MANAGING IN A GLOBAL ECONOMY

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The London Institute of Banking & Finance

MANAGING IN A GLOBAL ECONOMY

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INTRODUCTION

WELCOME

SIGNPOSTS THROUGHOUT THE COURSE BOOK

This course book contains the core content for this course. Additional learning materials can be found on the learning platform, but this course book should form the basis for your learning.

The content of this course book is divided into units, which are divided further into sections. Each section contains only one new key concept to allow you to quickly and efficiently add new learning material to your existing knowledge.

At the end of each section of the digital course book, you will find self-check questions. These questions are designed to help you check whether you have understood the concepts in each section.

For all modules with a final exam, you must complete the knowledge tests on the learning platform. You will pass the knowledge test for each unit when you answer at least 80% of the questions correctly.

When you have passed the knowledge tests for all the units, the course is considered finished and you will be able to register for the final assessment. Please ensure that you complete the evaluation prior to registering for the assessment.

Good luck!

REQUIRED READING

UNIT 3

Chitakornkijsil, P. (2009). Communication in global cultural teams and international communication challenge. *International Journal of Organizational Innovation, 1(*4), 102–112.

Sağ, S., Kaynak, R., & Sezen, B. (2016). Factors affecting multinational team performance. *Procedia – Social and Behavioral Sciences, 235*, 60–69.

UNIT 4

Makino, S. (2014). Three important perspectives for understanding national context. In J. J. Boddewyn (Ed.), *Multidisciplinary insights from new AIB fellows* (pp. 79–114). Bingley: Emerald Group Publishing.

UNIT 5

Acar, P., Gürbüz, F. G., & Yener, M. İ. (2015). The discovery of HR from strategy-as-practice perspective: A case study in durable consumer goods industry. *Procedia - Social and Behavioral Sciences, 207*, 325–334.

Gholba, A., & Dyaram, L. (2016). Unlocking the value of developing leaders: Towards global leadership. *Proceedings Of The European Conference On Management, Leadership & Governance*, 129–137.

Mathews, J. (2016). Toward a conceptual model of global leadership. *IUP Journal Of Organizational Behavior*, *15*(2), 38–55.

UNIT 8

Hentschel, B., Domański, R., Adamczak, M., Cyplik, P., Hadaś, L., Kupczyk, M., & Pruska, Z. (2015). Ranking of integration factors within supply chains of forward and backward types—Recommendations from researches. *LogForum, 11*(2), 161–169.

Steven, C. (2016). Consequences of IFRS for capital markets, managers, auditors and standard-setters: An introduction. *Accounting and Finance, 56*(1), 5–8.

LEARNING OBJECTIVES

Globalization can be seen as the trend towards furthering interconnectedness between countries, societies, cultures, and economies. **Managing in a Global Economy** explores various management issues that are affected by increased international business activities. It discusses the context of global operations and describes the cultural diversity that managers face in international business. It also addresses strategizing processes and explores strategies for choosing individuals with the ability to work successfully in foreign surroundings. Furthermore, the most important operational issues such as marketing and organization are discussed in order to illustrate the challenges and risks of global business. The course aims to enable students to assume leadership positions in corporate internationalization processes.

UNIT 1

INTRODUCTION TO MANAGING IN A GLOBAL ECONOMY

STUDY GOALS

On completion of this unit, you will have learned …

– the meaning of key expressions in the field of global business management.
– the recent trends in international business.
– why there is a trend towards international business models.
– the basics of important theoretical explanations for globalization processes.

1. INTRODUCTION TO MANAGING IN A GLOBAL ECONOMY

Introduction

GLOBALIZATION: A REALITY BEYOND IDEOLOGY

In today's interdependent global economy, an American can drive to work in a car designed in Germany that was assembled in Mexico by Ford from components made in the United States and Japan that were fabricated from Korean steel and Malaysian rubber. She may fill the car with gasoline at a BP service station owned by a British multinational company. The gasoline could have been made from oil pumped out of a well off the coast of Africa by a French oil company that transported it to the United States in a ship owned by a Greek shipping line. While driving to work, the American might talk to her stockbroker on a Nokia cell phone that was designed in Finland and assembled in Texas using chip sets produced in Taiwan that were designed by Indian engineers working for Texas Instruments. She could tell the stockbroker to purchase shares in Deutsche Telekom, a German telecommunications firm that was transformed from a former state-owned monopoly into a global company by an energetic Israeli CEO. She may turn on the car radio, which was made in Malaysia by a Japanese firm, to hear a popular hip-hop song composed by a Swede and sung by a group of Danes in English, who signed a record contract with a French music company to promote their record in America. The driver might pull into a drive-through coffee shop run by a Korean immigrant and order a "single, tall, nonfat latte" and chocolate-covered biscotti. The coffee beans came from Brazil and the chocolate from Peru, while the biscotti were made locally using an old Italian recipe. After the song ends, a news announcer might inform the American listener that anti-globalization protests at a meeting of the World Economic Forum in Davos, Switzerland, have turned violent; one protester being killed. The announcer then turns to the next item, a story about how the financial crisis, which started in the United States banking sector, might trigger a global recession sending stock markets down all over the world.

Source: Hill 2011, p. 4.

Globalization has undeniably become a matter of fact in our lives today. Despite understandable criticism of ethical misconduct occurring in international business, it is necessary to realize that globalization is a reality for all of us. Therefore, the question is not whether globalization is desirable but rather how to manage successfully in a business environment that is increasingly marked by international cooperation. This course will focus on the challenges facing managers in these processes.

1.1 What is Globalization?

Globalization has become a widely discussed topic today. Since globalization is a matter of controversy, it will come as no surprise that, so far, not one single definition has been commonly accepted among scholars and the public. At the very least, it can be stated that globalization describes the increasing interconnections of economies and societies worldwide. Nevertheless, beyond this very broad description, viewpoints vary considerably, depending on the underlying perspective of the academic discipline defining this term. Business people may focus on the increasing cross-border trade of goods and capital, while political scientists would prefer to look into the impact of globalization on national governments. Social scientists are interested in the cultural and societal influences emerging from globalization trends, while scholars from the field of international relations would most likely want to discuss the development of global institutions (Wall/Minocha/Rees 2010).

In order to approach a common understanding of **globalization**, we will gather the important aspects that are contained in this term. In the process, we will summarize a range of definitions provided by scholars. With respect to the key elements of various definitions, our summarized version is intended to capture a broad range of insights into globalization (Wall/Minocha/Rees 2010) including:

Globalization
Globalization is the increasing interconnectedness of societies and economies worldwide.

- cultural and political forces
- increasing interconnection between societies and economies
- integration of economic processes and information transfer on a global level and beyond national boundaries
- shrinking political influence of national governments
- a shift from national and regional to fully integrated global markets
- increasing homogeneity of societies and markets worldwide with considerable impact on local cultures

Without doubt, the business sector is affected by globalization. Let us investigate what kind of companies are actually contributing to the development of globalization. These companies can be broadly defined as 'international companies' and include all businesses operating across national borders. This can vary from simply buying or selling abroad to becoming a truly multinational company (Hill 2011). Various strategies of engaging in international business will be discussed later in this course.

Globalization in Practice

Global markets have developed in different ways. It is generally anticipated that over a certain period of time standardized goods and services naturally gain importance in an increasingly interconnected market. However, improved marketing research has led to a greater differentiation and segmentation of local markets than was previously the case. At the same time, technological progress has provided the opportunity to adapt products to the different markets. Consequently, many industries are now in a position to tailor their goods to the needs of consumers.

Similarly, globalized production has become reality in almost every industry. The reasons for internationalizing production vary considerably. Often, low relative unit labor costs play a key factor, however other circumstances are equally important. Operating independently from only one location, embedded in its political and economic environment, plays a role as well as desiring to move production closer to the sales markets or the source of raw material. In general, it can be stated that globalized production assists businesses in the early stages of internationalization prior to becoming fully integrated multinational companies. The latter require what is known as global thinking beyond national borders.

Relationship Between Globalization and Government

Finally, we will look at the relationship between globalization, and the autonomy and sovereignty of national governments. The increasing interconnectedness of economies, individuals, and societies worldwide has changed the role of a nation state significantly. Nowadays, national boundaries have, to some extent, lost their importance as a result of technological progress allowing a cross-border flow of information and capital.

It seems that nation states have lost competence and influence while to steer these processes. This can often be seen in legislation when national laws fail to sufficiently cover international business matters in areas such as legitimate taxation of multinational companies or liability issues in the case of international retailers distributing to almost any country worldwide or even relieving the tension in financial markets, which at times may harm an entire national economy. In many cases, the capacity of nation states to intervene and regulate is often restricted.

The trend towards a loss of competence is accompanied by a decline in the autonomy of nation states. The increase in global economic exchange has significantly changed the way formerly strong states treat internal and external issues. This can be seen, for example, in many developing countries where relatively weak nation states have identified the need to engage with foreign states and the huge sector of non-governmental organizations. The latter in particular have gained influence in recent years, steering a significant amount of political initiatives which had previously been a matter for the nation states only.

Given the trends thus described, the legitimacy of states is increasingly at risk—even in Germany. One strategy to undermine nation state autonomy has been to establish supranational organizations and multinational alliances, e.g. the European Community, the European Central Bank, the World Bank, and others. However, in the wake of the heated debate in Germany and other European countries, those developments have been questioned by many people who have become particularly sensitive concerning national issues, which, in many cases, are ruled on Europe-wide instead of on a domestic level.

In order to understand globalization, it is necessary to consider the main points of criticism raised by many activist groups. One complaint concerns the shift of jobs from developed countries to those that are economically underdeveloped. It seems that many companies have transferred production sites and jobs to low-cost locations in foreign countries. These companies are accused of making use of cheap labor abroad while firing

employees in their own country. It has also been suggested that, very often, working conditions abroad are miserable and payments are simply not sufficient to eke out a living. On the whole, there is a general belief that increasing poverty in developing countries is a result of powerful enterprises striving to maximise corporate profit. Moreover, low ecological standards and the absence of environment protection law enforcement has allowed companies to transfer the production of hazardous goods to countries in which they are able to operate without interference. Incidents such as the pollution of the Niger Delta in Nigeria by multinational oil companies are an example of this unethical behavior.

In order to generate even the smallest amount of revenue, poor countries often have no other option but to let these companies operate. At the same time, many of these companies put pressure on the governments to allow certain production processes, despite their harmful effects on the environment. These procedures correspond with an aspect discussed earlier in this unit: the potential decline in national sovereignty and autonomy. It can therefore be understood that labor and ecological standards need to be ratified on a global level in order to ensure that governments worldwide can keep up with global economic trends.

1.2 Facts about Globalization and the Global Economy

We will now look at developments and trends in global business (Wall/Minocha/Rees 2010). This should provide you with an understanding of the extent of international business transactions and the importance of globalization for national economies.

