Cross cultural management

Parts of the World, European Union

Seventh Edition INTERNATIONALEDITION INTERNATIONAL MANAGEMENT MANAGINGACROSSBORDERS AND CULTURES TEXTANDCASES Helen Deresky Professor Emerita, State University of New York-Plattsburgh Boston Columbus Indianapolis New York San Francisco Upper Saddle River Amsterdam Cape Town Dubai London Madrid Milan Munich Paris Montreal Toronto Delhi Mexico City Sao Paulo Sydney Hong Kong Seoul Singapore Taipei Tokyo PART OUTLINE Chapter 1 Assessing the Environment–Political, Economic, Legal, Technological Chapter 2 Managing Interdependence: Social Responsibility and Ethics Assessing the Environment Political, Economic, Legal, Technological Outline Opening Profile: Economic Crisis Spreads Through Financial Globalization The Global Business Environment Globalization Globality and Emerging Markets Effects of Institutions on Global Trade Effects of Globalization on Corporations Regional Trading Blocs The European Union (EU) Asia Comparative Management in Focus: China's Economy Keeps on Chugging. The Americas Other Regions in the World The Russian Federation The Middle East Developing Economies The African Union The Globalization of Human Capital The Global Manager's Role The Political and Economic Environment Political Risk Political Risk Assessment Managing Political Risk Managing Terrorism Risk Economic Risk The Legal Environment Contract Law Other Regulatory Issues The Technological Environment Global E-Business Conclusion Summary of Key Points Discussion Questions Application Exercises Experiential Exercise Internet Resources Case Study: Indian BPOs Waking Up to the Philippines Opportunity? Management Focus: Intel Brings Changes to Vietnam's Economy and Culture Information Technology OBJECTIVES: 1. To understand the global business environment

and how it affects the strategic and operational decisions which managers must make. 2. To critically assess the developments, advantages and disadvantages of globalization. 3. To review the role of technology in international business. 4. To develop an appreciation for the ways in which political, economic, legal and technological factors and changes impact the opportunities that companies face. 5. To discuss the complexities of the international manager's job. 14 Chapter 1 - Assessing the Environment 15 Opening Profile: Economic Crisis Spreads Through Financial Globalization A perilous global crisis of confidence has revealed both the scale and the limitations of globalimtion. 1 The 2009 World Economic Forum in Davos, Switzerland, announced its theme–" Shaping the Post-Crisis World." What crisis? What caused the crisis? Some of the developments as they occurred are discussed below, and the effects will no doubt be continuing as you read this book. Discuss updates in your class and how the effects are impacting international business. In September 2008, fears of a global recession fed a stock market panic as worries about toxic assets (highly leveraged securities mainly linked to risky mortgages taken out in the United States) spread from the financial sector to the credit markets and then to the broader economy. 2 The American export–the subprime mortgage mess–caused the global economy to hit the brakes. The problem is that Finance has become one of the most international of industries, with banks from around the world doing business across numerous countries. However, regulation of that industry is still only national or local. Because fear gripped depositors around the world concerned that their deposits and savings will disappear, and fear led banks worldwide to cease lending to one another, the entire credit system shut

down. Lending to even creditworthy companies dried up in Europe in 2008, causing the International Institute for Labor in Geneva to state: The financial crisis is hitting the world of work. . . The financial crisis which developed over the past year and erupted last August represents one of the most significant threats to the world economy in modem history. The credit crunch and collapse of stock markets are starting to affect firms' investment decisions as well as workers' incomes and jobs. Several major developed economies have practically entered into recession and unemployment is on the rise. Economic growth in emerging economies and developing countries has slowed down, in some cases significantly. INTERNATIONAL INSTITUTE FOR LABOR.' The United States Treasury Secretary, Henry Paulson, proposed a $700 billion bailout plan for banks, which (then) President Bush signed on October 3, 2008, the beginning of the most expensive government bailout in history, and there was an unprecedented coordination of central banks on three continents to cut interest rates. However, these moves seemed only to generate more fear, and did little to free up credit lines either between banks or to their customers. Stock markets around the world continued their massive losses–estimated at $6. 5 trillion on October 6 and 7, 2008. Iceland came to the brink of bankruptcy because several banks whose assets were greater than the country's economy were experiencing problems. The failure of banks and other financial institutions prompted governments to attempt to intervene. In the United States, the giant mortgage companies Fannie Mae and Freddie Mac were nationalized, Lehman Brothers and Washington Mutual companies were allowed to fail, but then the government later decided to bail out AIG, the huge global insurer, for fear of the global repercussions. A

global problem called for a global solution. However, coordinating policies for Europe's many countries7~fbr example, presents many difficulties. Some of the government rescue actions taken around the world were widely reported, and examples are summarized below as they developed in late 2008 and early 2009. The International Monetary Fund said it was ready to lend to countries hit by the credit crunch, using an emergency funding mechanism first used in the 1990s Asian financial crisis. CHINA: China joined the interest rate offensive, cutting rates by 0. 27 percentage points. SOUTH KOREA, HONG KONG, TAIWAN: The central banks of South Korea, Hong Kong, and Taiwan joined the growing number of countries to cut their interest rates. AUSTRIA and GREECE officially announced a guarantee for all personal bank savings. BELGIUM and DENMARK'S governments agreed to guarantee bank deposits. ICELAND: With the country on the brink of bankruptcy, Iceland's parliament passed emergency legislation giving the government wide-ranging powers to dictate banks' operations. Negotiations were under way with Russia for a big loan to support the country's banking system. Moscow has offered more than $5 billion in emergency loans. IRELAND: Ireland was the first government to come to the rescue of its citizens' savings, promising on 30 September to guarantee all deposits, bonds, and debts in its six main banks for two years. The move initially prompted consternation among some European partners, but several countries have since followed suit. 16 Part 1 - The Global Manager's Environment ARAB STATES: Share prices dropped precipitously, amid fears of weakness in Dubai's property boom and exposure to global markets. INDIA: The central bank moved to inject 600bn rupees ($12. 2bn) into the money markets after sharp falls in Mumbai's stock

