one of a "field of moving goal posts."

*Local content requirements* are regulations that require international manufacturers to use a certain amount of local resources. They foster local business activity and ease regional or national unemployment, but can also force companies to invest elsewhere if they are too confining.

2. Q: *Identify several steps managers can take to stay safe while on an international assignment.*

A: Managers should be cautious traveling to their destination and moving about the country. Specifically, a) take nonstop flights, b) vary routines, c) keep a low profile, d) guard personal data, e) use good judgment, and f) know local S.O.S. procedures.

3. Q: *Distinguish between confiscation, expropriation, and nationalization.*

A: Each of these is a form of property seizure. *Confiscation* is the forced transfer of assets from a company to the government without compensation. *Expropriation* is the forced transfer of company assets with compensation. *Nationalization* is government takeover of an entire industry.

4. Q: *What three methods can businesses use to manage political risk?*

A: (1) *Adaptation* involves incorporating risk into business strategies—often with the help of local officials. Companies can incorporate risk by establishing partnerships, localizing operations, offering development assistance, and obtaining insurance. (2) *Information gathering* involves monitoring and even trying to predict political events that could threaten local operations and future earnings. (3) *Political influence* involves proposing changes that positively affect their local activities, often through lobbying.

#### **Quick Study 4 (p. 92)**

1. Q: *What is meant by the term legal system?*

A: A legal system is a country's 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. A legal system is influenced by many cultural variables, including class barriers, religious beliefs, and whether



individualism or group conformity is emphasized. Many laws, rules, and regulations are used to safeguard cultural values and beliefs.

2. Q: *Explain the role of nationalism in politics.*

A: Nationalism can play a significant role in the political process of a country. Nationalism is essentially the devotion of a people to their nation's interests and advancement, it typically involves intense national loyalty and cultural pride, and it is often associated with drives toward national independence. A country's legal system is influenced by its political system that reflects nationalistic attitudes. Totalitarian governments tend to favor public ownership of economic resources and enact laws limiting entrepreneurial behavior. In contrast, democracies tend to encourage entrepreneurial activity and to protect small businesses with strong property-rights laws. The rights and responsibilities of parties to business transactions also differ from one nation to another. For all these reasons, business strategies must be flexible enough to adapt to different legal systems. In India, for instance, because most business laws originated when the country was struggling for "self-sufficiency," the legal system tended to protect local businesses from international competition.

3. Q: *Identify the main features of each type of legal system (common, civil, and theocratic).*

A: Most legal systems fall into one of three categories. A *common law* system is one in which the justice system decides cases by interpreting the law on the basis of tradition, precedent, and usage. A *civil law* system is based on a detailed set of written rules and statutes that constitute a legal code. A *theocratic law* system is one that is based on religious teachings. Three prominent theocratic legal systems are Islamic law, Hindu law, and Jewish law.

### Quick Study 5 (p. 96)

1. Q: *What are intellectual property rights? What is the significance of such rights?*

A: *Intellectual property rights* are legal rights to resources that result from intellectual abilities and any income these resources generate. Like other types of property, intellectual property can be traded, sold, and licensed in return for fees or royalty payments. Intellectual property laws are designed to compensate people whose property rights are violated.

2. Q: *Explain the term industrial property. What are its two types?*

A: *Industrial property* includes patents and trademarks. A *patent* is a right granted to the inventor of a product or process that excludes others from making, using, or selling the invention. *Trademarks* are words or symbols distinguishing a product and its manufacturer.

3. Q: *What is a copyright? Explain its importance to international business.*

A: *Copyrights* give creators of original works the right to publish or dispose of them as they choose. Copyrights give creators of original works the freedom to publish or dispose of them as they choose. The copyright holder can (1) reproduce the copyrighted work, (2) derive new works from it, (3) sell or distribute it, (4) perform it, and (5) display it publicly.

4. Q: *Identify the ramifications of antitrust (antimonopoly) laws and product liability laws.*

A: *Antitrust (antimonopoly) laws* are designed to prevent companies from fixing prices, sharing markets, and gaining unfair monopoly advantages. Antitrust efforts increase competition and thereby keep products fairly priced and ensure a variety of products in any one category.

*Product liability laws* hold manufacturers, sellers, and others responsible for damage, injury, or death caused by defective products. They differ greatly from one nation to another. The United States has the toughest product liability laws in the world, with Europe a close second. Awarded damages tend to be several times larger in the United States than in other developed nations. Developing and emerging countries have the weakest laws. Enforcement of such laws also varies from nation to nation, with highly developed countries being the strictest enforcers.

### **Quick Study 6 (p. 103)**

1. Q: *Define ethical behavior and corporate social responsibility.*

A: *Ethical behavior* is personal behavior in accordance with guidelines for good conduct or morality. *Corporate social responsibility* is the practice of companies going beyond legal obligations to actively balance commitments to investors, customers, other companies, and communities.