Economic Changes

On the whole, the past decades were marked by an increase in growth in international trade and investment. From 1980 to 2007, worldwide exports grew at an average annual rate of 5 %. In 2007, exports worldwide accounted for 31 % of the gross world domestic product (GDP). Moreover, developing countries have been able to increase their share in global exports, an encouraging sign showing that globalization offers the possibility of increasing economic integration and consequently reducing poverty. It is also evident that foreign direct investment has increased remarkably; between 1980 and 2007, it went up by a factor of five. Not surprisingly, cross-border mergers and acquisitions also rose by 700 % between 1990 and 2007.

Specific markets which were subject to liberalization during this time have contributed to this effect, e.g. financial services, telecommunications, and many more. The hundred largest multinational companies have experienced above-average growth of their foreign assets and their sales and workforces. Overall, value chains have been subject to globalization; today, multinational corporations source materials and produce and market products on a global level. Modern technology and telecommunications in particular have helped large companies manage their business across national borders and time zones.

All these developments are accompanied by a rapid growth in international currency transactions. Within three decades—from 1975 to 2005—daily turnover in currencies has increased by a factor of 150. This development can be seen in everyday life where currency trading as well as trading in stocks and commodities has become possible instantly using private computers and online bank accounts.

Political Changes

The globalization trend has required political and regulatory changes on both national and international levels. The trend towards increasingly international business activities is definitely not a new one. However, the collapse of the former communist regime and the end of the Cold War around 1990 opened up unprecedented opportunities for global growth. These economic trends have been accompanied (if not facilitated) by a liberalization of markets. The vast majority of regulatory changes carried out by national governments have been in favor of foreign direct investment. In addition, the world's economic landscape has changed. Previously dominated by North America and Europe, the world economy today relies heavily on the Southeast Asian region, with China being a driving force. The latter is likely to become the largest economy in the world. Other countries such as India, Indonesia, and Thailand are also expected to become economic world powers, while previously leading nations such as the US and Europe will fall behind. Therefore, it is no surprise that multinational companies are shifting their focus onto the regions with future potential.

Regional trading agreements have also increased in recent decades, allowing preferential treatment in terms of taxation and duties paid on trading activities within these regions. The European Community is a convincing example as it permits the free exchange of goods and services within the region. In addition, the common currency—the euro—has helped to save money previously spent on foreign exchange and exchange rate insurance. Other successful examples of regional trade agreements are the North American Free Trade Arrangement (NAFTA) and the Southern Africa Development Community (SADC).

Bilateral trading agreements serve the same purpose but exist only between two countries. These arrangements often facilitate foreign direct investments and help avoid double taxation. As important as these agreements are, they also discriminate against countries not included in the treaties. Furthermore, it is worth mentioning that, with the increasing number of bilateral agreements and membership in regional trading agreements, the complex regulations have become difficult to manage. This definitely applies to companies engaged in international activities as well as governments needing to ensure alignment between national laws, bilateral treaties, and regional arrangements.

Technological Changes

Major developments in technology in the last two decades can be considered another facilitator of globalization trends. Nowadays, information is readily available on the internet in literally every corner of the world. In addition, mobile phone services enable people to communicate on the go and are provided at comparatively low costs. These technologies have helped increase international business activities. Information concerning market trading, financial data, and currencies is instantly available, along with the opportu-

nity to immediately carry out transactions. All this is possible within seconds, as compared to days and even weeks in the past. It is no surprise that today multinational firms operate across continents, time zones, and cultural borders.

When it comes to international business, managers are often under great pressure. For example, a manager located in Berlin might receive phone calls from a Chinese branch at 3 a.m., then have to start his normal office day at 8 a.m. At 9 p.m. he may have to take phone calls from his American head office. Another example would be Chinese colleagues urgently requiring information on Christmas Eve, unaware that it is a religious holiday in Germany (as it is not celebrated in China). In February, conversely, when the New Year is celebrated in China and office work normally stops for about a week, a manager in Berlin might not be able to contact any of his Chinese colleagues. This example demonstrates the impact of technological changes on a 24/7 work schedule in global business.

Societal and Behavioral Changes

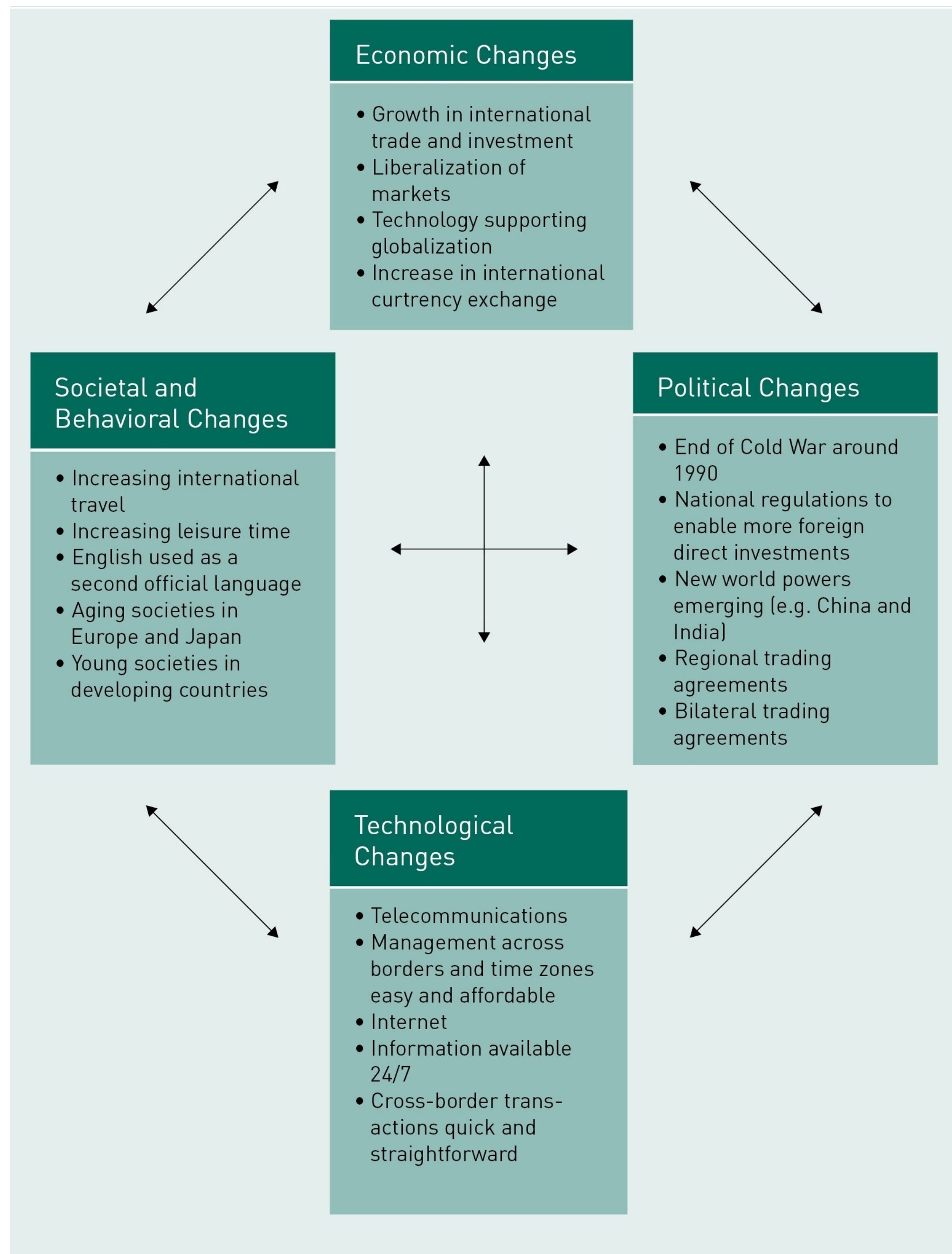
The trends described above have also influenced the way people travel. After World War II, the average German felt lucky being able to travel to Italy or Austria occasionally. Today, people travel around the world and can be seen in every corner of the globe. From 1980 to 2008, the number of international travelers rose annually from 260 million to 800 million.

One aspect contributing to this development is an increased amount of leisure time. In post-war Germany, working 48 hours over six days a week was not unusual for the working population. Nowadays, in many industries the weekly workload ranges between 35 and 40 hours. Moreover, paid leave has increased, with many sectors granting a minimum of 30 days per year.

With regard to the changing patterns in cross-border communication owing to technological changes, information is now exchanged in all parts of the world, leading to the dissemination and increase of English as a global language. Fifteen years ago, travelers to China had problems communicating in English and the road signs were only in Chinese characters, even in the major cities. Today, in cities such as Beijing and Shanghai, increasing numbers of people communicate in English and many road signs are now written in the Latin alphabet. Another significant demographic trend presently occurring worldwide is the increase in life expectancy and the shrinking of populations owing to improved medical treatment and disproportionate birth rates. Women in Europe and Japan are having fewer babies and the majority of the population in these areas is 60 and older, while many developing countries are confronted with a younger population owing to high birth rates and many people dying as a result of diseases such as HIV/AIDS. These developments and the fact that market demands vary considerably between young and aging societies mean that the focus on production and market activities is shifting.

The following diagram summarizes some of the factors contributing to globalization and global economic trends.

Figure 1: Facts about Globalization and Global Economic Trends



Source: Created on behalf of IU (2015).

1.3 Theoretical Explanations for Globalization

A number of theoretical concepts explain why international business and trade is beneficial for all countries involved. Without going into too much detail at this point, we will just briefly mention three theories:

- gains by absolute advantage
- gains by comparative advantage
- characteristics of competitive advantages

Interestingly, all these theories date back to the 18th and 19th centuries, when industrialization was in its early stages, especially in Europe. The development of large industrial corporations led to intense theoretical reflection on the potential harm and benefit of cross-border business activities.

Gains by Absolute Advantage

When Adam Smith published his book "Wealth of Nations" (Smith 1776), he noted that trade between countries would lead to overall benefits if countries specialized in the production of those goods they had an absolute advantage in. By absolute advantage he meant that the goods could be produced at lower unit costs. Smith's view is a simplification of reality, assuming that two countries could produce two identical products. However, the principle of specialization and the positive outcome of focusing on those activities remain convincing.

The chain of argument can be described as follows. Two countries, A and B, produce two products, textiles and steel. With one unit of resource for each product, country A would be able to produce 20 units of textiles or 40 units of steel while country B could produce 80 units of textiles or 20 units of steel. It is obvious that country A is more efficient in producing steel, while country B has an absolute advantage in producing textiles. If each country spends one unit of resource input on each product (2 units in total), the overall output would be 100 units of textiles and 60 units of steel. However, if country A spent 2 units of resource input on the product it has an absolute advantage in, in this case steel, it would produce 80 units of steel. If country B focuses on the product it does best, namely textiles, it would generate 160 units of textiles. By means of specialization, the overall output would be 80 units of steel and 160 units of textiles compared to 60 units of steel and 100 units of textiles in the case of country A and B not specializing. This example is summarized in the following table.

Table 1: Absolute Advantage From Specialization and Trade

	Country A	Country B	Explanation
Textiles	20	80	1 unit resource input for each product

	Country A	Country B	Explanation
Steel	40	20	1 unit resource input for each product
Overall output	60	100	
Specialization: Each country focuses on the product it has an absolute advantage in.			
Textiles	0	160	2 units resource input only in textiles
Steel	80	0	2 units resource input only in steel
Overall output	80	160	

Source: Created on behalf of IU (2015) using Wall/Minocha/Rees 2010, p. 80.