exchange and the plunge of the rupee to an all- time low. 4 These moves made it clear that the global ripple effect of Wall Street's woes had debunked the theory of " decoupling," the notion that the rest of the world was robust enough to ride out a U. S. domestic crisis; While attempts to stabilize the global financial system seemed to Stagnate, Britain's Prime Minister Gordon Brown announced a plan to recapitalize its major banks and try to find a broader international solution. The U. S. then followed on October 14, 2008 with a similar plan to buy $250 billion of non-voting preferred stock in major banks and financial institutions–thus also partially nationalizing the U. S. banking system. At that juncture, it became clear that Europe–led by Britain–was leading the way with a financial bailout plan that set the pace for-Washington. However, by the end of 2008, it became clear that " the world's dramatic financial rescue efforts are both unprecedented in scope and creativity–and wholly inadequate." 5 In spite of the huge amounts of money that governments around the world are spending to attempt to stanch the bleeding, there seems little to prevent the world economy from major downturn, according to the International Monetary Fund. Some encouraging news to combat the global slowdown came as China announced a huge economic stimulus plan on November 9: 2008, aimed at bolstering its weakening economy. The Chinese government topped the world in its rescue package saying it would spend an estimated $586 billion over the next two years–roughly 14 percent of its gross domestic product each year–to construct new railways, subways, and airports. China's banks, at least, remained relatively unscathed. Not to be outdone in the fight, The United States Federal Reserve and the Treasury announced $800 billion in new

lending programs, sending a message that they would print as much money as needed to revive the nation's crippled banking system. That commitment amounted to about $7. 8 trillion in direct and indirect financial obligations - equal to about half the size of the nation's entire economy and far greater than the $700 billion that Congress authorized for the Treasury's financial rescue plan. European countries then mounted a joint approach; the EU commission announced a 200 billion euro rescue plan among the 27 member states. The EU Commissioner urged that all attempts be made to bolster the sagging growth and confidence in the region. However, at least as of early 2009, although it seemed that the various measures had staved off financial collapse, the world awaited the stimulus that governments were spending billions of their taxpayers' money to gain. Meanwhile, credit was still tight and confidence was low; companies around the world were retrenching, shuttering plants and offices, and laying off thousands of workers. Protectionism and nationalism were increasing, further hampering trade, and the World Bank announced that the global economy is likely to shrink by one or two percent in 2009. In February 2009, President Obama signed a $787 billion stimulus package (3 percent of GDP). However, while the goal of much of the package was to create jobs in the U-S-, concern about " Buy American" clauses, such as for the steel industry, led to cries of protectionism that aroused fears of retaliation in trade wars. Increasing awareness of the causes and effects of the financial crisis led many to conclude, as posed in the New York Times, that: This crisis has shown the Achilles' heel of a globalized financial system to be lack of high-quality, and consistent, regulation to prevent overconfident bankers from taking irresponsible risks.

A year and a half ago, when it appeared to be a subprime mortgage issue for the United States, most countries thought they could glide past it. Bur it turned out that everyone in that globalized system was vulnerable to the collapse that began at the center. WWW. NYTIMES. COM February 8, 2009. In addition, the irony seemed to be that the rapid growth in open economies, as a result of globalization, was coming back to bite them; whereas those with more restricted financial systems appeared more able to weather the storm. Iceland is broke; India was one of the few to expect continuing economic growth. 6 Another unfortunate result, as noted at the global economic conference in Davos, Switzerland, in February 2009, was the warning that the global recession could sharply reduce lending across borders. Investment of private capital to emerging markets in 2009 was expected to be 82% lower than in Chapter 1 - Assessing the Environment 2007. British Prime Minister Gordon Brown said in an interview, " It's the first stage of a financial protectionism that will lead eventually to the kind of trade protectionism that we've seen in the past." 7 Time will tell the long-term consequences around the world, but clearly executives and their companies have been caught in the grip of a storm that will likely revolutionize business. The deepfreeze of capital markets, the implosion of financial groups and the resulting rise in governments' sway over the private sector has called into-question some of the foundations of Anglo-Saxon capitalism. In an effort to develop consensus about how to revive a paralyzed global economy, the leaders of the world's largest economies met at the Group of 20 (G20) meeting in London on April 2, 2009. They agreed to bail out developing, countries, stimulate world trade, and regulate financial firms more stringently. Leaders of those

countries committed to $1. 1 trillion in new funds to be available to the International Monetary Fund with the goal of a revival in trade, which was expected to contract in 2009 for the first time in 30 years. But differences of opinion between Continental Europe and the United States over whether to act now or wait to see whether existing spending measures took effect resulted in what many considered a shortfall of measures needed to stimulate the world economy. Prime Minister Gordon Brown of Britain concluded the conference saying: This is the day the world came together to fight against the global recession. Our message today is clear and certain: we believe that global problems require global solutions. 17 As evidenced in the opening profile, managers in the twenty-first century are being challenged to operate in an increasingly complex, interdependent, and dynamic global environment. In a globalized economy, developments such as those described in the opening profile can have repercussions wound the world almost instantaneously. Clearly, those involved in international and global business have to adjust their strategies and management styles to those kinds of global developments as well as to those regions of the world in which they want to operate, whether directly or through some form of alliance. Typical challenges that managers must face involve politics, cultural differences, global competition, terrorism, and technology. In addition, the opportunities and risks of the global marketplace increasingly bring with them the societal obligations of operating in a global community. An example is the dilemma faced by Western drug manufacturers of how to fulfill their responsibilities to stockholders, acquire capital for research, and protect their patents while also being good global citizens by responding to

the cry for free or low-cost drugs for AIDS in poor countries. Managers in those companies are struggling to find ways to balance their social responsibilities, their images, and their competitive strategies. To compete aggressively, firms must make considerable investments overseas–not only capital investment but also investment in well-trained managers with the skills essential to working effectively in a multicultural environment. In any foreign environment, managers need to handle a set of dynamic and fast-changing variables, including the all-pervasive variable of culture that affects every facet of daily management. Added to that " behavioral software" are the challenges of the burgeoning use of technological software and the borderless Internet, which are rapidly changing the dynamics of competition and operations. International management, then, is the process of developing strategies, designing and operating systems, and working with people around the world to ensure sustained competitive advantage. Those management functions are shaped by the prevailing conditions and ongoing developments in the world, as outlined in the following sections. THE GLOBAL BUSINESS ENVIRONMENT Following is a summary of some of the global situations and trends that managers need to monitor and incorporate in their strategic and operational planning. Globalization The World Is Flat T FRIEDMAN 10 18 Part 1 - The Global Manager's Environment The forces and effects of globalization seem to be inescapably evident in our daily lives: An estimated 2 billion people witness Live Earth, a series of concerts held in 11 locations around the world to raise environmental awareness. Chinese manufacturers decorate toys with paint containing lead, and children around the world have to give up their Batmans and Barbie dolls. Mortgage lenders

