University of
South Australia

Study Guide

International Business

BUSS 5251

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INTRODUCTION

This Study Guide provides details to assist your study with the International Business course within the Master of Business Administration program offered by the University of South Australia Business School.

This document should be read in conjunction with the Course Outline. In addition you will need to refer to the eReader and Textbook. You will also be expected to read and research beyond the references listed in this Study Guide.

If you have any concerns or questions please contact the Course Coordinator.

Note: Please do not quote any materials from this Study Guide as a reference in your essays. This booklet is a Study Guide and as such, it does not have the academic status of published books or refereed journal articles.

INTRODUCTION

Globalisation has become not just a house-hold term but a field of study in its own right (Sklair, 2000). The conventional units of analysis in business ranges from the micro-focus of individuals to the macro-focus of nation-states. Academic treatment of globalisation as a concept has found that many issues cannot be studied adequately at the nation-state level. There is indeed a need to review many issues such as capital flow and information communications, from a transnational perspective as they are beyond the level of the nation-state. Globalisation now puts in doubt the relevance of state-centrism in international business studies.

This Topic aims to provide you with the context in which international business is conducted. In the last two decades, globalisation has been hailed as the most significant era in history due to its pervasive impact on the political, economic and socio-ideological aspects of mankind.

Starting with an examination of the concept of globalisation, this Topic will provide different definitions and perspectives of the term and relate them to some of the phenomena observed in day-to-day conduct of international business. The root of globalisation will then be traced, with a view to comparing and contrasting the present with the past. This will be followed by an analysis of what has occurred versus what has been promised by globalisation. The challenges and opportunities presented by globalisation are then reviewed, culminating in an elaboration of the Study Framework used in this course.

LEARNING OBJECTIVES

On completion of this Topic, you will be able to:

- Describe the meaning of globalisation;
- Define globalisation;
- List the emerging theories of globalisation;
- Describe the historical development of globalisation and recognise drivers of the current phenomenon;
- Recognise contemporary perspectives from which globalisation can be examined from a business perspectives;
- Identify challenges and opportunities presented by globalisation.

WHAT IS GLOBALISATION?

Globalisation generally refers to the expansion of global linkages, the organisation of economic activities and business interactions on a global scale, and the growth of a global consciousness about the possible convergence of a world society (Lechner, 2000). While this meaning of the term captures most of the key issues under the umbrella of globalisation, it must be recognised that interpretation of globalisation is always a source of academic as well as ideological dispute. Indeed, most of the negative public attitudes towards multinational corporations and international trade organisations seem to have derived from the fear of convergence.

Expansion of global linkages is a key feature of globalisation with the advancement of information technology and the increasing affordability of international travel. Individuals, firms and government institutions are able to reach each other much faster, deeper and cheaper than ever before (Friedman, 1999). Thus, the distance and boundaries of social relations have been diminished (Aart Scholte, 1997)

Organisation of economic and business activities on a global scale is another characteristic of globalisation in that business is able to migrate the whole or part of their activities to any part of the world. These may involve the shift of production, marketing, sourcing and so on, to locations that provide the best advantage. There is now an international division of labour (Cox, 1994), and as Kanter (1995) states:

“the world is becoming a global shopping mall in which ideas and products are available everywhere at the same time”

Global convergence has been hailed as another feature of globalisation. Apart from increasing interconnectedness, there is a growing demand for individuals, firms and states to comply with values, practices and goals at a global level. Through such institutions as the World Trade Organisation (WTO), the International Monetary Fund (IMF), World Bank, and the United Nations (UN), human interactions at the individual, firm and state levels are regulated by ‘global’ codes of conduct, and the globe has now become the basis in shaping human activities (Albrow, *The global age*, 1996, p. 88).

Definition and Theories of Globalisation

Definitions

There are as many different definitions of globalisation as the number of people who attempt to define the concept. The following are some of the common ones:

- Globalisation can be defined as the decline in the cost of doing business internationally, caused by the shrinkage of economic distance between nations (Anderson, 2001; Rajan, 2001);
- Globalisation refers to all those processes by which the peoples of the world are incorporated into a single world society, global society (Martin Albrow, 1990);
- Globalisation can ... be defined as the intensification of worldwide social relations which link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice versa. (Anthony Giddens, 1990);
- We are living through an age of radical transformation. The best approach is to think about it in terms of an emerging global umbrella-civilization together with diverse sub-civilizations / cultural pluralism / cultural conflict. (Yehezkel Dror, 1998);
- Globalisation entails an accelerating rate and/or higher level of economic interaction between nation states and national economies. (Baker, Epstein & Pollin, 1998).

For Consideration

Which one of the above definitions do you prefer? Why? How would your definition of globalisation influence your attitude towards international business?

From the above definitions, it can be seen that globalisation should not be viewed purely from the economic and business perspective. It is a phenomenon that has to be considered from political, economic and socio-ideological perspectives as well. To provide a more comprehensive understanding of the concept of globalisation, it can be defined in four dimensions:

Globalisation as historical epoch

According to this definition, globalisation is a specific period of history to 'succeed' the Cold War. The ascendancy of a neo-liberal market oriented approach to economic management at the expense of the Keynesian welfare state approach that had dominated the post WWII era.

Globalisation as the confluence of economic phenomena

Globalisation is defined as an intrinsically related series of economic phenomena, including the liberalisation and deregulation of markets, privatisation of assets, retreat of state functions, diffusion of technology, cross-national distribution of manufacturing production (FDI), and the integration of capital markets. This definition refers to the world-wide spread of sales, production and manufacturing processes, all of which reconstitute the internal division of labour.

Globalisation as the triumph of American values

This definition suggests that globalisation leads to the homogenisation of values around the principles of capitalism and democracy as espoused by the United States. It also advocates the convergence of values.

Globalisation as sociological and technological revolution

This definition refers to globalisation as a new form of activity in that industrial capitalism has shifted to post-industrial conception of economic relations. These relations involve a comprehensive process of:

- globally integrated production;
- specialised but interdependent labour markets;
- privatisation of state assets;
- linkage of technology across conventional national borders.

Theories of Globalisation

As discussed above, globalisation has become a discipline of study in its own right. There is no shortage of theories being developed to guide managers through more systematic conceptualisation of this world-wide phenomenon. Based on a review of the literature, the following seem to be the more commonly-cited theories (Sklair, 2000):

The redistributive theory of globalisation – state vs international institutions (structuralism) is not the only way to see how political and social development is shaped. There is now greater responsibility placed on individuals to influence how the future form of the state should look like.

The regionalism theory of globalisation – preserving national differences yet compromising with the global economy. Regionalisation as an intermediary and mitigating stage in the relationship between states on the one hand and the globalising economy on the other.

The modernisation theory of globalisation – the diffusion of (American) capital, technology and culture and the expectation of convergence. This is done via the assimilation of political and economic institutions in the public sector, and 'best business practices' in the private sector.

The internet theory of globalisation – globalisation as scientific and technological revolution. It refers to the world-wide spread of sales, production facilities and manufacturing processes, all of which reconstitute the international division of labour.

Global system theory – focuses on global practices that cut cross state boundaries but do not necessarily originate with state agencies or actors. This theory primarily addresses the extent to which the nation-state is in decline.

As managers operating in the age of globalisation, it is important to observe that themes of the above-listed theories are reflected from time to time in various academic debates and international business activities.

Roots of Globalisation

While globalisation only became a house-hold term some two decades ago, its history of existence is in fact long. It is suggested that globalisation can be traced back to the 1800s during the period of enlightenment in Europe. A chronological sequence of events is tabulated below:

Period	Key Events	Significance
First Period (1800-WWII)	Cultural enlightenment	Decoupling of religion and science, secularisation.
	Political enlightenment	Formation of nation states in Europe, development of international law and treaties.
	Economic enlightenment	Money-economy interactions among nation states.
	Technological innovation	Standardisation of transport and communication systems – cars, telegraph, radio, etc.
	Spread of western enlightenment	Voyages of discovery, colonialisation, and aids for developing countries.
Second Period (WWII-1989)	Cultural modernisation	Political and economic refugees and Americanisation of culture and economy.
	Political modernisation	Decolonialisation and the establishment of the UN.
	Economic modernisation	Free market economy; end of Bretton Woods Treaty.
	Technological innovation	Interactive computing technology and the invention of space-technologies.
Third period (1989-to date)	Political development	End of Cold War; opening-up of communist economies; establishment of the EU.
	Economic development	Formation and contributions of GATT & subsequently WTO.
	Technological development	The arrival of the infocomm age.

Source: Lubbers, 2000

From the above table, it seems that globalisation has been part of the human history in the last 200 years. The debate among academics is whether convergence or divergence is going to come out as the winner. Certainly the debate is still going on and there are diverse opinions and views on the future of globalisation.

What is New about Globalisation?

Mass migration, regulation of interactions among nations and standardisation of technologies are not unique to the current period of globalisation. However, there seems to be general consensus that the following phenomena are unprecedented:

- Rapid growth of the volume of trade in physical commodities;
- Rapid growth of the volume of trade in information;
- Rapid growth of the volume of trade in currency with the globalisation of financial markets;
- Marriage of global communications and computer technology;
- A bottom-up approach to globalisation: non-government groups play a crucial role in the global society.

These phenomena will be further reviewed when the impact of globalisation is examined later in this Topic.

Responses to Globalisation

While globalisation seems to have produced many positive results for the world as a whole, negative responses are nevertheless the subject of regular media coverage.

There are protests across the globe against the erosion of job security due to effect of open borders, free trade and economic globalisation. As mentioned above, globalisation has triggered off massive relocations of people, including immigrants, temporary workers, retirees and visitors. The greatest relocation involves young, well-educated workers flocking to the cities of the developed world. Coupled with the outsourcing of production and services to destinations with cheaper labour and raw material costs, job security has become a major issue in the age of globalisation. On the positive side, globalisation also has led to a gradual standardisation of labour practices among industrialised countries (Johnston, 1991).

Uneven rewards and benefits of globalisation have given rise to extremist movements such as global terrorism and public protests. From an international economics perspective, traditional advantages of developing economies have been in primary commodities due to the low level of technological development and cheap labour costs. Opportunities for growth in the world market have shifted from raw or semi-processed commodities towards manufactured goods and services – and within these categories, towards more knowledge-intensive segments. This trend obviously favours rich countries over poor ones, since most of the latter are still peripheral players in the knowledge economy. The exceptions are the Asian Tigers. However, the restriction on immigration does not allow catch-up; making sharing of globalisation gains uneven (Scott, 2001). In a study of the impact of globalisation on developing countries (Malaysia, the Philippines), Mittelman (2000) found that the integration of world markets is lifting up all countries. However, global gains in productivity, living standards, education, and civic participation are offset by a growing loss of political control by the world's poorest citizens. It is therefore expected that massive relocation of people from the poorer countries to the wealthier ones will take place, which will impact on countries like Singapore which is going to become the destination for migrants and foreign workers.

There is also the rise of regionalism, decentralisation and localism to provide cultural and political autonomy for sub-national communities. This also off-sets the emergence of the transnational forms of governance, which are perceived to erode the sovereignty of the nation-states.

Drivers of Globalisation

Having reviewed the different concepts and the root of globalisation, it seems now possible to draw together the so-called "drivers" of globalisation:

The end of the Cold War has removed the division of the world into competing political blocs, paving the way for mutual cooperation among nation-states for economic gains. The formation of EU, GATT, WTO, APEC, NAFTA, and AFTA are typical examples how political institutions turn into cooperatives for the promotion of international trade.

a) The rise of the 'knowledge economy', in which products and services are inherently more mobile with the aid of advanced communication technologies;

b) The widespread availability of technology, finance and information to an enormous range of people and institutions in any part of the world;

c) The rise of the World Wide Web to provide instant electronic access to people and information;

d) The securitisation of assets, providing a huge sum of tradable wealth, which searches the world for the best 'deal';

e) Government promotion of globalisation through involvement in trade agreements and adoption of deregulation policies in order to increase international trading activities for economic growth;

f) The rise of transnational corporations which bring the world closer together by investing, producing, sourcing and marketing on a global scale;

g) The emergence of global consumers who share similar tastes and preferences in goods and services, possibly through the influence of information technology and communication.

Source: Godfrey, 2000; Rugman & Hodgetts, 2003

Is Globalisation Going to Continue?

The rosy picture of globalisation painted by political leaders all over the world has been rejected by many (James, 2001). The fears that the global economy would collapse were partly confirmed in 2008 when the effects of the Global Financial Crisis were felt around the world. The predictions that the global economy will collapse were made because:

- Rising volume and volatility of capital flows triggered unstainable booms and busts as evidenced in the Depression of the 1930s;
- Widespread protests against globalisation create social and political unrests. Globalisation has caused fear and uncertainty, which in turn generates social and political pressures on institutions responsible for global integration. The Seattle Protest is a good demonstration of such unrests.

Can Globalisation be Reversed?

Those who argue against globalisation propose that the trend can be stalled or reversed by disbanding such bodies as the WTO and IMF. However, there are also suggestions that these government-funded institutions are not the only driving force of globalisation. One of the most essential drivers of globalisation is technology and its unpredictable nature makes it difficult to predict what may be the future forms of human interaction.

The current uneven distribution of rewards and benefits among nation-states can be rectified by the development of 'global governance'. Current global institutions still find it difficult to manage and regulate actions, processes and problems of global scope or effect due to jurisdiction and territorial constraints (Lechner, 2000).

For Consideration

What is your own view of the future of globalisation?

Business Perspectives of Globalisation

Globalisation as a field of study can be researched from multiple disciplines. Hence, the definitions and theories presented in preceding parts of this Topic may involve disciplinary areas other than business. For the purposes of this 'International Business' course, globalisation can be examined from six perspectives as follows:

World trade expansion	Focuses on rapid growth in the world economy through the increase in international trade, emphasising the need for liberalisation, privatisation and market openness.
World market expansion	Expanding and enlarging markets for corporations beyond national and regional markets, making no distinction between globalisation and internationalisation.
World system domination	Extension and modification of the American version of capitalism.

Global manufacturing/marketing Globalisation is the delivery of products that are globally identical in terms of design, function and even fashion (*Leavitt, 1983*). Consumers increasingly display similar preferences and consequently demand the same products. It is hence significant for corporations that compete in the world market to produce standardised products and market them internationally, therefore lowering costs and improving quality.

Global capitalism	Globalisation is concerned with the creation of tangible and intangible (e.g. reduction of crime and protection of environment) wealth. Thus, companies should have moral and ethical values.
Global integration	Globalisation is an inclusive endeavour, featuring free trade, openness, equal access to information technology and virtual civil and legal institutions that uphold individual and group rights while facilitating social and economic integration.

(Ali, 2001)

For Consideration

Reflect on your current employing organisation, and identify globalisation perspectives that may have relevance.

Implications of Globalisation for International Business

Globalisation has significant implications for managers involved in international business. There are opportunities as well as challenges and it is important that they are recognised in pursuing any international ventures.

Opportunities provided by globalisation

Globalisation is likely to promote more international business activities, as MNC's (Multi-National Companies) can have less reservation in entering unfamiliar markets (Moshirian, 2003). This is facilitated by:

Security of Access: Removal of tariffs as a result of trade liberalisation makes it easier for firms to enter into overseas markets. International agreements also allow more transparency in the regulation of business in different countries.

Stability of Access: Global trading systems have provided uniform sets of rules across national borders. Such uniformity should give business confidence in knowing how to 'behave' in different markets.

Access to raw materials and services at competitive prices: The removal of tariffs and deregulation have allowed business to source raw materials and services in any part of the world. For example, many companies set up call centres in India to capitalise on the low labour costs and the English language proficiency of the workforce.

The globalisation of consumer preferences: Despite contradictory evidence, there is still belief that consumers share some common tastes and preferences in goods and services. This provides opportunities for business to tap into markets beyond national borders.

Challenges

Globalisation is such a global phenomenon that literally no economic activity is purely local. Investment, production and consumption decisions around the globe are highly interdependent. This interdependence, coupled with revolutions in telecommunications and information sciences, has significantly reduced the social distance among human beings. For all intents and purposes, the globe has become smaller and physical boundaries are considered unimportant (Huddleston, 2000). Thus, globalisation provides significant challenges to managers involved in international business and companies now need to attain sources of global competitive advantage through:

- Adapting to local market differences;
- Exploiting economies of global scale;
- Exploiting economies of global scope;
- Tapping the optimal locations for activities and resources;
- Maximising knowledge transfer across locations (Gupta & Govindarajan, 2001).

For Consideration

Based on Gupta and Govindarajan's model, reflect on how your current (previous) employing organisation obtains competitive advantage in the face of globalisation.

Consequences of Not Globalising

Proponents of globalisation further suggest that firms that do not embrace globalisation will:

- Miss out on business opportunities outside their national border;
- Undermine national economic growth as countries with limited international trading activities tend to perform poorly economically (North Korea is a typical example);
- Fail to develop a competitive edge through economies of scale and economies of scope;
- Not be protected from competition as trade liberalisation is going to continue anyway;
- Fall behind the rapid pace of innovation in technology;
- Become insensitive to changes in society values, tastes and fashion.

the Study of International Business

'International Business' is an advanced course in the MBA program designed to give participants the knowledge and skills of running a business outside one's country. As such, this Course has adopted a 'functional' approach in the development of curriculum content.

After exposing you to the concepts of globalisation, the Course will take you to Topic 2, which involves the management of negotiations, which is essential whether your firm is concerned with imports, exports or foreign investment.

Topic 3 will review the international business environment that affects such activities as imports, exports and foreign investment. Topic 4 will provide you with tools to assess opportunities and risks of doing business in a particular country.

Topic 5 will bring us to consider setting strategy and designing appropriate organisation structure for your international operations. Once these are assessed positively you, as the manager, will need to determine how the firm will internationalise and choose the appropriate entry strategy – the subject of Topic 6.

People issues in international business are dealt with in Topic 7.

INTRODUCTION

Once managers have done their homework and decided to internationalise, they will be involved in interaction with their counterparts in other countries. Regardless of the internationalisation mode or market entry strategy adopted, negotiations are almost inevitable. This Topic will provide you with tools to manage the negotiation process and to handle cross-cultural behaviours and communication.

LEARNING OUTCOMES

Upon completion of this Topic, you will be able to:

- Describe the key concepts of negotiation;
- Apply the negotiation model and manage the negotiation content and process appropriately;
- Describe features of the following models for understanding culture:
  - The Kluckholn & Strodtbeck Model;
  - The Hall Model;
  - The Hofstede Model;
  - The Trompenaars Model;
  - The Gesteland Model.
- Recognise how different cultural dimensions may impact on communication and behaviours in negotiation situations.

NEGOTIATION

Negotiation is one of the interpersonal methods of resolving conflict. It is a process where two parties attempt to reach acceptable agreement in a situation characterised by some level of real or potential disagreement. Negotiations may occur between two people, within a group, between groups and between firms.

Many managers find negotiation unpleasant because it involves conflict. Conflict is stressful, so is best avoided. Unfortunately, someone has to do it and the task always falls on the shoulders of managers.