The theory of Adam Smith presupposes a scenario, in which each country has an absolute advantage in the production of at least one item. However it can be expected that in practice some countries do not have an absolute superior production.

Gains by Comparative Advantage

More realistically, David Ricardo stated that even if two countries have no superior production of any kind, both countries would still benefit from specialization and cross-border trade (Ricardo 1817). To achieve this, the country with advantageous products must focus on the one product in which it has a comparative advantage. In other words, it needs to specialize in the product in which it has the greatest absolute advantage. For the disadvantaged country, it is then important to focus on the product in which it is least disadvantaged. This example is summarized in the following table:

Table 2: Comparative Advantage From Specialization and Trade

	Country A	Country B	Explanation
Textiles	320	80	1 unit resource input for each product
Steel	40	20	1 unit resource input for each product
Specialization: Each country focuses on the product it has a comparative advantage in. Comparison of the cost ratios of producing textiles and steel.			
Textiles	$320 : 80 = 4$	$80 : 320 = 0.25$	
Steel	$40 : 20 = 2$	$20 : 40 = 0.5$	

	Country A	Country B	Explanation
Overall output	Comparative advantage in textiles: $4 - 0.25 = 3.75$ Comparative advantage in steel: $2 - 0.5 = 1.5$	Country A's comparative advantage is greater in production of textiles than in steel Both countries benefit from specialization (A in textiles, B in steel) and trade.	

Source: Created on behalf of IU (2015) using Wall/Minocha/Rees 2010, p. 8.

The table shows that when the cost ratios for production of textiles and steel are considered it is apparent that country A's greater advantage lies in the production of textiles, while country B, though disadvantaged in both productions, is less disadvantaged in the production of steel. Therefore, it is to the benefit of both countries, if country A concentrates its input on textiles, while country B specializes in steel, and both countries then engage in mutual trade of both products.

The theories of Adam Smith and David Ricardo are doubtlessly convincing. Yet, it is worth mentioning that they are based on assumptions that do not have much in common with real life scenarios. For example, both approaches presuppose it would be possible to simply transfer resources and employees from one industry to the other. Furthermore, free trade without barriers such as tariffs and protectionist measures is assumed. Additionally, the underlying idea that there is mutual demand in the goods described. Finally, both theories provide a simplified scenario with two countries and two products. It can be assumed, that all these assumptions do not reflect the complexity and diversity in which international business is carried out.

Characteristics of Competitive Advantages

To conclude this chapter, we would like to consider the comparative and/or competitive advantages of a country. There are numerous theories to explain this concept, however we will focus on Michael Porter's (2011) explanation of competitive advantages both on corporate and on national level. The question posed is why certain companies are successful in creating a superior market position whereas others are simply incapable of surviving. Studies suggest the existence of three key characteristics that lead to a company having greater success in a competitive market:

- Architecture: Successful companies manage to agree on preferential contractual obligations with suppliers and customers.
- Innovation: Top companies are evidently more innovative than competitors.
- Incumbency advantages: These relate to a company's ability to be an earlier player in its particular market (or markets). This provides the chance to establish a good reputation and to control access to resources. This advantage is also closely related to a firm's innovation capacity.

It can be stated that these advantages are not necessarily ever-lasting. In fact, there are quite a number of major companies that over time have lost one or more of their competitive advantages, often resulting in a complete breakdown of the corporation. Take as an example, the computer company 'Commodore', a major hardware provider in the early

days of computerization. During the 1980s, this company was a key international player in the production of computer hardware, however it failed to follow and adopt key developments in the supporting software programs. Consequently, it disappeared from the market—a development that was hardly expected in 1985.

If one transfers the concept of competitive advantage from a corporate to a national perspective then, according to Porter, there are two key capacities that must be realized for a nation to be successful in international competition:

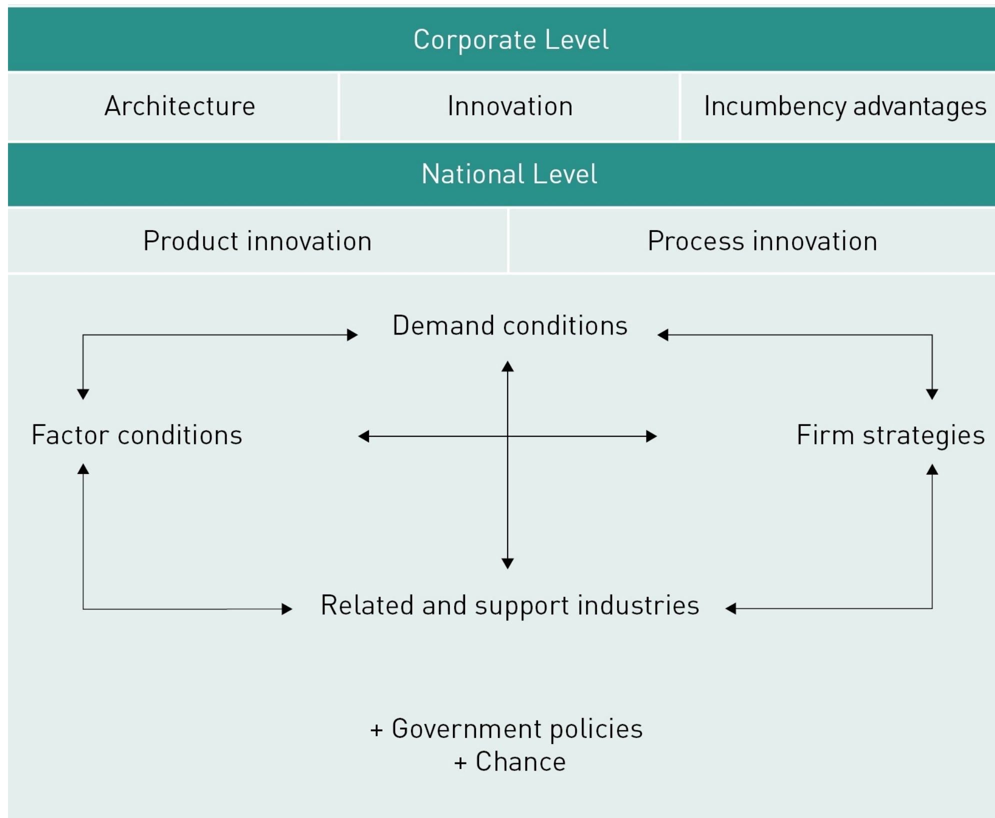
- product innovation
- process innovation

It appears that these characteristics will determine the success of a nation more than any other factors. They relate to six variables, which need to be looked at in order to understand why certain countries have gained competitive advantages over others.

1. Demand conditions: Is there sufficient domestic demand?
2. Factor conditions: Does a country have natural resources, advantageous infrastructure, and qualified labour forces?
3. Firm strategies: Is the private sector marked by internationally-successful, well-managed organizations?
4. Related and support industries: Does a country have business support services and a well-established sector of supply companies?
5. Government policies: What is the nature of the legal and regulatory framework in a country and what is the likelihood and extent of governmental interventions in the business sector?
6. Chance: Can a country, not unlike a company, recognize and seize opportunities or maximize the benefit of favourable circumstances, e. g. business opportunities in the former communistic European countries after the fall of the Berlin Wall.

The first four variables in this list are most important and interconnected. They are influenced by one another, as seen in the following figure illustrating Porter's view of competitive advantages.

Figure 2: Competitive Advantages on Corporate and National Level



Source: Porter 1990 and Porter 1998, cited in: Wall/Minocha/Rees 2010, p. 89.

In summary, it is important to recognize that all theories oversimplify economic reality. However, they help explain why international trade is beneficial for all parties. History clearly indicates the importance of international cooperation and exchange for national economic development. Numerous examples show that those countries that do not participate—or only to a minor degree—in cross-border trade are often less developed.

SUMMARY

This unit aims to lay the foundation for a shared understanding of global trends in the business management arena. Starting with a very broad definition of globalization as an increasing interconnectedness among societies and economies worldwide, we explained global markets and international business. We then considered a range of factors that influence global trends, such as cultural and political forces, the integration of economic processes, the shrinking influences of national governments, and the increasing connections between societies and markets worldwide.

With this deeper understanding of globalization, we eventually explored the current trends and facts of globalization. Here, we specifically discussed economic changes, political changes, technological developments, and changes in societal and behavioral patterns. It became obvious that these aspects are interrelated.

Finally, we briefly explored theories that explain the economic benefits of globalization. In particular, the treatises of Adam Smith and David Ricardo were outlined. Smith's theory revealed why there are absolute advantages resulting from specialization and trade, while Ricardo's theory showed that comparative advantages from specialization and trade benefit even those countries that face disadvantages in production of certain goods. Porter's ideas elucidate the sources of competitive advantages on a corporate level and among nations. His studies have proven that a set of key characteristics help to achieve national gains from international business activities.

UNIT 2

THE INTERNATIONAL COMPANY AND ITS ENVIRONMENT

STUDY GOALS

On completion of this unit, you will have learned …

- the key characteristics of international companies.
- how companies enter international markets.
- the special features of international business activities.
- how to systematically analyze the environment in which international companies operate or intend to operate.

2. THE INTERNATIONAL COMPANY AND ITS ENVIRONMENT

Introduction

COMPETING IN A GLOBALIZED ECONOMY

Emblazoned across the huge blue barns of the Daewoo shipyards on Koje Island off the southern coast of South Korea are signs declaring 'No change, no future'. Certainly it is a frequent mantra in Korea, as Hyundai Heavy Industries, Samsung Heavy Industries, Daewoo Shipbuilding, and Marine Engineering strive to maintain their positions at the top of the global industry. Presently, the top three are in a sweet spot; orders are rolling in fast, deep hedging means they are insulated against the strong Korean Won and their share prices have been skyrocketing. All are frantically extending their docks and building new quays to enable an increase in capacity.

"Korean shipbuilders are enjoying this very bullish market", says Koh Youngyoul, chief strategy officer at Daewoo, which has a three-year backlog of orders worth $29 billion. But how long will it last? Korean shipbuilders are being threatened by China, which is set to have 23 docks for construction of large ships by 2015, many more than Korea's 15. Meanwhile, Chinese manufacturers, already churning out standard container ships, are trying to make high-tech liquefied natural gas carriers and large containers, Korean industry's bread and butter.

Korean estimations of the time China will need to close the technological gap range from four to ten years. Industrial operators know they must not be complacent. "At the moment, China is simply building low-value added ships, while Korea is making many more highly technologically-oriented ships", says Mr Koh of Daewoo, who expected to win orders worth $11 billion this year but had to correct this upwards to $17 billion after achieving their target in the first half. "There is no serious competition from China right now but it is only a matter of time until China catches up with Korea the way Korea caught up with Japan ten years ago", says Mr Koh.