in the United States face a liquidity crunch, and global stock markets go berserk.'' Business competitiveness has now evolved to a level of sophistication commonly called globalization–global competition characterized by networks of international linkages that bind countries, institutions, and people in an interdependent global economy. Economic integration results from the lessening of trade barriers and the increased flow of goods and services, capital, labor, and technology around the world. The invisible hand of global competition is being propelled by the phenomenon of an increasingly borderless world, by technological advancements, and by the rise of developing economies such as China and India–a process that Thomas Friedman refers to as " leveling the playing field" among countries–or the " flattening of the world." 12 Whereas the general concept of globalization has been that business expanded from developed to emerging economies, now it is just as likely to refer to business flowing from and among developing economies. Sirkin et al. use the term " globality" stating that business these days is all about " competing with everyone from everywhere for everything." On a more strategic level, Ghemawat argues, rather, that the business world is in a state of " semi-globalization," and will remain so for decades to come. He bases this conviction on his analysis that " most types of economic activity that can be conducted either within or across borders are still quite localized by country." 14 Globality and Emerging Markets It is clear, however, that globalization–in the broader sense–has led to the narrowing of differences in regional output growth rates as economic activity increased, driven largely by increases led by China, India, and Russia. In spite of the recent slowdown, world trade

continues to grow – it has grown by 133 percent in the last 15 years and is over $54 trillion. Importantly, global trade is increasingly including the developing nations. Exhibit 1-1 shows the results from research by the A. T. Kearney Company of the Foreign Direct Investment (FDI) intentions and preferences of the leaders of top companies in 17 industry sectors spanning six continents. The exhibit shows the top 25 countries in which those executives have confidence for their investment opportunities- Their results show that China and India continue to rank at the top of the FDI Confidence Index and that six of the top 10 countries are emerging markets. 15 This phenomenon, says Fareed Zakaria, is something much broader than the much-ballyhooed rise of China or even Asia. Rather, he says: It is the rise of the rest–the rest of the world. PARKED ZAKARIA, THE POST-AMERICAN 16 WORLD, 2008. " The rest," he says, include countries such as Brazil, Mexico, South Korea, Taiwan, India, China and Russia. He states that, as traditional industries in the United States continue to decline. " The rest" are picking up those opportunities. Even so, the United States remains dominant in many " new age" industries such as nanotechnology and biotechnology, and is ranked as the globe's most competitive economy by the World Economic Forum. It is clear, also, that as emerging markets continue to grow their countries' economies, they will provide growth markets far the products and services of developed economies. Evidence of the growing number of companies from emerging markets can be seen in the Fortune 500 rankings of the world's biggest firms. It now stands at 62, mostly from the so-called BRIC economies of Brazil, Russia, India and China, up from 31 in 2003. 17 Further evidence that " globalization" is no longer just another word for "

Americanisation," is the increase in the number of emerging-market companies acquiring established large businesses and brands from the so-called " developed" countries. For example, in 2008 Budweiser, America's favourite beer, was bought by a Belgian-Brazilian conglomerate, and " several of America's leading financial institutions avoided bankruptcy only by going cap in hand to the Chapter 1 - Assessing the Environment EXHIBIT 1-1 2007 Foreign Direct Investment Confidence Index Top 25 Targets for FDI 19 Maintained ranking (all others) Moved Up Moved down from 2005 ranking Low confidence high confidence Source: A. T. Kearney, September 12, 2008. Copyright AT. Kearney, Inc., 2007. All rights reserved. Reprinted with permission. The main types of FDI are acquisition of a subsidiary or production facility, joint ventures, licensing, investing in new facilities on expansion of facilities. sovereign-wealth funds (state-owned investment funds) of various Arab kingdoms and the Chinese government." 18 Clearly companies in emerging markets are providing many opportunities for investment and alliances around the world, as well as establishing themselves as competitors to reckon with. However, there are important aspects of globalization other than economic factors, though these aspects are intertwined. Exhibit 1-2 shows the top 20 countries as measured by four comprehensive factors– economic integration, technological connectivity, personal contact, and political engagement; the details for those categories are given below the chart. As you can see, although the United States leads the world in technology, it falls behind a number of countries on the other three factors. As we consider the many facets of globalization and how they intertwine, we observe how Maintained ranking (all others Q Moved up H

Moved down from 2005 ranking economic power and shifting opinions and ideals about politics and religion, for example, result in Low confidence High confidence an increasing backlash against globalization and a rekindling of nationalism. Globalization has been propelled by capitalism and open markets, most notably by Western companies. Now, . . . economic power is shifting fast to the emerging nations of the south. China and India are replacing the U. S. as the engines of world economic growth. FINANCIAL TIMES, March 3, 2006. 19 The rising nationalist tendencies are evident as emerging and developing nations– wielding their economic power in attempted takeovers and inroads around the world–encounter protectionism. There is hostility to takeovers such as the Indian company Mittal Steel's bid for Europe's largest steel company, Arcelor. At times Europe seems to be closing its borders; and even the United States reacted to an attempted takeover of the British P&O by Dubai Ports World early in 2006. In particular, as the demand on energy resources burgeons with heightened industrial activity in China, we see increased protectionism of those resources around the world as Russia, Venezuela, and Bolivia have privatized their energy resources. 20 Part 1 - The Global Manager's Environment EXHIBIT 1-2 Measuring Globalization Source: Global Retail Development Index, Copyright A. T. Kearney, 2008. All rights reserved. Reprinted with permission. Recently, there has been increasing backlash against globalization coming from those who feel that it benefits advanced industrial countries at the expense of many other countries and people within them who are not sharing in those benefits. Joseph Stiglitz, for example, argues that such an economic system has been pressed upon many developing countries at the expense of their

