The challenge of foreign competition essay

Business

FIN 500 – Global Corporate Finance Case Study 2: The Challenge of Foreign Competition JUNE 4, 2009 Chapter Summary As the title of the case study clearly states, chapter 2, deals with issues relating to challenges of foreign competition.

The case begins by describing how a domestically-based television manufacturing company – Stellar Television Company – conducts its operations, and how Japanese competition has begun distorting the company's performance as time progresses. In the late 1950s Stellar employees earned a solid $50 a week, and a Stellar television was worth $250. Ed Johnson, who was the CEO of Stellar Television Company, measured the success of his company by calculating the amount of work hours needed by his employees to purchase 1 unit; so, in the late ' 50s it took a worker 5 weeks of work to earn a television. That number has been on a decreasing trend since the first year of the company's operation, showing increasing labor productivity and growth for the firm.

In the early 1960s, Ed Johnson came face-to-face with foreign competition as Japanese televisions began coming into America. As a result of the increased competition, Ed Johnson is very close to start laying-off workers, and also on the verge of lowering employee's wages. Therefore, in order to try and fix the situation he meets with his congressman, Frank Bates, and requests the he passes a bill limiting imports of Japanese televisions. After much argument and conversation Ed convinces Frank to sponsor a trade bill banning foreign televisions. This would gain him favor from the state, which would ultimately increase his chances of running for White House in the near future.

However, things don’t go as expected when Congressman Bates speaks about a plan to keep out all foreign products entirely, so that to pass-on the benefits to other industries as well. Literature Review In my opinion, the main argument that the case study brings forth is whether increasing protectionism measures would benefit the U. S more than increased free trade and foreign direct investment in the U. S.

In other words, would banning all foreign products be better for U. S. domestic firms, or will the ncreased competition from Japanese companies outweigh the advantages of the trade restrictions? It is evident that both protectionism and free trade share their own advantages and disadvantages, however, the main challenge is to find the perfect balance between the both that maximizes efficiencies for all parties involved.

Protectionism is a government set policy that controls or completely restrains trade between countries, and states, by means such as tariffs, quotas, and a variety of other restrictive government regulations. During our 3-week tentative course in global corporate finance, we studied some reasons why countries, and governments, would engage in protectionism; some of these include national security, unfair competition, infant industry argument, domestic employment, and diversification (Kim and Kim, 2006). Advocates for protectionism, often argue that protectionism measures benefit the economy and the country in the following ways: •National Security – if a country is aiming to be a world power, it must maintain key sectors for national security. By preserving and sustaining factor endowed commodities, it is guaranteed supplies in the event of a war. •Unfair Competition – may arise in the form of lower wages in foreign countries, and special tax incentives and subsidies from foreign governments. •Infant Industry argument – states that protectionism measures are sometimes necessary for new firms and industries that have just began to establish themselves in the domestic market. •Domestic Employment – protectionism upholds domestic employment due to fewer jobs been lost, and increases living standards through higher wages. Diversification – highly specialized economies rely on foreign countries for incomes, therefore, if they decide to decrease their dependence upon world markets for one or two products, these countries – i.

e. Kuwait – would need some protection to diversify their economy. However, we can't judge an issue by examining only one side of the coin. Despite the reasonable and fair reasons for adopting protectionism measures, advocates arguing against this issue (these would be supporters of free-trade policies) state that such economic policies would only harm the people it is meant to help. Free-trade supporters suggest that the gains from free trade outweigh the losses as this type of policy creates more jobs than it destroys because it allows countries to specialize in the production of goods and services in which they have a comparative advantage in. Free trade is a type of trade-policy that allows traders (countries, companies, and individuals) to act and transact without interference from government policies. Based on this theory, both trading partners experience mutual gains from trade due to the comparative advantage theory that we briefly discussed in the previous paragraph.

In free-trade agreements, prices of commodities are set based on market demand and supply forces, which are the sole determinant of resource allocation. As such, one of the many benefits of open/free trade is gains in allocation efficiency (Kim and Kim, 2006). Under the theory of comparative advantage, each country would import those goods produced more efficiently abroad and export those goods produced more cheaply at home. Such types of trade allow each trading country to allocate more of its resources to producing those goods and services that it can produce more efficiently. Other benefits of free trade also include increased competition, increased productivity from production efficiencies, and an expanded menu of goods and services (Kim and Kim, 2006). •Increased competition – free trade allows companies to compete beyond their own nation's borders, and as such this increases the number of actual and potential competitors in both domestic and foreign countries. With increasing competitive pressures this requires for companies and countries to innovate if they want to experience higher efficiencies and growth than their competitors. Increased productivity from production efficiency – the ability to access foreign markets and acquire information on how foreign competitors operate, allow the flow of new ideas necessary to achieve production efficiencies and thus increased productivity.

