**PART 1**

**FOUNDATION CONCEPTS**

**CHAPTER 1**

**INTRODUCTION: WHAT IS INTERNATIONAL BUSINESS?**

**Instructor’s Manual by Marta Szabo White, Ph.D.**

**I. LECTURE STARTER/LAUNCHER**

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

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

**Get Insights By Country:**

<http://globaledge.msu.edu/Global-Insights/By/country>

[**Currency Converter**](http://globaledge.msu.edu/countryInsights/currencyConverter.asp)**:**

<http://www.xe.com/>

[**Country Comparator**](http://globaledge.msu.edu/countryInsights/countryComparator.asp)**:**

<http://globaledge.msu.edu/comparator>

[**Ranking Countries**](http://globaledge.msu.edu/countryInsights/countryRank.asp)**:**

<http://globaledge.msu.edu/global-resources/resource/5128>

[**Country Tools and Data**](http://globaledge.msu.edu/countryInsights/capitalMemory.asp)**:**

<http://globaledge.msu.edu/tools-and-data>

**Global Resource Directory:**

<http://globaledge.msu.edu/global-resources/>

■ Under Country Insights click on a region, then select a country, Zimbabwe for example.

<http://globaledge.msu.edu/Countries/Zimbabwe>

Everyone in the class should be assigned a different country. Each student is then responsible for becoming an expert on that country. Twice during the term, each student could report on their country, and summarize a newspaper article published in their country, i.e. an International Newspaper Memorandum assignment.

**[1]** An exciting way to introduce your students to International Business is the *CIA Maps,* from the CIA World Factbook, which provides an interactive and fun tool to introduce to international business:

<https://www.cia.gov/library/publications/the-world-factbook/>

**[2]** Another great way to introduce student to the world of international business is to direct them to the BBC website:

<http://news.bbc.co.uk/1/hi/country_profiles/default.stm>

**[3]** Comic relief- Humorous (possibly offensive) introduction to IB 2:09 minutes

Catherine Tate- Translator:

<http://www.youtube.com/watch?v=ma8Vwkpx5y8>

**INTERNATIONALIZATION AT HARLEY-DAVIDSON [CLOSING CASE]**

■ Harley Davidson is the chapter Closing Case. These questions serve as hooks for students to familiarize themselves with the chapter concepts

■ **1908-** Harley Davidson sold the first Harley police motorcycle to which police department?
**ANSWER:** Detroit; Nearly every large U.S. police department employed Harley motorcycles

■ **1988-** Harley Davidson opened up its first foreign production facility. Which country was it in?

**ANSWER:** Brazil (Manaus)… Why is Brazil an important foray into the international arena? It represents a key emerging market country.

**II. LEARNING OBJECTIVES AND THE OPENING VIGNETTE**

**LEARNING OBJECTIVES**

*After studying this chapter, students should be able to*:

1.1 Describe the key concepts in international business

1.2 Understand how international business differs from domestic business

1.3 Identify major participants in international business

1.4 Describe why firms internationalize

1.5 Appreciate why you should study international business

**Key Themes**

■ In this chapter, there are five themes:

**[1] Key concepts in international business**

 **[2] How international business differs from domestic business**

 **[3] Who participates in international business**

 **[4] Why firms internationalize**

 **[5] Why you should study international business**

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

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

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

■ **International business** refers to the trade and investment activities by companies across national borders. **Globalization of markets**refers to ongoing economic integration and growing interdependency of countries worldwide. Stress the dramatic growth in world trade, which now exceeds some $18 trillion annually.

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

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

■ Address the broader questions of:

◘ **Why firms go international?** - Primarily toincrease sales and profits!

◘ **What is the difference between internationalization and globalization?** Former- Expansion of international business activities vs, Latter- Integration, interdependency & interconnectedness of internationalization (the 4 I’s) Example: Increasing exports vs. Sourcing value-chain activities strategically around the globe to leverage factor efficiencies

◘ **How international business is different from domestic business:** Complexity and Risks (4)

 ◘ **Who participates in international business-**

**Multinational Enterprise** (MNE)

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

**Born Global** - entrepreneurial firm that is international from almost inception

◘ **Why you should study international business**- Competitive advantage- for you and your firm!

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

**Teaching Tips**

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

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

**Commentary on the Opening Vignette:**

**FACEBOOK: A GLOBAL PHENOMENON**

* **Key message**

Facebook, a social networking platform, serves both personal and professional needs. Founded in 2004, by Mark Zuckerberg and his Harvard University classmates, Facebook underscores the economic, political and personal interconnectedness among countries, companies, and consumers.

* **Uniqueness of the situation described**

■ What is striking about this vignette is that by the time the reader finishes this vignette, Facebook usage will have again jumped exponentially- globally, users spend more than 700 billion minutes every month on Facebook; one of every six people on the planet- about **1.3 billion users**- has a Facebook account.

■ Half of all U.S. residents have a Facebook account; some 70% of Facebook users live outside the United States and speak over 75 languages.

■ There are 100 million users in each of Africa and India.

* **Classroom discussion**

■ This example illustrates how the global economy has permeated our everyday lives.

■ International business activity is increasingly complex and impacts our everyday lives - shopping, listening to music, watching a movie, or surfing the Internet- involve international business transactions that connect us to the global economy, and influence quality of life, standard of living, and economic well-being.

■ Facebook’s vision mirrors this activity by empowering individuals, mapping the social relationships among them, and creating a new system for exchanging information that many find indispensable.

■ Mode of Entry:

◘ FDI- foreign direct investment establishing offices around the world.
■ Which countries is it especially popular in?

◘ France, Italy, Japan, and the United Kingdom. It is the fastest growing social networking site in Indonesia, and is establishing a loyal user base throughout Africa.

■ Which countries have banned Facebook at one time or another:

 ◘ China, Egypt, Iran, Pakistan, Saudi Arabia

■ Primary revenue generation:

 ◘ Advertising- Brand awareness- Key

■ Who are Facebook’s competitors?

◘ Google and Microsoft

■ Competitive Advantage:

 ◘ Precise information on user interests, which is priceless to brand managers in a world of targeted advertising.

■ Specific country examples (India, France, Sweden, Japan, Australia, & Poland) enrich the overall theme: the Facebook phenomenon illustrates how converging lifestyles, modern communications technology, and imaginative entrepreneurship are facilitating the emergence of global enterprises.

■ Use this vignette as a springboard for the first teaching tip offered above.

■ Also ask students to update the Facebook saga since its Initial Public Offering (IPO) on May 18, 2012.

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

**QUESTIONS**

**1-1. What advantages does Facebook obtain from doing business in international markets?**

(LO 1.4; AACSB: Application of knowledge)

■ Capitalizing upon the global interdependency and interconnectedness among economic, political, social forces on professional and personal levels.

■ Facebook knows so much about its users—the site contains precise information on user interests, who voluntarily upload such information.

■ The information is priceless to brand managers in a world of targeted advertising; reach is enhanced.

**1-2. Why have some foreign governments banned their citizens from accessing Facebook?**

(LO 1.1; AACSB: Reflective thinking)

■ Some governments fear the Facebook database and the ease with which it can be used to form networks and spread information.

■ China, Egypt, Iran, Pakistan, Saudi Arabia, and other countries have banned Facebook at one time or another.