sovereignty, their well-being, and their environment. Critics point to the growing numbers of people around the world living in poverty. 20 Recently, globalization has also become increasingly unpopular with many in the United States as growth in emerging markets has raised prices for energy and commodities, as their jobs are being lost overseas, driving down wages, and as the weak dollar makes companies in the United States vulnerable to foreign buyers. 21 While the debate about the effects of globalization continues, it is clear that economic globalization will be advanced by corporations looking to maximize their profits with global efficiencies, by politicians and leaders wishing to advance their countries' economies, and by technological and transportation advances which make their production and supply networks more efficient. However, pressure by parties against those trends, as well as the resurgence in nationalism and protectionism, may serve to pull back those advances to a more regional scope in some areas, or bilateral pacts. This was made clear by the breakdown in the Doha round of talks; unfortunately, In pursuit of the perfect–an international trade deal agreed upon by some 150 countries with vastly different goals–negotiators wound up with nothing. The way forward is likely to be via bilateral and regional agreements. A global deal, if one can be reached, may be a package of smaller agreements between subsets of the full body. Chapter! - Assessing the Environment 21 In addition, while competition to provide the best and cheapest products to consumers exerts pressure on corporations to maximize efficiencies around the world, there is also increasing pressure and publicity for them to consider the social responsibility of their activities (discussed further in Chapter 2). Effects of Institutions on Global Trade23

Two major groups of institutions (supranational and national) play a differing role in globalization. Supranational institutions such as the World Trade Organization (WTO) and the International Labor Organization (ILO) promote the convergence of how international activities should be conducted. For example, the WTO promotes the lowering of tariffs and a common set of trade rules among its member countries. Similarly, the ILO promotes common standards of how workers should be treated. While many supranational institutions frequently promote rules or laws favorable to foreign firms (e. g., requiring intellectual property rights protections in China), others have been criticized for infringing on national sovereignty (e. g., challenges to certain environmental laws in the United States). National institutions, in contrast, play a role in creating favorable conditions for domestic firms and may make it more difficult for foreign firms to compete in those countries. For example, the stringent drug testing rules required by the U. S. Food and Drug Administration (FDA) and the anti-dumping rules enforced by the U. S. Department of Commerce's International Trade Administration act as entry barriers for foreign firms (see Chapter 6 for a more detailed discussion of these). Some supranational institutions represent the interests of a smaller group of countries. For example, the European Commission acts in the interest of the 27 EU members as a whole rather than the interest of individual member countries. The European Commission is the executive arm of the EU and is responsible for implementing the decisions of the European Parliament and the European Council. Of relevance to international business, the European Commission speaks for the EU at the World Trade Organization, and is responsible for negotiation trade

agreements on behalf of the EU. 24 Effects of Globalization on Corporations In returning to our discussion at the corporate level, we can see that almost all firms around the world are affected to some extent by globalization. Firms from any country now compete with your firm both at home and abroad, and your domestic competitors are competing on price by outsourcing or offshoring resources and services anywhere in the world. Often it is difficult to tell which competing products or services are of domestic or foreign origin. While Ford, for example, is pushing its Mustang with the slogan " buy American," only about 65 percent of the car content comes from the United States or Canada–the rest is purchased abroad. In contrast, Japan's Toyota Sienna model is far more American, with 90 percent local components being assembled in Indiana. 25 This didn't happen overnight. Toyota has been investing in North America for 20 years in plants, suppliers, and dealerships, as well as design, testing, and research centers. Toyota became the largest auto-manufacturer in the world in sales in 2009. In fact, on June 1, 2009, General Motors (GM) filed for Chapter 11 bankruptcy, pushed into a temporary partial nationalization by the U. S. government in order to save the company in a drastically downsized form. 26 Clearly, competition is borderless, with most global companies producing and selling more of their global brands and services abroad than domestically. Avon, for example, estimates it employs 5 million sales representatives globally, and believes a large share of future revenues will come from China, where it hired an additional 399, 000 sales representatives in 2006. 27 Nestle' has 50 percent of its sales outside of its home market, Coca-Cola has 80 percent, and Procter & Gamble has 65 percent. The Tata Group, a conglomerate

originating in India, has operations in 85 countries and has made a number of acquisitions of large firms around the world. Investment by global companies around the world means that this aspect of globalization benefits developing economies–through the transfer of financial, technological, and managerial resources, as well as through the development of local allies that later become self-sufficient and have other operations. Global companies are becoming less tied to specific 22 Part 1 - The Global Manager's Environment locations, and their operations and allies are spread around the world as they source and coordinate resources and activities in the most suitable areas, and as technology facilitates faster and more flexible interactions and greater efficiencies. It is essential, therefore, for managers to look beyond their domestic market. If they do not, they will be even further behind the majority of managers who have already recognized that they must have a global vision for their firms, beginning with preparing themselves with the skills and tools of managing in a global environment. Companies that desire to remain globally competitive and to expand their operations to other countries will have to develop a cadre of top management with experience operating abroad and an understanding of what it takes to do business in other countries and to work with people of other cultures. Many large firms around the world are getting to the stage of evolution known as the stateless multinational, where work is sourced wherever it is most efficient; the result of this stage of development is that for business leaders, building a firm that is seamlessly integrated across time zones and cultures presents daunting obstacles. Rather than huddling together in a headquarters building in Armonk or Millbank, senior managers will increasingly be spread around the

world, which will require them to learn some new tricks. 28 THE ECONOMIST, September 20, 2008. Small and medium-sized companies (SMEs) are also affected by, and in turn affect, globalization. They play a vital role in contributing to their national economies–through employment, new job creation, development of new products and services, and international operations, typically exporting. The vast majority (about 98 percent) of businesses in developed economies are small and medium-sized enterprises (SMEs), which are typically referred to as those companies having fewer than 500 employees. Small businesses are rapidly discovering foreign markets. Although many small businesses are affected by globalism only to the extent that they face competing products from abroad, an increasing number of entrepreneurs are being approached by potential offshore customers, thanks to the burgeoning number of trade shows, federal and state export initiatives, and the growing use of Web sites, with the ease of making contact and placing orders online. 29 There has never been a better time for SMEs to go global; the Internet is as valid a tool for small companies to find customers and suppliers around the world as it is for large companies. By using the Internet, email, and web-conferencing, small companies can inexpensively contact customers and set up their global businesses. One example of a very small global business (two people) is that of Gayle Warwick Fine Linen–a multinational player based in London. It high-end, handmade bed and table linens are woven in Europe, embroidered in Vietnam, and sold in Britain and the United States. Sales are soaring, and its full-time staff recently doubled–to two: Gayle Warwick and the assistant she recently hired. As she expanded, Ms. Warwick hired a French freight