In the international context, managers must understand the influence of norms and value systems and be sensitive to how these factors influence a firm's approach to negotiations.

Concepts of Negotiation

There are many ways to define negotiation. Most researchers define it as a process whereby one gets what one wants from the other party. In this sense, negotiation is a **process of influencing others to give you what you want**. This broad definition provides managers with the awareness of the many opportunities for negotiation, and extends the time frame when negotiation can take place.

Another important concept of negotiation is that it should be **outcome-based** rather than content-based. Most negotiators tend to lock themselves into the minute details of negotiation at the expense of the outcomes that they want to achieve.

Equally important in negotiation is the concept that how one negotiates affects the **consequences**. Thus, the way negotiation is managed and the way(s) negotiators behave will have direct impact on the consequences of the negotiation.

Negotiation Model

There are many negotiation models that managers can choose from. Robbins (2003) suggests that negotiation is a process involving the following steps:

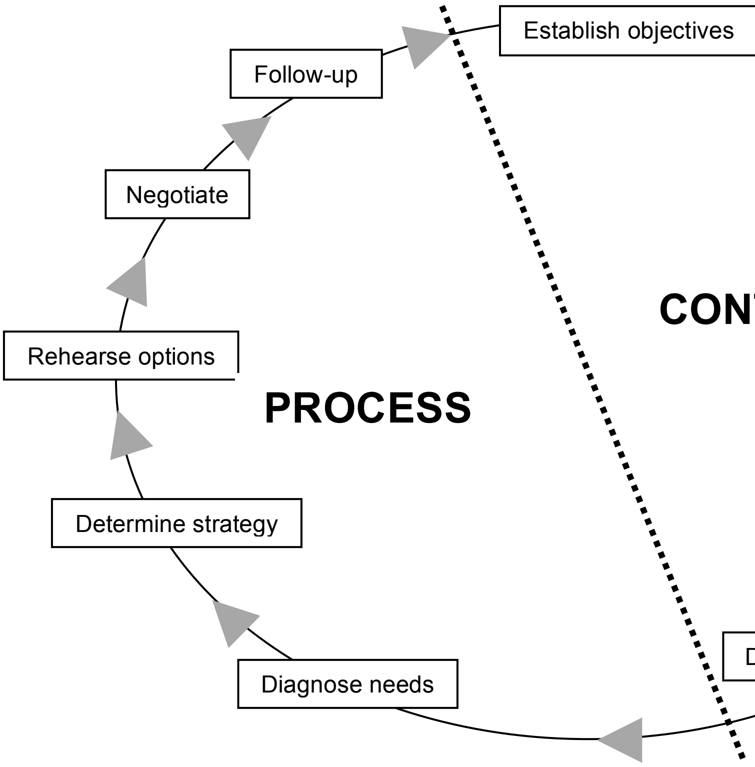
- Preparation and planning;
- Definitions of ground rules;
- Clarification and justification;
- Bargaining and problem solving;

- Closure and implementation.

Others describe negotiation models by time stages, e.g. Relationship development, pre-negotiation, negotiation event, post-settlement and relationship maintenance.

The negotiation model used in this Topic is adapted from Hawkins and Hudson (1990). In this model, there are two key components of any negotiation, i.e. **content** and **process**. Content deals with the subject matter of the negotiation, whereas process concerns how best to negotiate. Effective negotiators are effective in both components.

Exhibit 2.1: Model for Negotiation



Source: Hawkins & Hudson, 1990

Key elements in the content and process of negotiation include:

Negotiation Content

- Establish objectives;
- Test assumptions;
- Research facts;
- Define issues;
- Decide negotiation range.

Negotiation Process

- Diagnose needs;
- Determine strategy;
  - Determine style;
  - Develop climate;
- When;
- Where;
- Who;
- How;
  - Style;
  - Tactics;

- emotional mood;
- mode of contact;

- Rehearse options;
- Negotiate;
- Follow-up.

The content component of the negotiation involves hard work on the substance of the matter.

The starting point for preparing any negotiation is to establish objectives and ascertain subject matter. This involves testing assumptions held by oneself and the opponent(s). Managers usually do not have all the information needed, hence it is not unusual to go into negotiation with assumed 'facts'. Verification of assumptions from time to time can help sharpen the focus and refine the objective(s) of the negotiation.

Negotiation means hard work. It requires managers to research facts. For example, you need to find out who are you negotiating with, what role(s) do they play in their firm and what issues are of interest to them.

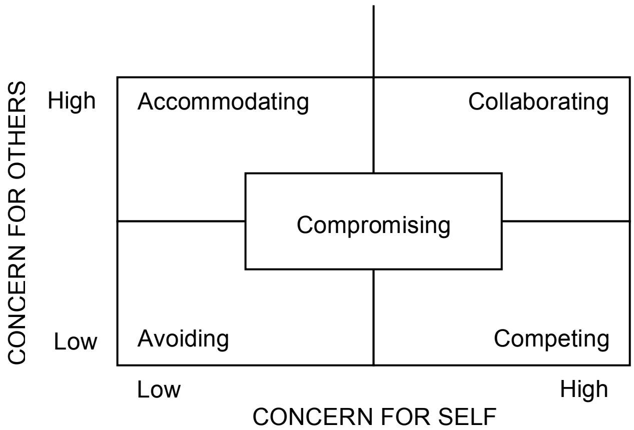
In preparing for negotiation, managers also have to define issues, i.e. What are the key issues? What priorities do they have? Careful and clear definition of issues provides managers with flexibility of what they must 'gain' and what they can 'concede' in the negotiation.

Managers must decide the negotiation range for each issue (What is the upper limit? What is the bottom line?)

Managing the negotiation process is as important as preparing well for the negotiation itself. A most important part of negotiation is to be able to know what are the needs of the opponent(s). Diagnosing their needs will help you identify the common ground to reach agreement.

Determining your negotiation strategy appropriately is an art as well as a science as this requires observation, self-awareness, self-control and sensitivity to the situation. Behaviours of individuals during negotiations are influenced by personality, background and the settings. Seasoned negotiators are able to utilise strategies appropriately to capitalise on these. The most classic framework for determining negotiation styles has been the Thomas-Kilman model:

Exhibit 2.2: The Thomas-Kilman Model of Negotiation Styles



Source: Thomas, 1976

The use of each style in specific situations is suggested below:

Table 2.1: Application of the Thomas-Kilman Model of Negotiation Styles

Negotiation orientation	Appropriate situations
Competition	When quick, decisive action is vital. On important issues where unpopular actions need implementing. On issues vital to company welfare when you know you have the upper hand in terms of power. Against people who take advantage of non-competitive behaviour.
Collaboration	To find an integrative solution when both sets of concerns are too important to be compromised. When your objective is to learn. To merge insights from people with different perspectives. To gain commitment by incorporating concerns into a consensus. To work through feelings which have interfered with a relationship.
Compromise	When goals are important, but not worth the effort or potential disruption of more assertive modes. When opponents with equal power are committed to mutually exclusive goals. To achieve temporary settlements to complex issues. To arrive at expedient solutions under time pressure. As a backup when collaboration or competition is unsuccessful.
Avoidance	When an issue is trivial, or more important issues are pressing. When you perceive no chance of satisfying your concerns. When potential disruption outweighs the benefits of resolution. To let people cool down and regain perspective. When gathering information supersedes immediate decision. When others can resolve the conflict more effectively. When issues seem tangential or symptomatic of other issues.
Accommodation	When you find you are wrong - to allow a better position to be heard, to learn and to show your reasonableness. When issues are more important to the opponent than yourself - to satisfy others and maintain cooperation. To build social credits for later issues. To minimise loss when you are outmatched and losing. When harmony and stability are especially important. To allow opponent to learn from mistakes.

Effective negotiators also develop the right climate for negotiation. The timing of negotiation is one element that can affect the climate for negotiation.

For Consideration

From your own experience, when is the best time to negotiate? What are the negotiation times that create competitive and cooperative climate respectively?

The venue for negotiation also plays an important part in creating the climate preferred by effective negotiators.

For Consideration

What are advantages and disadvantages of negotiating at your opponent's place, at your own place, at a neutral place? How would you arrange the physical set-up of the negotiation venue?

Apart from determining who should be the negotiator(s), managers should also consider the following issues:

- Team vs one-to-one negotiation;
- Negotiation team composition;
- Negotiation team coordination.

The 'how' of negotiation will be further discussed and demonstrated in class exercises.

Effective negotiators also rehearse for important negotiations.

For Consideration

From your own experience, how do you do negotiation rehearsals?

Following up on negotiation not only affects the long-term relationship with your negotiation counterpart, but also the implementation of the agreed outcomes. Negotiation is a continuous process and not a one-off event. Any breach of agreement means that you have to negotiate again!

Cross-Cultural Behaviours and Communication

Doing business outside one's home country means dealing with people with cultural backgrounds different from yours. Managers involved in international business therefore need to understand and manage some of the cross-cultural issues, particularly in negotiation situations.

There are two common elements in managers' mindsets that may affect their effectiveness in dealing with people from other cultures. The first is **parochialism**. This is the tendency to see the world from one's perspectives only. Managers from developed economies usually hold the view that they know enough about doing business in the less developed countries. The other element has to do with **simplification**. This is the tendency to treat all cultures the same as one's own (Hodgetts & Luthans, 2003).

"[Culture] consists of patterns, explicit and implicit of and for behaviour acquired and transmitted by symbols, constituting the distinctive achievement of human groups, including their embodiment in artefacts; the essential core of culture consists of traditional (i.e. historically derived and selected) ideas and especially their attached values; culture systems may, on the one hand, be considered as products of action, on the other, as conditioning elements of future action."

(Kroeber & Kluckhohn, 1952)

Thus, culture seems to have direct influences on behaviour.

Models for Understanding Different Cultures

Numerous attempts have been made by researchers to identify aspects of culture that affect individual behaviours. There are many models for understanding different cultures. For the purposes of this Topic, the following will be discussed:

- The Kluckholn & Strodtbeck Model;
- The Hall Model;
- The Hofstede Model;
- The Trompenaars Model;
- The Gesteland Model.

The Kluckholn and Strodtbeck Model

The Kluckholn and Strodtbeck Model (Kluckholn & Strodtbeck, 1961) suggests that culture can be compared in relation to some distinctive features. These features can be classified into six orientations. Provided in Table 2.2 is the six orientations in each national culture and how they may vary to result in cultural differences.

Table 2.2: Six Basic Cultural Orientations

Orientation	Variations
What is the nature of people?	Good (changeable/unchangeable) A mixture of good and evil* Evil (changeable/unchangeable)
What is person's relationship to nature?	Dominant* In harmony with nature Subjugation
What is person's relationship to others?	Lineal (hierarchic) Collateral (collectivist) Individualist*
What is the modality of human activity?	Doing* Being and becoming Being
What is the temporal focus of activity?	Future* Present Past
What is the conception of space?	Private* Mixed Public

* Indicates dominant U.S. orientation

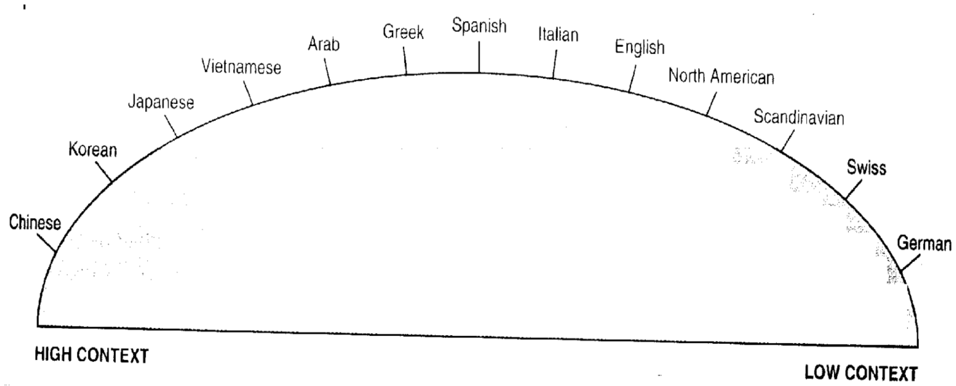
Source: Kluckholn & Strodtbeck, 1961

Variations in each of the six orientations result in different behaviours, attitudes and preferences, hence explaining the sources of cultural differences.

The Hall Model

Hall (1976) puts different cultures along a continuum of high and low context.

Exhibit 2.3 Hall's High-Low Context Model of Cultural Differences



Context is defined as the social and/or physical aspects of a situation. People communicate and behave differently depending on the historical, social, and political context of their interaction. According to this model, high-context culture is characterised by:

- long lasting relationships;
- communication is economical, fast and efficient;
- wider range of communicative expressions;
- people in authority are personally responsible for the actions of subordinates;
- agreements between persons are spoken rather than written;
- 'insiders' and 'outsiders' are distinguished;

- cultural patterns are ingrained and relatively slow to change.

On the opposite end, the following may be experienced when dealing with people from low-context cultures:

- shorter relationships;
- messages are made explicit;
- authority is diffused;
- agreements are written rather than spoken;
- ‘insiders’ and ‘outsiders’ are less closely distinguished;
- cultural patterns are relatively fast to change.

The Hofstede Model

The most popular model for understanding culture has been developed by Geert Hofstede. To him, culture is “the collective mental programming of the people in an environment” (Hofstede, 1980). Through research, Hofstede initially developed four dimensions of culture as follows:

Individualism/Collectivism

- Individualism implies loosely knit social frameworks in which people are supposed to take care only of themselves and their immediate families;
- Collectivism is characterised by tight social frameworks in which people distinguish between their own groups and other groups.

Power Distance

- Measures the extent to which less powerful members of organisations accept the unequal distribution of power.

Uncertainty Avoidance

- Measures the extent to which people in a society feel threatened by ambiguous situations and the extent to which they try to avoid these situations by providing greater career stability, establishing more formal rules, rejecting deviant ideas and behaviour, and accepting the possibility of absolute truths and the attainment of expertise.

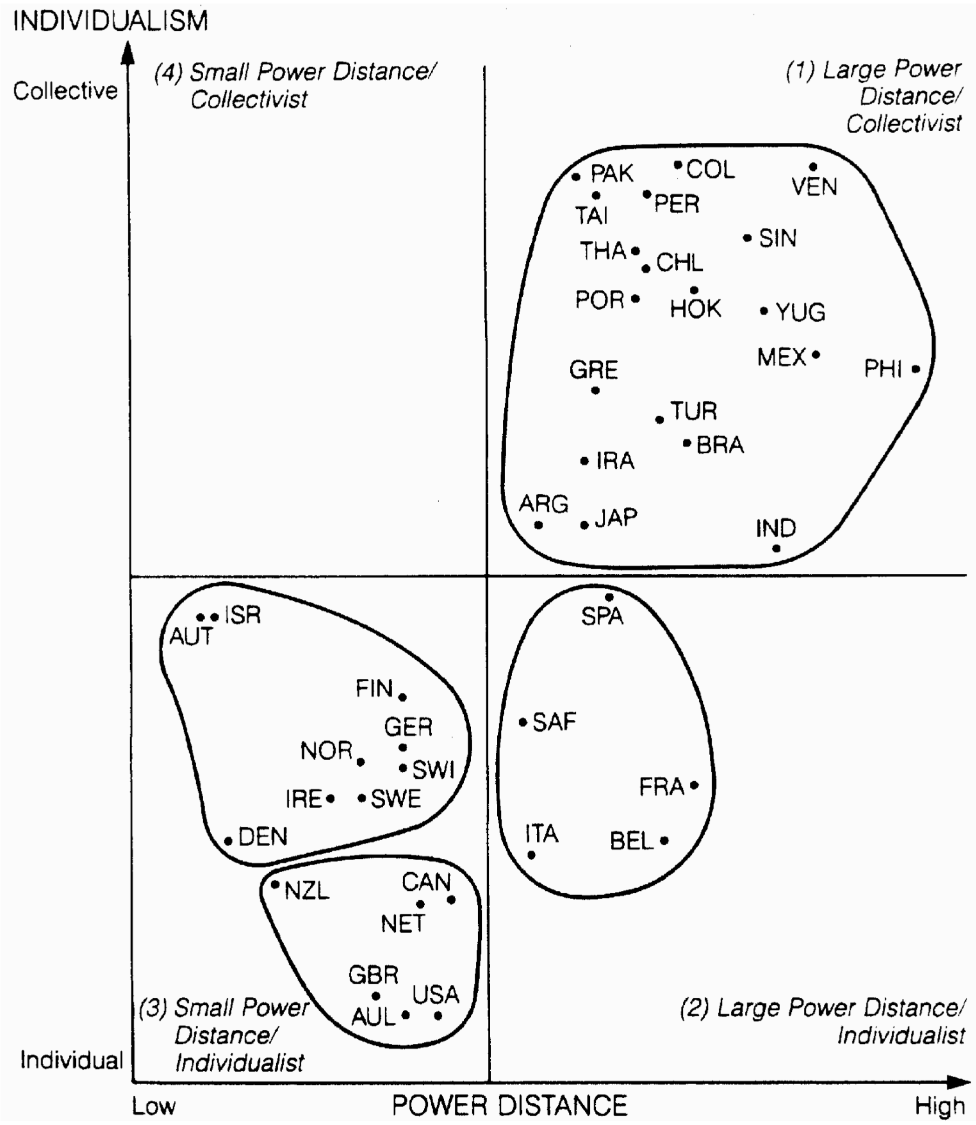
Masculinity/Femininity

- Masculinity is defined as the extent to which the dominant value in society emphasises assertiveness and the acquisition of money and things (materialism), while not particularly emphasising concern for people. Femininity is defined as the extent to which the dominant values in society emphasises relationships among people, concern for others, and the overall quality of life.

Later on, a fifth dimension was added, which concerns **short-term/long-term orientations** and is also referred to as ‘Confucian Dynamism’ as it originated from the Chinese Values Survey developed by Michael Bond (Franke, Hofstede, & Bond, 1991). Based on his research, cultural clusters have been developed to identify commonalities in different cultures. These cultural clusters are quite useful but caution must be taken to avoid over-generalisation.

In 2010, Hofstede added a sixth dimension called **indulgence versus restraint**. This dimension originated from Michael Minkov’s work on the World Values Survey (Hofstede, Hofstede, & Minkov, 2010). The dimension looks at whether a national culture permits indulgence or places restrictions on leisurely and fun-related activities.

Exhibit 2.4 Example of Cultural Clusters based on Individualism and Power Distance



Source: Hofstede, 1980

The Trompenaars' Model

Another popular model for understanding cultural differences has been developed by Trompenaars (Trompenaars, Trompenaars & Hampden-Turner, 1998). He identifies a number of dimensions in which cultures can differ.

- Universalism vs pluralism
- Individualism vs communitarianism;
- Specific vs diffuse;
- Neutrality vs affectivity;
- Inner directed vs outer directed;
- Achieved status vs ascribed status;
- Sequential time vs synchronic time.

