# CHAPTER 1

# MULTINATIONAL MANAGEMENT IN A CHANGING WORLD

## Learning Objectives

* Define multinational management
* Understand the characteristics of a multinational company
* Understand the nature of the global economy and the key forces that drive globalization
* Know the basic classification of the world’s economies
* Identify the characteristics of the next generation of multinational managers

## Introduction

* The global business environment is facing unprecedented changes
  + New multinationals from emerging markets in Brazil, Russia, India, and China (BRIC) are using innovative strategies to compete effectively with their established counterparts in developed countries
  + The nations of Colombia, Indonesia, Mexico, Poland, and Malaysia all present attractive conditions for growth. Widespread internet use and high population levels represent ideal conditions for investment
  + In Africa, an emerging middle class, relatively young populations, significant regulatory changes, and the growth of cross-border trade are making many nations increasingly attractive to investors
* Businesses of all sizes increasingly see the entire world as a source of business opportunities
* The world is becoming one connected economy
* Any company from any country can become a competitor
* The internet crosses national boundaries
* A company’s success in their home market doesn’t always equate to long-term profitability
* There are significant opportunities for most companies despite challenges and threats such as terrorism, wars, and recessions.
* Managers of the next century will need to be multinational in outlook and strategies
* Students of business should have at least a basic background in multinational management
* Multinational management – the formulation of strategies and the design of management systems that successfully take advantage of international opportunities and that respond to international threats

## The Nature of the Multinational Company

* Multinational company (MNC) is broadly defined as any company that engages in business functions beyond its domestic borders
* Most multinational companies are also multinational corporations; that is, publicly owned through stocks
* What kinds of activities might make a company multinational?
* The most apparent activity is international sales
* Crossing national borders opens up more international options than simply selling internationally

**Exhibit 1.1 Largest Companies in the World**

*(Lists the top 20 multinational corporations ranked by sales revenue)*

**Exhibit 1.2 Newcomers to Global 500 List**

*(Shows the list of newcomers and their country of origin)*

## The Globalizing Economy: A Changing (but Not Always Stable) Environment for Business

* Globalization – the worldwide trend of cross-economic integration that allows businesses to expand beyond their domestic boundaries.
* Trade barriers are falling
* World trade among countries in goods and services has grown faster than domestic productions
* Money is flowing more freely across national borders
* Downsides of Globalization
* Not a uniform evolutionary process, and not all economies benefiting or participating equally
* Terrorism, wars, and a worldwide economic stagnation limit or reverse progress
* Worrisome effects such as scarcity of natural resources, environmental pollution, negative social impacts, and increased interdependence of the world’s economies
* Widening of gap between rich and poor countries
* The Benefits of Globalization
* Lower prices in many countries as multinationals become more efficient
* Benefiting many emerging markets such as India and China as these countries enjoy greater availability of jobs and better access to technology
* The major reason why many new companies from Mexico, Brazil, China, India, and South Korea are the new dominant global competitors
* Several key trends driving globalization of the world economy and driving businesses to become more multinational to survive and prosper
* Falling borders
* Growing cross-border trade and investment
* Rise of global products and global customers
* Growing use of Internet and sophisticated information technology
* Privatization of formerly government-owned companies
* New competitors emerging in the world market
* Rise of global standards in quality and production

### Countries of the World: The Arrived and the Arriving

**Exhibit 1.3 Selected Economies of the World**

*(Shows some divisions of the world economies based roughly on classifications used by the United Nations and* The Economist*)*