Korea came from nowhere to become the world's biggest shipbuilding country and, thanks to Hyundai, Samsung, and Daewoo, has a global market share of around 40 %. The rise of the Chinese industry has led to Korean manufacturers looking at Japan's mistakes and ensuring they do not fall into the same trap. "Japan failed to accept diversity", says Park Chung-Heum, executive vice-president of project planning at Samsung Heavy, which likewise received $10 billion in orders in the first half and raised its projected orders to $15 billion.

About 90 % of all Korean orders are for run-of-the-mill container carriers and tankers but the other 10 % are orders for vessels such as floating production storage and offloading oil facilities that Korean shipbuilders hope will be their future. Already Daewoo has built the Agbami FPSO vessel for Chevron, the U.S. oil giant, for a record $1.6 billion offshore oil production facility for Abu Dhabi Marine.

Samsung is increasingly concentrating on offshore vessels such as barge-mounted power plants and drilling rigs. They have also built an Arctic tanker for Lukoil and ConocoPhillips that can break ice up to 1.5 m thick. “Six years ago, the average price of a Samsung ship was $50 million or $80 million at today’s prices but now it is $170 million”, Mr. Park says from his office overlooking the Koje shipyards, illustrating both the sophistication of the ships being built and the recent escalation of prices shipyards can demand.

But all this newly added value carries a risk, namely technology leakage. Korea’s National Intelligence Service has been investigating leaks from Korean companies to Chinese competitors and a former Daewoo employee has been arrested for selling drawings to a Chinese company.

“We are very concerned about this sort of leakage”, says Mr Park of Samsung. “Now we are putting watermarks on our drawings and printing them on paper, not on CDs. This is a very critical time as China would like to be able to catch up with Korea”.

Nevertheless, Sanjeev Rana, a shipbuilding analyst at Merrill Lynch in Seoul, says Korean shipbuilders will be able to remain market leaders in high value ships at least until 2010, although he adds that this is not necessarily a recipe for success.

“Korea will maintain their lead in the value added segment but they need to maintain conventional shipbuilding in their portfolio; you can’t have everything value-added”, S. Rana says. “So even if they increase the high-tech component of their portfolio to 65 %, they still will be exposed to China by 35 to 40 %.”

Strategy to cheap labor

China might present a threat to Korean shipbuilders but it also offers significant opportunities. Samsung Heavy Industries, and Daewoo Shipbuilding and Marine Engineering, Korea’s second and third largest shipbuilders, respectively, have both opened yards across the Yellow Sea. There, Chinese workers construct the blocks that form the basis for Korean ships, which are then transported back to Korea for value-added production. This enables Korean producers to utilize China’s cheap labor without, in theory, giving away core technology.

"China is supplying one-third of the blocks used in the ships that are put together in the Koje yards", says Park Chung-Heum, executive vice-president of project planning at Samsung Heavy. "The price of block fabrication in Korea has become very expensive so we are very happy to do this in China."

Samsung's factory in Ningbo, Zhejiang province now produces 200,000 tonnes of ship blocks a year, while Daewoo's subsidiary in the north-eastern port city of Yantai, Shandong province will churn out 220,000 tonnes of ship blocks when it reaches full capacity in 2011. However, Hyundai Heavy, Korea's largest ship-builder, does not have a joint venture in China and has no plans to open one, Kefin Chang, a company spokesman stated. "Shipbuilding is a very labor-intensive industry and Hyundai Heavy wants to supply jobs for Koreans", he said.

Source: Wall/Minocha/Rees 2010, pp. 25–27.

This introductory text describes the challenges that Korean shipbuilders face nowadays owing to the improved competitiveness of Chinese companies in this sector. What can be learned from this case study is that competing in a global economy is a process that needs ongoing attention and the capacity to adapt to the ever-changing characteristics of the environment in which international companies operate.

Many people are unaware of the fact that, in the 1970s and 1980s, German shipbuilders found themselves in a situation similar to the Koreans today. At that time, Korean companies were challenging the comfortable position of German shipbuilders. The latter had a technological advantage over Korean firms, which had been developing lower quality vessels. However, over a period of time, Korean shipbuilders were able to meet the technical standards of German competitors and even market ships at lower prices. As a result, the German shipbuilding sector, formerly a significant job provider in Schleswig-Holstein, Hamburg, Bremen, and the state of Lower Saxony, almost collapsed with only a few highly specialized producers remaining. The economic and political impact on these regions can still be experienced today, as the structural change proved to be a long-lasting process.

2.1 International Companies and their Operations

In unit one, international companies were broadly defined as businesses operating across national borders. It was also stated that these operations vary considerably (Hill 2011). Let us now have a look at multinational enterprises (MNE) and elaborate on their specific characteristics.

Multinational Enterprises

A **multinational enterprise** can be simply defined as a company that takes a global perspective on markets and production. It searches for market opportunities beyond the domestic arena and is ready to locate operations abroad (Daniels/Radebaugh/Sullivan 2009). Some of these enterprises engage in foreign direct investments, while others focus on a minimum number of countries in which to operate their business. In addition, the size of the company is frequently mentioned as a key determinant of multinational enterprises. However, in addition to all the big firms engaging in global activities, there are also a considerable number of small businesses taking a global view on markets and production.

Multinational enterprise
A multinational enterprise (MNE) is a company searching for market and production opportunities worldwide.

As a baseline, many authors regard a company operating in more than one country as a multinational enterprise. Dunning (1993), for example, defines a multinational enterprise according to two key characteristics: engagement in foreign direct investment and ownership and/or control of value-adding activities in more than one country. Usually, the organizational set-up is marked by a central headquarters where key strategic decisions are made. Furthermore, the multinational enterprise typically has several subsidiaries in a number of countries. These are allowed to operate with different degrees of entrepreneurial freedom and are thus able to adapt to the specific characteristics of their local environments. However, there are different organizational arrangements: these will be discussed in more depth at a later stage of this course.

Multinational enterprises can be further categorized on the basis of their different views on global markets (Wall/Minocha/Rees 2010):

- Global companies: These organizations produce standardized goods and provide standardized services globally. Goods and services are not or only minimally customized to local needs.
- Multidomestic companies: These organizations have established subsidiaries abroad that mainly operate independently. They produce goods and offer services customized to local demand.
- Transnational companies: These companies integrate location-specific activities into a single production process.

A brief note on terminology—the term ‘corporate’ is frequently used instead of company, firm, or enterprise. In common terms, it is used interchangeably. However, we will avoid using ‘corporate’ as it contains an element of ‘incorporation’. This could be potentially misleading, as in many countries the vast majority of businesses are not incorporated. One example is Germany, a world leader in international business activities. In this export nation, not even 0.5 % of the companies are large corporations; 99.5 % are small and medium-sized businesses (Institut für Mittelstandsstatistik 2003). While many of these business are internationally active, not many are in fact incorporated. Using the term ‘corporation’ has the potential to exclude these companies from consideration, thereby falsely disregarding their importance.

Expanding Internationally

What is the driving force behind an internationally operating company? Typically, there are three major reasons for deciding to enter global markets (Daniels/Radebaugh/Sullivan 2009):

- increase sales
- access resources
- balance risks

With many markets almost saturated nowadays, it has become increasingly important for companies to expand their sales operations to other countries. If costs of increasing production do not rise disproportionately, expansion of sales will result in higher profits for the company. For many international companies, the turnover from global markets is more important than the turnover generated domestically. To take the automotive industry as an example, for a company like Porsche, the US market is of key importance, as opposed to Volkswagen who depend heavily on sales in China, and Toyota who sell an important share of its vehicles in Africa. Interestingly, similar situations can be found in small firms. The large number of highly specialized small machine manufacturers in Germany are highly dependent on international markets.

Gaining access to resources is a further motive for engaging in international business activities. There are many opportunities for generating competitive advantages by sourcing from abroad. In many cases, it is simply the non-availability of necessary goods or services in the company's home country that drives the decision to enter global markets.

Costs are frequently a key factor in companies expanding their operations internationally. Many companies have started producing abroad to reduce the costs of workforces at home. In China and many other countries in South-East Asia, there are numerous European and American multinational enterprise production plants. India has become a major player in the service industry. With a cheap, yet well-educated workforce, it has attracted subsidiaries of international software companies and call center operators. Natural resources in the vicinity may also be a reason for operating internationally. Some companies group their production around natural resources; oil companies, for example, have started to refine oil in countries such as Nigeria, where resources are extracted.

Finally, the desire to balance and minimize a company's risks has led to more international operations in the private sector. One of the main explanations is that it helps equalize the volatility of particular markets. In recent years, for example, car sales in Europe have been relatively low, yet on the rise elsewhere, in countries such as China. In other words, international operations help minimize the risk of recessive trends in one region by increasing sales in another. Similarly, production plants are often set up to reduce risks from inconsistent foreign currencies. Many European producers manufacture in the US in order to ward off the harmful effects of a potential downturn of the dollar. Manufacturing in the US means that production costs and sales prices are charged in the same currency. This also applies when firms decide to procure their supplies from different countries. Again, this procedure helps to soften the effects of a single currency experiencing an increase in value compared to the currency at home. Finally, it is worth noting that some

companies simply start international operations in order to compete with their competitors. For example, all major consultancy firms can be found in several African countries. In these countries, the formal private sector is small with only a few companies; however, they are seen as potential clients. Here, it seems internationalization means being present in markets in order to prevent competitors from growing.

The following table summarizes key aspects of this section:

Table 3: Characteristics of Multinational Enterprises

Multinational Enterprises	
Definition:	• A company that takes a global perspective on markets and production. It searches for market opportunities beyond the domestic arena and is ready to locate operations abroad.
Types of multinational enterprises:	• Global companies are those that offer standardized goods and services globally. • Multidomestic companies have subsidiaries abroad that operate relatively independently. Products and services are customized to local demands. • Transnational companies integrate location-specific activities into a single production process.
Reasons for operating internationally:	• increase sales • access resources • balance risks

Source: Created on behalf of IU (2015).

2.2 Operational Patterns in International Markets

The last section dealt with the reasons for doing business internationally. Now we will discuss the various ways that companies enter international markets (Daniels/Radebaugh/Sullivan 2009). It is necessary for a company to consider the most suitable approach. Determining factors for this decision mainly result from consideration of a company's internal context and the environment abroad. Perhaps the most important issue is the financial capacity of a company: many companies start their international operations using inexpensive methods. If they prove successful, then other perhaps more expensive measures of operating abroad can be taken. The concepts underlying the internationalization of business are (Wall/Minocha/Rees 2010):

- export-based approaches
- non-equity-based approaches
- equity-based approaches

Export-Based Approaches

This is usually the first approach adopted when a company decides to go international. At this point, we will be focusing on export, although it should be understood that import follows similar patterns. In practice, export means that a firm produces domestically and then applies various logistical means to export its goods to markets abroad. A simple device such as a mobile phone can easily explain the significance of import and export in our daily lives: the mobile phone producer might be located in Central Europe, the model designed in the UK, the software developed in the US, the materials sourced from the Democratic Republic of Congo and Taiwan, and production carried out in China.