Universalism is the degree to which people believe that various ideas and practices can be effective in all circumstances. People from high universalism cultures believe they can develop rules and standards that can be reasonably applied to everyone in every situation. As a result, contracts, formal systems, and procedures are usually developed to convey what they expect from others. People from cultures that are low in universalism (i.e. high in **pluralism**) tend to consider personal relationship rather than rules or contracts.

For Consideration

Imagine that you are negotiating with a South Korean businessman. What sort of behaviour would you expect? Why?

Trompenaars' individualism-collectivism dimension is similar to Hofstede's definition. People from individualistic cultures tend to define themselves primarily as individuals instead of as part of a group.

The **neutral-affective** relationships dimension refers to the degree to which certain cultures are expressive or reserve. The focus is on expression of emotions. **Affective** cultures view expression of emotions as more natural. Expressions of anger, delight, and intensity in the public are viewed as unprofessional by neutral cultures.

The specific-diffuse dimension is the degree of involvement people are comfortable with in dealing with other people - relates to size of personal/private space. People from **specific** cultures tend to have larger public space, but smaller private areas. People with a **diffuse** cultural background may initially be cool to any relationship because they have a smaller public space. However, they tend to have larger private space which is carefully guarded until trust is built up.

Achievement-ascription dimension refers to how one establishes oneself in society. **Achievement-oriented** cultures ascribe status to individuals based on what they do and/or achieve, and on projects with which are identified. **Ascription** cultures attribute standing to individuals based on who they are, in terms of age, seniority, gender, family background, etc. An individual's social standing is independent of what they do.

The **sequential-synchronic** dimension determines how people view time. It is not difficult to observe that some cultures see punctuality less important than others. This has to do with the impact of this cultural dimension. Features of sequential and synchronic cultures are given below:

Table 2.5: Features of Sequential-Synchronic Time Cultures

Sequential	Synchronic
• do one thing at a time; • concentrate on the job; • view time commitments as critical; • are low context and need information; • are committed to the job; • adhere religiously to plans; • emphasize promptness; • are accustomed to short-term relationships.	• do many things at once; • are highly distractible and subject to interruptions; • view time commitments as objectives • are high context and already have information; • are committed to people and human relationships; • change plans often and easily; • base promptness on the importance of and significance of the relationship; • have a strong tendency to build lifetime relationships.

The Gesteland Model

Gesteland (*1996*) puts together different theoretical models to suggest that there are 4 patterns of cross-cultural behaviour which may be useful for managers working with people from other cultures:

Deal focus____________________________Relationship focus

Informal cultures_______________________Formal cultures

Rigid-time cultures_____________________Fluid-time cultures

Expressive cultures____________________reserved cultures

Based on these patterns, managers involved in international business negotiations can develop strategies to deal with them effectively.

Under the deal focus – relationship focus pattern, Gesteland suggests the following should be observed:

Table: 2.6: Behaviours of Deal-focus vs Relationship-focus Cultures

	Deal-focus	Relationship-focus
Initial contact	**Direct**	**Indirect**
Priority	Deal first	Rapport first face-to-face contact role of contract
Language	Direct (clarity)	Indirect (harmony)
Communication	Low-context	High-context

Formal and informal business cultures can be distinguished by observing how status, hierarchy, power and respect are handled in social contexts. For example, how people are addressed can be a good indicator of whether the culture they come from is formal or informal. Australians tend to address others by first name, whereas Japanese seldom drop another person's title unless the relationship is really close.

Rigid and fluid time cultures have similar meaning to Trompenaars' Sequential-Synchronic Time Cultures. Punctuality, attitudes towards plans, deadlines and flexibility are key issues.

Similarly, the pattern of expressive-reserved cultures seems to have been borrowed from Trompenaars' neutral-affective relationships dimension.

SUMMING UP

In this Topic, we have exposed to you a very comprehensive model of negotiation, covering key steps you need to undertake to manage its content and process effectively. Five models for understanding culture are also introduced, highlighting the different dimensions that can be used to identify commonalities and differences in culture. We will further explore these cross-cultural issues in our negotiation simulation in class.

INTRODUCTION

This topic looks at the general business environment at the international level. While Topic 1 has provided an extensive coverage of the concepts of globalisation, it is still necessary to give you a more comprehensive picture of other factors that are influencing the conduct of international business in today's dynamic environment. The topic is divided into two parts. In the first part, we cover some basic understandings of the nature of international business and how environmental forces influence it. In doing so you will be introduced to the key theories of international business so as to give you the theoretical basis for understanding other tools to be covered in later topics. In the second part, we move the discussion towards the growing emphasis on regionalisation and bilateral agreements between countries.

LEARNING OBJECTIVES

On completion of this topic, you will be able to:

- Describe the nature and key activities of international business;
- Explain the key theories of international business;
- List the key factors influencing the international business environment;
- Recognise the special features of the international trading system;
- Describe the rise of 'globalisation' and its impacts on the conduct of international business.

WHAT IS INTERNATIONAL BUSINESS?

International business is economic transactions between firms from two or more countries. These transactions have existed since the beginning of human history. Sometimes they are also referred to as 'trade' when a commercial element is involved. Throughout history international business has played a central role in bringing together people from diverse cultures and locations who are motivated by a desire to trade for something that is scarce, using something that they have in abundance in their home country. From the Vikings to Marco Polo and then Christopher Columbus, there is no lack of examples to show how early international businessmen have contributed to the promotion of economic, technological and cultural exchanges between the West and the East. The Meiji Restoration (early 1900s) in Japan and the Cheng He (1371-1435) of China are also frequently cited as leaders in international business, trade and explorations.

An important question asked by novice executives is "What transactions are usually involved in international business?" In general, international business transactions involve:

- Exports and imports;
- Foreign Direct investment.

Exports are goods and services produced by a firm in one country and then sent to another country. Imports are goods and services produced in one country and bought into another country by a firm (Rugman & Hodgett, 2003, p. 5). As managers, we would like to be able to determine what to export or import. To be able to do this, some understanding of theories of trade is essential.

THEORIES OF TRADE

1. Mercantilism

The earliest explanation of international business comes in the form of Mercantilism which emerged in the 1500s, when gold and silver were the most important sources of wealth and nations sought to amass as much of these treasures, particularly gold, as possible. Nations received payment for exports in gold, so exports increased their gold stock, while imports reduced it because they paid for imports with their gold. Thus nations benefitted by attempting to run a trade surplus. In the long run this resulted in nations placing import restrictions and colonizing countries to gain access to a country's resources.

2. Absolute advantage

One of the early theories of trade has been put forward by Adam Smith (*1776*) in that he argues that a country's wealth depends on the availability of goods and services to its citizens. He develops the theory of absolute advantage, submitting that different countries produce some goods and services more efficiently than others and hence they can sell what they do best, to gain absolute productivity advantages over other countries. According to this theory, a country exports goods and services that it can produce more efficiently than the importing country. Likewise, a country imports the goods that can be produced more efficiently abroad. This kind of absolute advantage is labelled ‘natural advantage’ which a country may enjoy because of climate and natural resources.

For Consideration

What if a country is less efficient in the production of any goods and services?

When a country is not as efficient as others in producing any goods and services due to lack of natural resources, including land, it will have to acquire certain competitive advantages over other countries. Acquired advantage considers technology and skills development to compensate for the lack of natural resources. With agricultural products progressively losing market appeal to manufactured goods as a consequence of technological changes, countries such as Hong Kong, Singapore and Switzerland which do not have sufficient natural resources, have to gain acquired advantage in order to trade with other countries. Thus, a country can develop both natural and acquired advantages over other countries.

For Consideration

What if a country can produce all products and services at an absolute advantage?

3. Comparative advantage

Richardo (1817) extends Smith’s ‘Theory of Absolute Advantage’ by suggesting that a country tends to specialise in those products and services that it can produce more efficiently than others, regardless of whether other countries can produce them even more efficiently. According to this theory, a country imports goods and services that:

- Are comparatively more efficient to produce abroad;
- Are comparatively more desired than abroad.

And exports goods and services that:

- Are comparatively more efficient to produce than abroad;
- Are comparatively more desired abroad.

The theory of comparative advantage is based on the concept of specialisation. It also assumes that transportation costs are low and that mobility of the goods and services is possible.

4. Theory of country size

The theories of absolute advantage and comparative advantage do not deal with country characteristics. A common factor to determine a country’s specialisation has to do with size. The general observation is that the larger the size of a country, more the variety and volume of resources. Thus, these countries tend to export and import less because they are self-sufficient. At the same time, countries with larger economic sizes, e.g. the United States, China, and India, can better achieve economy and production scales. Transportation costs are higher if the country is bigger in size.

5. Factor-proportions theory

Differences in countries’ endowments of labour compared to their endowments of land or capital, explained differences in the costs of production factors. This means if labour is abundant in comparison to land and capital, labour costs would be low relative to land and capital costs. If labour is scarce, labour costs would be high in relation to land and capital costs. These relative costs would lead countries to excel in the production and export of products that used their abundant, and therefore cheaper, production factors (Heckscher, 1991). This theory predicts that countries export the products that use their abundant factors intensively. A country is labour-abundant if it has a higher ratio of labour to other factors such as land and capital. A product is labour-intensive if labour costs are a greater share of its value.

Based on the Heckscher-Ohlin theory, countries with abundant labour relative to land tend to excel in products that do not require large of amounts of land. For example, Hong Kong and the Netherlands will not excel in the production of wool or wheat. The theory also provides an explanation of the labour-capital relationship: countries with scarce capital but abundant labour tend to export products requiring large amounts of labour relative to capital – emerging economies tend to excel in labour-intensive industries.

A major challenge to the Heckscher-Ohlin Theory is the varying degree of technological complexities in production. If a good or service can be produced in multiple ways, the costs of different production factors may vary from location to location.

For Consideration

What about if countries have similar factor endowment and similar technological knowledge?

6. The product life cycle (PLC) theory of trade

According to Vernon, firms are involved in international business as their products go through the cycle of introduction, growth, maturity and decline (Vernon, 1966). The Product Life Cycle (PLC) Theory suggests that the production location for many products moves from one country to another depending on the stage in the product's life cycle. Table 3-1 provides a summary of the different stages of a product's life cycle and their impact on production, market, competitive factors and technology.

Table 3.1: International Changes during a Product's Life Cycle

	Introduction	Growth	Maturity	Decline
Production location	An innovating (usually industrial) country	Innovating and other industrial countries	Multiple countries	Mainly in emerging economies
Market location	Mainly in innovating country, with some exports	Mainly in industrial countries Shift in export markets as foreign production replaces exports in some markets	Growth in emerging economies Some decrease in industrial countries	Mainly in emerging economies Some emerging economy exports
Competitive factors	Near-monopoly position Sales based on uniqueness rather than price Evolving product characteristics	Fast-growing demand Number of competitors increases Some competitors begin price-cutting Product becoming more standardised	Overall stabilised demand Number of competitors decreases Price is very important, especially in emerging economies	Overall declining demand Price is key weapon Number of producers continues to decrease
Production technology	Short production runs Evolving methods to coincide with product evolution High labour and labour skills relative to capital input	Capital input increases Methods more standardised	Long production runs using high capital inputs Highly standardised Less labour skill needed	Unskilled labour on mechanised long production runs.

Source: Daniels & Radebaugh, 2001, p. 174.

The PLC theory provides some very powerful explanations for the emergence of multinational corporations and the significance of innovation in gaining competitive advantage.

For Consideration

The PLC theory can explain why products initially made in the more advanced economies (e.g. United States and Germany) being sold or produced in developing countries at the later stages of their life cycle. Identify a product that can be exempted from this theory.

7. Foreign investments

The PLC theory has brought about the need to set up operations in another country in order to gain advantage over competitors. It means the ownership of foreign property in exchange for financial return. There are two forms of foreign investment:

- FDI is equity funds invested in other nations (Rugman & Hodgetts, 2003, p. 8). It gives the investor control in a foreign company. By doing so a company can have access to foreign markets, access to foreign resources, higher foreign sales than export due to by-pass of tariffs. It may also allow a company to acquire whole or partial ownership of a business in another country in some cases;
- Portfolio investment is the acquisition of a non-controlling interest in a company or ownership of a loan to another party. This can be done by buying up stock shares of or by providing loans to a foreign company.

For Consideration

Consult a colleague who has had experiences of FDI in another country and obtain advice on factors to be considered in making FDI decisions.

8. Country similarity theory

Once a firm has developed a new product in response to observed market conditions in the home market, it will turn to markets it sees as most similar to those at home (Linder, 1961). This explains why most of the world's trade occurs among countries that:

- Are in close physical proximity;
- Have similar competitive capabilities;
- Have cultural similarities;
- Have close international relationships.

For Consideration

Identify the 10 top trading partners of your country and comment on the extent to which the Country Similarity Theory has validity in your national context.

9. The theory of degree of dependence

This theory suggests that no country is completely dependent or independent economically, but some may be located at either end of the continuum (Daniels & Hodgetts, 2003).

At one extreme of this theory is independence. Countries that rely very little on imports and exports fall into this category and are regarded as self-sufficient economies. Paul Krugman (1994) once argued that the United States only exports about 10% of its GNP and is 90% self-contained.

The other side of the extreme is dependence in that certain countries rely heavily on others to buy their products. This is considered risky as one's economy becomes vulnerable to events in other countries. The 1997 Asian Financial Crisis was a typical example of how several emerging economies were affected by the decline in market demands for computer hardware products in the United States.

In order to ensure a high degree of certainty in dealing with trading partners, countries may attempt to establish interdependence amongst themselves. This involves the development of trade relationships with other countries for mutual gains.

The theory of degree of dependence has led to government intervention in foreign trade markets. For example, a high proportion of Australian goods and services are exported to Asia. This is regarded as heavy dependence on economies that are still recovering from the economic crisis of the late 1990s. The recent conclusion of the Australian-US free trade agreement may be regarded as an attempt to provide a more acceptable level of independence between the two countries.

10. Strategic trade policy

With declining employment in the primary industries world-wide, countries are increasingly concerned about building up their acquired advantage in order to bring economic prosperity to their citizens. As a result, governments are now actively involved in the development of strategic trade policy to determine what their countries should export and import for maximum economic gains (Krugman & Smith, 1994).

Strategic trade policy aims to alter:

- conditions for industries in general;
- conditions that affect a specific industry.

For Consideration

Go to the webpage of the trade promotion department/agency of your country and identify the 'preferred' industries that your government attempts to promote. What conditions are created for these industries and with what effect(s) to date?

11. Porter's national competitive advantage (Porter's Diamond)

Porter's National Competitive Advantage (Porter, 1990) attempts to explain why certain nations have an advantage in the production and trade of certain goods. According to Porter, a country's competitiveness is determined by:

Factor conditions:

These include basic and advanced factors. Basic factors refer to naturally occurring conditions such as geographic location, natural resources and so on. Advanced factors refer to investment in infrastructure such as roads, education, and telecommunication.

Demand conditions:

The nature of home demand for an industry's product or services.

Related and supporting industries:

The presence or absence in the nation of supplier and related industries that are internationally competitive.

Firm strategy, structure and rivalry:

The conditions influencing how companies are formed, organised, managed and compete with each other.

Why Companies Get Involved in International Business

So far, we have considered imports, exports and foreign investments as the main transactions in international business. Various theories have been introduced to provide you with the conceptual foundation to understand the field better. The next question, which has been partially answered by some of the theories covered above, is why companies get involved in international business? A useful tool to conceptualise involvement of firms in international business is Michael Porter’s Diamond Model (*Porter, 1980*). According to Porter, firms acquired international competitiveness by making full use of the following four conditions:

1. Firm strategy, structure and rivalry;
2. Factor conditions: labour, raw materials;
3. Demand conditions;
4. Related and supporting industries.

Favourable combination of these factors within a particular country therefore influences a firm’s decision to operate therein to achieve competitiveness.

Why Firms Export

To sum up preceding discussions, firms export for:

- Use of excess capacity as outputs are not consumed by domestic market;
- Cost reduction by achieving economy of scale by market expansion in another locale;
- Greater profitability to face different competition in different markets;
- Risk spreading so that dependence in the domestic market can be reduced.

Why Firms Import

Likewise, firms import from other countries to obtain:

- Cheaper supplies;
- Additions to product line;
- Reduction of the risk of no supply by domestic suppliers.

THE INTERNATIONAL BUSINESS ENVIRONMENT

While globalisation, as covered in Topic 1, provides an over-arching picture of international business, it is still useful to review some of the key factors in the international business environment which affect transactions in the forms of imports, exports and foreign investments.

- The emergence of a global trading system;
- The rise of regionalism;
- Technological changes;
- The liberalisation of the international financial market;
- International terrorism.

THE EMERGENCE OF A GLOBAL TRADING SYSTEM

As discussed above, firms import, export and invest overseas in order to obtain competitive advantage. To do this, firms also influence government policies to weed out competitors, particularly those from another country by erecting barriers to trade. Common barriers include:

- Import tariffs;
- Non-tariff barriers, e.g. import quota, voluntary export restraints, product standard imposition and domestic content requirements.

For Consideration

From the perspective of national interests, why do countries adopt such protectionist policies? What are the possible positive and negative impacts of trade barriers on a country's economy?

At the same time, in order to increase sales, firms with or without the assistance of government may push exports via:

- Dumping, i.e. selling exports at a price lower than the production costs, or the price charged, in the domestic market;
- Export subsidies;
- Countervailing duties.

The Product Life Cycle (PLC) theory may find relevance in export push by some firms.

In order to regulate the behaviours of firms in international transactions so as to promote more trading activities, countries enter into trade agreements. While initially these agreements may have been negotiated between two countries, increasing international transactions have resulted in multi-lateral pacts. The Country Similarity Theory at the same time also provides a powerful explanation that countries with similar characteristics and in close physical proximity tend to trade more with one and other. So we see throughout history the creation of trade blocks among 'friendly' countries to eliminate tariffs and to agree on appropriate behaviours in international transactions. The groundwork for developing an international trading system started at the end of World War II with the signing of the Bretton Woods agreements by 24 countries to promote international economic prosperity and stability through multilateral cooperation. These agreements later led to the establishment of:

- The World Bank;
- The International Monetary Fund (IMF);
- The International Trade Organisation (ITO).

While the ITO never materialised, countries involved signed the General Agreement on Tariffs and Trade (GATT) in 1947. Based on the GATT, the World Trade Organisation (WTO) officially came into being in January 1995 to become the

"only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business."

(WTO 2015: http://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm).

For Consideration

To gain more understanding of the nature, objectives, membership and organization of WTO, go to its official website at: http://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm

As on 30 November 2015, there were 162 members in the WTO. It is now the international body responsible for:

- Policing the reinforcement of GATT agreements, trade in services and the protection of intellectual property;
- Arbitrate trade disputes.

For Consideration

Consult a professional colleague who has been involved in trading with emerging economies and obtain opinion about the extent to which WTO is able to protect intellectual property rights.

Technological Changes

Technological innovations in microprocessors and telecommunications, the internet and the World Wide Web, and transportation systems have made international business much more easily accessible.

Microprocessors and telecommunication has made the exchange of information in the forms of text, image and sound more instant. The extensive reach of the internet and World Wide Web has removed uncertainties and misunderstanding of markets that are culturally, politically, economically and geographically different from potential investors. Transportation systems such as air travel, courier services and freight have also shortened physical distance to make international contacts and transactions convenient.