* Developed countries – countries with mature economies, high GDPs, and high levels of trade and investment
* Developing countries – countries with economies that have grown extensively in the past two decades (i.e. Hong Kong, Singapore, and Taiwan)
* Transition economies – countries in the process of changing from government-controlled economic systems to capitalistic (i.e., Central & Eastern Europe – Czech Republic, Hungary, Poland, and Russia)
* Emerging markets – countries that are currently between developed and developing countries and are rapidly growing (i.e. India, China, Brazil, and Russia)
* The term *emerging markets*, coined by the World Bank around 25 years ago, represents those markets that present tremendous opportunities for all multinationals
* Emerging markets now account for 30 percent of exports, compared to only 20 percent in 1970
* Recent trends also show that developed countries’ trade with emerging markets has been growing twice as much compared to trade with each other7
* While emerging markets such as Brazil, Russia, India, and China (BRIC) are now experiencing a significant slowdown in growth, they are still expected to grow at a much faster pace than developed economies
* The slowdown of growth in the BRIC nations has focused attention on upcoming nations, such as Colombia, Indonesia, Kenya, and Malaysia10

**Exhibit 1.4 Age Breakdown of Selected Economies**

*(Shows the age breakdown of the population of these nations)*

**Exhibit 1.5 The Globalizing Economy**

*(Illustrates the driving forces of the new world economy)*

### Disintegrating Borders: The World Trade Organization and Free Trade Areas

* General Agreement on Tariffs and Trade (GATT) – tariff negotiations among several nations that reduced the average worldwide tariff on manufactured goods
* Beginning in 1947, negotiations began which ultimately reduced average tariffs on manufactured goods from 45% to less than 7%
* World Trade Organization (WTO) – a formal structure for continued negotiations to reduce trade barriers and a mechanism for settling trade disputes
* Continued negotiations in Uruguay from 1986 – 1993 established the WTO
* There are over 150 nations now in the WTO, including 29 of the UN-classified least developed countries. Thirty more countries, including Russia, seek WTO membership
* In March 1997, trade ministers from countries representing 92% of world trade in IT products agreed to end tariffs on trade in software, computer chips, telecommunications equipment, and computers
* The immediate result was that, with tariffs eliminated, high-tech exports to Europe from Asia and the United States doubled
* Developing countries also benefited, as prices began to go down on products such as phones, faxes, and computers produced in tariff-free locations13
* The Doha Round represents the most significant trade negotiations since the WTO was established
* The trade talks of December 2013 resulted in the ‘Bali Package,’ leading to trade facilitation via simplified customs procedures and duty-free, quota-free access for least developed nations to export to wealthier nations
* Is free trade working?
* The WTO thinks so – data shows that world trade has grown at more than four times the world’s gross domestic product
* Critics argue that the WTO favors more developed nations because poorer nations have more difficulty competing in an unregulated environment
* Environmentalists argue that commercial interests have priority over environment, health, and safety
* Labor unions warn of migration of jobs to lower-wage countries
* Regional trade agreements – agreements among nations in a particular region to reduce tariffs and develop similar technical and economic standards (also called *free trade areas*)
* Such agreements have usually led to more trade among the member nations but are criticized for harming poorer nations who are left out of agreements
* The three largest groups – EU, NAFTA, and APEC – account for nearly half of the world’s trade
* European Union (EU) – includes 28 members, namely Austria, Belgium, Britain, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden.
* Since 1992, the EU countries allow goods and services to move across borders without customs duties and quotas
* EU adopted a unified currency called the Euro
* North American Free Trade Agreement (NAFTA) – a multilateral treaty that links the United States, Canada, and Mexico in an economic bloc that allows freer exchange of goods and services
* The Free Trade Area of Americas (FTAA) will expand NAFTA to include most of the other Caribbean, Central American, and South American nations
* Asia-Pacific-Economic Cooperation (APEC) – a confederation of 21 nations with less specific agreements on trade facilitation in the Pacific region. However, the ultimate goal calls for total free trade in the Pacific Region by 2020.