forwarder, SDV International Logistics, to handle her far-flung business by shipping unfinished and finished fabrics within Europe and to Vietnam, then delivering the embroidered linens to London and the United States. (Freight forwarders can also mange payments, a potential godsend for small exporters dealing with partners scattered around the globe.)30 Regional Trading Blocs The dominance of the United States is already over. What is emerging is a world economy of blocs represented by the North American Free Trade Agreement (NAFTA), the EU, and the Association of Southeast Asian Nations (ASEAN). There's no one center in this world economy. (The late) Peter Drucker31 Much of today's world trade takes place within three regional free-trade blocs (Western Europe; Asia, and the Americas) grouped around the three dominant currencies (the euro, the yen, and the dollar). These trade blocs are continually expanding their borders to include neighboring countries, either directly or with separate agreements. Chapter 1 - Assessing the Environment MAP 1. 1 EU Member States and Candidate Countries 23 Source: http://en. wikipedia. org THE EUROPEAN UNION The European Union (EU) now comprises a 27-nation unified market of over 400 million people, as shown in the map (Map l-l). This " borderless" market now includes ten Central and Eastern Europe (CEE) countries–the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia.–as well as Malta and Cyprus. They joined the EU in May 2004, having met the EU accession requirements, including privatizing state-run businesses, improving the infrastructure, and revamping their finance and banking systems. 32 Bulgaria and Romania joined in January 2007. Turkey, Croatia, and the Republic of Macedonia are official candidates but must meet

the requirements before 2015. Since the euro became a legally tradable currency, Europe's business environment has been transformed. The vast majority of legislative measures have been adopted to create an internal market with free movement of goods and people among the EU countries. The elimination of internal tariffs and customs, as well as financial and commercial barriers, has not eliminated national pride. Although most people in Europe are thought of simply as Europeans, they still think of themselves first as British, French, Danish, Italian, etc., and are wary of giving too much power to centralized institutions or of giving up their national culture. The continuing enlargement of the EU to include many less prosperous countries has also promoted divisions among the " older" members. 33 Global managers face two major tasks. One is strategic (dealt with more fully in Chapter 6): How firms outside of Europe can deal with the implications of the EU and of what some have called a " Fortress Europe"– that is, a market giving preference to insiders. The other task is cultural: How to deal effectively with multiple sets of national cultures, traditions, and customs within Europe, such as differing attitudes about how much time should be spent on work versus leisure activities. ASIA it would be difficult to overstate the power of the fundamental drivers of Asian growth. First, Asian economies have been enjoying a remarkable period of " productivity catch-up," adopting modern technologies, industrial practices, and ways of organizing–in some cases leapfrogging Western competitors. HARVARD BUSINESS REVIEW, July/August 2009. 24 Part 1 - The Global Manager's Environment Manufacturing accounted for approximately 30 percent of GDP in Asia's emerging markets in 2009, thus helping to fuel the demand for

materials and supplies from the developed world and lending hope for a quick global economic recovery. 35 Japan and the Four Tigers–Singapore, Hong Kong, Taiwan, and South Korea, each of which has abundant natural resources and labor–have provided most of the capital and expertise for Asia's developing countries. Now the focus is on China's role in driving closer integration in the region through its rapidly growing exports. Japan continues to negotiate trade agreements with its neighbors; China is negotiating with the entire thirteen-member Association of Southeast Asian Nations (ASEAN), while ASEAN is negotiating for earlier development of its own free trade area, Asean Free Trade Area (AFTA). The Chinese market offers big opportunities for foreign investment, but you must learn to tolerate ambiguity and find a godfather to look after your political connections. FINANCIAL TIMES 36 China has enjoyed success as an export powerhouse, a status built on its strengths of low costs and a constant flow of capital. Its growth phenomenon is further discussed in the accompanying feature " Comparative Management in Focus–China's Economy Keeps on Chugging." India: While China is known as the world's factory, India is becoming known as the world's services supplier, providing highly skilled and educated workers to foreign companies. India is the world's leader for outsourced back-office services, and increasingly for high-tech services, with outsourcing firms like Infosys becoming global giants themselves. India is the fastest-growing free market democracy, yet its biggest hindrance to growth, in particular for the manufacturing sector, remains its poor infrastructure, with both local and foreign companies experiencing traffic gridlocks and power outages. Nevertheless, with growth around 8. 5 percent in recent years, second only to China, optimism abounds

about the country's prospects. Trade liberalization started in 1991; India's Foreign Direct Investment (FDI) rules are more open, and the refining sector is now open to outside investors. While there is talk of reduced tariffs, there is serious political concern for protecting India's small to medium size enterprises, comprising 35% of exports. But with a middle class growing at 100 million people per year, improvements in customs processes, and 30% annual growth in tax revenues, trade is looking steady. 42 After the Indian economy began opening up to the outside world, there has been a surge based on strong industry and agriculture and rising Indian and foreign investment. The expanding middle class of almost 300 million is fuelling demand-led growth. Increasing deregulation is allowing whole sectors to be competitive. Here too there is considerable diversity in markets, incomes and economies; there are fifteen major languages and over 1, 600 dialects. A common comparison between China and India goes that China's economy grows because of its government, while India's economy grows in spite of it. However, with its one billion people, many are still mired in poverty, with per capita GDP below $1, 000, although the poverty rate is half that of twenty years ago. While India's large upcoming youth bulge, compared with China, will bring a wave of workers for the economy, it also brings many more mouths to feed. However, in many areas the economic transformation is startling, with growth fed by firms like the Tata Group–a global conglomerate producing everything from cars and steel to software and consulting systems. In August, 2008, India joined a free-trade agreement with the ten fast-growing countries in the Association of South-East Asian Nations (ASEAN)– making it clear that a regional deal was preferable to a