For Consideration

How would technological innovations change the way foreign operations are managed?

The Liberalisation of the Money Capital Market

Aided by the internet, money capital can now flow in and out of any country in the world where it is most needed. According to reports, during 1991-1999, there have been concerted changes worldwide in FDI laws (WTO, 2010), increasing the freedom of foreign investors while reducing government regulation. In 1999, WTO's Financial Services Agreement was signed by 102 member-states to give reduced restrictions on cross-border finance flows. Altogether the agreement covers 95% of the world trade in banking, insurance, securities and financial information.

International Terrorism

The September 11 terrorist attack on the World Trade Centre in New York has added a significant dimension to the risks of doing business in the international level. Indeed risk management has shifted from the country/industry as a unit of analysis to one focusing on global production and sourcing covering several countries (Kahal, 1999).

The Rise of Regionalism

While the inception of the WTO has been hailed as the arrival of a global trading framework, research has revealed that most MNCs do not earn the bulk of their revenue from overseas, but rather from their home country or from nearby locale (Rugman, 2000). Indeed, a great deal of world trade and FDI is conducted by companies in the United States, Europe and Japan. According to Rugman (2000), the three major trading blocs, called 'Triads', are as follows:

- The US-led NAFTA comprising Canada, US and Mexico;
- The European Union;
- The Japanese-led Asian countries including China, Hong Kong, Japan, Malaysia, South Korea and Taiwan.

Rugman's research suggests that 'global' consumer preferences are still far from homogeneous and that most MNCs still have to modify their products to suit local tastes. Regionalisation still helps achieve economy of scale though not as much compared to producing a product that suits all. Some researchers therefore label this phenomenon as 'glocalisation'.

Apart from the Country Similarity Theory, the spread of regionalism can also be explained by the following factors:

- Preferential deals in regional trade agreements (RTAs) are too good to miss out;
- Quicker results may be obtained regionally as international agreements take longer than the product's life cycle to complete;
- Regional liberalisation triggers off domestic reforms;
- Pursuance of non-trade concerns, e.g. lifting of labour standards and environmental protection (OECD, 2003).

For Consideration

What implications does regionalism have on your international business decisions?

Table 3.2 provides a summary of the world's major regional trade agreements today.

Table 3.2 The World's Major Regional Trade Blocs

Economic Bloc and member nations (membership date)	Population in millions (2014)	GDP in trillion $US PPP (2007)
NAFTA: Canada (1989), United States (1989), Mexico (1994).	476	17.617
EU: Belgium (1957), France (1957), Italy (1957), Luxembourg (1957), Netherlands (1957), Germany (1957), Denmark (1973), Ireland (1973), United Kingdom (1973), Greece (1981), Portugal (1986), Spain (1986), Sweden (1995), Finland (1995), Austria (1995), Estonia (2004), Latvia (2004), Lithuania (2004), Poland (2004), Czech Republic (2004), Slovakia (2004), Slovenia (2004), Hungary (2004), Cyprus (2004), Malta (2004), Bulgaria (2007), Romania (2007), Croatia (2013)	508 (2013 figures)	15.203
Mercosur: Argentina (1991), Brazil (1991), Uruguay (1991), Paraguay (1991), Venezuela (2006).	286	2.895
ASEAN: Indonesia (1967), Malaysia (1967), Philippines (1967), Singapore (1967), Thailand (1967), Brunei (1984), Vietnam (1995), Laos (1997), Myanmar (1997), Cambodia (1999).	601	3.084
EFTA: Austria (1960-1995), Denmark (1960-1973), Iceland (1960), Norway (1960), Portugal (1960-1986), Sweden (1960-1995), Switzerland (1960), United Kingdom (1960-1973), Finland (1986-1995), Liechtenstein (1991).	13.6	0.567
Andean Community: Bolivia (1969), Chile (1969-1976), Colombia (1969), Ecuador (1969), Peru (1969), Venezuela (1973-2006).	101.1	0.903
CAFTA: Salvador (1961-1971, 1991), Guatemala (1961-1971, 1991), Nicaragua (1961-1971, 1991), Honduras (1962-1971, 1991), Costa Rica (1963-1971, 1991).	33	0.059
Caricom: Barbados (1973), Guyana (1973), Jamaica (1973), Trinidad and Tobago (1973), Antigua and Barbuda (1974), Belize (1974), Dominica (1974), Grenada (1974), Montserrat (1974), Saint-Kitts-and-Nevis (1974), Sainte-Lucie (1974), Saint-Vincent-et-Grenadines (1974), Bahamas (1983), Suriname (1995), Haiti (2002).	15.9	0.091

SUMMING UP

This Topic starts with what firms do in international business, namely imports, exports and foreign investment, in order to achieve competitive advantage. Respective theories that explain how firms import, export and invest overseas have been introduced, leading to the development of an international trading system to regulate firm's cross-border behaviours. Using the WTO as the backdrop, other factors that influence the conduct of international business are also covered. These will provide a useful context in which other topics in this course will be examined.

INTRODUCTION

When a firm has decided to get involved in international business there are two essential questions to answer: where to market? And where to produce/source? There are numerous tools available to help managers to assess opportunities and risks associated with different locations.

This Topic will provide you with the general steps for choosing foreign locations and expose you to some of the assessment tools.

LEARNING OBJECTIVES

Upon completion of this Topic, you will be able to:

- Describe the general steps involved in choosing locations;
- Describe the general features of and apply the following tools:
  - PESTEL Analysis;
  - The Harvard Country Analysis Model;
  - The Economist Model of Country Analysis;
  - Market Potential Index;
  - Grids and Matrices for Comparing Locations.

STEPS IN LOCATION SELECTION

There are many ways to select a location for your business. Some are rational and some are not. For example, when China first opened its door to foreign investment in the late 1970s, there was a rush of MNCs to set up operations on the Mainland. However, many of them did not do their homework properly and ended up in financial losses (Fudicia Ltd., 1999). Presented below are the key steps involved in the selection of foreign locations:

1. Scan for alternatives;
2. Choose and weight variables;
3. Collect and analyse data for variables;
4. Use tools to compare variables and narrow alternatives.

(Daniels & Radebaugh, 2001)

Scan for Alternatives

Since managers are easily influenced by peer pressure, previous experiences and perceptual selectivity, this step can ensure that other options are not overlooked. It is also suggested that in scanning alternatives, the following factors should be considered:

- Objective of the off-shore expansion/venture – to market or to sell?
- Strategy – how are you going to internationalise?

For Consideration

What impact does the consideration of these two factors have on your scanning process?

Choose and Weight Variables

When scanning possible locations for foreign operations, it is necessary to consider some general variables that can be used as criteria for selection. Indeed these variables can be broadly divided into opportunities and risks, and their assessment will determine the final location for your business. Some of the common variables under opportunities and risks are given below:

Opportunities	Risks
Market size	Competitive risk
Ease and compatibility of operations	Monetary risk
Costs and resource availability	Political risk

There are many tools available to managers to assess opportunities and risks of investing in another country. We will examine a few of them in this Topic.

THE PESTEL ANALYSIS

PESTEL is an acronym of the broad categories of factors that are considered in assessing the external business environment (Sondhi, 1999):

Political
Economic
Social
Technological
Environmental
Legal

It is a technique commonly used in strategy formulation alongside the SWOT (**S**trengths, **W**eaknesses, **O**pportunities, **T**hreats) analysis.

Political factors	Political factors reflect governmental influences on the business environment in terms of industry policies, foreign investment and fiscal measures. They have significant implications for the feasibility of setting up operations in that location.
Economic factors	Economic factors refer to the elements of the economy that impact on the firm and its markets. These factors affect consumer behaviour, wages and savings as well as the overall costs of doing business in a country.
Social factors	Social factors involve demographic profile of the population, education and skill level, religion and cultural attributes. These factors influence behaviour and attitudes and will play a significant part in determining whether a particular location is attractive as a market and as a production basis.
Technological factors	These refer to the level of technological know-how in the country concerned. Issues such as the ability of the country concerned to adapt to new technology would need to be concerned if you were to re-locate a hi-tech manufacturing plant to capitalise on the proximity of the market. Likewise, a service requiring hi-tech support may not be easy to move off-shore since the locals may not be able to operate the relevant equipment.
Environmental factors	Responsible and ethical business strategy has demanded firms conform to environmental protection guidelines no matter where they are located. As a result, the local environmental regulations should be considered, as certain labour-intensive industries (e.g. wool processing) may find themselves unwelcome in countries which traditionally are labour-abundant.
Legal factors	Regulatory and legal factors shape the framework of industries, as well as the environments and markets in which they operate. These factors are probably the easiest to monitor, as they are likely to be enforced. However, organisations need to understand the dynamics of regulation and the legal process, aligned with the political motives of the environment, so as to be able to anticipate regulations that are to come into being.

For Consideration

Consult colleagues who have been involved in strategy formulation and seek his experience of operationalising the PESTEL analysis.

THE HARVARD COUNTRY ANALYSIS MODEL

The Harvard Country Analysis Model is a framework to help identify and evaluate the national business environment of a country (Dyck, 1997). It involves three interdependent components, namely national strategy, context and performance:

National Strategy

National strategy refers to implicit and explicit goals of the country concerned and the policies developed to achieve them. For example, Singapore aspires to be the telecommunication hub in Asia. It therefore has designed policies to attract investment in that industry, to intensify training in information technology, communications systems, etc.

- Goals may be economic (e.g. income per capita, high employment and low inflation), political (e.g. democratic structure and processes) and social (e.g. literacy rate, heath status and income distribution);
- Policies are government actions to achieve national goals, including fiscal, monetary, exchange rate, trade and investment, sectoral, industrial and social.

Context

The contextual components are:

- resources at a nation's disposal, i.e. human capital, physical capital, natural resources and technological skills;
- players in the national context, i.e. firms, government actors (central banks, ministries, state-owned enterprises and regulatory agencies) and non-government organisations (interest groups);
- rules of the game that define a national system and structure: the incentive to mobilise and allocate those resources. These include written and unwritten rules and how they are enforced.

There are national and international dimensions of context. The geographical location of a country is important as it influences its resource allocation capabilities. In addition, a country's international strategy influences how its players (firms, government and non-government agencies) resolve differences in domestic and international operations. The extent of the country's involvement in international business and its membership in international organisations such as WTO, IMF and the World Bank are both important factors to consider.

Performance

Based on the strategy set and resources available to it, a country can be assessed by its achievement in economic, social and political terms. There is also an international dimension in assessing a country's performance. Balance of payments, exchange rates and tariffs are useful measures.

Table 4-1 provides a summary of information required for country analysis in the Harvard Model.

Table 4.1

Strategy	Context	Performance
	NATIONAL	
Goals Higher per-capita income level and growth, equality of income, stability, autonomy, defence, etc.	*Resources* Labour, capital, natural resources, technology, geography	*Economic* GNP National income accounts Process (wages, interest rates) Inflation Unemployment, etc.
Policies Fiscal, monetary policies Exchange rate policies Trade and investment policies Sectoral policies	*Players in the Game* Firms Government actors Non-state organisations Unions, employer associations, religious groups, political parties, etc.	*Social* Income distribution Fertility, morality, literacy, etc. *Political* Political stability Political freedom, etc.
Industrial policies Social policies Constitutional reforms	*Rules of the Game* Formal rules - economic (e.g. property rights, contract laws), political (e.g. federal system, separation of powers), treaties Informal rules - conventions, culture, religious beliefs, ideology	*International* Balance f payments Exchange rates Tariffs, quotas
	INTERNATIONAL Location International organisations Treaties on trade and investment, international monetary system	

Source: Dyck, 1997

For Consideration

Apply the Harvard Country Analysis Model to a country you are interested in doing business in, and identify the strengths and weakness of this tool.

THE ECONOMIST MODEL OF COUNTRY ANALYSIS

There are many prescriptive models of country analysis available to managers. The one developed by the Economist is commonly known. The Economist Model classifies variables into 10 categories as follows:

1. Political environment

- Risk of armed conflict;
- Risk of social unrest;
- Constitutional mechanisms for the orderly transfer of power;
- Threat of politically motivated violence;
- International disputes or tensions;
- Government policy towards business;
- Effectiveness of political system in policy formulation and execution;
- Quality of the bureaucracy;
- Transparency and fairness of legal system;
- Corruption;
- Impact of crime.

2. Macroeconomic environment

- Inflation;
- Budget balance as % of GDP;
- Government debt as % of GDP;

- Exchange-rate volatility;
- Current-account balance as % of GDP.

3. Market opportunities

- GDP, $ bn at PPP;
- GDP per head, $ at PPP;
- Real GDP growth;
- Share of world merchandise trade;
- Average annual rate of growth of exports;
- Average annual rate of growth of imports;
- The natural resource endowment;
- Profitability.

4. Policy towards private enterprise and competition

- Degree to which private property rights are protected;
- Government regulation on setting up new private businesses;
- Freedom of existing businesses to compete;
- Promotion of competition;
- Protection of intellectual property;
- Price controls;
- Distortions arising from lobbying by special interest groups;
- Distortions arising from state ownership/control.

5. Policy towards foreign investment

- Government policy towards foreign capital;
- Openness of national culture to foreign influences;
- Risk of expropriation of foreign assets;
- Availability of investment protection schemes.

6. Foreign trade and exchange controls

- Capital-account liberalisation;
- Tariff and non-tariff protection;
- Openness of trade;
- Restrictions on the current account.

7. Taxes

- The corporate tax burden;
- The top marginal personal income tax;
- Value-added tax;
- Employers' social-security contributions;
- Degree to which fiscal regime encourages new investment;
- Consistency and fairness of the tax system.

8. Financing

- Openness of banking sector;
- Stockmarket capitalisation;
- Distortions in financial markets;
- Quality of the financial regulatory system;
- Access of foreigners to local capital market;
- Access to medium-term finance for investment.

9. The labour market

- Incidence of strikes;
- Labour costs adjusted for productivity;
- Availability of skilled labour;
- Quality of workforce;
- Restrictiveness of labour laws;
- Extent of wage regulation;
- Hiring of foreign nationals;
- Cost of living.

10. Infrastructure

- Telephone density;

- Reliability of telecommunications network;
- Extent and quality of road network;
- Production of electricity per head;
- The infrastructure for retail and wholesale distribution;
- Extent and quality of the rail network;
- Quality of ports infrastructure;
- Stock of personal computers;
- R&D expenditure as % of GDP;
- Rents of office space.

Source: The Economist, 2008

The PESTEL Analysis, the Harvard Country Analysis Model and the Economist Model are tools for the more general assessment of a country's attractiveness for international business. There are also more.

There are tools which are more focused or specialised. For example, many firms are mainly concerned about exporting to another country; hence their focus will be on market potentials.

MARKET POTENTIAL INDEX

Cavusgil (1997) develops a Market Potential Index to help managers to assess the potential of foreign markets, using 9 dimensions for measurement:

Table 4.2 Market Potential Index

Dimensions and Measures of Market Potential		
Dimension	***Weight***	***Measures used***
Market size	10/50	Urban population (million) Electricity consumption (billion kwh)
Market growth rate	6/50	Average annual growth rate of commercial energy use (%) Real GDP growth rate (%)
Market intensity	7/50	GNP per capita estimates using PPP (US dollars) Private consumption as a percentage of GDP (%)
Market consumption capacity	5/50	Percentage share of middle-class in consumption/income
Commercial infrastructure	7/50	Telephone mainlines (per 100 habitants) Cellular mobile subscribers (per 100 habitants) Number of PC's (per 100 habitants) Paved road density (km per million people) Internet hosts (per million people) - Population per retail outlet Television sets (per 1000 persons)
Economic freedom	5/50	Economic Freedom Index Survey of Political Freedom
Market receptivity	6/50	Per capita imports from US (US dollars) Trade as a percentage of GDP (%)
Country risk	4/50	Country risk rankings

Source: Cavusgil, 1997

ASSESSING RISKS

Firms typically employ various financial techniques to analyse risks, including:

- Discounted cash flow;
- Economic value-added;
- Payback return;
- Accounting rate of return;
- Return to equity;

- Return on investment (ROI).

While these are covered in your finance course(s), there are other risks associated with international business.

Competitive Risks

Different countries have different levels of technological and innovation capabilities. For firms relying on innovative advantage, the imitation lag may vary from one market to another. This may be even more disturbing if intellectual property rights are not well protected in certain locations.

Monetary Risks

Fluctuating exchange rates, exchange control, interest rates and commodity prices are some of the key monetary risks associated with international business.

Political Risks

Political risks occur when there are changes in political leaders' opinions and policies, civil disorder and conflict between the host and other countries. Political risks analysis has taken on a new dimension in the face of globalisation. Traditionally, political risk analysis focuses on:

- Government actions within the domestic political economy;
- Inter-governmental relations;
- External environmental factors;
- Industry/company specific factors.

Techniques used in the traditional risk analyses include advice from 'old hands', first-hand experience and sophisticated computing and statistical modelling techniques.

There are many risk analysis tools readily available from consulting firms, some of the more common ones are:

Macro-Risk-Oriented

- Harner's Business Environment Risk Index (BERI);
- Haendel & Weste Stability Index (PSSI);
- Primary Risk Investment Screening Matrix (PRISM);
- Frost and Sullivan's World Political Risk Forecast;
- Business International and Data Resources (POLICON);
- Institutional Investor's Credit Rating;
- Euromoney's Country Risk Index.

Corporate Focus Models

- Dow Chemicals' Economic, Social and Political Systems (ESP);
- Shell's Approach;
- Boston Consulting Group (BGC Matrix).

The Economist also provides a service to readers on country risks and forecast. Each country risk report includes:

- Analysis of local financial markets;
- Credit risk ratings reflecting trade, policy and political threats;
- Economic growth and financial indicators;
- International financial flows;
- Pointers for lenders and investors;
- Two-year projection of external finances.

Each country forecast report provides outlooks for the following:

- Environmental issues;
- Exchange controls;

- External debt;
- Foreign investment;
- Foreign trade and payments;
- GDP growth and its components;
- Industrial policy;
- Infrastructure;
- Interest and exchange rates;
- Political scene;
- Tax regimes;
- Ten-year growth picture;
- Wage and price inflation.

(The Economist, 2008)

Despite the proliferation of risk analysis tools, there are calls for a different approach to assessing risks because the traditional focus on one country is no longer appropriate in an era of globalisation. Kahal (1999) argues that international business risks should be assessed on a global scale due to:

- Globalisation of production and sourcing;
- Global competition and the growth of strategic alliance;
- Changing relationship between government and business;
- Globalisation of environmental concerns;
- Globalisation of business ethics.

For Consideration

To what extent would you agree with Kahal's arguments?

So far we have looked at a few tools for analysing opportunities and risks in a foreign country. They are certainly not meant to be exhaustive. What they have provided are different variables for data collection and comparison so that the location that provides the most favourable conditions can stand out and be selected for your foreign operations. We will now move on to the next step in the selection process.