**Exhibit 1.6 Regional Trade Agreements Around the World**

*(Shows all the major regional trade agreements and their member countries)*

### Sell Anywhere, Locate Anywhere: Trade and Foreign Investment are Growing but Setbacks Are Part of the Challenge

* World trade among countries (imports and exports) grew at an average rate of 6.5% per year between 1990 and 2000, but slowed to 4% by 2004, and grew again to 6 percent in 2005
* World trade grew by 8.5 percent in 2006
* The latest available figures suggest that trade subsequently slowed down due to the economic recession, remaining sluggish in 2013, and will likely to continue to be lethargic in 2014
* The latest report from the WTO suggests the following trends:
* Emerging markets continue to show dramatic trade growth, thereby reducing income inequality between countries and increasing general well-being factors in these countries
* Developing nations have played a more important role in international production networks known as Global Value Chains (GVC)
* Commodities such as energy and minerals have doubled between 2003 and 2008, and countries are finding they can develop growth strategies based on commodities
* Macroeconomic shocks seem to affect all countries
* Foreign Direct Investment (FDI) – multinational firm’s ownership, in part or in whole, of an operation in another country
* FDI, or cross-border ownership, occurs because multinational companies build global networks that link R&D, supply, production, and sales units around the globe
* FDI soared between 1996 and 2000 but had been declining, in part due to the declining rate of mergers and acquisitions
* Despite these declines, the importance of emerging markets is reflected in the growth of FDI in these economies
* After further declines in 2003, FDI then grew to its highest level in 2007; since 2007, FDI has seen both growth and declines25
* The latest data suggests that global FDI flows increased significantly the last two quarters of 2014 by 9% relative to the first half of that year
* Developing countries provide great opportunities, but pose significant risk
* Two types of risk
* Political risk – anything a government might do (or not do) that might adversely affect a company
* Economic risk – all factors of a nation’s economic climate that may affect a foreign investor

### The Internet and Information Technology Are Making It All Easier

* Companies and individuals can shop and sell anywhere because anyone in the world can access any Web site.
* Electronic communication vehicles allow communication around the world, and information technology expands the global reach of an organization
* Organizations are becoming virtual – linked by networks of computers
* Information technology is also spurring a borderless financial market
* Information technologies make available many new tools that facilitate business operations
* Developments in computing technology will eventually enable the manufacturing sector to move to highly automated machine tools, operated by computer
* The development of the 3D printer will allow prototypes to be printed easily and cheaply, allowing engineers, stylists, and even customers to collaborate with minimal costs

### The Rise of Global Products and Global Customers

* Needs of customers for many products and services are growing more similar
* Global customers search the world for their supplies paying attention to price and quality without regard for national boundaries

### New Competitors are Emerging

* Current trends suggest that two new forms of competitors are having dramatic influences on global business:
* Powerful emerging market competitors using new techniques and strategies to compete successfully in their local markets
  + Formidable state competitors—companies that are often well run but can also rely on the state for financial support; some state multinationals have also invested aggressively in other countries and have been active in industries beyond oil and energy

### The Rise of Global Standards

* Increasingly, especially in technical industries, global product standards are common
* Why? Cheaper to produce fewer product versions, gains in product design efficiencies
* The company that can establish its standard as dominant will have a tremendous strategic advantage
* Consistency in quality has also become a requirement to do business in many countries
* ISO 9001:2000 – the current name for the technical and quality standards of the International Organization for Standardization (ISO) in Geneva, Switzerland
* ISO 14000 – the current name for the environmental protection standards of the International Organization for Standardization
* In 1992, ISO compliance became part of product-safety laws in many European countries

***Corporate Social Responsibility and Business Ethics***

* Multinationals are under increased scrutiny by both the media and the public to be socially responsible.
* Companies that do not pay attention to issues such as climate change, environmental degradation and pollution, sweatshop conditions, and bribery can suffer significant loss in terms of both reputation and finance.
* Ethics rankings, such as the annual survey of the world’s most ethical corporations as produced by Geneva-based Covalence, are important to multinationals

**Exhibit 1.7 Ethisphere’s Most Ethical Companies (by Industry and Nationality)**

*(Shows the list of the top most ethical companies as determined by the Ethisphere Institute)*