2. Q: *What are four commonly cited philosophies of business ethics and social responsibility?*

A: The *Friedman view* says that a company's sole responsibility is to maximize profits for its owners (or shareholders) while operating within the law. Today, many people disagree with this argument and assume a company has CSR obligations and the issue is how it will fulfill them.

The *cultural relativist view* says that a company should adopt local ethics wherever it operates because all belief systems are determined within a cultural context. It sees truth, itself, as relative and argues that right and wrong are determined within a specific situation. "When in Rome, do as the Romans do" captures the essence of cultural relativism.

The *righteous moralist view* says that a company should maintain its home-country ethics wherever it operates because the home country's view of ethics and responsibility is superior to others' views.

The *utilitarian view* says that a company should behave in a way that maximizes "good" outcomes and minimizes "bad" outcomes wherever it operates. A utilitarian manager asks the question, "What outcome should I aim for?" and answers, "That which produces the best outcome for all affected parties."

3. Q: *List several issues of ethics and social responsibility relevant to international managers.*

A: Business leaders realize that the future rests on healthy workforces and environments. Still, international managers face dilemmas on a daily basis. (1) Bribery and corruption lead to the misallocation of resources, hurt economic development, distort public policy, and damage the integrity of "the system." In 2002, Congress passed the Sarbanes-Oxley Act, which set more stringent accounting standards and reporting practices. (2) Managers must monitor behavior of themselves, employees, and business partners. Governments, labor unions, consumer groups, and human rights activists force apparel companies to implement codes of conduct and monitoring principles in international production. (3) Fair trade products involve companies working with suppliers in more equitable, meaningful, and sustainable ways. TransFair USA certifies that a product embodies fair prices, fair labor conditions, direct trade, democratic community development, and environmental sustainability. (4) Companies pursue "green" initiatives to reduce their toll on the environment and to reduce operating costs and boost profit margins. *Carbon footprint* refers to the environmental impact of greenhouse gases (measured in units of carbon dioxide) that results from human activity.

4. Q: *Why are international relations among countries important to international business?*

A: Favorable political relationships foster stable business environments and increase international cooperation. A stable environment requires a strong legal system to resolve disputes quickly and fairly. Multilateral agreements are treaties concluded among several nations, each of which agrees to abide by treaty terms even if tensions develop. All of these are helped by the presence of good relations among countries.

## TALK IT OVER

1. *Q: The Internet and the greater access to information it can provide are forcing politicians to change their methods of governing. How might the Internet change totalitarian political systems, such as North Korea? What might the Web's future expansion mean for nations with theocratic systems, such as Iran? How might technology change the way that democracies function?*

A: Control of information and state-run media that bias news reports in their favor help totalitarian leaders remain in power. The Internet is making it more difficult for leaders to maintain absolute control. Theocratic states sometimes also rely on closed media that is controlled by the government. At the very least, they censor much incoming programming to weed out what the government considers immoral. The Internet is also making it more difficult for theocracies to restrict access to information that is not created by or permitted by the government.

The Internet may also radically alter the way that democracies function. For instance, with the necessary infrastructure, online voting for the masses could soon become a reality. Many U.S. states are exploring online voting for state elections but are cautious out of concerns over fraud. Because online voting may make it easier for many citizens to vote, it could spark greater use of referendums. This could make many representative democracies closer resemble pure democracies—in which *all* citizens are involved in most decisions.

2. *Q: Under a totalitarian political system, the Indonesian economy grew strongly for 30 years. Meanwhile, the economy of the largest functioning democracy, India, performed poorly for decades until recently. Relying on what you learned in this chapter, do you think the Indonesian economy grew despite or because of a totalitarian regime? What might explain India's relatively poor performance under a democratic political system?*

A: It is quite probable that the types of political systems in place in Indonesia and India have played large roles in the pace of economic development in these two countries. In the case of Indonesia, President Suharto's long reign in

power (which ended in 1998) created a right-wing totalitarian state that was very pro-business. Suharto's family grew incredibly wealthy in the process, but it can also be argued that Indonesia's general population would not have fared nearly as well over these recent decades if it were not for the stability that the Suharto regime provided. After a year of pro-democracy demonstrations, Indonesia held its first free election in 44 years in 1999. If the country moves away from the "Golkar" party, it will be interesting to see if true democracy will come to Indonesia and what it will mean for business and the economy.

India is clearly a democracy and should therefore create a stable business environment. In the past, numerous political parties and resulting coalition governments made it difficult for India to create consistent policies on domestic economic and business issues. One administration took an anti-free market stance and the subsequent one took a pro-business stance. This made India a risky proposition for multinationals because the ground rules were continuously in flux. But today India is more pro-business than at any time in its history. Still, some politicians encourage antiforeigner sentiment and demonstrations because they help to unify the electorate.

3. Q: Consider the following statement: "Democratic political systems, as opposed to totalitarian ones, provide international companies with more stable environments in which to do business." Do you agree? Why or why not? Support your argument with specific country examples.

A: This question forces students to examine the relation between the type of political system and economic performance from a theoretical perspective. They will often look for country examples that support the statement. Indonesia had stellar growth under totalitarianism whereas India had slow growth under democracy. Analyzing India in detail allows students to see an example of how political change can disrupt the investment plans of multinational companies—even in democracies.