Collect and Analyse Data for Variables

As a manager it is important to recognise that information is never enough and is not always accurate. In collecting and analysing country data, there is always the problem of inaccuracies and comparability problems (Daniels & Radebaugh, 2001).

Inaccurate information may be collected because:

- Some countries, particularly the newly industrialised economies, do not necessarily have information systems sophisticated enough for advanced level of analysis;
- Some countries purposely provide misleading information for window-dressing.

Comparability problems may also occur as different countries have different time period preferences in publishing company reports, censuses and other economic data.

As covered above, there are various sources from which data and analyses can be obtained, and managers should familiarise themselves with the strengths and weaknesses of individual tools and service providers.

Use Tools to Compare Variables and Narrow Alternatives

Once data is collected through scanning, the next step is to analyse and compare them against different countries. The two most common tools for comparing variables are grid and matrix (Daniels & Radebaugh, 2001, p. 446).

Grid

Grid is one of the most simple tools to use to compare countries on whatever factors are deemed important. Each country is then weighed against the variables.

Exhibit 4.1: Market Penetration Grid

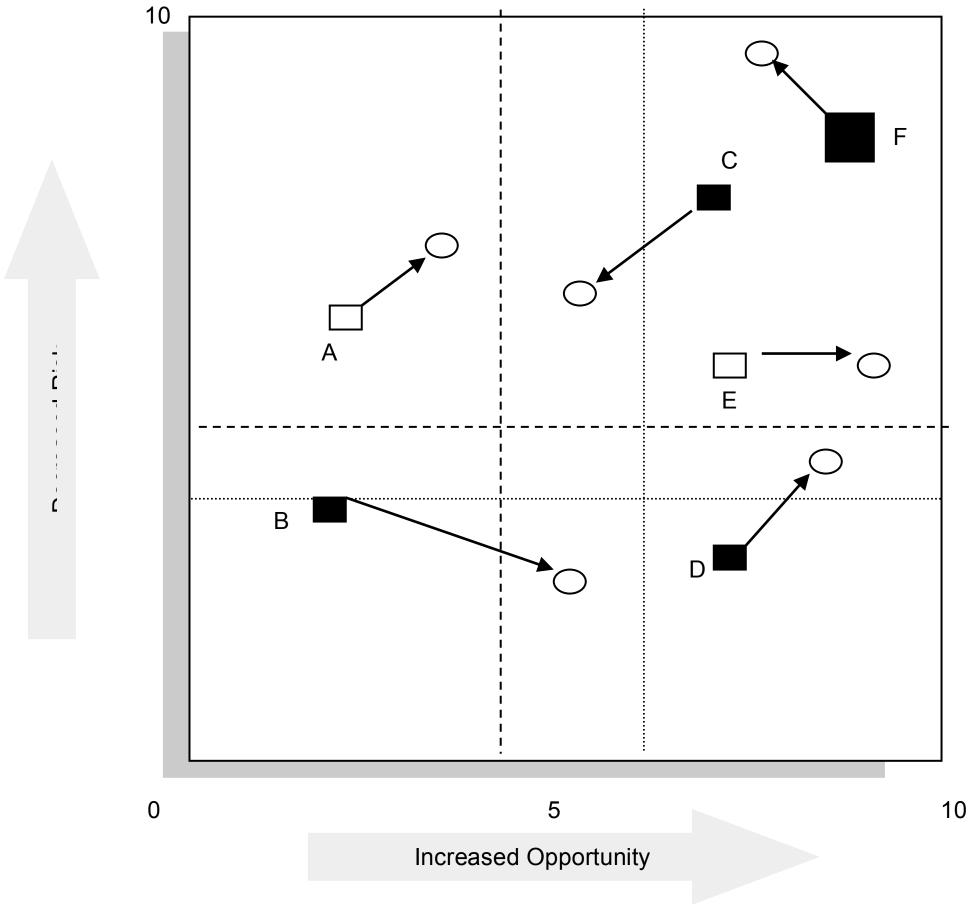
		Country				
Variable	**Weight**	**I**	**II**	**III**	**IV**	**V**
1. Acceptable (A), Unacceptable (U)						
a. Allows 100% ownership	-	U	A	A	A	A
b. Allows licensing to majority owned subsidiary	-	A	A	A	A	A
2. Return (higher number = preferred rating)						
a. Size of investment needed	0-5	-	4	3	3	3
b. Direct costs	0-3	-	3	1	2	2
c. Tax rate	0-2	-	2	1	2	2
d. Market size (present)	0-5	-	3	2	4	1
e. Market size, 3-10 years	0-3	-	2	1	3	1
f. Market share, 0-2 years	0-2	-	2	1	2	1
g. Market share 3-10 years	0-2	-	2	1	2	0
Total			**18**	**10**	**18**	**10**
3. Risk (lower number = preferred rating)						
a. Market loss, 3-10 years (if no present penetration)	0-4	-	2	1	3	2
b. Exchange problems	0-3	-	0	0	3	3
c. Political unrest, potential	0-3	-	0	1	2	3
d. Business laws, present	0-4	-	1	0	4	3
e. Business laws, 3-10 years	0-2	-	0	1	2	2
Total			**3**	**3**	**14**	**13**

Source: Daniels & Radebaugh, 2001, p. 462.

Matrix

There are two most commonly used matrices used in location selection: Opportunity-Risk Matrix and Country Attractiveness-Company Strength Matrix.

Exhibit 4.2: Opportunity-Risk Matrix



☐ = No operations in the country
■ – Current operations (size of square represents size of company operations in the country)

○ = Future placement (five years from present
- - = World average rating, present
… = World average ratings, future

Source: Daniels & Radebaugh, 2001, p. 463

Using the **Opportunity-Risk Matrix**, you can decide on indicators and weight them and evaluate each country on the weighted indicators. You can then determine which factors are good indicators of risk and opportunity and the factors then must be weighted to reflect their importance. A key feature of this matrix is its ability to project the future country location.

The matrix is important as a reflection of the placement of a country relative to other countries.

The **Country-Attractiveness-Company Strength Matrix** highlights the fit of a company's product to the country. Country attractiveness covers such variables as:

- market size;
- growth prospects;
- price controls;
- red tape;
- requirements for local content and exports;
- inflation;
- trade balance;
- political stability.

Company strengths involve:

- market share;
- market share position;
- product fit to the country's needs;
- absolute profit per unit;
- percentage profit on cost;
- quality of products;
- fit of the company's promotion program to the country in comparison with that of its competitors.

Exhibit 3.3: Country Attractiveness-Company Strength Matrix

Source: Daniels & Radebaugh, 2001, p 465

SUMMING UP

This Topic introduces you to the key steps in selecting locations for your foreign operations. There are different tools available at different stages of the selection process. It is important that you get yourself familiar with them and apply them to case analysis and your workplace.

INTRODUCTION

This Topic considers the formulation of strategies for international business. Apart from strategy formulation, various structural models for integration and control of international business operations are reviewed.

LEARNING OBJECTIVES

Upon completion of this Topic, you will be able to:

- Describe the strategic planning process;
- Follow the steps in developing international strategies;
- Recognise the impact of strategic predispositions towards international business;
- Apply different international strategies in appropriate situations;
- Describe the strategic fit concept and its impact on organisational structure; and
- Recognise the strengths and weaknesses of different structural forms for international operations.

STRATEGIES FOR INTERNATIONAL BUSINESS

There are two different approaches to developing international strategies. One is to treat international business strategy as an extension of domestic strategies to a larger, international environment. The other approach is to devote the same process to developing international business strategies. For the purposes of this Topic, we will first quickly go through the basic strategic management process, then consider some of the unique features of formulating strategies for international operations.

THE STRATEGIC PLANNING PROCESS

Strategy is concerned with courses of actions managers take to attain the firm's objectives. This is usually achieved by identifying products and markets which will serve to ensure the continuing survival and growth of a company. There are normally five stages in the strategic planning process:

- Identification of company mission;
- Analysis of external and internal environment;
- Formulation of strategy and overall plan;
- Implementation of the plan;
- Evaluation and control.

Stage 1 involves the identification of the mission and vision of the company. This is to get agreement on the sort of business the company is in and the reason for its existence;

Stage 2 is concerned with the analysis of the external and internal environment through SWOT analysis or Porter's competitive analysis (Porter, 1980);

Stage 3 should be a process that results in the specification of overall corporate strategy and establishment of operational plans in line with overall strategy;

Stage 4 entails how the plan is broken into major parts and each affiliate and department is assigned goals and responsibilities;

Stage 5 pertains to periodic reviews of strategy in terms of objectives versus performance. Progress is periodically evaluated and changes are made to the plan to accommodate changing circumstances and new information.

Proponents of international strategy as an extension of domestic strategy argue that no matter what strategies are pursued for international operations, they should still follow the generic strategy of the company, i.e. cost leader, differentiation, focus (Porter, 1980). However, they also recognise that international operations face a number of risks:

- **Economic risks** - changes in exchange rates, etc.;
- **Political risks** - changes in policy actions of governments, wars, civil disorders, etc.;
- **Business risks** - competitors' actions and responses, changes in consumers' choices, etc.;

- **Resource risks** - changes in requirement of firm resources.

Based on these risks, it is generally agreed that international strategy, whether it be an extension to domestic strategy, demands specific attention.

Recognition of these risks leads to the development of a number of steps for development of international strategy, so that such risks can be minimised.

Strategic Predisposition in International Business

At this point it is important to note that international business strategy development can be a very subjective venture. Research suggests that management usually have specific attitude(s) towards international business:

Ethnocentrism

- Emphasise volume expansion in international operations, not the specialised needs of foreign consumers. It may result in disassociation by local customers.

Polycentrism

- See each country, its people, and its markets, as different. Their firms are therefore highly decentralised operations, with little sharing of goods, technologies and ideas with other units within the same company.

Regiocentrism

- Use a strategy that addresses both local and regional needs.

Geocentrism

- Recognise that similarities and differences exist between countries. They take advantages of uniformity and low-cost, high volume production opportunities; and national differences where specialised production and marketing strategies are required.

(Thorelli, 1966; Rugman & Smith, 1994)

These strategic predispositions may lead to the adaptation of the following strategy and structure:

Table 5.1: Typical Strategic Orientations of MNCs

	Ethnocentric	Polycentric	Regiocentric	Geocentric
Strategy	Global integration	National responsiveness	Regional integration and national response	Global integration and national responsiveness
Structure	Hierarchical product divisions	Hierarchical area divisions with autonomous national units	Product and regional organization tied together through a matrix structure	A network of organizations
Cultural orientation	Home country	Host country	Regional	Global

Source: adapted from Rugman & Hodgetts, 2003, p. 217

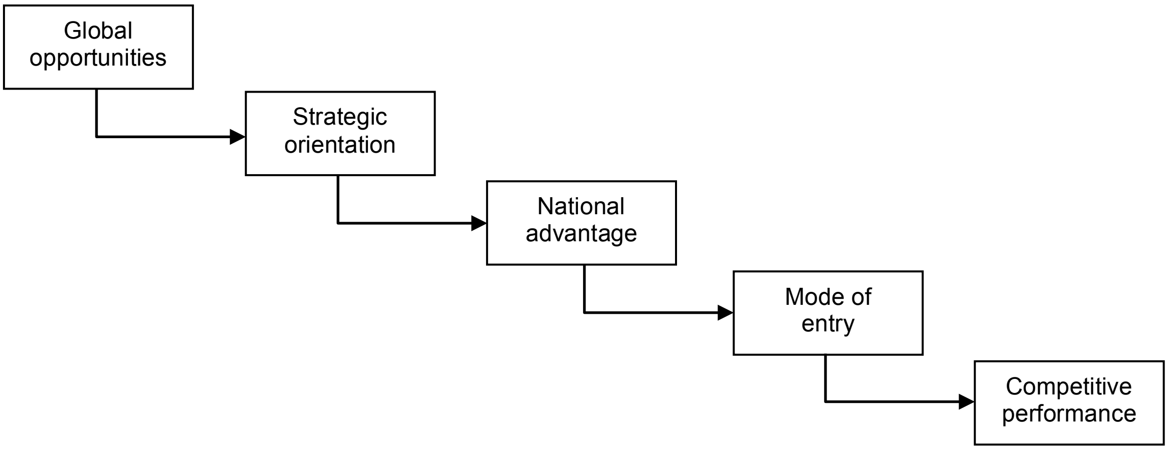
For Consideration

Consider some of the international fast food chain stores, e.g. KFC and McDonald's; what type of predisposition they seem to have?

International Strategy Development Steps

Even if managers are conscious of the influences of their predisposition about international business, certain steps should still be followed in IB strategy development to undertake the process in a systematic and rational manner.

Exhibit 5.1: Steps in International Strategy Development



- Identification of Global Opportunity;
- Alignment with corporate-level international strategic orientation;
- Analysis of industry-specific national advantages;
- Determination of business-level mode of entry into each country of operation;
- Review of competitive performance.

Identification of Global Opportunity

As indicated in Topics 2 and 3, international business is about selling to and buying from overseas as well as foreign investment. The motives may include:

Sales expansion motives

- Maturity of domestic markets;
- Slower domestic than foreign growth rates;
- Ability to gain foreign product capabilities – new or differentiated product capabilities.

Cost reduction motives

- Spreading fixed costs;
- Using lower-cost location;
- Value chain integration.

Risk reduction motives

- Smoothing sales and profits;
- Lessening dependence on existing customers and suppliers;
- Preventing competitors' advantages.

In addition, international expansion could exploit three sources of competitive advantage:

- ***Global efficiencies:*** location efficiencies; economies of scale; economies of scope (broadening product lines);
- ***Multimarket flexibility:*** international firms can exploit and respond to changes in their operating environments better than domestic firms can;
- ***Worldwide learning:*** diverse operating environments of MNEs may also contribute to organisational learning.

(Daniels, Radebaugh & Sullivan, 2001)

Alignment with corporate-level international strategic orientation

From the risks and opportunities presented by international operations, managers are torn between two opposing forces, i.e. integration and centralisation of activities to reduce costs, and customisation of producers and services to respond to local customer needs. These two dimensions have been used by Prahalad and Doz (1984) to develop their seminal work on the four types of international strategy. According to Prahalad and Doz, there are two opposing forces:

Need for global integration

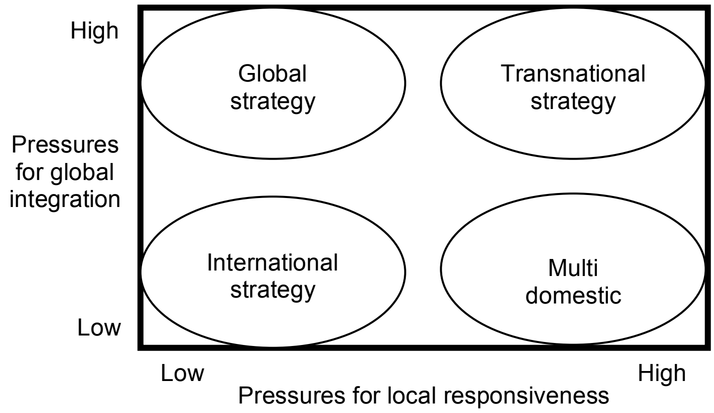
- Pressure for global integration;
- Importance of multinational customers;
- Importance of multinational competitors;
- Investment intensity, Technology intensity, Market structure, Government demands.

Need for local responsiveness

- Differences in customer needs;
- Differences in distribution;
- Need for substitutes & product adaptation;
- Pressure for cost reduction;
- Universal needs;
- Access to raw materials.

Based on the requirements of these two forces, Prahalad and Doz (*1984*) have developed four types of international strategy:

Exhibit 5.2: Four International Strategies



An international strategy focuses on creating value by transferring skills to local markets where skills are not present. It has a low operating cost, as what is exported does not incur significant additional costs of production. It also has the ability to protect important functional skills at home, such as R&D knowledge. The down side of that it is a very ethnocentric approach, making no attempt to consider the needs of the local customers.

A multi-domestic strategy involves decentralised strategic and operating decisions to allow each business unit to customise their products/services to the operating requirements of the host country. This strategy assumes markets are different in different countries, use of the multi-domestic strategy can increase market share. On the other hand, the strategy does not help achieve better efficiency or economy of scale.

A global strategy is about standardisation of products/services and business functions to reduce risk via achievement of a higher level of efficiency. Depending on the nature of the products/services, this strategy may be regarded as ignoring local customer needs.

A transnational strategy focuses on both global efficiency and local responsiveness. It requires a good balance of both forces by emphasising the augmentation of their standard business formulas with specific products and processes tailored to country-specific conditions.

Analysis of industry-specific national advantages

Once opportunities and strategic orientation are identified, managers need to assess whether various country factors in a country are attractive to the industry that company wishes to compete in. Porter's National Competitive Advantage Theory (Porter, 1990) covered earlier is a useful framework to undertake this assessment

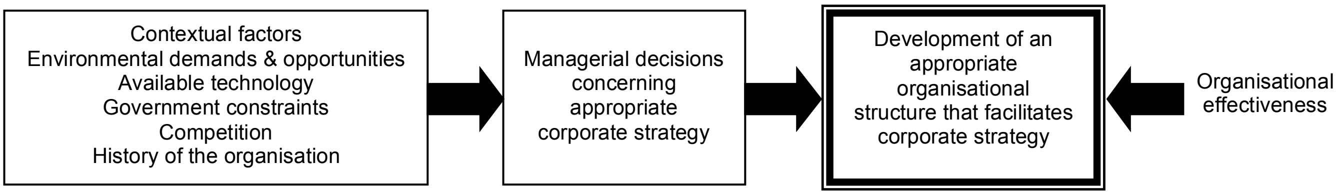
STRUCTURING INTERNATIONAL OPERATIONS

Once international strategy has been determined, managers need to develop systems and processes to ensure that global integration and local responsiveness are balanced. One of the key management tools involved is **organisational design**.

Chandler's Strategy-Structure Hypothesis

When designing organisational structure, it is important to take note of Chandler's contribution to strategic management, organisational design and international business. According to Chandler (1962), most organisations design their structure in cognisance of the strategy pursued. This suggests that there should be a high degree of alignment between the organisation's structure and strategy.

Exhibit 5.3: Chandler's Structure-follows-strategy hypothesis



Source: Chandler, 1962, p. 13.

Chandler's seminal work has provided the impetus for the development of 'configurational' research on strategic fit. The basic thesis is that an organisation with a particular strategy should have a particular type of organisational structure in order to be effective. For example, an organisation using a low-cost strategy should have a rigid, hierarchical structure with centralised decision-making to avoid duplication of activities to achieve cost effectiveness. One of the first configuration models that link structure to strategic choices of the organisation has been developed by Miles and his associates:

Table 5.2: Strategic Fit Model

	Strategy	Environment	Organisational characteristics
Prospector	Innovative Find new market opportunities Grow Take risks	Dynamic growing	Creative, innovative, flexible, decentralised.
Defender	Protect turf Retrench Hold current market	Stable	Tight control, centralised, production efficiency, low overhead.
Analyser	Maintain current market plus moderate innovation	Moderate change	Tight control and flexibility, efficient production, creativity.
Reactor	No clear strategy React to specific conditions Drift.	Any condition	No clear organisational approach; depends on current needs.