## The Next Generation of Multinational Managers

## The next generation of successful multinational managers must have the following characteristics:

* *Global mindset* – mindset that requires managers to think globally, but act locally
* *Emotional intelligence* – the ability to manage one’s emotions prepares the manager to better adjust to and deal with new cultures and people
* *A long-range perspective* – successful companies must be persistent if they are to overcome the complexities of dealing with the international environment
* *The talent to motivate all employees to achieve excellence* – always a hallmark of leadership, they will also need to develop motivational strategies that transcend cultures
* *Accomplished negotiating skills* – leaders in the global economy will spend considerable time negotiating cross-culturally
* *The willingness to seek overseas assignments* – they will demonstrate management skills and success in more than one cultural environment
* *An understanding of national cultures* – multinational managers will often need to learn two or more additional languages as well as the nuances of local cultural differences
* *Three forms of capital*:
* *Intellectual capital —* the general willingness to learn and build one’s knowledge base regarding cultural differences and how to adapt to such differences
* *Psychological capital* —the ability to be receptive to new ideas and experiences
* *Social capital* — the ability to develop networks of individuals who are different from one’s self

**Exhibit 1.8 Forms of Capital Needed to be a Successful International Leader**

*(Shows some ways to build the intellectual, psychological, and social capital needed to succeed as an international leader)*

## Multinational Management: A Strategic Approach

* Why should you study multinational management? Foreign competition and doing business in foreign markets are daily facts of life for today’s managers.
* Multinational managers must take a strategic approach to multinational management, namely how they formulate and implement these strategies
* Strategy – the maneuvers or activities that managers use to sustain and increase organizational performance
* Strategy formulation – process by which managers select the strategies to be used by their company
* Strategy implementation – all the activities that managers and an organization must perform to achieve strategic objectives
* Strategies must include maneuvers that consider multiple countries and cultures, as well as opportunities and competition located anywhere in the world
* Several trends will shape the future business environment
* *Blurring of industry boundaries* – information and other communications technologies make industry boundaries less clear, and harder to identify and understand competitors
* *Flexibility matters more than size* – increased outsourcing, alliances, and partnering allow conversion of fixed costs to variable costs, making scale less useful
* *Finding your niche* – companies are finding they can do well by finding and satisfying the needs in a niche, as opposed to being the leader in their respective industries
* *Hypercompetition* – the new environment is characterized by intense competition coming from companies located in all parts of the world
* *Emphasis on innovation and the learning organization* – multinationals will need to develop the appropriate mechanisms and systems to integrate the local knowledge to produce value for the company
* Multinationals will need new strategies to compete with emerging market multinationals and will need to avoid the following traps:
* Ignoring the low- and middle-market segments
* Failing to fully commit when entering emerging markets
* A fundamental assumption of this book is that successful multinational management requires managers to understand their potential competitors and collaborators
* This text devotes several chapters to comparative management – the comparison of management practices used by people from different nations

## Exhibit 1-9 Differences Betwdeen Emerging Market Multinationals and Traditional Multinationals

*(Shows how each type of multinational addresses various aspects of success in markets)*

## Summary and Conclusions

* This chapter covered the following items:
* Key background information that supports the study of multinational management
* Definitions of multinational management and the multinational company
* Forces that drive globalization
* Key characteristics of successful multinational managers
* Global mindset is perhaps the most encompassing characteristic of successful multinational managers.
* After reading this text, you should have the foundation for understanding the latest challenges and practices of multinational management.

***Answers to In the News Questions From MindTap***

**Chapter 01: You're Still Welcome: Foreign Firms in China**

1. This case discusses the case of India and the potential impact of the new government's reforms on the future of India. The case discusses some of the factors that have prevented India from growing faster while also emphasizing the need for reforms. Answer the following questions:

Why have foreign firms have a difficult time in China? What are some of the major factors that make doing business in China difficult?

Suggested Answer: Answers will vary. Growth in China is officially slowing down. Data states that the growth rate is the slowest in 24 years in China. China has led an anti-corruption drive that has made it difficult for anyone seeking government employees willing to look the other way. Pharmaceuticals and other firms that had hoped their "guanxi" or connections offered them protection from competition but that has not been the case. China has, in the past, set up a system of restrictive and complex rules highlighting how multinationals can invest there. Under some of these rules, foreign companies investing in industries deemed "strategic" for the government can only invest using a joint venture and must transfer the technology involved to the local partner. This makes it difficult for foreign firms to do business in China.