Export is broadly categorized by Wall/Minocha/Rees (2010) as:

- indirect export
- direct export

Indirect export means that international operations, as a whole, are carried out by third party businesses. Acting as intermediaries, they are responsible for the shipment of goods abroad and their distribution via various channels in foreign markets. The responsibilities of these intermediaries vary, depending on the extent of their activities. Export houses, confirming houses, and buying houses constitute these intermediaries. Export houses buy the products from a domestic manufacturer and then ship them abroad to be sold. They take the full financial risk of the internationalization process. In contrast, confirming houses assume the role of agents working on commission, bringing buyer and seller together. The financial risks are taken by the producing company. Buying houses are similar to confirming houses, however their business is dependent on the demand. They look for sellers to match the needs of the buyers identified abroad.

Indirect export means that there are fewer risks for the producing company and costs are only incurred when goods are sold. This may be why many firms choose this business option. On the other hand, indirect export means having almost no control over the market activities abroad and little information on consumer reactions. There are also reputational risks to consider. The company remains disconnected from its foreign customers.

In comparison to indirect export, direct export means the production company carries out their own export activities. Physical distribution needs to be arranged and appropriate distribution channels chosen for abroad. Obviously, this method is more expensive compared to indirect export as it requires more resources and also entails higher risks. However, the direct interaction with foreign markets and customers provides valuable market information and additional service provision opportunities.

Non-Equity-Based Approaches

This internationalization approach has gained tremendous importance in recent decades. It is the sale of know-how, either a sort of technology, patents, usage of brands, copyrights or others. It is outlined in a contract that grants the use of intellectual property. Today’s technology has become user-friendly, taking only seconds to transfer technology and/or intellectual property rights via the internet. This means physical distribution is no longer

required to enable international business activities. Industries heavily engaged in this internationalization process are tourism and transportation, technical management performance providers, and the hospitality industry. We will briefly discuss the following non-equity-based approaches to business internationalization (Wall/Minocha/Rees 2010):

- licensing
- franchising
- management contracting

Licensing

This basically means that the owner of any kind of intellectual property grants permission to the licensee to use the intellectual property, usually for payment of a license fee. Intellectual property is normally protected by a trademark, patent, or copyright against unauthorized usage. In other words, licensing is the transfer of knowledge. It is a relatively cost-effective method of internationalization, frequently used when it is crucial to gain a considerable market share in a short period of time.

One key challenge of this method is the protection of intellectual property. Imagine developing a brand new technology and being offered a financially beneficial license contract from a Chinese company. In the past years, after entering into such agreements in China, a number of Western companies discovered slightly varied imitations of their products appearing in the market. Law enforcement regarding intellectual property rights protection in China is still in its infancy, though improving. Were this to occur to a small or medium-sized company with limited financial resources, such an incident could seriously jeopardize its existence.

Franchising

This is similar to licensing. It transfers the right to third parties to undertake certain business activities using the franchise provider's name, trademark, specific business procedures and much more. A well-known franchise concept is McDonald's restaurants. Generally, we can distinguish between (Wall/Minocha/Rees 2010):

- first-generation franchising
- second-generation franchising

These two concepts differ in the way business activities are controlled by the franchise-provider. While the first concept allows the franchisee to use the concept without any major limitations, the second is marked by strict controls.

Franchising is mainly used in the service industry. It requires relatively little investment in the internationalization process and allows a fast market penetration, however conflicts with franchisees have proven to be difficult to resolve. One example is the legal struggle between fast food franchiser X and a number of disgruntled franchisees in Germany over unrealistic forecasts and questionable operational requirements. The reputational damage resulting from such cases should not be underestimated. Often, this control has franchisees doubting their function as owner-managers. Little entrepreneurial freedom

remains when marketing methods, interior design, location, suppliers, pricing, and business strategies are closely regulated. This limited freedom is a disadvantage for the franchisee—the price paid for deciding to use a well-known brand.

Management contracting

Management contracting can take various forms of contractual agreements. Basically, it means that a service provider in one country carries out certain management tasks for a foreign company, which has decided not to establish a subsidiary in the country of service. The advantage of such an arrangement is that the service provider is located in the area and is knowledgeable about the specific characteristics of the market. In general, this cooperation is more cost effective than establishing an internal subsidiary. However, the disadvantage is that the foreign company has no way of receiving any direct feedback from customers and is therefore disconnected from the market. Furthermore, it proves difficult to supervise the service provider in the same manner as an internal subsidiary.

Equity-Based Approaches

An equity-based approach to international business is the method that requires the highest level of commitment from the company in terms of personnel and finances. More feedback from the foreign market is provided, and controlling the operations abroad and protecting property rights is made easier. On the other hand, the investment bears a considerable loss should the internationalization fail. Three kinds of equity-based internationalization approaches are (Wall/Minocha/Rees 2010):

- joint ventures
- alliances
- acquisitions

Joint ventures

A joint venture means that partner companies collaborate in a formal, often contractual, manner in order to create an entity with a new identity. The companies involved in the joint venture share strategic and operational duties. Joint ventures provide an opportunity to gain a better market position by combining competencies from two or more players, thus creating a sustainable added value. Moreover, a joint venture helps reduce R&D expenditure as this no longer has to be carried out by each company individually. The joint approach also helps to gain benefits from insights into the expertise of the partner company. However, in some cases, joint ventures have failed as a result of cultural differences and different legal systems.

Alliances

These are similar to joint ventures. However, they are not as structured and often involve a mismatch of capabilities and resources between partners. Alliances are the intermediary between joint ventures and acquisitions. Often, legislation prohibits formal agreements

negotiated in joint ventures or complete takeovers in the case of acquisitions. Companies will tend towards an alliance should the risks resulting from an acquisition or a joint venture appear too high.

Acquisitions

Acquisitions are the method of internationalization that requires the highest commitment. Taking over or merging with an existing company is one way of organizing an acquisition; however it is also possible to create an entirely new entity. In any case, the acquiring firm holds full ownership of the newly established company. The initial stage is expensive; however, it helps to avoid some of the risks of other equity-based approaches, including a lack of control and problems owing to different organizational cultures.

The following table provides an overview of the internalization patterns of companies:

Table 4: Operational Patterns in International Markets

Export-based approaches	Non-equity-based approaches	Equity-based approaches
• indirect export • direct export	• licensing • franchising • management contracting	• joint ventures • alliances • acquisitions

Source: Created on behalf of IU (2015).

2.3 Assessment of the Environment for Internationalization

We have seen the different approaches to the internationalization of business operations. It is important to understand that moving operations beyond national borders normally requires extensive effort, time, and resources. In order to ensure that this money is well invested, a company aiming to gain access to international markets should thoroughly investigate the environment of the country or countries in which it intends to start operations. Even though internationalization often happens by chance, it should be based on a thorough assessment of the environment in which the company intends to operate.

This section will focus on three important contextual issues that require research when moving operations abroad (Daniels/Radebaugh/Sullivan 2009):

- political context
- legal context
- economic context

A further contextual aspect that must be considered in the internationalization process is the cultural context. Culture is a crosscutting issue that determines to a certain extent all other context factors. It is also closely related to ethics, a topic that is also of key importance. However, cultural issues are so crucial to success that they are discussed in a separate unit.

Political Context

A political system consists of the governmental institutions of a country, its political organizations, various stakeholder groups, formal and informal relations between these groups, and the regulatory norms established to administer the political process. It is important for a political system to be supported by a majority of the country's population. Therefore, its ability to govern the multitude of societal perspectives is of crucial importance. A company needs to understand that it cannot just transfer the way it conducts business at home to foreign countries as it must take into consideration the various political systems in the countries into which it desires to move its operations. So what are the key elements of a political system analysis? They include the following:

- general emphasis placed on either individualism or collectivism,
- political structure ranging from democracy to totalitarianism, and
- assessment of various political risks.

Individualism versus collectivism

Let us examine the following example. You may have followed the political discussion in the United States on health reform strongly promoted by President Obama and his Democratic Party. From an external perspective, it may seem that the country is deeply divided over this issue with only a slight majority now being in favor of a state-governed health system. However, a considerable number of Americans still believe that taking out health insurance should not be made mandatory by the government. Now imagine the same discussion in Germany where most of the population is obliged to make financial contributions to the health care system. It can be assumed that hardly anyone would want to end the state-governed health system with all the social welfare benefits it entails. Children, for example, are included in their parents' health insurance at no additional cost. This example shows the standing of individualism in American society in contrast to the strong collectivistic tendency in Germany. Individualism is based on individual freedom, while collectivism often restricts individual freedom for the sake of collective societal gains. This is an important aspect in terms of internationalization.

Political structure

The political structure also needs to be assessed. In Central Europe, operating businesses in democratic systems is taken for granted but once operations are shifted abroad, totalitarian systems may be encountered. Democracy is based on two important principles: the rule of law is universally applied and citizens are granted the right to participate in the decision-making process of a country by means of regular elections. Democratic systems

normally promote distribution of power. Contrary to this, totalitarian systems tend to place political power in the hands of one person, a few individuals, or a party. In other words, power is monopolized and opposition is often suppressed.

When business activities are moved to two democratic countries, it should be understood that both countries do not necessarily offer the same political environment. Decision-making in politics varies considerably between parliamentary democracies with a multi-party parliament, as seen in Germany, and representative democracies with only two parties and a relatively strong president, as in the US. In the case of China and North Korea, both may have totalitarian systems but the degree of pressure on their people and the freedom granted to citizens varies considerably. China's communist party leadership is certainly far from being deemed democratic while North Korea, which is led by a family and a supporting party, can be seen as a dictatorship, as it refuses to grant individuals any personal freedom.

Assessment of political risk

This assessment is important when a company intends to do business internationally. A company in the technology sector that is considering a move to Switzerland and Austria, for example, has no need to fear product or software piracy as they would be able to rely on a legal system that protects intellectual property. Now imagine the same scenario in China and Indonesia. It is critical for companies to take measures to protect individual rights as well as obtain information on how to deal with legal systems that have differing views on intellectual property. Consider the example of an African country in which judges went on strike for about one year and where political interference occurs frequently throughout court cases. A business manager would need to take a risk premium into account in order to operate in highly dangerous environments.

The following political risks must be considered (Daniels/Radebaugh/Sullivan 2009):

- Systemic political risks are risks caused by a change in political leadership and a subsequent shift in political orientation. Often opportunities rather than risks are the result, but in terms of corporate risk management, it is valid to call them risks.
- Procedural political risks relate to changes in governmental behavior that might affect companies. Corruption and generally low procedural reliability are examples of this type of risk.
- Distributive political risks mean that governments feel they should receive more financial benefits from certain industries or companies. When Germany introduced the road tax for trucks, this was a clear risk for the transport businesses affected.
- Catastrophic political risks are the impact of events such as war and civil unrest on private businesses. They can lead to a decrease in turnover or even to a complete operational breakdown.

Legal Context

Legal systems are mechanisms that enforce laws by interpretation of the content of laws and regulations (Daniels/Radebaugh/Sullivan 2009). Usually, legal systems comprise the elements of constitutional law, criminal law, and civil/commercial laws. A distinction may

be drawn between common law, civil law, theocratic law, customary law, and systems that mix elements of the above systems. Common law is based on traditions, certain judicial codes, and previous court decisions.