Source: Miles, Snow, Meyer, and Coleman, 1978

The Stopford & Wells Model

Stopford and Wells (1972) also developed a model of international structure based on Chandler's earlier work. According to them, firms usually have a pattern of designing the structure of their international operations. There are three phases and each has the following characteristics:

Table 5.4: The Stopford & Wells IB Structure Model.

Phase	Characteristics
1	No designated international units, subsidiaries are relatively autonomous
2	International business division established to increase control and coordination of expanding international activities.
3	International business division may be structured according to worldwide product divisions and geographic area division for all products.

Source: Stopford & Wells, 1972

The Bartlett and Ghoshal Model

Based on the work of Prahald and Doz (1984) on international strategy, Bartlett and Ghoshal (1989) developed a model that describes four types of organisation structure for international operations:

Exhibit 5.5: the Bartlett and Ghoshal Model of IB Structure

		GLOBAL CO-ORDINATION	
		Low	***High***
LOCAL INDEPENDENCE & RESPONSIVENESS	***Low***	International divisions	Global product companies
	High	International subsidiaries	Transnational corporations

Source: Bartlett & Ghoshal, 1989

International Divisions

This form of multinational structure is the most basic form for organising international operations, reflecting the size of the domestic business and the stage model of internationalisation. This structure may be appropriate when the demand for global coordination and product customisation are both low.

International Subsidiaries

In order to respond more promptly to local market requirements, international subsidiaries are a common form of structure for international operations. This structure may compromise control from the company's headquarters and uniformity of corporate structure. It may be appropriate in situations where the overseas market is larger than the domestic one. However, given intensified global competition, international subsidiaries may not be the best option for greater global integration.

Global Product Companies

The demand for greater global integration has given rise to the use of global product structures, such that activities such as component manufacturing and R & D can be fully integrated on a global scale. It is considered an appropriate structure for achieving cost efficiencies and for transferring resources at the intra-firm level. However, its ability to respond to local requirements is questionable.

Transnational Corporations

Increasing global competition has resulted in companies having to emerge as transnational organisations to both globally co-ordinate activities and respond to local needs. This organisational structure has the following characteristics:

- **global functional management** - to encourage the transfer of learning and core competencies across the organisation, allowing managers to accumulate knowledge and skills and be able to apply them on a global basis;
- **global business management** - for managers with global product responsibilities championing the search for world-wide efficiency and integration;
- **geographic management** - within each country, responsive to local market requirements, sensing these needs and feeding them into the corporation as a whole.

This leads to a much more complex, multidimensional structure than in traditional multinationals. Bartlett and Ghoshal (1989) argue that this puts pressure on managers to develop new capabilities to meet these challenges. These challenges require managers to avoid generalisation, with the new transnational structures exhibiting significantly different features from with previous models:

- with uniform/symmetrical organisational structures being replaced by differentiation - with different structures and managerial control arrangements in different parts of the organisation;
- with a move away from the dependence of business units on a strong centre or the alternative of independence of subsidiaries - instead the corporation moves towards interdependence, with collaboration and co-operation encouraged between business units and with the centre;
- with traditional control arrangements moving towards co-ordination and co-option, stressing the 'people' aspects and creating differing approaches depending upon the strategic significance of the particular business unit.

Above all, Bartlett and Ghoshal stress that the achievement of this different approach is less about the structure of the organisation, but more about a "mind matrix" of the managers who make up the organisation. This is similar to the argument raised by Ohmae (1989) about the thinking of global managers - "think global - act local" and the need for "insiderisation". (Johanson and Vahlne, 2009)

Finally, Bartlett and Ghoshal also outline the changing organisational structure patterns implied by the wider discussion, particularly the problems of matrix structures. Whilst not being specific, they also build on the features outlined above to argue for multidimensional perspectives; distributed, interdependent capabilities; and a flexible, integrative process. Together these argue for an integrated network model for the transnational corporations.

Other Important Concepts about Organisational Structure

There are some important concepts about organisational structure, and it is important that you are fully aware of them, so that you can consider different options when designing structure for your international operations.

Underlying Themes of Organisational Design

Two major themes underlie the design of organisational structure, i.e. specialisation and coordination and control (Li, 1994).

Specialisation can be further divided into horizontal and vertical dimensions. Horizontal specialisation refers to the grouping of people and resources together by function, division or in matrix form. Vertical specialisation defines who manages the department or unit and how decisions are made, leading to different levels in a hierarchy of authority.

Coordination ensures communication among component parts/units within the organisation, whereas control aims to establish goals, plans, measuring results, etc. Coordination and control can influence the shape of an organisation, e.g. flat or tall, as well as the degree of centralisation versus decentralisation, particularly in decision-making (Li, 1994).

These two underlying themes of organisational design can be easily observed in the "classic" organisation described by Max Weber. Weber (quoted in Henderson and Parsons, 1947) describes the "Ideal Bureaucracy" as follows:

- Specialisation of labour;
- Well-defined hierarchy of authority;
- Clearly defined responsibilities and authority;
- Systems of rules and procedures;
- Impersonality of relations;
- Promotion based on technical qualifications;
- Centralisation of authority;
- Written records.

For Consideration

Put the 8 features listed above under either specialisation or coordination and control, and reflect on your current employing organisation to see the extent to which those organisational features are present.

Specialisation

There are many ways to group people and resources together in organisations. The most common approaches are functional, divisional and matrix organisations. Functional structure is based on the assumption that efficiency is obtained when similar activities are grouped together. It involves grouping people with similar skills or who use similar tools or techniques to perform their jobs. Examples are easily found in today's workplace. Manufacturing, marketing, R & D, etc. are typical functional structures. Divisional structure is made up of different functional business units that work together to produce a particular product or to serve particular groups of customers. It can be in product, customer or location based. Advantages and disadvantages of functional and divisional structures are given below:

Table 5.5: Advantages and Disadvantages of the Functional Structure

Advantages	Disadvantages
Encourage specialisation of labour	Employees lack total perspective
Employees understand the structure	No one function is accountable for results
Eliminate duplication	Lack of training opportunities for top management

Source: Schermerhorn, Schermerhorn, Hung, and Osborn, 1994, p. 381

Table 5.6: Advantages and Disadvantages of the Divisional Structure

Advantages	Disadvantages
Expansion is easy	Duplication of activities
Accountability is increased	Limited communication between specialists of the same discipline in different divisions.
All rounded expertise within divisions	Central coordination and/or control difficult
Training for top management positions	

Source: Schermerhorn, Schermerhorn, Hung, and Osborn, 1994, p. 382

For Consideration

Obtain a copy of the organisational chart at your place of work, identify the presence of functional and divisional structures, then review the appropriateness of the generalisation tabulated above.

Coordination and Control

The other underlying theme of organisational structure is how much coordination and control managers want in the company.

A most common observation on the degree of coordination and control in organisations can be made by looking at the shape of the organisation's organisational chart. In general, 'tall' and 'flat' are the adjectives used to describe the shape of an organisation. The following table provides a comparison of the specific features of the two different shapes:

Table 5.7: Tall & Flat Structures

Tall	Flat
More levels, narrow span of control, therefore closer or tighter control	Span of control wide, more discretion
Decision-making tends to be centralised and slow	Decentralised decision-making
Information flow slow and distorted	Loose control
	Higher satisfaction level (but not performance level)

Source: Li, 1994.

A factor which may critically influence the shape of an organisation is the span of control, i.e. how many people can a manager oversee? What is the volume, i.e. frequency and intensity, of interpersonal relationships a manager can handle? Factors determining the span of control include:

- Required contact between the manager and subordinates;
- Degree of subordinate specialisation;
- The manager's ability to communicate.

The degree of coordination and control also influences the extent to which various management activities are centralised and decentralised. Centralisation and decentralisation refer to whether decision-making is centralised in a few individuals or at the senior levels of an organisation. While the current trend favours more decentralised decision-making, the strengths and weaknesses of both approaches must be considered:

Table 5.8: Strengths and Weaknesses of Decentralisation.

Strengths	Weaknesses
Facilitates fast response to change	Narrow perspective
Enhances ownership of product/service	Difficult to allocate pooled resources
Helps staff development	Communication problem
Cultivates self-esteem	Competition for resources

Source: Drucker, 1985

OTHER STRUCTURAL FORMS OF ORGANISATIONAL DESIGN

The increasing complexities of the business environment, particularly with the arrival of the global economy, have placed demands on business to look for different forms of organisation structure. The use of matrix organisations and the emergence of network structure and the so-called 'boundaryless organisations' are commonly observed. We will discuss more of these in class and relate them to the management of international operations.

SUMMING UP

This topic has exposed you to the strategic planning process from a domestic as well as international perspective. International strategies are developed with particular objectives, hence are different from domestic strategies. However, there should still be significant alignment between the two. There are different international strategies serving different strategic objectives of business. To support the implementation of relevant strategies, appropriate organisational structure should be put in place. Chandler's strategic fit concept provides you with an important theoretical basis to look at the relevance of structure to strategy. It is also important to understand the different concepts underlying the selection of structural forms, as they impact on how well the relevant international strategies are supported. Provided below is a typical example of the different types of structure for different types of international strategies.

Exhibit 5.6: Strategy, Structure & Control in International Operations

Strategy

Structure and Controls	***Multidomestic***	***International***	***Global***	***Transnational***
Vertical differentiation	*Decentralized*	*Core competency centralized; rest decentralized*	*Some centralized*	*Mixed centralized and decentralized*
Horizontal differentiation	*Worldwide area structure*	*Worldwide product division*	*Worldwide product division*	*Informal mix using matrix or network structure*
Need for coordination	*Low*	*Moderate*	*High*	*Very high*
Integrating mechanisms	*None*	*Few*	*Many*	*Very many*
Performance ambiguity	*Low*	*Moderate*	*High*	*Very high*
Need for cultural controls	*Low*	*Moderate*	*High*	*Very high*

INTRODUCTION

Once opportunities for international business are identified, managers can start thinking about how to internationalise their business. The first step is to assess whether their business has internationalisation potential and to consider the best options to internationalise. Market entry strategies will then have to be examined.

LEARNING OUTCOMES:

Upon completion of this topic, you will be able to:

- Assess the potential of your business to internationalise;
- Describe the advantages and disadvantages of different options for internationalising your business;
- Describe the appropriate applications of different market entry strategies in specific situations.

ASSESSING INTERNATIONALISATION POTENTIAL

According to George Yip (2003), a business intending to internationalise needs to consider whether the industry it is in has any globalisation potential. It has to be noted that Yip's concept is that business has to operate in an "integrated, worldwide basis, not as a loosely knit federation of subsidiaries" (p xiv) in a globalised economy. In what he labels as "total global strategy", a business has to start with a core business strategy that defines:

1. the type of products or services that it offers;
2. the types of customers that it serves;
3. the markets it gets into;
4. the major competitive edge it has;
5. its value-adding activities in its operations;
6. its competitive posture;
7. investment strategy.

Once a business has worked out its core business strategy, it may expand outside its home market, and hence require an internationalisation strategy which covers such issues as international market selection, competition with local competitors and localisation of products and services. The internationalisation strategy may typically result in fragmented approaches across different countries due to the concern for accommodating local needs. The total global strategy addresses the disadvantages of internationalisation by integrating world-wide business leverage and competitive advantage. This means that managers have to identify certain aspects of their "multi-local" business strategies for developing a global strategy. To help managers to evaluate whether their business can become global, a systematic analysis of "industry globalisation potential" has to be undertaken (Yip, 2003).

Globalisation potential can be evaluated systematically by assessing the following industry drivers:

- Market drivers;
- Cost drivers;
- Government Drivers;
- Competitive drivers.

Market drivers

Market drivers look at commonalities in the following areas:

- Common customer needs;
- Global customers;
- Global channels, i.e. channels of distribution that buy on a global scale;
- Transferable marketing, i.e. marketing elements that require minimal local adaptation, eg. Branding;
- Lead countries, i.e. countries that are perceived to be the best producer of certain goods and services.

Cost drivers

This concerns how efficiencies can be achieved through:

- Global scale economies;
- Steep experience curve effect;
- Sourcing;
- Favourable logistics;
- Differences in country costs, including exchange rates;
- High product development costs relative to the size of national markets;
- Fast changing technology that shortens product life cycle.

Government drivers

Government policies and attitude towards business in general and foreign business in particular can have significant impact on business potential and opportunities. Some of the key elements to be considered include:

- Favourable trade policies;
- Compatible technical standards;
- Common marketing regulations;
- Government-owned competitors and customers;
- Host government concerns over the mobility of multinationals impacting on employment, technology transfer and national strategies.

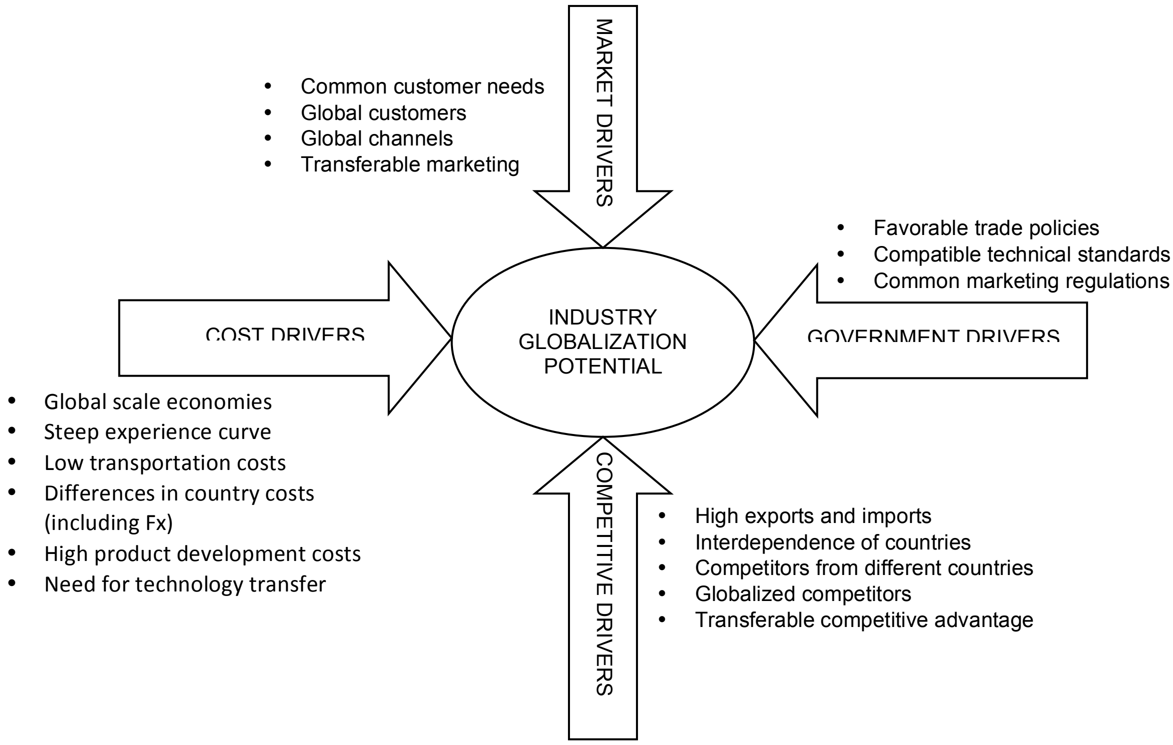
Competitive drivers

This involves assessment of the magnitude of competition in an industry on a global scale. Assessment can be undertaken by considering the following elements:

- High exports and imports, i.e. the volume of trading of both final and semi-finished products and services;
- Competitors from different continents;
- Interdependence of countries;
- Competitors globalised.

Yip's model is diagrammatically presented in Exhibit 6.1.

Exhibit 6.1: Model for Assessing Globalisation Potential.



Source: Yip, 2003

According to Yip (2003), once globalisation potential is assessed as positive, managers can develop a global strategy for their business by looking at:

- Market participation: choice of markets;
- Products/services: same or different products in different countries;
- Location of value-adding activities;
- Marketing: same brand name used in different countries;
- Competitive moves: strategic moves in individual countries as part of a global competitive strategy.

INTERNATIONALISATION OF BUSINESS

Once a business has made a positive assessment of internationalisation potential, it may consider to actually internationalise its activities. According to Beamish (1990), internationalisation of business refers to:

"the process by which firms increase their awareness of the direct and indirect influence of international transactions on their future, and establish and conduct transactions with other countries"

(Beamish 1990, p. 77)

MODELS OF INTERNATIONALISATION

There are many models of internationalisation. The most common ones are the Stage (Uppsala) Model, the Transaction Cost Model, the Eclectic Paradigm, and the Network Model.

The Stage (Uppsala) Model

This is a model developed at the Uppsala University, Sweden, in the 1970s, hence it is also known as the Uppsala Model. It suggests that managers typically internationalise to increase long term profit and growth while at the same time minimising risks. As a result, they normally take incremental steps to internationalise their business. A business enters new markets with reduced "psychic distance", that is familiarity with language, culture, customs and political systems of the host country (Johanson & Vahlne, 1977, 1990, 2009).

The model suggests that there are four modes of internationalising business:

Stage 1: Distribution and agency involving indirect/ad hoc exporting;

Stage 2: Active exporting and/or licensing;

Stage 3: Joint venture to intensify exports, licensing, and equity investment in foreign manufacture/marketing;

Stage 4: Foreign direct investment (FDI), including full-scale multinational marketing and production.

(Root, 1998)

The Stage Model predicts that a business enters new foreign markets by exports. The four stages are sequential and represent higher degrees of international involvement as managers acquired more knowledge of the new market/location, hence reducing the "psychic distance".

For Consideration:

Apply the Stage Model of internationalisation to the management consulting industry and reflect on its applicability.

The Transaction Cost Analysis Model

The Transaction Cost Analysis Model focuses on the costs of doing business. It suggests that a business expands when the cost within the organisation is equal to the cost of carrying out the same transaction by external exchange (Williamson, 1975; Hennart, 1982). Thus, managers choose the least-cost international location for each activity they perform and grow by internationalising markets, bringing interdependent activities under common ownership and control up to the point where the benefits of further internationalisation are outweighed by the costs.