India in Detail: India is an independent republic made up of 25 states and 7 territories. A president serves as India's head of state but a prime minister actually heads the government. India's constitution went into effect in 1950. Like the American Bill of Rights, it names and guarantees the basic equal rights of every citizen. The Indian Constitution gives every person who is 21 years of age or older the right to vote. It prohibits unequal treatment on the basis of race, religion, caste (social class), sex, or place of birth. The document also contains goals for the federal and state governments including decent working conditions, fair wages, and old-age assistance.

India has a parliament-cabinet form of democratic national government. Parliament meets at New Delhi, the capital of India. It consists of the Lok

Sabha (House of the People) and the Rajya Sabha (Council of States). The prime minister is usually the leader of the political party that has the most seats in Parliament. The president appoints the prime minister to office. The prime minister chooses a cabinet and heads the government with the support of Parliament. If Parliament withdraws its support, the president either dismisses the prime minister or dissolves the Lok Sabha and calls a new election. Parliament and all the state legislatures elect the president to a five-year term.

Representatives of states and territories make up Parliament, the numbers of which increase or decrease along with changes in the population of the state or territory. The voters elect most of the 545 members of the Lok Sabha. They serve five-year terms unless the Lok Sabha is dissolved. Most of the 244 members in the Rajya Sabha are elected by state legislatures. They serve six-year terms and every two years, one-third of them stand for reelection. The president appoints a few members of each body.

The Congress Party, or one of the branches that developed from it, has ruled India almost continuously since 1947. In the early days, the Congress Party had a majority in Parliament but today must frequently form coalitions with other parties.

Parliament has great power over the states. It can change the state boundaries, and even break up old states to make new ones. Parliament can prevent the Supreme Court from interfering in certain types of legislation. In an emergency, Parliament can also take over the powers of the state legislatures. It taxes the largest sources of money, such as personal and business income. The states can tax only the poorer sources, such as real estate. As a result, the states rely heavily on Parliament for financial assistance.

The Indian states have a governor, a chief minister, and a legislature composed of one or two houses. The federal government rules the seven territories through appointed officials. The president of India appoints the state governors who name chief ministers, who are the leaders of the majority party in their state legislature. The people elect almost all of the legislators but the governor appoints some legislators. A Supreme Court heads India's court system. Each state in India has a High Court and a number of lower courts.

It is common today for India to be governed by a coalition government because of the very large number of political parties. India's political scene is almost always in a state of turmoil so that managers must closely monitor events.

## **TEAMING UP**

1. *Q: Debate Project. Two groups of four students each will debate the ethics of doing business in countries with totalitarian governments. After the first student from each side has spoken, the second student will question the opposing side's arguments, looking for holes and inconsistencies. The third student will attempt to answer these arguments. A fourth student will present a summary of each side's arguments. Finally, the class will vote to determine which team has offered the more compelling argument.*

A: Students arguing in favor of entering countries with totalitarian governments should consider the perspective of companies based in like countries, not just democratic ones. Many students will overlook the fact that many companies based in totalitarian countries do business in other like countries. Trying to view business from this perspective might challenge students not coming from such a country. For this reason, it can be interesting for international students in the class to be divided into different groups so that each group has a variety of opinions and perspectives.

Likewise, students arguing against entering totalitarian countries must grapple with whether their not investing will create political change—it oftentimes does not. These students will also need to accept the fact that not investing might actually mean a lower standard of living for people in the totalitarian country and perhaps less work at home for the multinational that would undertake the investment.

2. *Q: Market Entry Strategy Project. This exercise corresponds to the MESP online simulation. For the nation you are studying, what type of political and legal systems does it have? Do free elections take place? Is the government heavily involved in the economy? Is the legal system effective and impartial? Do political and legal conditions suggest the country could be a potential market? If so, for what kinds of goods or services might the market be appealing? What is the level of corruption in the nation? Is legislation pending that may be relevant to international companies? Integrate your findings into your completed MESP report.*

A: This may be a good time to get students working on their Market Entry Strategy Project. This exercise gets students to learn more about a country and to generate interest in countries other than their own. The project focuses on important aspects of each country and the process can begin to develop teamwork in the course.

## **ETHICAL CHALLENGES**

1. *Q: You are the president of a firm that publishes textbooks for medical students in more than 30 languages. On a recent trip to a university in a*

*developing country (with a GDP per capita of less than \$1,000 per year), you discover that many of the students are using bound photocopies of your best-selling medical textbook. Speaking with several students, they inform you that if they were required to pay for the actual books, they could not afford medical school. Witnessing the clear copyright violation firsthand, how do you react? What possible courses of action might you take? If additional information would be helpful to you, what would it be?*

A: We first need to know how many students and how many books are involved. If the financial impact is minimal, and this is a large firm, we could perhaps donate the books and benefit from goodwill. Yet if the financial impact is significant, a different alternative must be selected. Producing a low-cost version in the local country is another option. The firm could also attempt to sponsor a local scholar that could develop a textbook. An analysis of the theory of justice is relevant to this discussion.