compromise to protect its farmers by saying " no" to the multilateral trading system in the Doha trade talks. 43 In South Asia, an agreement was signed to form the South Asia Association of Regional Cooperation (SAARC), a free trade pact among seven South Asian nations: Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka, effective January 1, 2006. The agreement will lower tariffs to 25 percent within three to five years and eliminate them within seven years. The member nations comprise 1. 5 billion people, with an estimated one-third of them living in poverty. Trade in South Asia is estimated at $14 billion, though the majority of that trade will be Chapter 1 - Assessing the Environment 25 COMPARATIVE MANAGEMENT IN FOCUS China's Economy Keeps on Chugging China's gross domestic product (GDP) growth rate–over 9 percent a year for thirty years–has been the fastest in the world. 37 Its economy has doubled every eight years for thirty years and the income of its people has increased sevenfold. Even in 2009, with most of the world in a global recession, China's economy quickly snapped back, growing at 8 percent by mid-year, because of the aggressive approach to the slowdown by committing $586 billion–9 percent of GDP–to infrastructure projects, and because its banking system remained relatively unscathed compared with others around the world. Indeed, China surpassed Germany in 2009 as the world's largest exporter. 38 Continuing its aggressive long-term approach, China stepped up to the plate in early 2009 to take advantage of the economic downturn by going on a major shopping spree, investing in energy and other natural resources that could give it an economic advantage it has never had before. Examples were lending the Brazilian oil giant Petrobras $10 billion in exchange for a long-term

commitment to send oil to China; and similar deals with Russia and Venezuela, bringing Beijing's total oil investments for February 2009 alone to $41 billion; as well as deals such as a $19. 5 billion investment in Rio Tinto, an Australian mining company. Such moves put China in an advantageous position of increased access to oil and other commodities at a better price than it would likely be as the world pulls out of the recession. In fact, PetroChina passed Exxon Mobil as the world's most valuable company in May 2009. 39 However, faced with a possible global recession and weakening demand for Chinese exports, there was concern in China and the rest of the world that the Chinese government would not be able to prevent the financial crisis from derailing the country's economic miracle; continued Chinese growth is vital to the global economy as the United States and Europe face severe downturns. The United States, for example, had imported $321 billion worth of goods in 2007, but that demand reduced substantially because of the recession in the U. S., and also because of reduced imports of some tainted products such as toys. The precipitous decline of the housing industry in the United States, for example, which sources 70 percent of its furniture from China, indicates the interdependence of the two economies. However, as mentioned earlier, as of mid-2009, China's resurgence promised to provide leadership for the world's economic rebound, in particular as the Chinese government provided incentives to its people so as to stoke a consumer-driven economy. Indeed, MAP 1. 2 China S$f#s£;-. ^^^^^ij^f^^i^-^^^s S-S- 5X. vV>'-.:.-:!: z£: te-£?.*z£>..:&fcS.-, M-&£g> i8&s£im 26 Part 1 - The Global Manager's Environment China has becotae a battleground for companies wanting a piece of the action in this rapidly

growing and opening economy. In fact, over 400 of the Fortune 500 Global companies are operating there. China's rapid rise–and the burgeoning opportunities for foreign businesses–is partly attributable to its membership in the World Trade Organization (WTO) and its actions for structural reforms and opening of many of its industries to foreign investment. China is now a market-driven economy–driven by competition, capital and entrepreneurship. What accounts for China's rapid rise? China's recent exports in a single day have been more than it exported in all of 1978. With its 1. 3 billion people, China benefits greatly from its large and rapidly growing foreign and domestic market size, which provides significant economies of scale. The World Economic Forum assessment of China is that its " macroeconomic stability is a source of competitive advantage, with the government budget moving into surplus, and manageable debt levels, although rising inflation has become an area of concern. Innovation is becoming another competitive advantage, with rising company spending on R&D coupled with strong university-industry research collaboration, and an increasing rate of patenting." Indeed, China has the world's largest foreign-exchange reserves–three times the holdings of the entire EU, for example. As of September 2009, China had accumulated $2 trillion in foreign reserves, mostly in Treasury bonds and other dollar-denominated assets. 40 China's vast population of low-wage workers and massive consumer market potential has attracted offshoring of manufacturing from companies around the world. In fact there are 49, 000 U. S. companies alone operating in China. It is estimated that China has over 160 cities with populations of over 1 million: One town manufactures most of the eyeglass frames in the world, while the

town next door produces most of the portable cigarette lighters in the world, and the next one is doing most of the computer screens for Dell, and another is specializing in mobile phones. THOMAS FRIEDMAN, 2OO5. 41 It is this low-cost manufacturing base that contributes greatly to its exports and growth–as a major factor in China's uniqueness–according to Fareed Zakaria in his book " The Post American World"'–making the world's largest manufacturer, second-largest consumer, largest server and probably the second-largest military spender. China has the world's largest shipped goods port capacity. For these reasons China would seem well positioned to expand globally as long as global demand for its products and manufacturing continues. In addition, with its substantial foreign exchange reserves from trade surpluses and heavy foreign investment in China, it could acquire discounted stakes in Western banks and industrial companies. The government is aware that it must stoke consumer spending among its own people in order to stave off unemployment. There are still over 500 million people living on less than $2 a day, and average per capita income is under $2, 000. The Boston Consulting Group estimates that, in 2009, some sixty million households are considered middle class. There are considerable differences among the country's regions, making for quite varied markets. The great diversity is indicated by China's eight major languages, several dialects, and several other minority languages. Mandarin is the main language in the north; Cantonese in the south, in particular in Hong Kong. Each language reflects its own history and culture, and therefore markets and economies. Generally speaking, it is clear that China is aggressively opening its doors. The fact remains, however, that, in virtually all industrial sectors, state firms play a

significant or dominant role. Sixteen State-owned enterprises make up about half of GDP. In addition, central, regional, and local political influences create unpredictability for businesses, as do the arbitrary legal systems, suspect data, and underdeveloped infrastructure. However, in addition to foreign investment, China continues to enjoy significant inflows of money from the ethnic Chinese outside of China, often called the " Bamboo Network" or the " Chinese Commonwealth" network. Using their contacts (guanxi) and their familiarity with the culture, language and how to navigate layers of government, Chinese business people around the world–though primarily in Asia–invest large amounts in China. One of the many challenges for international managers is how to negotiate with the Chinese business people and government representatives. This is the subject of the Comparative Management section in Chapter 5. Chapter 1 - Assessing the Environment 27 between India and Pakistan, the two largest countries in the region. 44 Officials in those countries hope to follow the success of the other Asian regional bloc, the ASEAN. Australia–while not regarded as part of Southeast Asia, but of the region called Oceania that includes also New Zealand and neighboring islands in the Pacific Ocean–did sign an ASEAN friendship treaty with Southeast Asia. Australia is one of the richest countries in the world, and over 50 percent of her exports go to East Asia, with more transported through the region to markets around the world. THE AMERICAS Mexico's exports have exploded under NAFTA, quintupling to $292 billion in 2008, but Mexico is still exporting people too, almost half a million each year, seeking opportunities in the United States that they do not have at home. 45 NAFTA: The goal of the North American Free Trade Agreement (NAFTA) between the