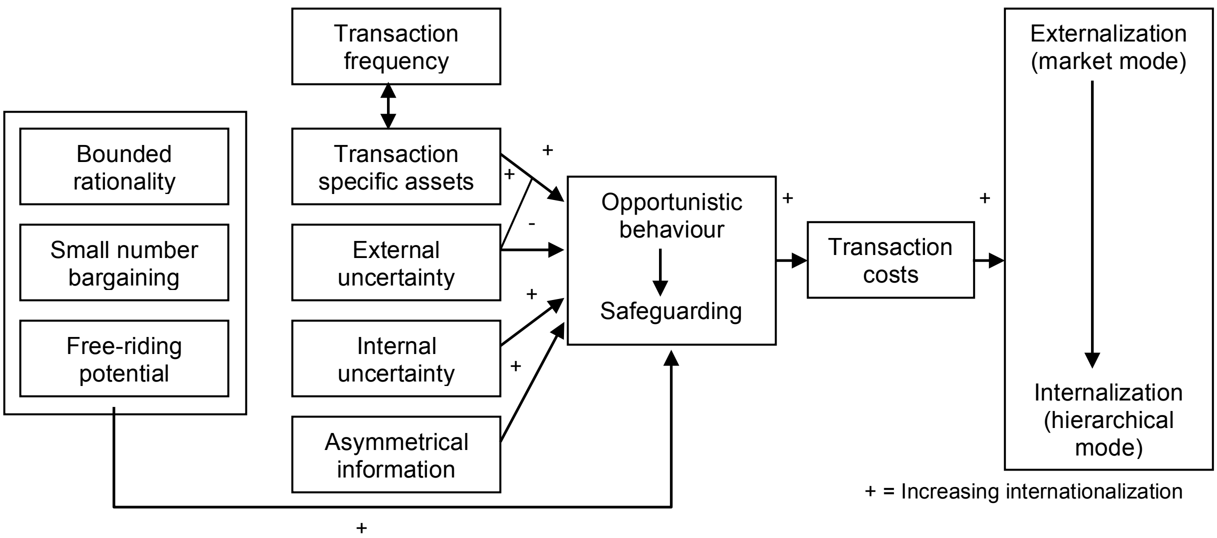
Cost minimisation explains business decisions in the Transaction Cost Analysis Model. Managers prefer to internalise e.g. integrate vertically (within the company) to reduce transaction costs. There are two major forms of transaction costs involved in business expansion:

- **Ex ante costs** - the costs of searching and contracting. Search costs include gathering information to identify and evaluate potential export intermediaries. Contracting costs are associated with negotiating and writing an agreement between seller (producer) and buyer (export intermediary);
- **Ex post costs** - the costs of monitoring and enforcement. Monitoring costs are associated with monitoring the agreement (fulfilling of predetermined set of obligations). Enforcement costs are costs involved in sanctioning of a trading partner not performing in accordance with the agreement.

Since the goal of business under the Transactional Cost Analysis Model is to minimise the combination of the ex ante costs and ex post costs, internationalisation of business will be a choice between externalisation and internalisation. The external approach would involve use of agents and distributors, whereas the internal approach would involve setting up of sales subsidiaries.

Provided in Exhibit 6.2 is a diagrammatical illustration of the Transaction Cost Model for choice of internationalisation mode.

Exhibit 6.2: The Transaction Cost Model for Choice of Internationalisation Mode



Source: Chandrashekhar, 2004

For Consideration

Review the Stage (Uppsala) Model of Internationalisation, and see how Transaction Cost Analysis may influence your choice of mode(s) in that model.

Eclectic paradigm

The eclectic paradigm theory proposed by John Dunning (1980) builds on the theory of internalization proposed by Buckley and Casson (1976). According to Dunning companies internationalise to take advantages of ownership and location and to overcome imperfections in the market. The theory is therefore also referred to as the OLI Model. The theory states that in order to protect intellectual property, firms would keep control of ownership; firms will select a location based on certain advantages such as availability of raw materials, tax rates etc.; and internalising operations by producing through partnership agreements.

The Network Model of Internationalisation

The Network Model of internationalisation breaks away the internal focus of the Stage and Transactional Cost Models in that it allows for external influences on the internationalisation process of a business (Johanson & Mattsson, 1988).

According to this model, industries are seldom monopolistic. Most industries consist of businesses engaged in production, distribution and use of goods/services. Businesses in a network are linked to each other through exchange relationships. Individual businesses are dependent on resources controlled by others, generating the need for coordination of activities. These coordination activities require businesses to be linked to each other through technical, social, cognitive, administrative, legal and economic relationships. These relationships can be direct and indirect but take time and effort to development. There are two types of relationships:

- **Micro-position**, i.e. relationship to a specific counterpart in the same industry;
- **Macro-position**, i.e. relations to a network as a whole.

The Network Model measures:

1 What positions a business has in different nets which refer to sections of the total network;

2 How strong they are;

3 How integrated they are.

Internationalisation is therefore pursued through establishing and developing positions to counterparts in foreign networks. This can be done by:

- International extension, i.e. getting into new national networks;
- Penetration, i.e. developing positions in networks;
- International integration, i.e. co-ordination between positions in different national networks.

Different businesses may adopt different internationalisation approaches under the Network Model. There are two dimensions that classify firms into four types:

- the degree of internationalisation of the firm;
- the degree of internationalisation of the market.

Exhibit 6.3: The Network Model of Internationalisation

		Degree of internationalization of the market	
		Low	**High**
Degree of internationalization of the firm	**Low**	The early starter	The late starter
	High	The lonely international	The international among others

The four types of businesses will have different characteristics in terms of their relationship in the networks, hence different internationalisation modes:

The early starter

- No important international relationships in the production network;
- Size and resourcefulness of the firm is important;
- May face local resistance.

The lonely international

- The firm has experience in relationships;

- Ability to make resource combinations;
- Can give counterparts access to other networks.

The late starter

- Indirect relationships;
- Products even spread through others;
- Company size is important.

The international among others

- Firm and environment highly internationalised;
- Positions used for bridging;
- Need of international integration, benefits from co-ordination of R&D, procurement and production.

The Network Model explains why many knowledge based business service firms, in particular, achieve their competitive advantage by developing mutually supportive interactions with other service firms in foreign locations (O'Farrell et al, 1998b).

BORN GLOBALS

The popular models of internationalisation discussed above tend to assume that managers tend to incrementally build up market and location knowledge in internationalising their business. The rationale is to reduce uncertainty and risk over time. The usefulness of these models has been increasingly questioned in the last few decades with increasing number of firms that do not seem to follow the traditional pattern of internationalisation (Cavusgil & Knight, 2009; Rialp, Rialp & Knight, 2005). Instead, research has revealed that many of these firms indeed have been aiming at the global market right from birth (Rasmussen, Madsen & Evangelista, 1999).

Born Globals has received considerable attention among researchers in international business, particularly those focusing on entrepreneurship with a small and medium enterprise flavour. So far few commonly-accepted theoretical framework has been developed for Born Globals, and this is reflected in the different terminologies used.

These Born Globals (sometimes referred to as *International New Ventures* or *Early Internationalising firms*), these types of firms do have certain features:

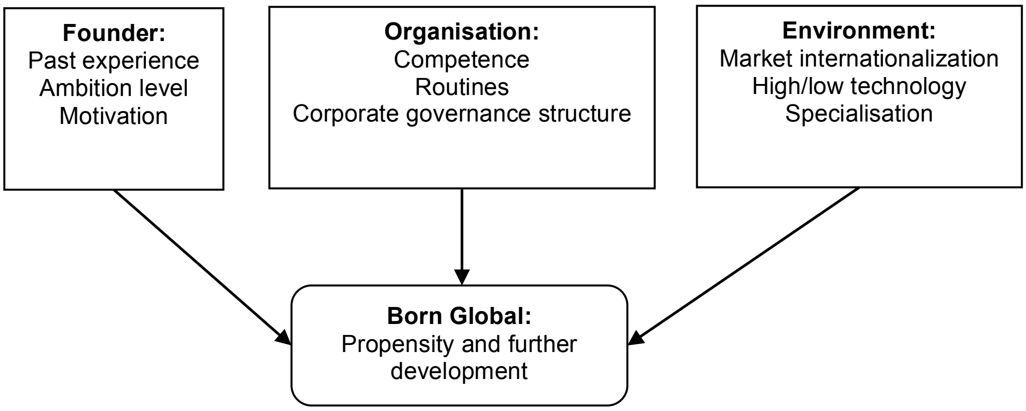
- High share of foreign sales;
- Strong internal capabilities and competitive platform for specialised production which are important for international exports;
- Wide geographical scope of operations;
- Small size;
- Limited resources.

(Madsen, Rasmussen & Servais, 1999)

The interest shown in Born Globals is particularly strong in countries where the drivers of the economy are small and medium-sized enterprises. They include Australia, Scandinavian and Eastern European countries, and many countries in the Asia-Pacific.

A model to assess Born Global propensity has been developed and is illustrated below:

Exhibit 6.4: Model for Development of Born Globals



Source: Rasmussen, Madsen & Evangelista, 1999

MARKET ENTRY STRATEGIES

Once managers have assessed the potential for internationalisation and reviewed options for internationalisation, they will have to determine market entry strategies.

In determining market entry strategies, an important activity to undertake is to obtain strategic and market intelligence. This is not always easy despite the arrival of the internet because in some countries hard data is difficult to find and people's responses to market surveys are culturally biased.

In general, international market entry has to start with the location of the market. Market entry therefore involves three dimensions:

- Where?
- When?
- How to enter and implementing the market entry plan.

(Shenkar & Luo, 2004)

International Market Entry Location (*Where*)

The decision to enter a particular market involves consideration of a number of factors. Among them are:

- **Cost/tax factors:** transportation, wage, availability of land and its costs, construction cost, materials cost, financing costs, tax rates, investment incentives, profit repatriation costs;
- **Demand factors:** market size and growth, customer presence, local competition;
- **Strategic factors:** investment infrastructure, industrial concentration, supply/distribution linkages, workforce productivity, complementary industries;
- **Regulatory/economic factors:** industrial policies, foreign direct investment policies, availability of economic zones;
- **Sociopolitical factors:** political risk and instability, cultural barriers and openness, local practices, government efficiency and corruption, attitudes toward foreign business, community characteristics, pollution control.

Not only must the above factors be considered, but also strategic objectives, global integration, and market orientation objectives must be met.

- **strategic objectives** are related to growth and competitive factors;
- **integration factors** are related to access to trading blocs and integrated economies;
- **market orientation factors** are related to whether primary target markets are available from the host location.

Table 6.2 provides a summary of the key factors that determine choice of markets.

Table 6.2: Determinants of Market Locations

Micro-Context	*Macro-Context*
Cost/Tax Factors	*Regulatory Factors*
Transportation costs	Industrial policies
Wage rate	FDI policies
Land availability and costs	Availability of special zones
Construction costs	*Sociopolitical Factors*
Costs of raw materials and resources	Political instability
Financing costs	Cultural barriers
Tax rates	Local business practices
Investment incentives	Government efficiency and corruption
Profit repatriation	Attitudes towards foreign business
Demand Factors	Community characteristics
Market size and growth	Sustainable development (eg pollution control and recycling requirements)
Customer presence	
Local competition	
Strategic Factors	
Investment infrastructure	
Manufacturing concentration	
Industrial linkages	
Workforce productivity	
Inbound and outbound logistics	

Source: Shenkar & Luo, 2004

International Market Entry Timing (*When*)

Market entry timing is important because it determines the risks and potential returns from investment. Timing of market entry determines whether a business is an early or late mover.

Early movers have certain advantages, which may include factors like market power, more pre-emptive opportunities, and strategic advantages over late movers. At the same time, an early mover may face environmental and operational risks that can come from the host governments' experiences, underdeveloped investment laws and regulations, protectionism, difficulties in overcoming early growth stages, shortages of workers, underdeveloped support services, lack of financing, uncertain foreign exchange, consulting cost burdens, poor infrastructure systems, and unstable market structures. This explains why many companies moving into China in the early 1980s did not report good returns.

Table 6.3: Advantages & Disadvantages of Early Movers

Economic Effects of Being an Early Mover	
Highest Possible Returns (Advantages)	**Higher Uncertainty/Costs (Disadvantages)**
1. Market Power	**1. Environmental Uncertainty**
● Barriers to followers	● Underdeveloped regulations
● Technical leadership	● Lack of government experience
● Customer loyalty	● Embryonic industry
● Product positioning	**2. Operational Risks**
2. Preemptive Opportunities	● Lack of supply and inputs
● Preemption of marketing	● Lack of supporting services
● Preemption of resources	● Poor infrastructure
● Brand recognition	● Unstable market structure
3. Strategic options	**3. Extra Operational Costs**
● Industry/location selection	● Learning/adaptation costs
● Access to infrastructure	● Local training costs
● Low competition	● Anti-imitation costs

International Entry Strategy Selection (*How*)

Market entry strategies are specific forms or ways of entering a target country to achieve the strategic goals related to presence in that country. These can be trade related, transfer related, and foreign direct investment related.

Trade Related Strategies

Trade related market entry strategies include:

- Export, using intermediaries to export products to market through an exporting company while negotiating letters of credit and terms of trade that are favourable.
- Subcontracting, includes contracting with a local manufacturer to process goods into finished goods that will distribute into the local market.
- Countertrade, where merchandise is traded in a barter-like system. Barter, counterpurchase, buybacks, and offsets and used in this method.

Transfer Related Strategies

Market entry strategies in relation to transfer of know-how include:

- International Leasing;
- International Licensing;
- International Franchising;
- Build-Operate-Transfer (aka “turn-key operation”).

Foreign Direct Investment (FDI) Related Entry Strategies

FDI market entry strategies include:

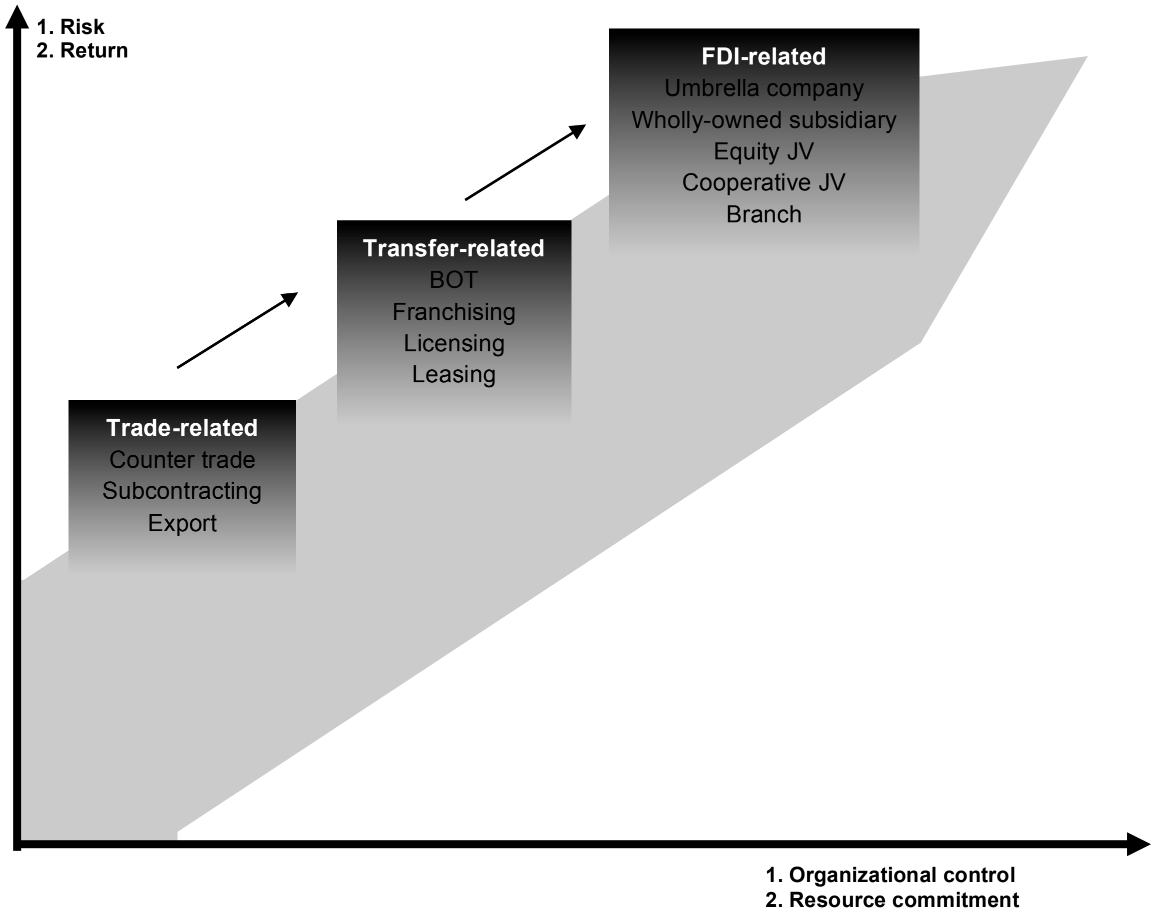
- Branch Office;
- Cooperative Joint Venture;

- Equity Joint Venture;
- Wholly Owned Subsidiary;
- Umbrella Holding Company.

A close look at Shenkar and Luo's (2004) (Exhibit 6.5: Market Entry Strategies) model of market entry strategies can find significant familiarity with the Stage Model of Internationalisation (Johanson & Vahlne, 1977).

Indeed, in terms of market entry strategies, Johanson and Vahlne's Stage Model remains the mostly frequently cited framework. We will consider the strengths and weaknesses of those strategies in class.

Exhibit 6.5: Market Entry Strategies



Summing Up

This topic begins by introducing Yip's model to assess potential for internationalisation. The model helps managers to ascertain whether firms in certain industries should internationalise. Different models of internationalisation are then presented, followed by the presentation of the new concept of "Born Globals". The topic finishes with an analysis of market entry strategies. From here, managers will face some of the day-to-day operations of international business, which will be the subject of topics to be presented later in the course.

INTRODUCTION

One of the key factors for success in international business is the management of people. As human resources are central to achieving global competitive advantage, they must be managed strategically by ensuring that human resource management (HRM) practices are fully integrated with the organisation's international strategy.

This Topic is divided into two parts. The first part will introduce some frameworks for describing and analysing HRM issues in international operations. Measures to deal with the issues will also be suggested. The second part will look at national level industrial relations differences and leadership/motivation issues.

LEARNING OBJECTIVES

On completion of this Topic, you will be able to:

- Describe the variables that moderate differences between managing people in domestic and international environment;
- Explain issues and their implications for actions on:
  - international HRM approaches and activities;
  - contextual factors affecting international HRM;
- Recognise and apply the Contingency Model for international HRM;
- Describe and apply the frameworks for purposes of expatriation and international adjustment;
- Describe HRM tools for implementing global integration;
- Recognise issues of ethics and social responsibility in international operations and develop actions to overcome them.