2. *Q: You are the proprietor of a fledgling computer graphics company in Shanghai, China. The sophisticated business application software you need for your business normally sells for 2,900 renminbi (around \$350) at computer stores in Shanghai. But with an income of a little more than \$5,000 a year, you cannot afford to buy the original graphics software for your business. A friend has told you she can get you all the software you need, and more, at a nearby street market for only \$40. Because very few people buy official software, you know the authorities will not punish you if you are caught. Is it unethical for you to purchase the pirated software? Do you believe you are justified in doing so?*

A: This question forces students to consider the piracy issue from the perspective of a budding entrepreneur who cannot possibly afford the legal version of the software. One option that students often suggest is for companies to offer their products at reduced prices in markets where piracy is rampant. However, the company must be able to ensure that products are not then re-exported to other wealthier markets and sold at the official price—earning pirates a huge profit. Another is the precedent that is set for other markets—all people need to do to have companies reduce their prices would be to start an underground market. The position most students might arrive at is for multinationals to fight piracy but to be less forceful in the poorest markets.

3. *Q: You are the CEO of a major pharmaceutical firm that holds worldwide patents on several highly successful drugs. Your company invests heavily to develop its drugs because patents allow it to recoup its investment. But your firm has come under pressure from competitors selling cheaper alternatives, and from politicians and nongovernmental groups to supply drugs to people in*



*poor nations at reduced prices. Several senior executives in your company feel the firm is unfairly being asked to discount its drugs that treat diseases afflicting people of poor nations. Some executives suggested that the firm focus on drugs to treat diseases (such as heart disease and cancer) that occur mostly in wealthy nations, but you are uneasy with such a move. Would such a course of action be ethical? Diseases such as AIDS, cancer, and heart disease all kill their victims. Should drugs for only certain diseases be exempt from patent protection?*

A: To answer this question, students should read a few articles for more background information. This will help them understand the economics of the drug business. Companies must often sell their products for years in order to recoup their investment and earn a fair return. Students might also suggest government subsidies for makers of drugs that prevent death from certain diseases.

## **PRACTICING INTERNATIONAL MANAGEMENT CASE**

### **Pirates of Globalization**

1. Q: *What actions can companies and governments take to ensure that products cannot be easily pirated? Be specific.*

A: The first and most obvious response is to have an effective intelligence operation that has a close working relationship with local authorities worldwide. This gives a company a reputation of intolerance regarding counterfeiting and makes pirates aware that if they counterfeit the firm's products, they will be raided and prosecuted. Second, the tags on products can be emblazoned with special holograms that are extremely difficult, if not impossible, to duplicate. Buyers could then be made aware of how the hologram should appear. Third, companies can tighten security at their production sites so that employees cannot steal merchandise and sell it on their own—this is a significant problem in emerging markets, especially China. Fourth, companies should destroy any defective products coming off the assembly line rather than throwing them in the trash. This prevents pirates from fixing minor flaws or defects and selling them on the black market. Of course, there are many additional possibilities.

2. Q: *Do you think that the international business community is being too lax about the abuse of intellectual property rights? Are international companies simply afraid to speak out for fear of jeopardizing access to attractive markets?*

A: This question gets students to consider the ramifications of cracking down on counterfeiters in lucrative markets. A policy of zero tolerance in some

developing and emerging markets may invite the wrath of politicians and government bureaucrats. Officials might see multinationals with deep pockets as extremely greedy and determined to go after every petty pirate in a market. This can create a damaging backlash by local law enforcement.

3. *Q: Increased digital communication may pose a threat to intellectual property because technology allows people to create perfect clones of original works. How do you think the Internet is affecting intellectual property laws?*

A: The spectacular growth of e-business conducted over the Internet will force a reevaluation of intellectual property laws. Holders of intellectual property will likely want existing laws revised to protect them from hackers that break into company networks and others who monitor e-mails and other Internet traffic in an effort to steal valuable data and information.

4. *Q: Locate information on the Tiffany vs. eBay lawsuit mentioned in the case. Identify the arguments of the plaintiff and the defendant and who prevailed. What are the implications of that lawsuit for the sale of counterfeits in online auctions?*

A: Tiffany's allegation that eBay contributed directly to infringement of the Tiffany trademark due to the sale of counterfeit Tiffany jewelry is a strong warning to online auction houses. The policy of eBay has been to monitor its own site for fraud, yet that has been insufficient according to Tiffany executives. Defendant eBay was victorious in the lawsuit, though Tiffany is appealing the case. The ongoing saga can be tracked online through newspapers and search engines.

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## CHAPTER 4: ECONOMICS AND EMERGING MARKETS

### LEARNING OBJECTIVES

1. Describe what is meant by a centrally planned economy and explain why its use is declining.
2. Identify the main characteristics of a mixed economy and explain the emphasis on privatization.
3. Explain how a market economy functions and identify its distinguishing features.
4. Describe the different ways to measure a nation's level of development.
5. Discuss the process of economic transition and identify the obstacles for business.