United States, Canada, and Mexico was to bring faster growth, more jobs, better working conditions, and a cleaner environment for all as a result of increased exports and trade. This trading bloc– " one America"–has 421 million consumers. Now, many years since the 1993 agreement, the debate continues about the extent to which those goals have been accomplished. That perspective varies, of course, among the three NAFTA countries and also varies according to how it has affected individual business firms and employees in various parts of those countries. The Canada-United States trade is the largest bilateral flow between two countries. In addition, the vast majority–around 84 percent–of both Canadian and Mexican exports goes to the United States. From Mexico's perspective, the country's exports have exploded under NAFTA, quintupling to $292 billion in 2008, but Mexico is still exporting people too, almost half a million each year, seeking opportunities in the United States that they do not have at home, in particular because MNCs displaced farming. However, Mexico's dependence on the United States for its exports–NAFTA's greatest success–has become a liability, as Mexico feels the full brunt of declining consumption in the United States. The auto industry, for example, which has flourished under NAFTA, ground to a virtual standstill early 2009. Mexican auto exports fell more than 50 percent in the first two months of 2009 compared with 2008, and production dropped almost 45 percent. In addition, since NAFTA attracted so many multinationals, which, in turn sourced parts from its own suppliers, Mexico's domestic industries were severely curtailed. Overall, many feel that attracting MNCs was short-sighted for an overall strategy–in particular because their low wages have perpetuated poverty and therefore also low

purchasing power, thus weakening the economy. " Economic growth has averaged about 3 percent a year since NAFTA took effect, far below what is needed to create jobs for the million young people who enter the work force each year and the millions more who barely scrape by." 46 However, some changes for Mexico in those years are not debatable, whether or not they all are attributable to the NAFTA. Mexican trade policy is among the most open in the world, and Mexico has become an important exporting and importing power. While the Mexican economic cycles are very dependent on American economic behavior, she has signed 12 trade agreements with 43 nations, putting 90 percent of its trade under free trade regulations; the latest agreement was made with Japan in 2005. 47 The trade agreements have resulted in an increase in GDP from $403 billion in 1993 to $893. 4 billion in 2007, with exports of $213. 4 billion. 48 Mexico's 3. 3 percent GDP growth in 2007 also included an increase in remittances by migrants–those contributions made by Mexicans living abroad both legally and illegally, mostly in the United States, to their families at home in Mexico; they comprised $18 billion in 2005, up from $2. 4 billion in 1994. 49 Recent competition from China for offshored jobs from foreign firms has put downward pressure on opportunities for Mexico, as manufacturing facilities and some service facilities migrate from Mexico to China in a race for the lowest cost operations. 50 CAFTA: Modeled after the NAFTA agreement, the goal of the U. S.-Central America Free Trade Agreement (CAFTA) was to promote trade liberalization between the United States and five Central American countries: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. In 2004, the Dominican Republic joined the negotiations, and the

agreement was renamed DR-CAFTA. The treaty must be approved by the U. S. Congress and by National 28 Part 1 - The Global Manager's Environment Assemblies in the Central American countries before it becomes law. CAFTA is considered to be a stepping-stone to the larger Free Trade Area of the Americas (FTAA) that would encompass 34 economies, but which has met with considerable resistance. 51 MERCOSUR is the fourth largest trading bloc after the EU, NAFTA and ASEAN. Established in 1991, it comprises the original parties–Brazil, Argentina, Paraguay, and Uruguay; Venezuela is an applicant country awaiting ratification. This regional trading bloc comprises 250 million people and accounts for 75 percent of South America's GDP. Other Regions in the World Sweeping political, economic, and social changes around the world present new challenges to global managers. The worldwide move away from communism, together with the trend toward privatization, has had an enormous influence on the world economy. Economic freedom is a critical factor in the relative wealth of nations. One of the most striking changes today is that almost all nations have suddenly begun to develop decentralized, free market systems in order to manage a global economy of intense competition, the complexity of high-tech industrialization, and an awakening hunger for freedom. The Russian Federation Foreign investment in Russia, as well as its consumers' climbing confidence and affluence, bode well for the economy. In the first quarter of 2009, for example, FDI into the Russian economy was about $8. 4 billion. 52 However, corruption and government interference persist: The writing has been on the wall for years. The Kremlin won't stop until it has recouped control of all the energy assets that were sold off at bargain prices when the Iron Curtain fell–and it will use

any means necessary to achieve that goal. INTERNATIONAL HERALD TRIBUNE, March20, 200853 Until recently, Russia has been regarded as more politically stable. New land, legal and labor codes, as well as the now-convertible ruble have encouraged foreign firms to take advantage of opportunities in that immense area, in particular the vast natural resources and the well-educated population of 145 million. Moscow, in particular, is teeming with new construction sites, high-end cars, and new restaurants. Growth has been steady, but the real GDP growth for Russia is considered to be controlled by the so-called business " oligarchs"–a small group of businesspeople with political influence who capitalized on the privatization of Russia's economy and who limit competitive opportunities for small businesses. However, foreign investors became very wary after the break up of the Yukos oil group, including jailing its head Mikhail Khodorkovsky with an eight-year sentence; this made foreign investors reluctant to propose new deals that would require political approval. About two dozen Russian companies have come under the control of the Kremlin in the last few years, including newspapers and banks. 54 As an example, in September 2008, British Petroleum had to make deep concessions to its Russian partner in its TNK-BP oil joint venture. in order to avoid a forced sale of its assets there to a state company. BP had to agree to dismiss the American chief executive of its joint venture and give up some board seats to its Russian partners55. The Middle East. The United Arab Emirates is the most competitive economy in the Arab world among the countries at the third and most advanced stage of development according to The Arab World Competitiveness Report 2007 by the World Economic Forum. It is followed by Qatar and Kuwait. Among