Civil law applies comprehensive legal codes that are designed to cover as many legal cases as possible. Theocratic law bases legal decisions on religious codes and employs religious leaders as judges. Customary law is based on certain traditions or experiences. Mixed law systems employ more than one of the abovementioned legal systems.

It is interesting to note that, in many African countries, traditional laws and regulations can still be found alongside relatively modern common or civil law systems. Often the rules are contradictory, e.g. concerning the issue of land rights. In rural areas, land is still governed by local chiefs and customs passed down over centuries. Thus, a company could buy a piece of land in good faith, not knowing that the local chief has already assigned the plot to someone from the village.

This relates directly to a key question that managers should ask when considering going abroad: what is the base rule in a legal system? What is the difference between the rule of man principle and the rule of law principle? The latter is widely applied in democratic political systems and is based on democratically legitimized law enforcement applying to every member of society. The idea of fairness underlies the rule of law. In opposition to this, the rule of man is an attribute of totalitarian systems. It grants a ruling person, group or party the ultimate power to determine the rules, how the rules are to be applied, and to whom they apply. The rule of man is often perceived as unjust.

What are the most important legal issues that a manager considering the internationalization of his/her business would need to take into account? Firstly, what is required to establish a business in a foreign country? Secondly, how difficult would it be to obtain business permission and what restrictions could possibly hinder the process? Thirdly, how are contracts concluded and are there sufficient legal means in place to enforce them? A further consideration would be labor and workplace regulations and to what extent unions and other groups are allowed to intervene in company policy. In terms of production, an investigation into product standards in the respective countries is a prerequisite, as well as exploring how product liability is regulated.

Marketing regulations also need to be observed. Think of the warnings carried on every pack of cigarettes in Germany. Equally important is the question of how long court cases normally last and to what degree extrajudicial arbitration is allowed. As a result of the increase in service industries, intellectual property rights have gained significant importance, thus it is worth investigating whether the foreign legal system protects these rights and to what degree.

Another major issue is a country's environmental regulations. It might be tempting for a company to establish a potentially harmful operation in countries with weak law enforcement in environmental issues. However these countries tend to be unpredictable in their attitudes once a company has committed to building production plants.

Economic Context

Economic context is closely related to the political and legal circumstances in a country (Daniels/Radebaugh/Sullivan 2009). In fact, these aspects are inseparable as economic activities are affected by political decisions and regulated by legal systems. Many types of economic systems are found throughout the world and can be based on theoretical frameworks ranging from true capitalism to a strictly command environment. However, these are extreme concepts, which are seldom found anywhere, perhaps with the exception of the strictly controlled command economy in North Korea. Western countries generally support market economies to a greater or lesser degree, with varying amounts of governmental interventions. Free market systems are known for their capacity in terms of wealth creation. However, they fail as far as wealth distribution, social security, and ecological issues are concerned.

Germany has established a social market economy. It grants property rights but these are accompanied by an obligation to contribute to society. Furthermore, both the economic and the political system are designed to spread power, demonstrating the willingness to seek compromises and support broad participation in decision-making processes. Overall, this system has proven to be extraordinarily successful over a period of almost 70 years; it comes as no surprise, therefore, that Germany is considered the powerhouse of the European Community in times of financial turmoil.

Should you, as a manager, be interested in starting business operations abroad, then you will need to know to what degree governments intervene in business activities in the country/countries selected and also to what degree private ownership is granted. In a free economic system, such as the US, legislation protects private ownership. However, in many countries in Africa, foreigners will encounter a number of obstacles when trying to buy land. In countries such as North Korea and Cuba, private property is not allowed and government officials, rather than entrepreneurs, determine issues of business.

Another area for investigation to obtain information on a potential market is the key figures that represent a country's economy. The primary figure for examination is the Gross Domestic Product (GDP). It represents the total goods and services produced in a country during a period of one year. The Gross National Income (GNI) is calculated by adding the revenues from import, export, and international activities carried out by domestic companies to the GDP. Both indicators provide information on the overall market power of a country. The GNI is then divided by the population of a country to calculate the GNI per capita. This indicator describes the wealth created annually per person. It is useful to observe the growth rate of the GNI and also to compare the GNI with regard to its buying power. A manager might want to know whether the Gross National Income is rising steadily. She might also be interested in whether an increase in GNI is accompanied by rising prices, which could overcompensate for the positive effects of an increasing GNI. In this case, a market would be less attractive for international businesses as consumer spending is limited or even shrinking.

The GNI is an average figure but for a business planning to go abroad with its operations more attention needs to be paid to income and wealth distribution. In many developing countries, the majority of the population has little income and lives mainly on subsistence

farming. In contrast, a small percentage of this same society may enjoy a high income and a considerable amount of personal wealth. It is not necessary to discuss poverty and distribution aspects here but for a company moving into international markets, market potentials and risks simply must be considered.

A further useful indicator for checking a potential market abroad is the trajectory of the cost of living; rising prices indicate inflation and decreasing prices indicate deflation. High inflation is normally accompanied by little confidence in future markets. Those holding large amounts of cash see their money losing value. In such an environment, consumers and companies struggle to plan for the future.

The unemployment rate is another factor to consider. Some Southern European countries are suffering from youth unemployment levels of around 50 %. Moving operations into a country marked by high unemployment can have both positive and negative effects. Providing a production plant with thousands of jobs attracts advantages such as tax holidays, easy access to commercial land, relatively low wages, and many others, however targeting consumers in this environment is difficult as only minimal buying power is available for newly launched products.

Closely related to unemployment is the labor market—to what extent is it regulated? In the US, for example, making employees redundant in times of corporate crisis is relatively straightforward, while in Germany, laying off staff is complicated and expensive. Germany provides a high rate of social stability and is very committed to its working population. It is difficult to state whether regulated or free labor markets are better for firms wanting to go abroad. However, it is essential that a manager in charge of the internationalization process considers these issues, taking the effects on her company into account.

Workforce skills, the cost of labor, and employee productivity are further matters of concern, which are in many cases interconnected. In many African countries, there is a strong belief that labor is cheap. This is true in terms of costs per working hour. Nevertheless, considering productivity and costs per unit output, many of these countries become extremely expensive owing to inefficiency, corruption, and theft. Let us take one example. In one of the poorest countries of the world, Malawi in Central Africa, a university graduate in engineering can be hired for as little as €200 per month. However, the skills acquired at the local university do not meet the standards required to work in contemporary architecture, structural engineering, or other technical sciences. The result is extremely low productivity, eventually leading to relatively high costs per output unit.

Finally, the general business climate should be considered. One aspect is of particular importance—the prevalence of fraud, corruption, and political interference. These issues are linked to political and legal contexts. An excellent indicator for these is the Transparency International Corruption Perception Index. Despite discussions on the methods applied to obtain this data, this indicator provides information on a country's governance and transparency. For a company about to start its activities in that country, fraud, corruption, and political interference can be major obstacles to business success.

The following table summarizes the most important aspects to analyze regarding the environment of a new country in which a firm intends to start its operations:

Table 5: Aspects of the Environment to be Assessed When Preparing for Internationalization

Political Context	Legal Context	Economic Context
Individualism vs. collectivism Democracy vs. totalitarianism Political risk analysis: • systemic political risks • procedural political risks • distributive political risks • catastrophic political risks	Legal systems: mixture of constitutional, criminal, civil, and commercial law Law systems: • common law • civil law • theocratic law • customary law • mixed systems Base of rule: • rule of man • rule of law	Economic system: • capitalism vs. command economy • level of governmental interference Indicators: • Gross Domestic Product (GDP) • Gross National Income (GNI) • GNI per capita • growth rate of GNI • GNI compared to inflation • income distribution • wealth distribution • inflation/deflation • unemployment rate • regulation of labor market • available workforce skills • cost of labor • workforce productivity • business climate (e. g. Corruption Perception Index by Transparency International

Source: Created on behalf of IU (2015).

SUMMARY

This lecture has provided an insight into international companies and the environment in which they operate. Following a general definition of the international company and a global perspective on markets and production, international companies were subsequently categorized into global, multidomestic, and transnational ones. The reasons for internationalization are to increase sales, access resources, and limit risks.

We then explored the different patterns of international business operations and distinguished between export-based approaches, non-equity-based approaches, and equity-based approaches. We viewed the various sub-categories of these methods and also discussed the advantages and disadvantages of the different approaches.

Which contextual aspects need to be considered when moving business operations abroad? We discussed an assessment framework for an environmental analysis comprising of political, legal, and economic contexts. It became clear that these aspects are interrelated and thus all

need to be taken into account. It was concluded that culture is also a contextual factor of importance and is characterized by a crosscutting nature. Therefore, it will be considered in the following lecture.

UNIT 3

CULTURE AND INTERNATIONAL BUSINESS

STUDY GOALS

On completion of this unit, you will have learned ….

– how culture can be described.
– the key characteristics and determinants of a national culture.
– the specifics of organizational culture.
– what cross-cultural business activities demand from today’s managers.

3. CULTURE AND INTERNATIONAL BUSINESS

Introduction

You are a young woman and part of your company's 'High Potential Program'. You hold a master degree in engineering and are an expert in mining and drilling. Your company, a key player in the exploration of natural resources, has made some efforts to engage with local mining companies in a number of African countries to ensure access to important minerals. Your responsibility is to sign a project contract in a joint venture in Angola. You also need to discuss important technical deals. Your company has an excellent reputation among young graduates and professionals. It is known for lean hierarchy and assigning challenging responsibilities to young and capable staff: it is no surprise that despite your age, you are already in charge of this project in Angola.

On a trip to the country's capital, Luanda, you have arranged to meet the CEO of the local mining company. It is your first visit to the country. At the agreed meeting time, you are told that the CEO is still in another important meeting and are asked to wait. The secretary asks you for your business card. One and a half hours later you are annoyed because of the delay; the secretary informs you that the CEO is attending another meeting outside the office, and you are invited to meet with a staff member to talk about the technical specifications of the mining activities. After the long delay you are not at all interested in small talk. Therefore, after a few kind introductory words, you immediately start discussing technical issues. Your counterpart is seemingly not interested and not aware of this business opportunity. Eventually, the meeting ends with his promise to inform the CEO about the issues you have raised.

You feel your visit has been quite unsuccessful. Over the next two days, you try to reach the CEO on his mobile phone but he does not respond. His secretary takes your calls at his office and tells you that he is temporarily out of the office and will call you back later that day. Nothing happens and your email does not receive any response, so you ask yourself what went wrong.

Before you continue reading, please consider which cultural aspects might have contributed to the disappointing outcome of your visit.

Here are some pointers on what might have gone wrong:

A number of situations are a matter of fact in our society but not in others. Take, for example, the fact that you are a young woman yet you have already been assigned the responsibility for a project in Africa. Western companies are used to sending experts, often young staff, to solve business problems. In other cultures, seniority matters most. Therefore, if you wish to meet with the CEO, it is very important that you have the same position or function as your counterpart; otherwise, it may be taken as a sign of disrespect if your

company sends staff on a lower hierarchical level. Another topic is punctuality. Time matters to us: it is essential to the valued concept of efficiency. In other cultures, time is less important than personal relationships.