**1-3. What are the different ways that people use Facebook around the world?**

(LO 1.1; AACSB: Diverse and multicultural work environments)

■ **India**- Facebook is popular with business executives, who use the site to track down and keep up with friends from their youth.

■ **France**- people use Facebook to connect with their contemporaries, just as the French government erects barriers to protect France from what it considers cultural invasion.

■ **Sweden** -Ikea used the Facebook photo tagging option to promote the opening of a new store. Sweden is densely populated, and Facebook deepens ties among people who are often already connected through mutual friends.

■ **Japan**- users access Facebook via their cell phones as they travel between home and office on the nation’s massive commuter train network. Marketers set up their own communities to interact with members.

■ **Australia**- Facebook fans use the site not only for social networking, but also for social dating, and are a prime target for firms that market youth-oriented services.

■ **Poland**- Facebook is popular with the upwardly mobile set, young people with rising incomes who perceive Facebook users as better educated, successful urban dwellers. Firms use Facebook for display ads and targeted advertising to attract upwardly mobile managers.

**III. DETAILED CHAPTER OUTLINE**

**INTRODUCTION: WHAT IS INTERNATIONAL BUSINESS?**

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

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

■ **Exhibit 1.1- Elements of International Business (Six)**

1] Globalization of markets

2] International trade

3] International investment

4] Risks

5] Participants: Firms, distribution channel intermediaries, facilitators and governments.

6] International entry strategies, including exporting and direct investment

■ **Globalization of markets** (or the globalization of economies) refers to ongoing economic integration and growing interdependency of countries worldwide.

■ Online platforms- Amazon, Alibaba, Facebook and Instagram underscore this integration and are central to globalization.

■ **Internationalization** refers to the tendency of firms to systematically increase the international dimension of their business activities.

■ This has resulted in the widespread diffusion of products, technology, and knowledge worldwide.

■ **Macro perspective (trend)** *-* globalization of markets means intense economic interconnectedness between/among countries.

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**Market globalization is characterized by several related trends:**

● **Cross-border transactions**- unprecedented growth rates - from $100 billion per year in1960 to current numbers of $18 trillion annually

● **Trade** = Substantial international flows of capital, technology, and knowledge

● **Development of highly sophisticated global financial systems and mechanisms** to facilitate cross-border flows of products, money, technology, and knowledge.

● **Greater collaboration among nations** through multilateral regulatory agencies such as the World Trade Organization (WTO: [www.wto.org](http://www.wto.org)) and the International Monetary Fund (IMF: [www.imf.org](http://www.imf.org))

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

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

■ Globalization both *compels* and *facilitates* companies to expand abroad- international expansion is easier due to market and product globalization.

■ A “level playing field” has made cross-border activities appealing to all types of firms- large and small; manufacturing and service sectors (e.g. banking, engineering, insurance, and retailing).

■ Globalization impacts everyone, as evidenced by the global financial crisis (2008). The economic contagion, or interconnectedness was underscored as the crisis began in the U.S. and rapidly spread to U.S. trade partners, eventually impacting Canada, Mexico, Japan, China and the world. This manifestation illustrates the integration and interdependency of national economies throughout the world.

**WHAT ARE THE KEY CONCEPTS IN INTERNATIONAL BUSINESS?**

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

**International Trade**

■ Cross-borderexchange of products (merchandise) and services (intangibles) typically through exporting and importing.

■ **Exporting** (outbound activity) - entry strategy involving the sale of products/ services to customers located abroad.

■ **Importing**(**global sourcing**; inbound activity) - the procurement of products/services from foreign suppliers for consumption in the home country or a third country

■ Exporting and importing may include both intermediate (raw materials and components) and finished products.

**International Investment**

■ Cross-border investment is the transfer of assets to another country or the acquisition of assets in that country.

■ The ***factors of production*** (assets) include capital, technology, managerial talent, and manufacturing infrastructure.

■ **Trade** = products and services cross national borders.

■ **Cross-border investment**= the firm itself crosses national borders.

**Two Types of International Investment:**

■ **International portfolio investment** (typically short-term) is the passive ownership of foreign securities such as stocks and bonds for the purpose of generating financial returns.

■ **Foreign direct investment**(FDI) (typically long-term) is a foreign-market entry strategy that gives investors partial or full ownership of a productive enterprise. The firm establishes a physical presence abroad through acquisition of productive assets such as capital, technology, labor, land, plant, and equipment.

**The Nature of International Trade**

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

**■ Micro**-International Business: Cross-border transactions of an *individual* business enterprise.

■ Gross domestic product (GDP) is the total value of products and services produced in a country during a year.

**■ Exhibit 1.2** contrasts the growth of total world exports to the growth of total world *gross domestic product (GDP)* since 1980.

■ Due to the global recession, world trade declined in 2009, ending a 27-year boom period.

■ Trade revived and returned to normal levels by 2012.

■ Remarkable- since 2008, annual rate of growth in **world exports** surpassed **world GDP** by almost 2x (5.4% versus 2.8%).

**Trade Growth > GDP Growth:**

**[1]** Significant rise of emerging markets during the past three decades, which are home to growing middle class households equipped with substantial disposable incomes.

**[2]** Advanced (or developed) economies such as the U.S. and the European Union are now sourcing many of the products from low-cost manufacturing locations such as China, India, and Mexico.

**[3]** Advances in information and transportation technologies, decline of trade barriers, and liberalization of markets fuel the rapid growth of trade.

■ **Exhibit 1.3** identifies the leading nations in merchandise exports (not including services).

■ During the recent global recession, China surpassed the U.S. as the world’s leading exporter in total dollar terms, trade accounts for about **45%** of its GDP (U.S. is 23% of its GDP).

■ For other economies, merchandise trade is a much larger component of economic activity: e.g. Belgium (125%), Netherlands (118%), and South Korea (81%).

■ ***Entrepôt* *economies*** (*intermediate depot*; exports = imports): Singapore, Hong Kong and Malaysia export more than 100% of their respective GDPs.

■ Such countries import a large volume of products, some of which they process into higher value-added products and some they simply re-export to other destinations.

**The Nature of International Investment**

■ **Foreign Direct Investment** (FDI) - (asset ownership and long time frame) is the ultimate commitment-level of internationalization, and thus this text focuses primarily on FDI (most common mode of entry strategy) as opposed to International Portfolio investment.

■ New legal business entity, recognized by the host country and subject to its regulations.

■ Motivations for firm FDI: (Note how these fit into the value chain)

**(1)** **Primary** Activity: Set up manufacturing/assembly facilities to produce products/services;

**(2)** **Primary** Activity: Open a sales/representative office to conduct marketing or distribution activities; or

**(3)** **Support** Activity: Establish a regional headquarters

■ **FDI and Competitive Advantage**:

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

1. Manufacture/assemble products in low-cost labor countries (or for other resources), i.e. China, India, Russia, Brazil, and Mexico:

**■ Example-**

◘ Ford invested some $3 billion to build a new car factory in **Mexico** to manufacture Fiesta automobiles.

1. Global challengers originating in rapidly developing economies invest in western markets:

**■ Examples-**

◘ **Turkish** company Yildiz (2008) acquired the premium chocolate maker Godiva from U.S.-based Campbell Soup Company in a deal valued at $850 million.

 ● 2014- Yildiz paid over three billion dollars to acquire British based cookie and snack maker, United Biscuits.