•Expanded menu of goods and services – as a result of free trade, companies can gain access to a wider variety of resources, and consumers get to choose from a wider range of goods and services. As a result, this boosts efficiency and improves the standard of living in trading countries. As you can see, the benefits and advantages of each economic policy, whether it is protectionism or free trade, need to be carefully analyzed and evaluated in order to obtain the goals that a government, corporation, or an individual has set to be achieved.

Whether foreign competition is beneficial or not really depends in the state of a country's economy, or how well a company is prepared to face foreign and domestic competition. I personally support free trade over protectionism, primarily because I believe that the benefits that free trade offers maximizes benefits for the majority, while at the same ime imposing less burdens on a fewer number of people. However, in recent years and activities we have observed many instances how even in the presence of free trade; mighty giants such as General Motors, AIG, Ford, etc are still susceptible to failures and inefficiencies. The following article comments generally on how U.

S. domestic producers are continuously losing a share of their home market to foreign competition. Findings The article by Alan Tonelson and Peter Kim (2006) aims at explaining how more than a dozen U. S. anufacturing industries have experienced losses due to foreign competition since the late 1990s.

A primary example of this case are Ford, General Motors, and Chrysler, where in recent events have suffered huge losses in their domestic market share due to foreign – particularly Japanese – imports. The term " import penetration", which was frequently used in the article, refers to " the proportion of a country's domestic consumption accounted for by imports" (AmericanEconomicAlert, 2006). According to a study of import penetration conducted by the U. S. Business & Industry Council (USBIC), between 1997 and 2005, 111 of 114 U. S.

industries experienced a loss of sales due to customer's preferences shifting towards foreign produced goods. Generally, if import penetration rates are on a rise, this indirectly means that U. S. located producers are failing in acquiring and retaining new and current customers. This contradicts the notion that U. S.

manufacturing output has been on a growing trend since the 2002 recession (Tonelson and Kim, 2006). Instead, according to the USBIC, between 1997 and 2005, output had actually deceased in almost 35 of the 53 industries where import penetration rates were high. Whenever an industry is faced with an above average import penetration rate, companies should be on alert, because a company's domestic market should be the market in which they perform best. Therefore, the question put forth is that if domestic companies aren't performing well within their natural environment how do they expect to compete on a foreign scale while sustaining domestic operations? The reasons for U. S. industries failing to capture a greater portion of home-market share can be attributed mainly towards ineffective international trade policies. According to the author, the U.

S. did a poor job in countering a number of predatory trade policies ranging from regulating exchange rates to giving out illegal subsidies (Tonelson and Kim, 2006). Also, too many U. S.

trade agreements – such as NAFTA – have promoted the export of too many U. S. based manufacturing and knowledge to foreign countries. Instead of utilizing these agreements to penetrate new foreign markets for U. S. ased industries; these agreements were primarily used by MNCs as an outsourcing method in order to reap profits from new manufacturing facilities that they would set-up in foreign countries. The bottom-line, however, is that if imports continue to dictate the U. S.

industrial markets, it might be too late to reverse these actions and many more mighty companies might be next in line to suffer the same fate as General Motors. Conclusion Whether protectionism or free trade favors a country and its businesses or not depends primarily on the state of the economy and how well an industry's performance is in relation to its foreign competition. While there will always be necessary adjustments to new and changing circumstances, free trade between nations ultimately benefits all who participate; this is the basic motivation for countries and industries engaging in free trade. However, recent trends in U. S.

economy, that has affected global economies as well, show us that maybe sometimes it is better if a country decides to close some of its borders in order to protect its employment and standard of living. After all that the U. S. as gone through, one question comes to my mind…if the U. S. could turn back time, would it have adopted more protectionist measures knowing what the state of its economy would be in our current times? My guess would be… YES!? Bibliography Tonelson , Alan & Kim, Peter.

" U. S. Domestic Producers Lose Increasing Share of Home Market to Foreign Competition". American Economic Alert. Accessed on May 29th, 2009 . Kim, Suk & Seung, Kim.

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