countries at the second stage of development, Tunisia and Oman are the best performing Arab economies while Egypt is the regional best performer in the third group of countries. The Forum predicted there will be prosperity with challenges for the Middle East Oil and gas revenues provide unique investment opportunities, but the region's greatest challenges are likely to be in managing expectations, lowering trade and investment barriers and educating the next generation to handle the wealth that is now being produced. Education is the biggest challenge. Developing Economies are characterized by change that has come about more slowly as they struggle with low gross national product (GNP) and low per capita income, as well as the burdens of large, relatively unskilled populations and high international debt. Their economic situation and the often-unacceptable level of government intervention discourage the foreign investment they Chapter 1 - Assessing the Environment 29 need. Many countries in Central and South America, the Middle East, and Africa desperately hope to attract foreign investment to stimulate economic growth. The African Union (AU): The AU comprises the 53 African countries and was formed from the original Organization of African Unity (OAU) primarily to deal with political issues. However, that union is not able to provide a vehicle for integration of trade and economic growth because of the many major problems in the region. Unfortunately, Africa has been virtually ignored by most of the world's investors, although it receives increasing investment from companies in South Africa, which has the region's biggest economy. South Africa: The South African economy has been growing continuously since 1998, amid a more stable political environment since the defeat of apartheid. It is the

longest economic upswing in the country's history, although, according to Statistics South Africa, GDP had slowed near the end of 2008 to +0. 2 percent. In addition, unemployment was 23. 2 percent of the population of 48. 7 million (as of January, 2009). 57 The rapid growth of consumer demand, along with increasing tourism and foreign business investment, has made the country's outlook very positive. Foreign investment is encouraged through the Strategic Industrial Project, which provides approved companies with substantial tax reductions as well as other incentives. These incentives, along with more political stability, encouraged the return of most of the foreign companies which had left during the apartheid era. In addition, companies in South Africa no doubt realize that they have a competitive edge on the African continent that they do not have in more developed parts of the world. 58 For firms willing to take the economic and political risks, developing economies offer considerable potential for international business. Assessing the risk-return trade-offs and keeping up with political developments in these developing countries are two of the many demands on international managers. Among proactive managers taking advantage of such opportunities are those at Intel–a corporation that epitomizes the ways in which " globalization" is affecting less-developed countries (LDCs) and developing economies such as Vietnam, as discussed in the accompanying Management Focus. MANAGEMENT FOCUS Intel Brings Changes to Vietnam's Economy and Culture59 The United States opened trade relations with Vietnam in 2000, opening the way for that country's expansion. Although Vietnam is a communist country, its rapid growth can be attributed to its entrepreneurial traditions and those aspects of globalization that attract

corporations such as Intel to take advantage of new markets and lower costs of production. While the debate continues about whether globalization brings overall positive or negative effects to less developed countries, the inevitable march of trade and investment has led Daniel Altman to believe that " the more relevant question today is whether these multinational relationships can be managed in a way that benefits both guests and hosts." Intel's success in this regard started with the awareness of the tight control of the Vietnamese government in all aspects of society and on foreign companies wishing to do business there. After painstaking and secret negotiations with Vietnamese government officials who were unused to market economics, Intel's general manager, Rick Howath, decided to build its biggest semiconductor manufacturing plant ever along the Hanoi Highway in Vietnam, a nation of 85 million with limited higher education opportunities. This is Intel Corporation's seventh assembly site of its global network. (Other sites include Penang and Kulim, Malaysia; Cavite, Philippines; Chengdu and Shanghai, China; and San Jose, Costa Rica.) Planning to hire 4, 000 workers by 2010 to produce chips for the company's extensive global supply chain, Intel has demonstrated how multinationals which are industry leaders can change the economic and cultural dynamics in a developing country by the decision to locate a plant there. However, this was no light decision. Intel's company strategic decision-makers spent years investigating and evaluating the benefits and constraints of locating there and considerable effort in working with the government in Hanoi. The company's investigations were relentless, evaluating school curricula, traffic congestion, the poor infrastructure, and the size of the average adult in order to tailor the factory

to them. Their main concern was finding enough qualified engineers. In the end, the Vietnamese government's desire to attract multinationals, along with the country's proximity to China and its young, low-cost workforce, convinced Intel to invest $1 billion there 30 Part 1 - The Global Manager's Environment for its 115-acre construction site in the new Saigon Hi-Tech Park. The company called the project A-9. (Nine is regarded as a lucky number in Vietnam.) However, this was not until the government-owned Saigon Hi-Tech Park signed a pact with Intel to fight against corruption and improper business conduct. This was the first time a state agency had made such a pact and also a first for Intel, who was concerned about Vietnam's reputation as one of the world's most corrupt countries. Changes resulting from Intel's investment in Vietnam are already evident. The Vietnamese government is giving Intel's managers unprecedented access to high-ranking officials, and other global giants are showing interest in investing there. The plant will create a higher-end manufacturing base beyond garment assembly lines and create desperately needed professional jobs for its youth. Intel is also bringing its culture to Vietnam. Executives work alongside the workers, with no big offices for the bosses–contrary to Vietnam's hierarchical culture. It also sponsors team-building exercises like karaoke Fridays. Intel's company buses shuttle workers to the plant, passing low-slung shacks, which house so many Vietnamese. In all, the Vietnamese view the new plant in Ho Chi Minh City with patriotic pride and hope for further economic emergence. For its part, Intel's success is largely attributable to cultivating government officials and to understanding the government's goals and work towards them. These include the desire to increase the use of personal computers

and the Internet, and also to get a reputation for Vietnam to export high-tech items. Focusing on local traditions and working with the government's Communist youth group, Intel developed a program under the brand Thanh Giong, a Vietnamese hero, with the goal of beating back the enemy of illiteracy. Information Technology Of all the developments propelling global business today, the one that is transforming the international manager's agenda more than any is the rapid advance in information technology (IT).