◘ **India's** Mittal Steel Co. acquired the Belgium-based Arcelor SA in August 2006, creating a $38 billion conglomerate -- the world's largest steel company.

◘ **Russian** oil and gas firm Lukos established thousands of service stations in the U.S. and Europe.

■ **Exhibit 1.4** shows the dramatic growth of FDI since the 1980s.

■ September 11, **2001** interrupted FDI inflows with the worldwide panic that ensued following the terrorist attacks in the U.S.; then interrupted again in **2008** by the global recession. Stability in world economy is key.

■ **Developed (Advanced) economies** = Japan, Australia, Canada, the U.S., and most countries in Western Europe. Dollar volume of FDI has grown immensely since the 1980s, in developed economies.

■ **Developing economies** = Parts of Africa, Asia, and Latin America.

■ Significant- is the growth of FDI into developing economies (surpassing advanced economy inflows in 2010) despite widespread poverty, lower incomes, less-developed industrial bases, and less investment capital than advanced economies, and represent the need for modern industrial infrastructure.

**Services as Well as Products**

■ Key international players: Tangible merchandise (products) and intangibles (services- e.g. banks, consulting firms, hotels, construction companies, retailers, airlines, etc.).

■ International trade in services accounts for about **one-quarter** of all global trade and is growing faster than products, however the value of merchandise trade is still much greater than the value of services trade.

■ Challenges unique to services:

 ◘ Not all services can be exported.

 ◘ Physical presence in host country is a prerequisite for many services.

■ Approximately $2 trillion worth of services are sold abroad every year.

■ **Exhibit 1.5** identifies the leading countries in total international services trade.

■ Larger, developed economies account for the greatest proportion of services- as services typically comprise more than 2/3 of the GDPs of these countries.

■ EBay- the giant Internet retailer earned $75 billion in 2014, of which more than 50% came from international sales.

■ EBay expanded to India, China, Korea, and Europe in anticipation of most of its future revenue growth coming from abroad.

■ When developing its business in India, eBay acquired the Mumbai-based e-retailer Baazee.

■ **Exhibit 1.6** (great chart) illustrates the diversity of service sectors that are internationalizing.

**The International Financial Services Sector**

**■ Banking and financial services are the most active** cross-border services.

■ Explosive growth of global capital markets is attributed to:

**(1)** **Internationalization Banks/Financial institutions** → increased amount of cheap, local investment capital, stimulating local financial markets and encouraging savings

**(2)** **International Flow of** Money → into pension funds and portfolio investments

■ Developing economies- banks/financial institutions have fostered economic activity by increasing the availability of local investment capital, which stimulates the development of financial markets and encourages savings.

■ International banking is prosperous- Return on Equity:

◘ Saudi Arabia exceeds 20%

◘ U.S. it is 15%

◘ France and Germany it is less

■ **Saudi Arabia**- National Commercial Bank- non-interest-bearing deposits comprise nearly 50% of total deposits, which banks lend out at high margins.

■ Banks bypass Islamic rules forbidding interest payments by structuring loans as partnerships.

**HOW DOES INTERNATIONAL BUSINESS DIFFER FROM DOMESTIC BUSINESS?**

■ **Complexity**- Macro forces differ from country to country- economic conditions, national culture, legal and political systems- vary by country.

■ **Risk**- Uncontrollable variables- the firm has little or no control over these.

■ Foreign environments involve new risks that firms must manage.

■ **Facebook** (opening vignette)- exemplifies how distinctive conditions in each country requires firms to adapt their products and approaches, from country to country.

**The Four Risks of Internationalization**

**The Four Risks of International Business**

■ **Exhibit 1.7** summarizes the four major risks: cross-cultural risk, country risk, currency risk, and commercial risk.

**Cross-Cultural Risk**

■ Situation where a cultural misunderstanding places some human value at risk.

■ Differences in language, lifestyles, mind-sets, customs, and religion.

■ Cross-cultural literacy - critical to embrace culturally-valued mind-set and/or work style.

■ Cultural blunders- hinder the effectiveness of foreign managers.

■ Language- critical dimension of culture- a window to value systems.

■ Language challenges impede effective communication.

■ Cultural differences may lead to inappropriate business strategies and ineffective customer relations.

**Country Risk or Political Risk**

■ Differences in host country political, legal and economic environments may adversely impact firm profitability.

■ Government intervention: restricts market access; imposes bureaucratic procedures hindering business transactions; and limits the amount of income that firms may repatriate from foreign operations- varies by country.

■ Economic freedom differs among nations- The Index of Economic Freedom from the Heritage Foundation ranks countries according to a myriad of economic freedom variables.

■ Hong Kong, Singapore and Australia typically occupy the top three countries in terms of having the highest levels of economic freedom, see (<http://www.heritage.org>). Ireland also ranks high in terms of a liberal economic environment; whereas China and Russia are the opposite- governments regularly intervene in business.

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

**Currency or Financial Risk**

■ Risk of adverse fluctuations in exchange rates.

(**Exchange rates**- the value of one currency in terms of another).

■ Inflation and other harmful economic conditions create uncertainty of returns due to the growing interconnectedness of national economies.

■ When international transactions are conducted in more than one national currency → currency risk.

■ The value of a firm’s earnings may be substantially reduced when currencies fluctuate significantly.

■ **Examples-** **2014-15**- Rising value of U.S. dollar vis-à-vis most currencies cut into revenues of U.S. multinational firms, e.g. Apple, Caterpillar, and Pfizer. Procter and Gamble’s Duracell battery business experienced a 31% decline in profits due to weaker currencies in its foreign markets

**Commercial Risk**

■ Poor development/execution of business strategies, tactics or procedures, resulting on firm loss, e.g. partnering selections, market entry timing, pricing, product features, and promotional themes

■ Failures in international markets are far more costly than domestic business blunders.

■ Firm reputation and profitability may also be at risk from marketing harmful products, failing customer expectations, or providing inadequate customer service.

 ■ Commercial risk is often affected by currency risk, because fluctuating exchange rates can affect various types of business deals.

**Risks: Always Present but Manageable**

■These types of risks are omnipresent in international business.

■ Managers need to understand their implications, anticipate them, and employ proactive measures to reduce their adverse effects.

■ **Examples** of global financial disruptions:

◘ **2015**- Greek debt crisis has lingered for several years and affects not only the European Union but creditors elsewhere.

◘ **2008-** The global financial crisis spread to banks and insurance firms in Asia, Europe, and elsewhere. Many countries experienced deflation and severe declines in consumer confidence and spending power.

◘ **1998-** The East Asian economic crisis generated substantial commercial, currency, and country risks- several East Asian countries lost currency values of between 35% and 70%, leading to the collapse of national stock markets, deepening trade deficits, and suspension of normal business activity. Political and social unrest surged to Indonesia, Malaysia, South Korea, Thailand, and the Philippines.

**WHO PARTICIPATES IN INTERNATIONAL BUSINESS? (Four categories)**

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

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

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

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

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

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

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

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

**Focal Firms in International Business [Most prominent players]**

**Three Types: MNE** and **SME** and **Born Global**

**Multinational Enterprise (MNE)**

Also known as Multinational Corporation (MNC)

■ MNE owns a worldwide network of subsidiaries and affiliates located in multiple countries; large firm with a home office and substantial resources.