2. What are some of the proposed reforms? How will these reforms make it easier for foreign firms to do better?

Suggested Answer: Answers will vary. The proposed reforms promised the global business elite that China would treat Chinese and foreign companies as equals and reject protectionism by easing its restrictions on foreign investment. The draft reforms, which are now open for comment, would include scrapping most of these restrictions. Additionally, foreign firms would be treated the same way as the national ones rather than the current system of case-by-case approvals. This will be replaced by a simpler "negative" list, which will help investors know which particular industries are viable to invest in or not.

3. Why would local firms still have an advantage despite these reforms? What does that tell you about doing business in other countries?

Suggested Answer: Answers will vary. The proposed reforms, while indicating that foreign investment will still be welcome in China, there is very little that they can do to help multinationals compete with well-connected domestic companies. This is due to the subsidies favoring Chinese companies and restrictions on foreign ownership of sectors such as Internet providers and finance. This shows us that other countries are happy to accept capital but are protective of nationally important areas of business.

**Chapter 01: Feeling Green: The Mighty Dollar**

1. This article discusses the rise of the dollar and the problematic impact it places on many countries. Discuss the following questions:

Why is the dollar's rise so problematic for many countries?

Suggested Answer: Answers will vary. Globally, the dollar has a huge impact on the economies of many countries. Most of this impact comes from borrowings by companies outside the United States of America. The dollar rate should increase in value due to an increased growth rate in the US. When the Federal reserve raises its rate on debts, which is expected, the debts associated with the dollar will increase in value, making it more problematic for companies outside the US to pay back their debts.

2. What role do currencies play in terms of global trade?

Suggested Answer: Answers will vary. Globally, currencies have different values, which allow capital to flow from country to country. Stronger currencies are used more often in international trade. Most of the international trade takes places in dollars, with the biggest growth being in emerging markets.

**Chapter 01: A Chance to Fly: India's Economy**

1. This case discusses the case of India and the potential impact of the new government's reforms on the future of India. The case discusses some of the factors that have prevented India from growing faster while also emphasizing the need for reforms. Answer the following questions:

What are some of the factors that show that India has lots of promise to shine among the emerging market economies?

Suggested Answer: Answers will vary. Nearly half of India's 1.25 billion population is under 25, poor, and possess an entrepreneurial spirit. Prime Minister Narendra Modi and the Bharatiya Janata Party won the recent elections on the back of a promise of an economic revitalization. They promised reforms across the board making India more financially stable and less corrupt. In addition to this, the International Monetary Fund (IMF) has been showing a progressive increase in India's growth rate. These are some of the factors that shows India's promise among the emerging market economies.

2. What are some of the factors that are preventing India from achieving its full potential? Why was China able to achieve such economic growth more easily than India?

Suggested Answer: Answers will vary. India has to encourage reforms in nearly every sector of its governance if it aims to achieve its full potential. China's rise to global economic heights was due to manufacturing for exports. India, while not able to follow in China's footsteps, can achieve this growth by balancing its surplus of unskilled labor by focusing on educating them and providing labor for service sectors like information technology. There is also the question of providing widespread political reform and a strong anti-corruption stance to weed out the harmful aspects that slow down India's economic growth.

3. What are some of the tough reforms that India has to go through in order to succeed?

Suggested Answer: Answers will vary. There a lot of reforms that India needs in order to succeed. One of these is a reform on how electricity and electricity generation need to be improved to meet larger demands. A lack of power hurts India's economic potential. The majority of state and national laws in India are nebulous when it comes to taxes, labor, and licensing. A unifying law for the entire country would be able to encourage more trade and growth. A lot of archaic and arcane laws that are outdated need to reviewed, changed, or removed. Lastly, the purchase of land is a complex situation and needs to be free of political influence before it can be legally streamlined.