### QUICK STUDY QUESTIONS

#### Quick Study 1 (p. 116)

1. *Q: Define economic system. What is the relation between culture and economics?*

*A: An economic system consists of the structure and processes that a country uses to allocate its resources and conduct its commercial activities. A nation's economy tends to express individual or group values as reflected in its history and culture. However, no economy is focused entirely on the group at the expense of individuals or vice versa.*

2. *Q: What is a centrally planned economy? Describe the link between central planning and communism.*

*A: A centrally planned economy is one in which a nation's government owns most of the land, factories, and other economic resources and plans nearly all economic activity. Karl Marx popularized the idea of central economic planning in the nineteenth century while promoting his belief in communism. Marx argued that market economies cannot be reformed—governments must be overthrown and economies replaced with more equitable “communist” systems.*

3. *Q: Identify several factors that contributed to the decline of centrally planned economies.*

A: Factors included: (1) failure to create economic value, (2) failure to provide incentives, (3) failure to achieve rapid growth, and (4) failure to satisfy customer needs.

4. Q: *Describe China's experience with central planning, and the challenges it faces.*

A: China always reserved a place for private initiative even in the early days of its implementation of communism in 1949. Families in rural areas owned their own land. Each family's crop production in excess of that dictated by central planners could be consumed by the family or sold on the open market. In 1979, the Chinese government strengthened work incentives in agriculture by allowing families to grow whatever crops they wanted and to sell the produce at market prices. The government also legalized township and village enterprises (TVEs) in 1984.

Challenges ahead for China include: (1) Political and social problems loom, such as skirmishes between secular and Muslim Chinese, and restrictions on democracy. (2) Unemployment, slow economic progress in rural areas, and misery of migrant workers. (3) China's one country, two systems policy must preserve order if Taiwan is ever going to freely accept reunification with the mainland.

### **Quick Study 2 (p. 122)**

1. Q: *What is a mixed economy? Explain the origin of mixed economies.*

A: A *mixed economy* is one in which land, factories, and other economic resources are more equally split between private and government ownership. Support for mixed economies grew out of the belief that an economic system must protect society from the excesses of unchecked individualism and organizational greed.

2. Q: *Explain the changes occurring in mixed economies and the role of privatization.*

A: The basic rationale underlying mixed economies is that a successful economic system must be not only efficient but also must protect society from excesses. Many mixed economies are beginning to mirror market-based systems. This is due in part to the need to be more competitive. By selling off government-owned businesses, nations are both embracing market-based economies and becoming more competitive from a tax and price perspective.

3. Q: Define what is meant by market economy and identify its three required features.

A: A *market economy* is an economic system in which the majority of a country's land, factories, and other economic resources are privately owned. To function smoothly, a market economy requires: (1) *Free choice* that gives individuals access to alternative purchasing options. (2) *Free enterprise* that gives companies the ability to decide which goods and services to produce and the markets in which to compete. (3) *Price flexibility* that allows most prices to rise and fall to reflect the forces of supply and demand.

4. Q: Explain government's role in a market economy. How are economic freedom and living standards related?

A: In a market economy, the government has relatively little direct involvement in business activities. Even so, it usually plays an important role in four areas: *enforcing antitrust laws*, *preserving property rights*, *providing a stable fiscal and monetary environment*, and *preserving political stability*. The more economic freedom a country has, the higher its per capita income is, but economic freedom does not *guarantee* a high per capita income.

### Quick Study 3 (p. 127)

1. Q: What is meant by the term economic development? Explain the relation between productivity and living standards.

A: *Economic development* is a measure for gauging the economic well-being of one nation's people, as compared to that of another nation's people. Three categories of nations regarding their levels of economic development are *developed* (e.g., Germany, Japan, and the United States), *newly industrialized* (e.g., India, Mexico, and Taiwan), and *developing* (e.g., Chad, Nicaragua, and Laos). Productivity can increase standards of living by bringing more wealth into a nation. Some experts argue that information technology (IT) can assist in the improvement of firm, and ultimately national, productivity and result in greater income at all levels. The Productivity Paradox refers to the lag between IT spending and productivity gains, which arise only after firms reorganize themselves around new technologies.

2. Q: Describe two measures of economic development and list their advantages and disadvantages.

A: *National production* provides a good estimate of a nation's overall wealth. It provides marketers with a broad indicator of whether a nation's people are

wealthy enough to purchase their products. It also gives managers an overall indicator of whether a nation has the level of development to support production facilities.

But there are problems with national production as an indicator of economic development. First, estimates for the wealth generated in the official economy can be almost meaningless for countries with large, shadow economies or those that extensively employ barter. Second, national production figures alone do not tell whether an economy is growing, static, or shrinking. Third, national averages ignore differences between different regions within a nation. Fourth, simply converting national production figures at official exchange rates does not provide any indication of the quantity of goods that money can actually buy in an economy. Finally, this indicator takes into account only the financial well-being of a people.