■ Multinational enterprises have historically been the most important type of focal firm; adding value in multiple countries, through subsidiary affiliates, leveraging R&D, procurement, manufacturing, and marketing activities, to exploit economic advantages.

■ **FDI** (Foreign Direct Investment) - Key entry strategy.

■ **Examples-**

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

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

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

■ ***Affiliates-*** Network of subsidiaries that MNEs collaborate with.

■ **Typical MNEs -** Nestlé, Sony, Citibank, Unilever, Nokia, Ford, Barclays, DHL, Four Seasons Hotels, and Shell Oil.

■ Recently, the largest MNEs have been firms in the oil industry (such as Exxon-Mobil and Royal Dutch Shell) and the automotive industry (General Motors and Honda), as well as retailing (Walmart).

■ **MNEs** – For many, more than 50% of total sales/profits comes from international operations, e.g. Exxon, Honda, and Coca-Cola.

■ 1970- fewer than **7,500** MNEs worldwide; today roughly **80,000**.

■ **Exhibit 1.8** (great chart) provides a geographic distribution of the world's leading MNEs, drawn from *Fortune*’s Global 500 list- concentrated in mostly advanced economies.

■ The **U.S.** is home to 128 of the top 500 MNEs, a number that has declined over time as other countries’ firms increase in size.

■ **China** has the second-most MNEs (95 firms). **Europe** is home to many top MNEs: **Germany** (28 firms), **France** (20 firms), and the **United Kingdom** (20 firms).

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

**■ Examples-**

 ◘ The Mexican firm **Cemex** is one the world’s largest cement producers.

 ◘ Russia’s **Lukoil** has big ambitions in the global energy sector.

 ◘ In China, **Mobile** dominates the cell phone industry in Asia.

◘ **China-** Most top firms are state-owned enterprises; owned by the Chinese government, which provides them substantial advantages.

**Small and Medium-Sized Enterprises (SME)**

■ SME is a company with 500 or fewer employees (in Canada and the U.S.).

■ SME- 250 or fewer employees in the EU and elsewhere.

■ Small firms comprise 90% - 95% of all firms in most economies.

■ Even MNEs start small.

■ **SMEs Strategies for Success:**

**(1)** SMEs are more innovative, entrepreneurial, flexible, adaptable, and have quicker response times.

**(2)** SMEs are less bureaucratic.

**(3)** SMEs are better able to serve niche markets.

**(4)** Due to limited financial and human resources, SMEs tend to minimize fixed investments costs and outsource, e.g. FedEx and DHL.

**SMEs OVERALL**

■ **Exporting**- Primary foreign market entry strategy as FDI is more expensive.

■ **Niche markets**- Target specialized products too small to interest large MNEs.

■ **Success** – Enabled by foreign intermediaries, facilitators, and global logistics specialists such as FedEx and DHL.

■ **Proficiencies**- Information and communications technologies enable SMEs to identify global market niches and efficiently serve specialized buyer needs.

■ International business complexities are considerably more challenging for SMEs than MNEs- requiring specialized knowledge, commitment of resources, and considerable time to develop foreign business partnerships.

■ **SMEs** are gaining equal footing with MNEs in marketing sophisticated products around the world.

■ **Born Global Firms**

Young, entrepreneurial SMEs that initiate international business close to inception (within 3 years), and are found in both advanced economies, e.g. Australia and Japan, as well as emerging markets such as China and India.

■ Export to 20 or more countries, generating over 25% of their sales from abroad.

◘ **Example**- **History and Heraldry** ([www.historyandheraldry.com](http://www.historyandheraldry.com)), a born global in the United Kingdom specializing in history and English ancestry gifts.

◘ In its first 5 years, the firm expanded its sales to 60 countries, exporting about 70% of its total production.

◘ Biggest markets: France, Germany, Italy, Spain, and the Americas, recently opening a subsidiary in North America.

■ **Born Globals Strategies for Success:**

**(1)** Born globals account for a substantial proportion of national exports in countries like Australia, Denmark, Ireland, and the U.S.

**(2)** Born globals offer leading-edge products with strong potential to generate international sales.

**(3)** They leverage the Internet and communications technologies to facilitate early and efficient international operations.

**(4)** Born globals emergence is linked with *international entrepreneurship*, where innovative, smaller firms pursue business opportunities regardless of national borders.

**(5)** Entrepreneurs are creative, proactive, adaptable and risk-takers.

**(6)** Born globals leverage communications and transportation technologies, falling trade barriers, and niche markets to compete globally.

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

**Governments and Nongovernmental Organizations (NGOs)**

■ Governments are central participants in international trade and investment.

■ *Non-profit* international organizations include charitable groups and *non-governmental organizations* (NGOs).

■ Non-profits serve special causes- education, research, health care, human development, and the natural environment.

■ **Examples:** (Nonprofit Organizations)

 ◘ Bill and Melinda Gates Foundation.

 ◘ British Wellcome Trust- supports health and education .

◘ CARE- dedicated to reducing poverty.

■ **Examples:** (MNE- operating charitable foundations)

 ◘ GlaxoSmithKline (GSK) -

● Canada, France, Italy, Romania, Spain & U.S.

**ADDITIONAL TOPICS OF CONVERSATION-**

**GSK Global Partnership with Save the Children:**

● Barretstown, Ireland and L’Envol, France for seriously ill children

● Slovakia- Promote healthy eating/exercise for children

● Spain- Healthcare for homeless children

● Russia- Children with disabilities

● Ethiopia- Reduction of preventable children’s’ diseases

 ● Vietnam- Birthing support

■ **IN-CLASS EXERCISE**

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

**WHY DO FIRMS INTERNATIONALIZE?**

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

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

■ **Reactive** motive- serve a key customer that has expanded abroad.

**Nine specific motives:**

**1.** Seek growth opportunities through market diversification.

**2.** Earn higher margins and profits.

**3.** Gain new ideas about products, services, and business methods.

**4.** Better serve key customers that have relocated abroad.

**5.** Locate closer to supply sources, benefit from global sourcing advantages, or gain flexibility in product sourcing.

**6.** Gain access to lower-cost or better-value factors of production.

**7.** Develop economies of scale in sourcing, production, marketing, and R&D.

**8.** Confront international competitors more effectively or thwart the growth of competition in the home market.

**9.** Invest in a potentially rewarding relationship with a foreign partner.

**✪ MyManagementLab:** Watch It!

MINI: Globalization

Apply what you have learned in this chapter.

Go to **MyManagementLab**, click your course, and choose multimedia library.

**WHY STUDY INTERNATIONAL BUSINESS?**

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

**● Global Economy**

Dimensions in the world that influence all nations.

**● National Economy**

Set of factors that influence all firms competing in a single country.

**● Firm**

Focuses on each company and its competitors.

**● Manager**

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

**Facilitator of the Global Economy and Interconnectedness**

■ Since the General Agreement on Tariffs and Trade (GATT) (1947), following World War II, international business has transformed the world with unprecedented growth in trade and investment.

■ **1980s**: Political/Economic transformations of **Emerging Markets** (some 30 countries) have given new impetus to worldwide economic interconnectedness.

■ Fast-growth developing economies- Brazil, Russia, India, and China [**BRICs**] - have registered substantial market liberalization, privatization, and industrialization, fueling global economic transformation.