Variables that Moderate Differences between Domestic and International HRM

Managing people for international assignments is more complex than that in the domestic environment. According to Dowling et al. (2013), there are six factors that differentiate international from domestic HRM:

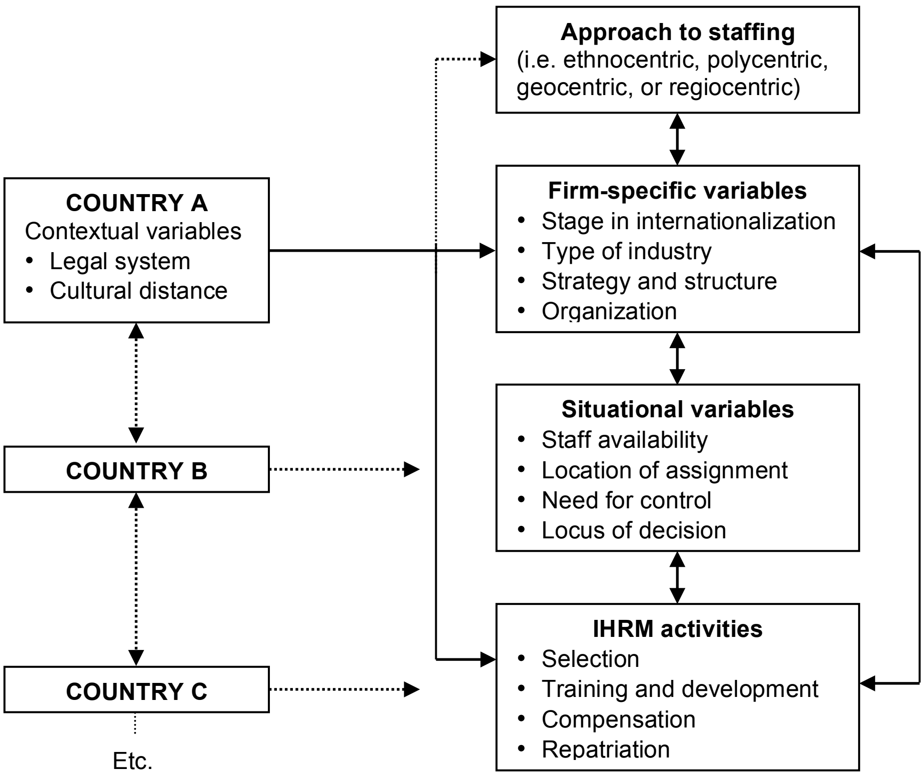
- **more HR activities**. For example, a human resource department must deal with aspects such as international relocation and orientation, administrative services for expatriates and host government relations;
- **the need for a broader perspective**. As seen in the way that HR managers must design and administer programs for more than one national group of employees;
- **more involvement in employees' personal lives**. HR department may be involved in arranging housing, health care, and children's schooling;
- **changes in workforce mix of expatriates and locals**. As the firm's international operation expands, the mix of expatriates and locals change and HR activities such as recruitment, selection and training broadens;
- **risk exposure**. Expatriate failure, loss of international market share and terrorism are examples of risk that involve greater challenge than domestic operation;
- **more external influences**. External factors such as the type of government, the state of economy and the way each country conduct business affect the management of people in international business.

The Determinants of International HRM Approaches and Activities Framework

It is important for managers to understand the various interrelationships between organisational factors and contextual factors that influence the management of people in international business.

Dowling et al. (2013) adapt the framework on approaches and activities of the management of HR developed by Welch. This framework links between firm-specific variables (such as stage in internationalisation, organisational structure and organisational culture) and situation variables (such as staff availability, need for control) with international HRM approaches and activities. Contextual factors include the legal system and cultural dimensions.

Figure 7.1: Determinants of International HRM Approaches and Activities Framework



Source: Dowling et al 2013

For Consideration

In relation to the variables in this Model, discuss several HRM challenges faced by your or other organisation as a result of business expansion to overseas market.

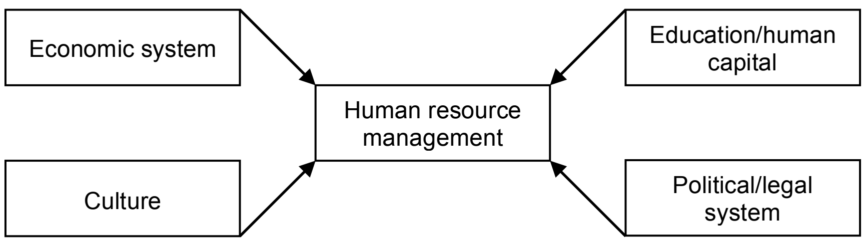
Contextual Factors Affecting HRM in Global Market

Noe, Hollenbeck, Gerhart and Wright (2000) identify four contextual factors that affect the management of people in the global markets, namely:

- Culture;
- education/human capital;
- the political/legal system;
- the economic system.

Figure 7.2 demonstrates the linkages of the factors.

Figure 7.2: Contextual Factors Affecting HRM in International Markets



Source: Noe, Hellenbeck, Gerard and Wright, 2000, p. 536

Education/human capital

One of the key considerations of expanding to foreign markets is the availability of a qualified work force. A country's human capital, the productive capabilities of individuals that consist of the knowledge, skills, and experience, can be an important HR issue. Countries with low human capital is attractive for operation that needs low skills and low wage levels. On the other hand, countries with high human capital attract direct foreign investment that creates high-skilled jobs.

Political/legal system

The political/legal system of a country often determines HRM regulations. The laws are a reflection of societal norms of a particular country. In India, for example, the Indian labour law provides strong protection to employees from layoff. Under the Industrial Dispute Act, layoffs and dismissal are difficult and the involvement of government in the activity through the bureaucracy makes the process time consuming.

Economic system

The economic system of a country is influential to the practice of HRM. In socialist economic systems, the free education system promotes the development of human capital. However, there is little monetary incentive to further develop human capital. For example, the development of human capital in the former Soviet bloc countries is focused on the investment of the Socialist Party. In the capitalist economic countries, developing human capital, usually through education, is very costly. However, people are able to get the reward through getting good jobs which further enables them to invest more on education. Therefore, in the U.S. for example, salary levels indicate differences in the accumulation of human capital.

Culture

Culture often determines the effectiveness of HR practices. Practices effective in one culture may be less effective when implemented in other cultures. For example, compensation in many companies in the western countries is tied to individual performance. In Japan, however, group orientation is highly valued and the reward system is linked to achievement of the group rather than that of individual employees. The dimensions of national culture are discussed in the following section followed by explanation on the impact of these dimensions on the management of people.

DIMENSIONS OF NATIONAL CULTURE

The four dimensions of national culture developed by Hofstede are further conceptualised by Griffin and Pustay (2007), who assert that these dimensions are not absolutes as there are people within the cultural grouping who are at every point on each dimension. Selected people management issues that are impacted by the dimension are presented below. (Griffin & Pustay, 2007; Milliman, Nason, Zhu, & De Cieri, 2002.)

Collectivism	**Individualism**
• Nepotism may be normal hiring practice;	• Nepotism is frowned upon;
• Compensation system reflects the group, not personal achievements.	• Compensation according to individual achievements.
Power Respect	**Power Tolerance**
• Salary reflects seniority;	• Salary is merit/individual oriented;
• Seniority differentiates employees in the organisational hierarchy.	• Employees are differentiated through performance appraisal.
Uncertainty Avoidance	**Uncertainty Acceptance**
• Life time employment;	• Higher job mobility;
• Promotion based on length of service.	• Promotion based on performance.
Passive Goal Behaviour	**Aggressive Goal Behaviour**
• Higher Salary;	• More fringe benefit;
• Social performance is highly regarded.	• Performance based on work output.

For Consideration

A foreign firm is about to open an operation in your country. Advise this firm on HR issues affected by your country's contextual factors: economic, education, culture and legal/political systems.

Discuss the cultural orientations of a country in which your organisation has an international presence and the HR implication that it has to deal.

The Contingency Model for International HRM

Given the differences of contextual factors in various countries, it is useful for managers to develop contingency-based HRM practices that meet the need of the local workers. Thus specific HRM activities, such as recruitment and selection, training, and labour relations, can be analysed contingently on a country-by-country basis (Hodgett, Luthans & Doh, 2006), as shown in Figure 7. HRM practices in Germany, Japan and China are used as examples.

Figure 7.4: A Contingency Matrix for International HRM

	Japan	Germany	China
Recruitment and selection	• Prepare for long process; • Ensure that your firm is 'here to stay'; • Develop trusting relationship with recruit.	• Obtain skilled labour from government subsidised apprenticeship program.	• Recent public policy shifts encourage use of sophisticated selection procedures.
Training	• Make substantial investment in training; • Use general training and cross-training; • Training as everyone's responsibility.	• Reorganise and utilise apprenticeship programs; • Be aware of government regulations on training.	• Careful observations of existing training programs; • Utilise team training.
Compensation	• Use recognition and praise as motivator; • Avoid pay for performance.	• Note high labour costs for manufacturing.	• Use technical training as reward; • Recognise egalitarian values; • Use 'more work more pay' with caution.
Labour relations	• Treat unions as partners; • Allow time for negotiations.	• Be prepared for high wages and short work week; • Expect high productivity from unionised workers.	• Tap large pool of labour cities; • Lax labour laws may become more stringent.
Job design	• Include participation.	• Utilise works councils to enhance worker participation.	• Determine employee's motives before implementing participation.

Source: Hodgetts, Luthans and Doh, 2006

For Consideration

Find a colleague or classmate who has a different national background than yours. Work together with this colleague and draft a contingency matrix using the HRM practices in your and his or her country. HRM practices may include selection, recruitment, training, compensation, and performance management.

The Purpose of Expatriation

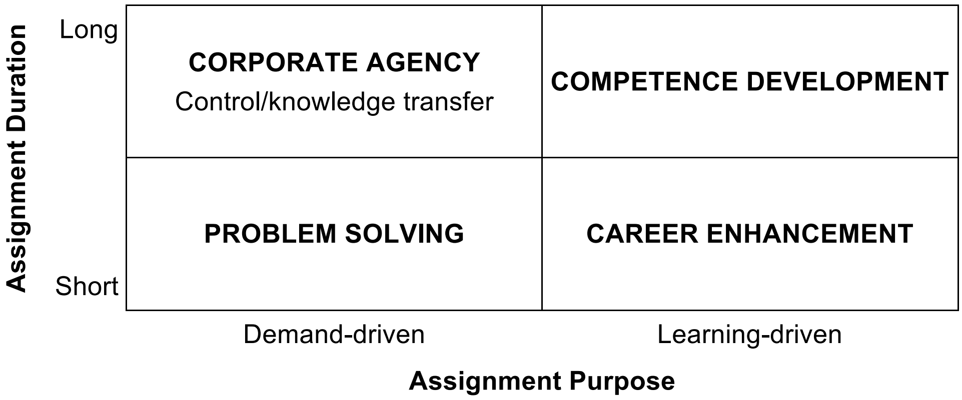
One of the strategic decisions that managers in international firms may make is sending expatriates for international assignments. To enhance the effectiveness of the assignments and help with planning, it is important to be fully aware of the purpose of the assignments and the role of expatriates whilst abroad.

Evans, Pucik and Barsoux (2004) argue that there are three reasons that drive expatriation:

- **to fill positions** – usually due to the lack of technical or managerial skills in the foreign location;
- **management development** – to provide international experience to high potential employees;
- **organisational development** – for control and coordination of international operations.

The length of time spent abroad is generally linked to the purpose of assignments. Figure 7-5 shows the framework developed by Evans, Pucik and Barsoux (2004) that can be used to clarify the nature of expatriate roles in relation to the purposes of the assignment.

Figure 7.5: The Purpose of Expatriation Model



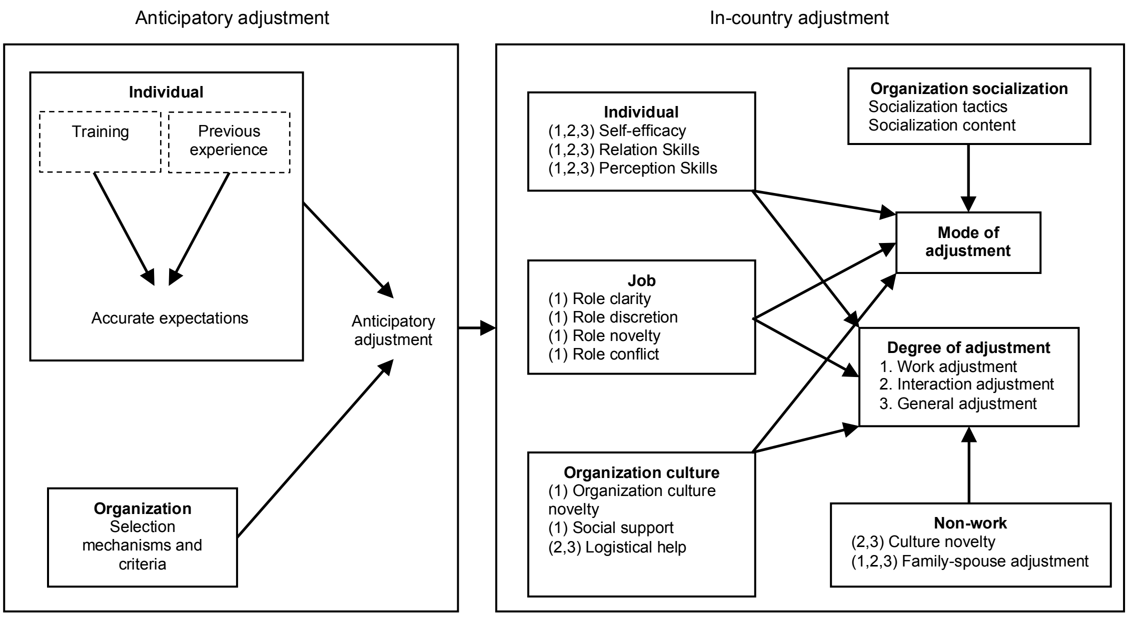
Source: Evans, Pucik, Barsoux, 2002, p. 119

Model of International Adjustment

A model of expatriate adjustment proposed by Black, Mendenhall and Oddou (1991) is useful in helping managers to understand factors that influence adjustment in international assignments. As shown in Figure 7.6 there are two determinants of adjustment in the Model:

- '**Anticipatory adjustment**' is adjustment in the period before departure that consists of individual and organisational factors;
- Adjustment taking place in the host country, or '**in-country adjustment**' includes factors related to individual, job, organisation culture and organisation socialisation. The degree of adjustment is influenced by factors such as job, organisation culture and non-work which include family-spouse adjustment.

Figure 7.6: Model of International Adjustment*



* Numbers in parentheses indicate the number of facet(s) of adjustment to which the specific variable is expected to relate

Source: Black, Mendenhall and Oddou, 1991, p. 303

One of the strategies to overcome problems with international adjustment is by instituting a training and development program for international managers. A planning model for the development of multinational managers includes dealing with adjustment in foreign country by expatriates as well as adjustment to own country when expatriates return to their own country (repatriation) (Hodgett, Luthans and Doh, 2006).

There are nine phases of development activities:

Phase 1: set the overall objective of the program that is to increase the effectiveness of expatriate or repatriated executives;

Phase 2: recognise the problems that must be dealt with in order to reach the overall objectives;

Phase 3: identify the development objectives;

Phase 4: determine the amount of development that will be needed regarding each of these objectives;

Phase 5: choose the specific methods to be used in the development process from types or pre-departure training to language instruction to re-entry training;

Phase 6: conduct an intermediate evaluation of how well things are going and the institution of any needed midstream corrections;

Phase 7: evaluate of how well the expatriate managers are doing, thus providing evaluation feedback of the development process;

Phase 8: establish re-entry training for returning expatriates;

Phase 9: evaluate the effectiveness of the executives after they have returned.

(Source: Adapted from Hodgett, Luthans & Doh, 2006)

HRM Tools for Implementing Global Integration

One of challenges in international operations concerns the way global integration can be achieved. Based on the theory of control, Evans et al. (2002) suggest three ways of implementing globally integrated strategies. Each way is connected to specific HRM tools and techniques:

- the alignment of decision making between subsidiaries and parent company;
- the standardisation of processes;
- the socialisation of key individuals to ensure global orientation.

Alignment

The alignment of decision making ensures that global perspective is reflected in subsidiary operations. There are two ways to achieve this alignment:

- maintain global standards through expatriate staffing who will socialise the company norms;
- performance management systems that measure both employee performance and subsidiary performance.

Standardisation

International firms concern with standardisation of processes to achieve both efficiencies and uniform performance in the delivery of product and services. This can be accomplished through:

- education and training;
- transplanting the work system through practices such as worker participation in problem solving and job rotation.

Socialisation

Socialisation involves inculcating organisational culture which can be achieved through:

- recruitment activities in subsidiaries that include selection of people that ‘fit well here’, and formal and informal induction process;
- expatriation or international transfer.

For Consideration

Identify the HRM approach to implement global integration in your organisation or an organisation that you know of.

Ethics and Social Responsibility

The issues of ethics and social responsibility in international business operations are complex as the issues relate to principles adhered both by firms in the home country and the cultural and social norms of the host country. Practices such as corruption, bribery, and workers’ rights involve ethical issues in international business.

Actions to Achieve the Goal of Social Responsibility

Managers or HR professionals that are involved in international operations may need to take the following actions to achieve the goal of corporate social responsibility:

- assist in the development, publication, and implementation of appropriate codes of conduct to minimize the exposure of employees to corrupt conduct;
- include ethical concern, such as bribery and human rights, in the training program consistent with the company's objectives;
- align performance appraisal and compensation systems to include the company's position on ethical issues;
- familiarise staff on international assignments about ethical issues and provide the necessary training on negotiating skills to deal with the problem situations.

(Dowling et al., 2013)

For Consideration

What is your view on these responses on ethical issues? Discuss with your colleagues.

How does your organisation deal with ethical issues in their international operations?

NATIONAL LEVEL DIFFERENCES

For MNEs, understanding national level differences in the labour-management relations or industrial relations systems. Generally, labour union memberships numbers around the world have dropped, however, as Figure 7.7 shows, there are many countries where majority of the workforce are union members.

Figure 7.7 Percentage of workers who belong to trade unions, 1999 and 2011

Country	1999	2011
Australia	24.9	18.1
Canada	28.1	26.8
Denmark	74.9	68.5 (2010 figure)
Finland	76.3	69
France	8.1	7.8 (2010 figure)
Germany	25.3	18
Greece	26.8	25.4
Italy	35.4	35.6
Japan	22.2	18.1
S. Korea	11.7	9.9
Netherlands	24.7	18.2
New Zealand	21.7	20.8
Norway	54.8	54.6
Poland	20.5	14.6 (2010 figure)
Spain	16	15.6 (2010 figure)
Sweden	80.6	67.5
Turkey	10.6	5.4
United Kingdom	30.1	25.6
United States	13.4	11.3

Source: OECD Statistics 2013 (stats.oecd.org).

Industrial action in a country can affect a firm's operations with delays to deadlines. Strikes and other delays are calculated by multiplying the number of hours lost by industrial action with the number of workers on strike. This is referred to as "working days lost". Figure 7.8 shows the number of working days lost due to industrial action in selected countries.

Figure 7.8: Average annual days not worked due to labour disputes, 1998–2008 (per 1000 employees)

Country	***Days***
South Africa	214
Canada	183
Spain	121
Finland	57
Australia	35
Ireland	29
United States	28
United Kingdom	23
Sweden	18
Turkey	13
Mexico	9
Netherlands	8
Russia	7
Germany	4
Japan	2

Source: The International Labour Organization (ILO), www.ilo.org.

SUMMING UP

This Topic discusses important issues in the management of people in international business. The discussion on factors that moderate differences between domestic and international HRM set the scene for this Topic. Frameworks and models on contextual factors affecting HR issues, contingency matrix, and international adjustment, and tools for implementing global integration were discussed. People issues on the practice of ethics were highlighted and the related actions to deal with the issues recommended.

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