*Purchasing power parity* remedies the fourth disadvantage of national production figures. This modified national production indicator relays the quantity of goods that a person can buy in their own country using their own currency. The problem with this indicator of development is that it ignores other aspects of a people's total well-being.

3. Q: *Explain the concept of purchasing power parity. What are its implications for a nation's relative income per capita?*

A: (1) Purchasing power parity is the relative ability of two countries' currencies to buy the same "basket" of goods in those two countries. It shows what a currency can actually buy in real terms. This basket of goods represents daily-use items such as apples, rice, and soap. (2) Purchasing power parity can be used to compare the relative wealth of nations. For example, unadjusted Swiss GDP per capita is \$47,900. But, at PPP it falls to \$34,700 and is actually lower than the comparable figure for the U.S. GDP at PPP—\$39,700. Thus, it costs more to buy the same basket of goods in Switzerland than in the United States.

#### **Quick Study 4 (p. 129)**

1. Q: *Explain the value of the Human Development Index (HDI) in measuring a nation's level of development.*

A: The United Nations Human Development Index (HDI) evaluates the extent to which a government equitably provides its people with a long and healthy life, an education, and a decent standard of living. This indicator goes beyond estimating only financial wealth and directly assesses human aspects of development.

2. Q: *How are communicable diseases devastating human and economic development in some poor nations?*

A: A number of diseases create a serious challenge for poor nations and hamper the global economy. HIV/AIDS, tuberculosis, and malaria are rampant in some regions of the world. AIDS has killed more than 22 million people worldwide, tuberculosis kills 2 million people annually, and malaria kills between 1 and 3 million per year.

3. Q: *Identify the main characteristics of: (a) developed countries, (b) newly industrialized countries, (c) emerging markets, and (d) developing countries.*

A: (a) *Developed countries* are highly industrialized, highly efficient, and whose people enjoy a high quality of life. People in developed countries receive the finest health care and benefit from the best educational systems. Developed nations support aid programs to help poorer nations improve their economies and their standards of living. (b) *Newly industrialized countries* have recently increased the portion of national production and exports derived from industrial operations. In the past two decades, these countries have received an increasing share of total worldwide direct investment. (c) *Emerging markets* is the term for the group of countries formed by combining newly industrialized countries and countries that have the potential to become newly industrialized. They have developed some (but not all) of the operations and export capabilities associated with NICs. (d) *Developing countries* have poor infrastructures and low personal incomes. They may show potential for becoming newly industrialized countries, but typically lack the resources and skills to do so. They often rely for much of their wealth on production from one or a few sectors of the economy such as agriculture, mining, or oil.

### **Quick Study 5 (p. 132)**

1. Q: *What are several reform measures that are involved in economic transition?*

A: Several reform measures include: (1) stabilize the economy, reduce budget deficits, and expand credit availability; (2) allow prices to reflect supply and demand; (3) legalize private business, sell state-owned companies, and support property rights; and (4) reduce barriers to trade and investment and allow currency convertibility.

2. Q: *Describe some of the remaining obstacles to businesses in transitional economies.*

A: (1) A lack of managerial expertise caused by the fact that central planners formerly decided nearly every aspect of the nation's commercial activities hampers progress today. There was little need for managers to learn management skills including how to develop production, distribution, pricing, and marketing strategies. (2) A shortage of capital presents special problems because of the high cost of economic transition. Governments of nations in transition can often only afford a portion of the required investment. These nations lack capital because of the disastrous financial management during the years of central planning. (3) Economic transition can be especially slow when a nation's people find reform difficult for cultural reasons. In addition, importing modern management practices without tailoring them to the local culture can have serious consequences. (4) Environmental degradation caused by the headlong rush among transition economies to catch up to developed countries is leaving serious environmental damage in its wake. The direct effects of environmental destruction are evident in increased levels of sickness and disease, including asthma, blood deficiencies, and cancer—which obviously negatively impact national productivity.

3. Q: *Explain Russia's experience with economic transition.*

A: Russia's experiment with communism lasted nearly 75 years beginning in 1917—a longer period than for any other centrally planned economy. Communism became so ingrained in Russian culture in part because it endured for so many generations. Also, Russia's political and economic systems fell apart at the same time. The nation is now struggling to rebuild itself with new institutions. The political system is rife with corruption and contract killings of major political figures. The economy is in turmoil because of the government's empty coffers—this being a direct result of its inability to collect taxes because of the very little business actually being done in the “official” economy. Inflation is one force that has hampered more rapid progress. Personal incomes and business profits are eaten away by rising prices and costs.

## TALK IT OVER

1. Q: *The Internet has penetrated many aspects of business and culture in developed countries, but it is barely available in many poor countries. Do you think this technology will widen the economic development gap between rich and poor countries? Why or why not? Is there a way for developing countries to use such technologies as tools for economic development?*

A: The dissemination of the Internet throughout developed nations could very well widen the economic development gap between themselves and developing nations. One reason is that the Internet is creating economic



efficiencies in developed nations (particularly the United States). For example, companies can provide product information to potential buyers on the Internet any time of day or night that it is desired. The cost of having customer representatives attend to the basic needs of customers is therefore reduced.