■ **Emerging markets**-

◘ Located on every continent.

◘ Home to the largest proportion of the world population .

◘ Increasingly immersed in foreign trade.

■ Facebook- numerous emerging markets, including China, India, and Poland.

■ **Two MEGATRENDS** underlying the changing business landscape- globalization and technology

 ◘ **Globalization-** accelerates the development of the latest technologies.

 ◘ **Technology-** facilitates globalization to progress more rapidly.

■ The Internet/e-commerce and production/process technologies make international business a viable, cost-efficient and increasingly imperative mandate for firms of all sizes and resource levels.

■ Technological advances **both** accelerate, and are accelerated by, globalization.

**Contributor to National Economic Well-Being**

■ International business promotes economic prosperity through efficient resource allocation, increased consumer options and world interconnectedness.

■ Governments have increasingly opened their borders to foreign trade and investment.

■ International trade is a pivotal engine for job creation.

 ◘ It is estimated that every $1 billion increase in exports creates more than

 20,000 new jobs**.**

 ◘ Cross-border trade directly supports at least 12 million U.S. jobs.

◘ One of every seven dollars of U.S. sales is made abroad.

◘ One of every three U.S. farm acres; and one of every six U.S. jobs is

 producing for export markets.

◘ On average, exporting firms create jobs faster and provide better pay, than non-exporting firms.

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

**A Competitive Advantage for the Firm**

■ To sustain a competitive advantage in the global economy, firms must participate in cross-border business and acquire the necessary skills, knowledge, and competence.

■ **Examples-**

◘ **Procter & Gamble** sells shampoo, disposable diapers, and other consumer products in more than 150 countries.

 ◘ **MTV** broadcasts its programming in some 140 countries.

 ◘ **Nestlé** sells its food and beverage products worldwide, obtaining nearly all its revenue from foreign operations.

■ **Global Sourcing**- Firms secure cost-effective factor inputs by establishing manufacturing in emerging markets like Malaysia, Mexico, and Poland, or sourcing from foreign suppliers.

■ **Examples-**

◘ **Microsoft** cuts the costs of its operations by having much of its software written in India.

 ◘. **Renault** achieves efficiency by assembling cars at low-cost factories in Romania.

**A Competitive Advantage for You**

■ Every day we are impacted by a variety of international business transactions.

■ Traveling abroad leads to exciting challenges and learning experiences.

■ Global managers of the world’s leading corporations fashioned their managerial skills in international business.

■ In this text you will learn about the merits of gaining international business proficiency, through the experiences of people like you, in a special feature called *You Can Do It: Recent Grad in IB*.

**An Opportunity to Support Sustainability and Corporate Citizenship**

■ With trade barriers declining and global power increasing, environments are increasingly characterized by limited resources, vulnerable human conditions, and stakeholder consciousness.

■ Corporate citizenship dictates that companies consider stakeholders in decision-making and develop sustainable, socially responsible policies and practices.

■ This means employing both economic and social goals; transcending legal requirements by proactively implementing ethical standards.

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

**Examples:**

 ◘ **Starbucks** will only sell coffee from Rain Forest Alliance certified

 growers ([www.rainforest-alliance.org](http://www.rainforest-alliance.org)),

◘ **Philips**, **Unilever**, and **Walmart** follow business practices that promote sustainable development.

◘ **McDonald’s** purchases beef from farmers certified for animal welfare and environmental standards.

◘ **McDonald’s** sells only organic milk in Austria, Germany, Sweden, and the United Kingdom.

**ADDITIONAL TOPICS OF CONVERSATION-**

■ Large corporations like **Walmart,** **Unilever**, and **Sony** have annual revenues larger than the GDPs of many of the nations in which they do business.

■ The globalization of thousands of firms negatively impacts the natural environment, e.g. pollution (BP oil spill in the Gulf of Mexico; Royal Dutch Shell’s oil refining operations in Nigeria).

■ Large banks and international investment brokers have disrupted the economies of nations with aggressive currency trading or stock markets manipulations, e.g. MNEs abruptly withdrawing invested capital.

■ Human Rights violations- Some MNEs ignore human rights and basic labor standards by establishing factories in countries that pay low wages with substandard working conditions, e.g. Nike in Asia.

■ Building factories abroad often leads to job losses in the home country.

■ National governments and international institutions such as the *World Trade Organization* are working to improve environmental, financial and labor standards around the world.

■ **CSR is global and strategic**. It must be embedded into global firms at their strategic levels, as well as their processes/practices if international corporate citizenship is to be achieved and sustained. Chapter 4 is devoted this important topic.

**You Can Do It: Recent Grad in IB: Ashley Lumb**

International Marketing Specialist

■ Ashley’s international experience was an impressive asset to prospective employers in the U.S.

■ Success factors in working abroad were hard work and networking.

**IV. CLOSING CASE**

**INTERNATIONALIZATION AT HARLEY-DAVIDSON**

**● Summary [Identifying key issues]**

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

The following Learning Objectives are emphasized:

**1.1] Learn the key concepts in international business.**

**1.2] Understand how international business differs from domestic business.**

**1.4] Describe why firms internationalize.**

**OVERVIEW**

■ From a shed with *Harley Davidson Motor Company* scrawled across it in 1903, four men- William Harley and the Davidson brothers-Walter, William, and Arthur- produced the first Harley Davidson motorcycle.

■ Today, Harley-Davidson (HOG) offers 35 Harley models through a global network of nearly 1,500 dealers, with over $6 billion in 2014 sales, an increase of about 45% from 2009.

■ Harley earns nearly 65% of its total sales in the U.S., where it manufactures most of its bikes to ensure quality control.

**FOUR KEY SEGMENTS IN THE MOTORCYCLE INDUSTRY**

**[1] Standard** (Practical bikes used for low-cost commuting)

**[2] Performance** (Sleek, sport-style racing bikes built for speed and easy handling)

**[3] Custom** (Stylized bikes customized to customer tastes)

**[4] Touring** (Long-distance, large-capacity, comfort bikes that typically include cruise control, stereos, and luggage racks)

**COMPETITORS**

■ Competitors are headquartered outside the U.S.:

◘ **Japan**- Honda, Suzuki, Yamaha, and Kawasaki.

◘ **Europe**- BMW, Ducati, and Triumph.

◘ **China**- Emergence of new competitors.

**ICONIC BRANDING**

**■ Harley Owners Group** (HOG) - one key to Harley’s success is the club of loyal Harley owners with over one million members, including 100,000 in Europe.

■ HOG is a key marketing tool- In the U.S. brand loyalty is fierce, and **switching costs** for Harley owners are high.

■ The mystique associated with its heavyweight bikes, drives sales and a culture of Harley tattoos.

■ Harley heavyweight bikes price at $17,000 or more.

■ 50 is the average age of a Harley owner in the U.S.

**THREAT OF FOREIGN COMPETITORS**

■ By the 1980s, Honda, Kawasaki, Suzuki, and Yamaha were selling millions of motorcycles in the U.S. and specializing in inexpensive, lightweight models.

■ **Myopic**- Harley paid little attention to the competition, focusing on heavyweight bikes, while the market for lightweights continued to grow.

■ **Bankrupt almost** - Major problems with the quality of Harley bikes, poor productivity, image suffering and sales declining sharply.