Showing signs of impatience and only exchanging a few introductory words, as in the case mentioned above, is interpreted as discourtesy and not taking your counterpart seriously. It might also be assumed that the engineer of the Angolan company was technically incapable of understanding your offer or not even involved in the joint project; instead, he was related to the CEO and thus a special contact. This person may be involved in the decision-making process owing to informal structures overlapping the formal company hierarchy.

This situation illustrates some of the cultural challenges that may be experienced when launching international business operations. This unit will examine such cultural issues in greater detail.

3.1 A Generic Perspective on Culture

What is meant by 'culture'? No common definition exists, yet many agree on what the term entails. In the context of business, what does it mean when a manager states that corruption is part of a foreign country's culture and thus accepts that his company engages in corrupt practices in order to be successful?

Culture is a set of traditional values and norms of a group. A group can either be a country, an organization, or people that share a set of values and norms. Culture develops over time and is embedded in a process instead of a single activity. Culture is commonly referred to as "the way we do things here" (Deal/Kennedy 1982, p. 4) which in spite of its simplicity is in fact a very good description. Cultural norms exist across all levels of society; the introductory case study for example concerns various cultural sets, such as national/regional cultures and organizational culture as well as the individual value sets of the people involved.

Culture
Culture is a set of traditional values and norms of a group, e.g. a country or an organization.

When talking about culture, it is important to distinguish between formal and informal culture (Ethics Institute of South Africa 2012). Formal cultural aspects can be laws, regulations, hierarchies, and rules, and are often found in written form. Informal culture refers to patterns of behavior, stories, traditions, and taboos. Informal culture is not normally written down but lived in daily life. However informal culture should not be underestimated as it is, at times, extremely powerful and durable, sometimes even strong enough to prevent formal cultural aspects from being put into practice.

In order to summarize these thoughts on a suitable definition for culture, let us refer to the Encyclopaedia Britannica (2000), which states that culture includes the knowledge and beliefs, art, morals, laws, customs and habits shared by a group.

Efforts have been made to identify key distinguishing marks for national cultures. In other words, what are the determinants of national culture? What differentiates the culture of country A from that of country B? We would like to look into two models helping us under-

stand the unique features of a national culture. It is worth mentioning, that the models apply to organizations and other cultural groups as well, but are best fit when used for national assessment.

Differentiation of cultures

We can explore the patterns of communication between members of a society, differentiating between low context cultures and high context cultures (Hall 1976).

In high context cultures, an individual is always seen in the context of their link to the group. Therefore, collectivism is more important than individualism. Personal space is limited as the group and involvement in matters of the group are highly valued. Communication is marked by physical contact during conversational interaction. Being on time is regarded less important than nurturing personal relationships, therefore punctuality is not given much attention.

In low context cultures, individualism prevails and physical space taken during communication is respected. Verbal communication is more important than non-verbal communication. Furthermore, communication is more codified through explicit rules. In low context cultures, punctuality is given priority and appointments are kept.

Let us look at a very simple example from my own experience. In Western Europe it is normal to shake hands when meeting a business partner and the duration of a handshake is normally one or two seconds, whereas in many parts of Africa you shake hands for up to ten seconds or even longer while having small talk. When you go to certain Asian countries, you do not shake hands at all but bow your head as a sign of respect. There, European behavior might be seen as inappropriate and rude.

This framework is summarized in the following table:

Table 6: Differentiation of Cultures

Low context culture	• emphasis on individualism • higher expectation of personal space during communication • limited importance of non-verbal language • communication is codified through explicit rules • time matters, punctuality is given priority • preparation is important
High context culture	• emphasis on the group • lower expectation of personal space during communication • personal communication is marked by physical contact • time is less important • personel relationships are important • punctuality is not given much attention

Source: Hall 1976, cited in: Wall/Minocha/Rees 2010, p. 173.

Dimensions of culture

Let us discuss a second well-known framework which tries to explain important cultural determinants. The six dimensions of culture (Hofstede 1980) are:

- individualism
- power distance
- uncertainty avoidance
- masculinity/femininity
- long-term orientation
- indulgence

Individualism refers to the importance of individual interests compared to group interests. In societies characterized by individualism, a person's own interests are given preference over the group's interests. In collectivistic societies, the group is what matters to the individual. Disregarding group interests is unacceptable in such societies, where living in harmony with others and avoiding conflicts are priorities.

Power distance defines whether authority is gained by means of hierarchy or character. In large power distance groups, authority is an integral part of a hierarchy. Openly criticizing a superior is inappropriate in such societies. Instead, hierarchical positions are respected and not subject to discussion. In low power distance groups, the acceptance of superiors tends to result from achievements rather than from hierarchical positions. Criticizing superiors is common and in fact is often encouraged.

Uncertainty avoidance is the readiness to accept and deal with uncertainty. If uncertainty avoidance is weak, then people are more likely to accept change; individuals feel they have a right to influence superiors and authorities. In strong uncertainty avoidance societies, people believe that decisions must be made by authorities and experts. They tend to rely on bureaucratic structures as this provides a feeling of security.

Masculinity / femininity concerns the motivation of people to achieve certain goals. Focusing on material possessions and values, masculine societies tend to strive more aggressively towards their goals. The members of a group marked by femininity are more likely to focus on social issues, relationships, and enjoying life. Goal orientation tends to be less aggressive than in masculine groups.

Long-term orientation is a dimension that describes the importance of time within a group. In a society marked by long-term orientation, diligence, and professional ambition are not only expected, they determine the individual's self-image. In short-term oriented groups, diligence is of less importance and acquiring self-esteem is independent of professional achievements. Instead of constantly planning for the future, enjoying each minute of life is paramount.

Indulgence expresses the degree to which an individual feels free to enjoy life and has fun without feeling constrained by societal norms. In restrained societies individuals are less likely to openly enjoy life due to respective social norms.

Regarding our case study, the differences between the cultures involved can be clearly seen. The young project manager expects to be ranked higher in her organization based on her expertise and achievements. Hierarchy is not considered as important as her commitment and professional orientation. It can also be assumed that long-term orientation is less important to this young project manager. Her counterparts in Angola certainly come from a different cultural background. Little emphasis is placed on punctuality, while hierarchical seniority is crucial. Angola would appear to be a collectivistic society with a great power distance.

Whenever considering a potential clash of cultures, be it on a national or organizational level, it is important to be aware of these dimensions in order to understand the different viewpoints.

Hofstede's framework is summarized in the following table:

Table 7: The Six Dimensions of Culture

Individualism	• Individualism: Individual interests are paramount • Collectivism: The group and its interests matter most
Power distance	• Large power distance: Authority based on hierarchical position, no criticism of superiors • Low power distance: Authority based on achievements, criticism of superiors possible and often encouraged
Uncertainty avoidance	• Weak uncertainty avoidance: People accept change, they feel they can influence authorities • Strong uncertainty avoidance: People think decisions need to be made by authorities. Bureaucracy is expected to take care of people's business.
Masculinity/femininity	• Masculinity: Material wealth is important, aggressive goal orientation • Femininity: Focus on social matters and relationships, low goal orientation
Long-term orientation	• Long-term orientation: Diligence and ambition are important, self-image depends on achievements at work • Short-term orientation: Enjoying life is more important than hard work, goal achievement, and long-term planning, building self-esteem is independent of professional achievements
Indulgence	• Indulgence: Society allows individuals to freely enjoy life and have fun. • Restraint: Social norms do not allow individuals to openly enjoy life and have fun.

Source: Hofstede 1991, cited in: Wall/Minocha/Rees 2010, p. 174

3.2 Organizational Culture

This section will move from national culture to examine culture on the organizational level. The term organizational culture is often used but it is important to define both the term and its features. Firstly, we will discuss the particular characteristics of organizational culture. Then we will explore the instruments used to measure corporate culture. This is important because if, as a manager, you consider moving corporate operations abroad, you may need to think about adapting your organization's culture to the local environment. Similarly, you will need to be familiar with your company culture when preparing for a merger with another firm.

In the past, many large companies have not been able to successfully complete the internationalization process or merger, e.g. Wal-Mart failing to gain ground in Germany and the failed merger of former Daimler-Benz and Chrysler. There are many other examples such as these, where one of the major reasons for failure is ignorance of cultural issues within the organization.

The previous section stated that culture is a set of traditional values and norms of a group. If we use this broad definition as a starting point, then it is worth discussing what exactly characterizes an organizational culture. It is well regarded that four specific factors within a hierarchy constitute organizational culture (Johnson/Scholes/Whittington 2008):

- paradigms
- behaviors
- beliefs
- values

Perhaps the most deeply grounded factor is the paradigm or the set of paradigms. They can be described as common basic assumptions within an organization. Paradigms evolve from experience. It is essential to note that paradigms are not easily identified; they occur, develop, and are not recorded. This will be reflected later in the unit when we discuss ways of assessing organizational culture.

Behavior is clearly visible and is the operational pattern followed in an organization. It could also be claimed that behavior is the common way in which work is carried out. Behavior includes routines as well as reactions to various incidents.

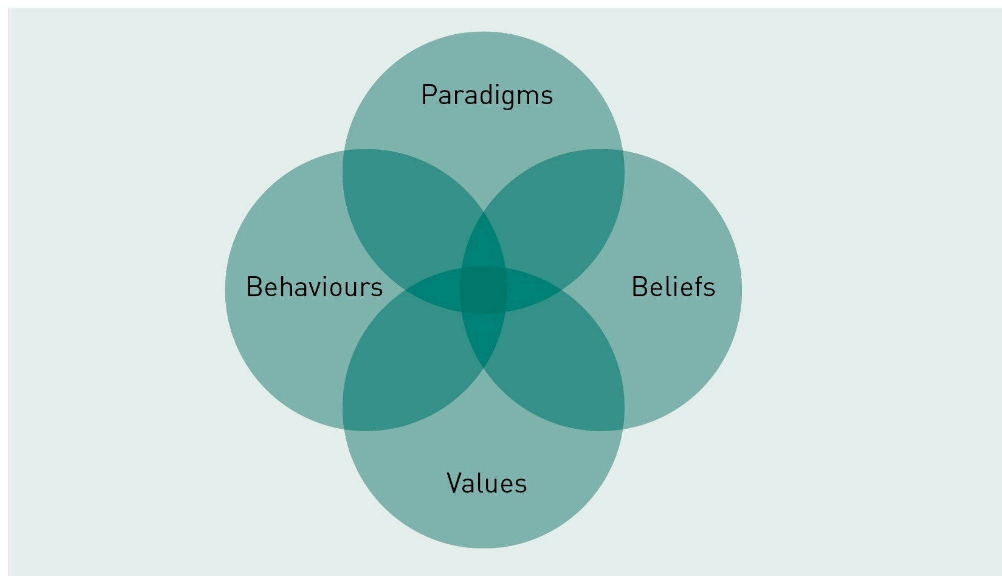
Beliefs are the convictions shared in an organization. They are based on organizational values and beliefs, and are not easily distinguished.

Values are traditional norms shared in an organization. They are the basis on which beliefs are developed, e.g. a common value could be concern for the environment and its corresponding belief would be the organization adhering to pollutant emission regulations.