Then when potential buyers contact the company they can simply order the product they desire or request any last-minute information they may want. Potential buyers can even purchase certain products such as books, music, and prescription drugs over the Internet directly—eliminating the need for buyers to travel to a store and perhaps even eliminating the need for a “store” to have a physical retail presence. These costs are passed on to buyers in the form of lower prices. Money saved by conducting business over the Internet can be used for other purchases or invested in new private ventures or government projects. Developing nations not taking advantage of such efficiencies could potentially fall further behind developed nations.

2. *Q: Imagine that you are the director of a major international lending institution supported by funds from member countries. What one area in newly industrialized and developing economies would be your priority for receiving development aid? Do you suspect that any member country will be politically opposed to aid in this area? Why or why not?*

*A: An international lending institution could provide newly industrialized and developing countries two types of aid. It could provide aid in the areas of health, education, and the general welfare of the recipient nation’s people. These investments could include schools, hospitals, prenatal care, pregnancy prevention, and so on. Aid could also be designed to improve a nation’s infrastructure such as in granting or guaranteeing loans to build roads, bridges, ports, and telecommunications networks, for example. It is unlikely that member nations would object to the education and health care investments. However, nations could certainly object to infrastructure improvements if a member had disagreements with the political leadership in a recipient nation. The donor nation might hope that withholding economic aid to a nation might cause changes in the recipient nation’s political leadership or ideals.*

3. *Q: Two students are discussing the pros and cons of different measures of economic development. “GDP per capita,” declares the first, “is the only true measure of how developed a country’s economy is.” The second student counters: “I disagree. The only true measure of a country’s economic development is its people’s quality of life, regardless of its GDP.” Why is each of these students’ statements incorrect?*

*A: Response to Student #1.*

Gross national product (GNP) per capita is a good estimate of a nation's overall wealth. It provides marketers with a broad indicator of whether a nation's people are wealthy enough to purchase their products. It also gives managers an overall indicator of whether a nation has the level of development to support production facilities.

However, there are problems with national production as an indicator of economic development. First, estimates for the wealth generated in the official economy can be almost meaningless for countries with large, underground economies (black markets) or those that extensively employ barter. Second, national production figures alone do not tell whether an economy is growing, static, or shrinking. Third, national averages ignore differences between different regions within a nation. Fourth, simply converting national production figures at official exchange rates does not provide any indication of the quantity of goods that money can actually buy in an economy. Finally, this indicator takes into account only the financial well-being of a people.

A: Response to Student #2.

The second student attempts to broaden the measure of economic development beyond financial statistics. By trying to say that there are other, noneconomic factors involved in determining development, the student's point is valid. For example, purchasing power parity relays the quantity of goods that a person can buy in their own country with their own currency. Also, human development indicators such as the United Nations Human Development Index (HDI) could be employed to estimate the extent to which a people have long and healthy lives, a solid education, and decent standards of living. As such, this indicator goes beyond financial wealth and assesses human aspects of development.

The fundamental flaw that this student makes is to ignore the central role of a strong GNP per capita in elevating quality of life. In an attempt to emphasize nonfinancial aspects of development, the student has ignored the fundamental resource that allows a people to have long life spans, receive an excellent education, and have a high standard of living.

## TEAMING UP

1. *Q: Debate Project. In this project, two groups of four students each will debate the benefits and drawbacks of both market and mixed economies. After the first student from each side has spoken, the second student will question the opposing side's arguments, looking for holes and inconsistencies. The third student will attempt to answer these arguments. A fourth student will present a summary of each side's arguments. Finally, the class will vote on which team has offered the more compelling argument.*

A: In this debate, assign one team to the side of market economies and the other to mixed economies. Note that students will often fully develop arguments for why their economic system is better than the other system. But they often fail to develop clear and defined arguments that diminish the drawbacks of their system. For example, students arguing for mixed economies should be able to explain why the social welfare system is worth (perhaps) higher taxes on citizens.

2. *Q: Market Entry Strategy Project. This exercise corresponds to the MESP online simulation. For the country your team is researching, what type of economic system does it have? Has it always had this type of economic system? Is it a developed, newly industrializing, emerging, or developing country? How does it rank on the various measures of economic development? Has it undergone any form of economic transition within the past 20 years? If so, how has that transition affected the culture and the country's political, legal, and economic systems? Integrate your findings into your completed MESP report.*

A: This may be a good time to get students working on their Market Entry Strategy Project. This exercise gets students to learn more about a country, and to generate interest in countries other than their own. The project focuses on important aspects of each country and the process can begin to develop teamwork in the course.