**REVIVAL: JAPANESE STYLE**

■ New CEO adopted Japanese-style management techniques: updated manufacturing methods, improved quality, expanded model offerings, instituted just-in-time inventory systems & total quality management, and empowered production workers.

■ Management increased marketing efforts, improved the dealer network, and undertook various cross-branding ventures.

■ **Repositioned** by mid-1990s- Harley excelled in the performance motorcycle market, dramatically improving company image and sales.

**INTERNATIONAL EXPANSION**

■ Global markets demonstrate significant growth opportunities

■ **Japan**- distribution network and local subsidiary by 2005, annually selling more than 12,000 motorcycles there. Heavyweight motorcycles went for more than $18,000, more than Honda’s standard lightweight model.

■ Foreign sales growing, increasing 9.2% from 2013 to 2014.

■ Europe, Middle East, Africa comprise Harley’s key regions.

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

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| **EMERGING MARKETS** |
| ■ **Brazil** - Harley’s biggest potential market in Latin America, yet is fraught with barriers.■ Brazil provides less than 2% of total sales. ■ Low buying power in Latin America is a challenge.■ To address the high import tariffs, Harley established an assembly plant in Brazil.■ Local assembly avoids import barriers and reduces costs due to the availability of low-cost workers. |

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| **CHINA** |
| ■ Home to 1.3 billion people, many of whom ride small motorcycles.■ Income levels are growing rapidly, although average wages are low.■ Harley is concerned about piracy- Chinese entrepreneurs are known to counterfeit well-known foreign-branded products,■ Harley also must overcome the perception that motorcycles are only for commuting; management wants to develop the market for leisure riding too. |

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| **INDIA** |
| ■ Millions of households have annual incomes over $80,000.■ Honda, Yamaha, and Kawasaki all have a strong presence.■ Harley established a subsidiary near Delhi, but market entry has been delayed due to high trade barriers and local emissions regulations. |

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| **CANADA** |
| ■ Harley’s fastest-growing market outside the U.S.■ Canada only accounts for 4% of total Harley sales. |

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| **JAPAN** |
| ■ Harley holds a roughly 4% market share in Japan, but the economy is stagnant, and disposable income has declined. |

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| **AUSTRALIA** |
| ■ With a population of 20 million people, this market is limited. |

**ENVIRONMENTAL SUSTAINABILITY CHALLENGES**

■ **Pollution-** motorcycles pollute the natural environment.

■ Regulatory sanctions impact Harley because it manufactures very large bikes.

■ **Integrated sustainability strategy**- Harley’s greenhouse gas (GHG) emissions emanate from its manufacturing plants, thus, pollution reduction and energy/water conservation initiatives, as well as a recycling program have been implemented.

■ **Climate change**- transitioning to a lower-carbon economy.

■ California and Taiwan have recently imposed rigorous, new GHG motorcycle standards; Japan and various European countries are developing similar standards aimed at GHG reduction; Harley is proactively staying ahead of evolving regulations, e.g. in **Japan**, they launched a motorcycle recycling program.

**THE FUTURE**

■ The global recession hurt Harley as discretionary income fell around the world.

■ **Positioning**- Given declining global demand, how best to position Harley?

■ Key to sustainable growth is global expansion, driven by:

**[1]** Heightened focus on foreign markets;

**[2]** Appeal to lighter-weight, performance-based international markets;

**[3]** Improved and larger dealer networks;

**[4]** Geographic expansion;

**[5]** Strategic control of distribution.

■ Global markets demonstrate significant growth opportunities, while the domestic motorcycle industry is increasingly saturated.

■ Through enhanced distribution networks and a *multidomestic* international strategy that underscores local market preferences, Harley delivers culturally-responsive experiences from Spain to Singapore.

■ Revenue stream diversification reduces risk. To reduce its dependence on U.S. sales, Harley strives to increase its international business, targeting an ideal sales mix of 60% U.S. and 40% international.

■ Harley also needs to balance production and sales for domestic and international markets.

■ The strategy to achieve this goal must be formulated and implemented.

**● SUGGESTED SOLUTIONS TO CASE QUESTIONS**

**1-4. What is the nature of the international business environments Harley faces? What types of risk does the firm face?**

■ Domestic and international environment: complex and risky

■ All FOUR types of risks in international business are present:

**Cross-cultural Risk**

Harley-Davidson Motor Company and Buell Motorcycle Company collectively operate eight production/assembly facilities in the U.S., Brazil and Australia, with a global network of nearly 1,500 dealers. Key markets are in North America, Europe and Japan. The first Beijing Harley dealership was established in 2006. Growth Markets:Canada, Japan, Australia, Latin America (Brazil - Largest Market).

■ **Translation of HOG Mystique**

Considering the cross-cultural risk category, one of Harley’s global challenges is their American icon branding, which may also represent the negative side of globalization. A negative image emerged during the 1950s-1970s, that of Hells Angels or outlaw motorcyclists, as captured by some Hollywood films. Does the HOG brand translate internationally?

■ Differences in language, lifestyles, mindsets, customs, and religion of a national culture.

■ Cultural blunders can hinder effectiveness of managers in working with foreign business partners.

■ Language is a critical dimension of culture- it is a window to people’s values and living conditions.

■ Language differences may impede effective communication and result in misunderstandings.

■ Cultural differences may lead to inappropriate business strategies and ineffective customer relations.

**Country Risk** (also known as *political risk)*

■ **Chinese Market**-With the opening of its third dealership in China during 2008, Harley faces a large and potentially risky market.

■ Differences in host country political, legal and economic regimes may adversely impact firm profitability.

■ Also, laws, regulations and indigenous factors e.g. property rights, intellectual-property protection, product liability, taxation policies, inflation, national debt, and unbalanced international trade, may encumber firm operations and performance.

■ Government intervention: restricts market access; imposes bureaucratic procedures hindering business transactions; and limits the amount of earned income that firms may repatriate from foreign operations.

■ Economic freedom differs among nations- Hong Kong, Singapore and Ireland are known as having the highest levels of economic freedom, see:

(<http://www.heritage.org>).

**Currency or Financial Risk**

■ **International Risk from Global Economic Contagion-**

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

■ **Harley-Davidson Financial Services [HDFS] -** [**Interest Rate**](http://www.wikinvest.com/wiki/Interest_Rates)**/Credit Exposure**

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

■ **Strong U.S. Dollar**

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

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

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

**Commercial Risk**

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

■ China- three Harley dealerships

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

■In 2008, HOG acquired MV Augusta, (Cagiva brand), a premier Italian sport motorcycle producer, which provided a gateway to the European motorcycle market and accelerated Harley's exposure to younger buyers.

■ **International/Domestic Business Risk- Changing Emission Standards**

Climate change concerns will lead to tailpipe emission limits, which will eventually require product design strategies to meet the new regulatory requirements.

■ **Market Penetration**

As most of Harley’s core baby-boomer market is currently 44-62 years old, their peak riding years may be behind them.

■ Poor formulation/implementation in terms of partnering selections, market entry timing, pricing, product features, and promotional themes result in commercial risk.

■ Failures in international markets are far more costly than domestic business blunders.

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

(LO 1.4; AACSB: Analytical Thinking)

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

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

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

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

(LO 1.1; AACSB: Application of knowledge)

■ The Harley icon is a powerful weapon. Advertising strategy should underscore its immense global branding, yet employ local people.

■ Harley can leverage global efficiencies in terms of technology, production, and distribution. However, tailoring motorcycle preferences to local markets is also paramount.

■ The European market is fragmented due to country differences and the diversity of European preferences. This coupled with the narrow European streets and high speed limits, and a functional rather than recreational focus, as one would expect, there is a greater demand for the standard and performance motorcycle segments in Europe.

■ International expansion into Asia could be hindered by strict emissions standards, high tariffs and cheaper Asian reproductions of the Harley brand.

■ However, if Harley were to collaborate with a Japanese partner, this mode of entry would enable market knowledge and branding economies with that partner. Additionally, Harley’s organic structure of three interlocking circles- (1) Create Demand Circle, (2) Produce Products Circle and a (3) Support Circle with the Leadership/Strategy Council in the center- would fit well with the Japanese culture than a more traditional structure.

■ This industry demands an integrated approach – global yet with a local/regional focus.

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

(LO 1.1; AACSB: Diverse and multicultural work environments)

■ Global incumbents must leverage their advantages in terms of global efficiencies in order to compete with global challengers indigenous to emerging, host markets.

■ After China joined the World Trade Organization in 2001, import restrictions, quotas and tariffs dropped substantially against foreign motorcycle manufacturers.

■ Partnering through strategic alliances affords immense networking opportunities and market expertise otherwise unavailable to a new entrant.

■ Competing with Lifan and Zongshen, China's emerging competitors, presents both challenges and opportunities. Harley may take the offensive and compete even more aggressively in competitors’ domestic markets and/or implement a more defensive strategy in their own home market. Either way, innovation and market research will be cardinal.

■ Promoteand leveragethe HOG experience so that it clearly translates internationally, and in fact turns into a global competitive advantage.

■ An interesting assignment for students would be to divide the class into small groups and assign a Harley Chinese competitor to each group. Each group should briefly research the competitor in terms of strategy, international markets, market share in China, and any other interesting facts. This can be done during class as most students will attend class with their laptops. Use websites such as: globaledge.msu.edu and Hoover’s database to report their findings.

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

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

**1-8. Evaluate Harley’s environmental sustainability initiatives in the evolving regulatory environment on global greenhouse gas. What advantages does Harley gain by attempting to produce environmentally safe and sustainable products?**

(LO 1.3; AACSB: Application of knowledge)

■ Like automobiles, motorcycles pollute the natural environment, and Harley is vulnerable to regulatory sanctions because it manufactures very large bikes.

■ Most of Harley’s greenhouse gas (GHG) emissions emanate from its manufacturing plants, and management is moving to reduce pollution, as well as energy and water usage, as part of an integrated sustainability strategy.

■ HOG is also addressing climate change by preparing for the transition to a lower-carbon economy.

■ California and Taiwan have recently imposed rigorous new GHG standards on motorcycles.

■ Japan and various European countries are developing similar new standards aimed at GHG reduction.

■ Harley is attempting to stay ahead of evolving regulations. In 2005, they launched a motorcycle recycling program in Japan.

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

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

**V. END OF CHAPTER QUESTIONS**

**● TEST YOUR COMPREHENSION**

**✪ 1-9. Distinguish between international business and globalization of markets.**

Visit MyManagementLab for suggested answers.

 (LO 1.2; AACSB: Analytical Thinking)

**1-10. What is the difference between exporting and foreign direct investment?**

(LO 1.1; AACSB: Application of knowledge)

Level of commitment

■ *Exporting* is thesale of products/services to customers located abroad.

■ *Foreign direct investment*  (typically long-term) gives investors partial or full ownership of a company or productive assets such as capital, technology, labor, land, plant and equipment .

**✪ 1-11. What makes international business different from domestic business?**

Visit MyManagementLab for suggested answers.

(LO 1.2; AACSB: Application of knowledge)

**1-12. What are the various types of risks that firms face when they conduct international business?**

(LO 1.2; AACSB: Reflective thinking)

***Cross-cultural risk***

■ Differences in language, lifestyles, attitudes, customs, and religion, where a cultural miscommunication jeopardizes a culturally-valued mindset or behavior.

■ Cultural blunders- hinder the effectiveness of foreign managers.

■ Language- critical dimension of culture- a window to people’s values

■ Language differences impede effective communication.

■ Cultural differences may lead to suboptimal business strategies.

***Country risk (also known as political risk)***

■ Differences in host country political, legal and economic regimes may adversely impact firm profitability.

■ Also, laws, regulations and indigenous factors e.g. property rights, intellectual-property protection, product liability, taxation policies, inflation, national debt, and unbalanced international trade, may encumber firm operations and performance.

■ Government intervention: restricts market access; imposes bureaucratic procedures hindering business transactions; and limits the amount of earned income that firms may repatriate from foreign operations.

■ Economic freedom differs among nations- Hong Kong, Singapore and Ireland are known as having the highest levels of economic freedom, see:

(<http://www.heritage.org>).

***Currency or financial risk***

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

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

***Commercial risk***

■ Less than optimal formulation and/or implementation of strategies, tactics or procedures, e.g. partnering selections, market entry timing, pricing, product features, and promotional themes

■ Failures in international markets are far more costly than domestic business blunders.

*Risks: Always present but manageable*

■The four types of risks in international business are omnipresent.

**1-13. Who are the major participants in international business?**

(LO 1.3; AACSB: Application of knowledge)

**WHO PARTICIPATES IN INTERNATIONAL BUSINESS? (Four categories)**

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

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

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

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

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

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

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

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

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

(LO 1.3; AACSB: Application of knowledge)

***Multinational Enterprise (MNE):***

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

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

■ **Exhibit 1.8** provides a geographic distribution of the world's leading MNEs. The size of each circle represents total MNE revenues per country.

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

■ SME is a company with 500 or fewer employees.

■ Small firms comprise 90% - 95% of all firms in most economies.

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

■ Small firms:

 ◘ Are the drivers for innovation.

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

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

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

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

■ SME Strategies for success:

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

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

(3) Smaller firms can better leverage the Internet.

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

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

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

(LO 1.4; AACSB: Reflective thinking)

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

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

**B.** Earn higher margins and profits.

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

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

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

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

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

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

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

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

(LO 1.5; AACSB: Reflective thinking)

***A Competitive Advantage***

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

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

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

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

**● APPLY YOUR UNDERSTANDING**

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

(LO 1.2; AACSB: Analytical Thinking)

TO: Richard

FROM: Myself

DATE: 07/07/15

RE: International vs. Domestic Business- Differences, Opportunities & Threats

*Differences:*

■ Complexity- Environmental forces differ from country to country- economic conditions, political systems, laws and regulations, and national culture- vary according to nation.

■ Risk- Each of these factors introduces an element of risk for the firm.

*Opportunities:*Internationalization affords certain opportunities that are unavailable to domestic businesses, which may lead to competitive advantages and superior performance:

■ Maximizing returns

■ Attaining global scale economies

■ Resource acquisition ease and cost

■ Enhanced competitiveness

■ Knowledge transfer

At the same time, threats are also more pronounced:

*Threats:*

Complexity and risk.

Complexity is due to the interrelatedness and layering of numerous political, social and economic systems.