## **ETHICAL CHALLENGES**

1. *Q: You are the CEO of a Canadian–Chinese joint venture that operates in China. Your Chinese partner is the People's Liberation Army (PLA). The PLA has built a sprawling network of businesses that do everything from raise pigs to run airlines and hospitals, mine coal, manage hotels, and operate paging and cellular networks. As a business conglomerate, the PLA does business with international investors. Some argue that a large portion of foreign investment going to China is with companies and cartels controlled by the Chinese military. Others argue that it's easy to read too much into the PLA's foray into business. They point out that there is little centralized coordination among the thousands of businesses with military affiliations. Some companies are run by retired officers, others by civilians. As the CEO of the joint organization, do you have any ethical concerns about partnering with the PLA? If so, what are they? Suppose a clash between pro-democracy demonstrators and the PLA turns bloody. How would this turn of events affect business relations with your PLA partner? Are the ethical issues of partnering with the Chinese military any different from those that arise from exporting to China? Why or why not?*

A: Students' responses to the questions posed here hinge on past actions of the PLA. Because we know the history of the PLA in putting down demonstrations (Tiananmen Square, 1989) many students will take an ethical stance against partnering with the PLA or officers it employs. Students should also be able to distinguish between partnering with a PLA entity and exporting to China or investing in a wholly owned subsidiary there. If the PLA is not involved, students often say it is unethical to deny Chinese citizens access to the company's product. Nevertheless, individual political ideas and personal moral compasses will color students' responses to this ethical dilemma.

2. Q: *You are the managing director of your U.S. firm's subsidiary in southern France. The social-welfare states of Western Europe were founded after the Second World War with specific ethical considerations in mind: reduce social and economic inequality, improve living standards for the poor, and provide nearly free health care for all. Now many of these countries have trimmed social-welfare provisions and increased their reliance on market forces. Do you think that the ethical concerns of half a century ago are a thing of the past? Or do you feel that market reforms will simply re-create the conditions that motivated the development of the welfare state in the first place? What can you do as a manager to alleviate workers' fears that a more open economy will reduce their social safety net?*

A: As a manager, you must convey to your workers that there are risks involved with capitalism, yet the potential rewards are great. Ethical issues never become dated. The dilemma of the role of the state in providing for its people was argued two thousand years ago by the great philosophers of the time. The issues remain the same, only the context is different. The reason many Western European nations are cutting back on corporate welfare is because they believe market forces are more efficient at allocating resources in most situations. They are also imposing austerity programs to reduce rising government debt levels since the global recession began in 2008–2009. The extent to which these nations cut back on social-welfare benefits for individuals is impossible to estimate. However, it is highly unlikely that we will anytime soon see the kinds of conditions that existed in Europe immediately following the Second World War.

## **PRACTICING INTERNATIONAL MANAGEMENT CASE**

### **Cuba Comes Off Its Sugar High**

1. Q: *Why do you think the Cuban government requires non-Cuban businesses to hire and pay workers only through the government? Do you think it is ethical for non-Cuban businesses to enter into partnerships with the Cuban government? Why or why not?*

A: The Cuban government is clearly skimming off the top the difference between what it is being paid for workers and what is actually paid to workers. This allows the government to keep the people under its thumb because they continue to feel powerless with little or no voice in matters. The practice also allows the government to control where these profits go such as into the military, infrastructure, or perhaps into the private offshore bank accounts of politicians and powerful business leaders.

2. Q: *Do some research on Cuba, and describe a scenario for economic transition in the event that the current regime collapses. How do you think transition to a market economy in Cuba would differ from the experiences of Russia and China?*

A: There are obviously a large number of possible scenarios. Students should be encouraged to be creative, yet realistic. They should recognize several important differences between these nations. First, Cuba became communist in 1959 (versus 1917 for Russia) and this might mean that the roots of communism are shallower. Second, the tie with the United States is very strong with there being a large Cuban-American population waiting for economic reform to begin in Cuba so they can invest and help their people's development. Although there are many Russian- and Chinese-Americans, their proportion is not as great as the proportion of Cuban-Americans relative to the population of Cuba. Third, because of the difference in size between Cuba and the United States, U.S. companies will likely dominate the Cuban landscape very quickly—the scale of which could not occur in Russia or China.

3. Q: *The United States has enacted a law that permits U.S. companies to sue companies from other nations that traffic in the property of U.S. firms nationalized by Cuba. The law also empowers the U.S. government to deny entry visas to the executives of such firms as well as their families. Why does the United States maintain such a hard line against doing business with Cuba? Do you think this embargo is in the United States' best interests? Why or why not?*

A: Implementation and enforcement of this law, called the Helms-Burton Law, have been repeatedly suspended by the United States in fear of reprisals from Canada and European nations. Reasons for the continued embargo are rooted in politics and foreign relations. The main political argument is rooted in continued U.S. policy against allowing a communist nation to operate freely just 90 miles from the United States (the “not in this hemisphere” argument).

As far as whether it is in the best interest of the United States, there are again political and economic arguments involved. Obviously, there is no easy answer to such a question. Although U.S. companies cannot invest now, they

will likely have little trouble catching up to others as soon as political and economic reforms occur. In discussing whether it is in the United States' best interest, students might want to consider the perspective of many Cuban-Americans who themselves engage in debate over whether the embargo should continue because of the impact on ordinary citizens.