Risk consists of the four types of omnipresent risks in international business-

■ Cross-cultural risk

■ Country risk

■ Currency or financial risk

**■** Commercial risk

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

(LO 1.4; AACSB: Analytical Thinking)

Your memo should include:

Cottonwood Corporation should internationalize to expand growth and profit opportunities in order to build competitive advantage. Specifically:

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

**B.** Earn higher margins and profits.

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

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

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

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

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

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

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

Due diligence mandates that a risk assessment also be conducted. Risk consists of the four types of omnipresent risks in international business-

■ Cross-cultural risk

■ Country risk

■ Currency or financial risk

**■** Commercial risk

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

(LO 1.5; AACSB: Analytical Thinking)

Your presentation should include:

*Who Participates In International Business?*

■ *Focal firm-* firms that initiate and implement international business activities.

■ *Distribution channel* *intermediary-* [Ch.3] distributors and retailers that provide distribution services in international markets.

■ *Facilitator or support firm-* [Ch.3] freight forwarders and banks that assist the focal firms with specialized needs.

*Multinational Enterprise (MNE)*

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

**Why Study International Business?**

*A Competitive Advantage*

■ The role of international business grows in importance and impact, daily.

■ Cross-national experiences expose managers to diversity, new knowledge, novel ways of seeing the world, and unusual challenges.

■ Managers with extensive international experience are typically more self-confident, cosmopolitan, are positioned for unique professional development opportunities, and essentially have a competitive advantage over others.

**● GlobalEDGE™ INTERNET EXERCISES** [**http://globaledge.msu.edu**](http://globaledge.msu.edu)

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

(LO 1.4; AACSB: Analytical Thinking)

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

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

■ India and South Africa are emerging markets. Germany is an advanced economy. Thus, **Germany** is ranked first in GDP per capita and industrial production growth rate; second in both GDP and GDP real growth rate after India; and had the lowest inflation rate. **India** is ranked first in GDP and GDP real growth rate; second in industrial production growth rate; last in GDP per capita and highest on inflation rate. South Africa ranks last in GDP, GDP real growth rate, and industrial production growth rate, but it had the second highest inflation rate and the second highest GDP per capita.

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

■ With a well-developed infrastructure (transportation, information and communication, power, etc.), **Germany** is poised to accentuate its information and communications technologies position relative to other advanced economies. However, there is ‘less room’ for growth in its economy, which is partly explained by its low real growth rate in GDP and high industrial production rate. The country’s inflation rate of 1.1% compares favorably among the three countries. Moreover, each German euro bought more goods and services with such a low inflation rate relative to the purchasing power of the rupee and the rand in the respective countries.

■ **India’s** emerging economy experienced a hefty real growth rate in GDP and GDP real growth rate compared to Germany. India is a large emerging economy both in population (about 1.22 billion) and GDP. On the other hand, its low per capita GDP indicates relatively low economic wealth among its citizens, which is partly explained by the low industrial production. While the country’s per capita GDP, for the relevant period, may be lowest among the three countries; it is poised to increase as the economy grows.

■ **South Africa’s** inflation was the second highest among the three countries compared; it is still low for an emerging economy. With GDP at US$528.2 billion, it is small in comparison to Germany’s developed economy, but it compares favorably with that of India when GDP per capita is considered.

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

(LO 1.2; AACSB: Analytical Thinking)

This can be answered in various ways. One example is the Czech Republic.

■ **Cross-cultural risk**: One of the main business cultural differences between U.S. businesspeople, for example, and those in the Czech Republic is the ‘urgency’ of making a sale. While the typical American “lets get down to business” approach is effective domestically, Czechs are more reserved and will have reservation about this way of doing business. They prefer to get to know a potential U.S. business partner’s background and company and will be offended by too much emphasis on an immediate sales pitch.

■ **Country risk**: Although the Czech Republic has made various improvements, its tax, labor, environment, health and safety laws are considered to discourage inward foreign investment. Research reveals 2that domestic and foreign investors perceive that government bureaucracy and unnecessary red tape remain a source of frustration. Moreover, it is not uncommon for investors to experience delays and potentially corruption, especially in the company registration process and in changes to corporate structure.

■ **Currency risk**: Inflation in the Czech Republic has been running at about 2%. Although low by most standards, volatility in this rate directly affects the value of the koruna (crown) (CZK) against the US dollar and the euro. Given that the country will not adopt the euro until at least 2012, U.S. and Euro zone companies that do business with Czech Republic firms will experience higher or lower cost as the CZK rises or falls in value relative to dollar and the euro.

■ **Commercial risk**: Agents and distributors in the Czech Republic expect exclusivity in representing a foreign company’s product or service according published reports. Research reveals that many Czech Republic agents and distributors are undercapitalized and understaffed, but still represent a wide diversity of foreign products. Thus foreign exporters and manufacturers should be careful to avoid weak partners by negotiating an agreement that ties exclusivity to performance via a time limitation on the agent/distributor agreement or an escape clause to terminate the partnership for nonperformance.

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

(LO 1.4; AACSB: Analytical Thinking)

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

■ **Understanding Exporting**

◘ Assess and develop export knowledge in the firm; evaluate the importance of exporting, its pros and cons as well as the firm’s strengths and weaknesses

◘ Explain the role that trade-related data will play in the company’s export decision

■ **Ensure the Basics of Exporting are met prior to Execution**

 ◘ Do a preliminary screening and select a country or region

 ◘ Conduct an industry market potential analysis

 ◘ Select a foreign partner and structure the relationship

 ◘ Conduct a company sales potential analysis

■ **Evaluate our Company’s Ability to Export**

◘ Understand how Assessment of Company Readiness to Export (CORE) software can assist with assessing our export capability

 ◘ Prepare for defensive competition

◘ Assess top management’s commitment to the company’s export capability

◘ Assess the significance of company and product readiness as they influence our export capability

■ **Preparing a Budget for Exporting**

◘ Assess the effects of foreign exchange rates on the company’s export budgeting

 ◘ Understand how to control the export budget

 ◘ Explore the areas where standard cost can be applied

■ **Assessing Export Cost**

 ◘ Compose a list of export cost elements

 ◘ Perform a cost-volume-profit analysis with different tools

◘ Assess the important factors involved in costing a product for an overseas market(s)

■ **Understanding Export Documentation**

 ◘ Identify and understand the mandatory documents for exporting

◘ Understand documents such as a bill of lading, commercial invoice and packing list

◘ Understand significant financial exchange documents such as the bill of exchange, sight draft and time draft

◘ Assess the pros and cons of the letter of credit’s value in the exporting process

■ **Export Financing**

 ◘ Assess the effective use of methods of payments and insurance

 ◘ Evaluate the details of international countertrade

 ◘ Assess the details of private and non-private financing

■ **Export Marketing and Logistics**

◘ Explain the necessity of an export marketing plan, information required to prepare it

◘ Assess movement and storage options for exporting the company’s products that includes understanding warehouse location and inventory levels

 ◘ Assess the requirements for effective export pricing

**MyManagementLab**

Go to MyManagementLab.com for Auto-graded writing questions as well as the following Assisted-graded writing questions:

**✪ 1-23**. **What role do distribution channel intermediaries fulfill?**

**✪ 1-24. What risks do companies typically engage in with international business?**

**✪ 1-25.** MyManagementLab Only**–** comprehensive writing assignment for this

 chapter.

Visit MyManagementLab for suggested answers.