Organizational paradigms, behaviors, beliefs, and values may be similar to individual ones but a huge challenge in organizations arises if there is conflict between personal and organizational values. This puts tremendous pressure on the individual within an organization who may have to work in opposition to her convictions. One of the key tasks for managers is to align organizational culture with staff values.

The diagram below summarizes key features of organizational culture and illustrates the interconnectedness of the components:

Figure 3: The Components of Organizational Culture



Source: Johnson/Scholes/Whittington 2008, p. 194.

The components of culture are not all directly visible and measurable in an organization's day-to-day operations, but it is possible to assess behaviors and identify beliefs, values, and paradigms. The challenges of such an evaluation, namely to identify cause and effect relations between these components, have led to the development of frameworks that assess certain indicators. These indicators are regarded as obvious for organizational culture.

Collecting and analyzing data for these indicators provides information on the most basic cultural assumptions—the underlying paradigms. However only if a relationship is accepted between the indicators and the underlying cultural paradigms can the results of an organizational cultural analysis be seen as valid.

The following indicators are used to reach conclusions on organizational culture and the underlying paradigms (Johnson/Scholes/Whittington 2008):

- routines
- rituals
- stories

- symbols
- power structures
- organizational structures
- control systems

We will look at these indicators in detail and pose questions that should be asked in order to assess an organization. These aspects have been summarized in the following table:

Table 8: The Indicators of an Organizational Culture

Indicators of Organizational Cultures:	**Description**	**Assessment Questions**
Paradigms	Basic assumptions commonly shared within an organization	• What basic assumptions can be drawn from the answers to the questions below: • What is the dominant culture of the organization? • How could change be achieved? (These questions can be answered by analyzing responses to questions on the following indicators)
Routines	Describe how things are usually done in an organization.	• What routines are followed and which are most important? • To what degree have they developed from the organization's history? • What behavior results from these routines? • How difficult is it to change these routines?
Rituals	Activities carried out in an organization (formally or informally) that usually emphasize what is considered important in the organization.	• What rituals are there? • What are the underlying beliefs of these rituals? • How difficult is it to change these rituals?
Stories	Relate events or issues that are somehow of importance to the organization.	• What are the stories about? • What beliefs do they reflect? • What norms are promoted in the stories?
Symbols	Convey meanings for a functional purpose. Events, objects, and activities are used to represent status and hierarchical position.	• What status symbols are important in an organization? • What do the symbols express through the wording applied (e.g. importance, resistance, valuation, etc)?

Indicators of Organizational Cultures:	Description	Assessment Questions
Power structures	Deal with the distribution of power in an organization and show how leadership is conducted.	• How is power distributed? • Do informal structures overlap formal ones? • What form does leadership take?
Organizational structures	Reflect the various relations and, to some extent, the power structures within an organization.	• How are the formal structures designed? • Do informal structures overlap the formal ones? • Do structures support collaboration and modern leadership (flat hierarchies)?
Control systems	Show what must be monitored and evaluated in an organization.	• Which aspects are given highest priority in terms of monitoring? • Is control applied to incentives or to punishment? • Does control align with the strategy of the organization?

Source: Johnson/Scholes/Whittington 2008, p. 198.

The assessment of organizational culture is a necessary and important task in international business. It helps managers to understand their own organizations. At the same time, they can identify weaknesses and necessary changes when moving operations abroad, helping them to adapt corporate culture to new or different environments. Finally, as pointed out at the beginning of this unit, it is crucial to examine corporate cultures in mergers and acquisitions to ensure that companies are compatible before they start cooperating. Finally, an evaluation of corporate culture is a prerequisite for any change management process. If changes are required in an organizational culture, the range of challenges accompanying long and difficult processes must be taken into consideration. Unfortunately, we cannot elaborate on change management in this lecture, as this would go beyond the intended scope, however for those who are interested, there is excellent literature available on change management processes.

3.3 Cultural Diversity and the Contemporary Manager

After having elaborated national cultures and organizational cultures, we will discuss the specific requirements for managers when dealing with cultural diversity.

Acting in diverse and often unfamiliar environments has become a reality in the daily lives of managers; this does not only apply to large companies and multinational enterprises. Nowadays, many small and medium-sized firms have started operating abroad as well,

though often on a smaller scale than larger corporations. Cultural sensitivity is essential for managers relocating to foreign countries and for those dealing with international business partners at home.

Many challenges of globalization with regards to management have already been mentioned. Nowadays, diversity is a key issue and challenge for managers. There is considerable diversity in international markets, cultures, procedures, legal frameworks, and political environments, among others, that managers will encounter.

What does this mean for corporate leaders running successful global companies? One of the most important tasks of management is establishing and sustaining transformational interrelations with staff members and other partners. Cooperation between leaders and employees guides both to higher levels of motivation and understanding. Superiors must support their staff in their personal development; assisting employees in their personal growth is a major characteristic of today's successful leaders. It is thus vital that companies prepare their managers accordingly. Furthermore developing a match between corporate strategy and corporate culture is a necessary task for leaders; shared values and a common set of beliefs must be established (Darcy 2006). In addition, leadership needs to be connective in order to be effective in globalized operations (Ciulla 2002). It requires managers to deal with cultural differences. It is often a major task to bridge the gap between these differences, therefore the ability of leaders to build and maintain relationships based on mutual trust is paramount.

Bearing these challenges in mind, we can now draw a picture of the characteristics necessary for a truly successful manager in times of globalized markets (Beamish/Morrison/Inkpen/Rosenzweig 2003, p. 199). A good manager is no longer expected to know everything but must be willing and capable of learning quickly. He needs to develop a global perspective and possess an ability to adapt mentally to different environments. Future developments can no longer be derived from past experiences. Instead, intuition is needed, as is the capacity to convey future development to staff members. Teamwork is also increasingly important and this means that today's managers must be able to communicate effectively with people from various cultural backgrounds. Being aware of cultural sensitivity, leaders must be able to deal with ambiguity.

Let us now discuss the skills that mark a culturally sensitive and adaptable manager, specifically:

- global strategic skills
- change management and transformation skills
- cultural sensitivity
- ability to adapt to flexible organizational structures
- teamwork
- communication skills
- fast learner with the ability to transfer knowledge

Global strategic skills require a manager to think strategically across borders and develop global strategic perspectives. At the same time, he or she needs to enable local staff to understand the global strategy and put it into practice in the local context. It can thus be concluded that global strategic skills also include an element of human resource management with regard to providing guidance to local staff.

Change management and transition skills necessitate the acceptance of ever-changing context factors that an organization must adapt to. It is important to understand that changes and transitions are continuous. This alone puts a great deal of pressure on managers as they might feel their job consists of ongoing, unresolvable challenges. In fact, given the status of globalization in today's business, this conclusion is absolutely valid. Thus, managers must be able to cope with constant challenges.

Cultural sensitivity is highly important. Managers must understand their own culture as well as the cultural characteristics of their organization. It is also crucial to understand the various cultures of foreign markets and, in the event of operations being started abroad, it is necessary to develop compatibility between corporate strategy and the prevailing culture. We have already mentioned the transformational and connective leadership skills of managers in global business operations.

Closely related to the previous aspect is the adaptability to flexible organizational structures. The ability to deal with ambiguity is a key characteristic as is the willingness to fit into various organizational set-ups quickly. Why is this essential? Simply because international operations of multinational companies lead to diverse structures and cultures in foreign branches, often owing to legal requirements.

The necessity of teamwork is self-explanatory. When launching global business operations, transnational teams are likely to be created and the overall cooperation is more international and more culturally diverse. This requires a high level of team spirit and the willingness to understand and acknowledge different patterns of behavior.

Communication skills are closely related to teamwork. Communicating effectively on all levels and across national borders makes it necessary to accept cultural diversity and to acquire soft skills such as a foreign language and negotiation skills, in addition to many others.

Finally, being able to learn quickly and transfer knowledge skills are priorities owing to the shift in global manager characteristics. We pointed out earlier in this unit that managers are no longer expected to know everything but to be fast learners and pass on knowledge in order to motivate their staff.

In summary, today's managers must be culturally sensitive and able to motivate their staff, as well as be highly flexible and knowledgeable, in order to cope with the increasing demands of a global economy. This necessitates changes in organizations' recruitment processes. Companies need to employ people who enjoy working and living in culturally diverse environments. Only those who regard it as an opportunity for personal growth will

eventually succeed as global managers. In addition to recruitment, training is necessary to familiarize managers with cultural and managerial diversity. Finally, on-the-job exposure to such environments is important to initiate the individual's adaptation to diversity.

The following table summarizes the key findings of this section:

Table 9: Managers in Globally and Culturally Diverse Environments

Challenges	Diversity of: • markets • cultures • procedures • legal frameworks • political environments
Leadership requirements	• transformational leadership • connective leadership
Individual skills	• global strategic skills • change management and transformation skills • cultural sensitivity • ability to adapt to flexible organizational structures • teamwork • communication skills • fast learner with the ability to transfer knowledge
Organizational response to challenges from culturally diverse contexts	• recruiting 'the right people' • cultural sensitivity training • on-the-job exposure to diverse contexts

Source: Created on behalf of IU (2015).

SUMMARY

This lecture dealt with cultural issues. We first looked at national cultures, before exploring features of organizational cultures and finally discussing the characteristics of culturally sensitive managers. We stated that a culture is a set of traditional values and norms of a group, and that it is necessary to distinguish between formal and informal cultures.

On a national level, we examined the frameworks used to explain differences between cultures. We took a closer look at Hofstede's cultural dimensions: individualism, power distance, uncertainty avoidance, masculinity/femininity, long-term orientation, and indulgence.

Organizational cultures comprise four components: paradigms, behaviors, beliefs, and values. Apart from behaviors, these cannot be easily measured, thus a framework of indicators was developed to explain an

organizational culture.The following indicators that describe a cultural paradigm were examined: routines, rituals, stories, symbols, power structures, organizational structures, and control systems. In order to carry out this assessment we developed guiding questions.

Finally, we discussed the requirements of a contemporary manager operating in culturally diverse environments. We concluded that managers in global business are mainly challenged by a diversity of contexts. We then listed leadership characteristics that are necessary to cope with the demands of global business, stating that today's leadership needs to be transformational and connective. Then we discussed the key skills of culturally sensitive managers, which included global strategic skills, change management and transformation skills, cultural sensitivity, the ability to adapt to flexible organizational structures, teamwork, communication skills, and being a fast learner with the ability to transfer knowledge. Organizations need to address these requirements by recruiting individuals with the ability to acquire the necessary skills. Managers also need to be given training and on-the-job exposure to diverse contexts.

UNIT 4

STRATEGY DEVELOPMENT IN INTERNATIONAL BUSINESS

STUDY GOALS

On completion of this unit, you will have learned …

- the importance of strategy in international business.
- the potential benefits of global strategies.
- the key strategic choices in globalized business operations.
- how to successfully manage strategy development and strategy adoption.

4. STRATEGY DEVELOPMENT IN INTERNATIONAL BUSINESS

Introduction

DAIMLER-BENZ AG AND CHRYSLER

Karl Benz constructed the first automobile in 1886 at the time Gottlieb Daimler was active in the same field of business. After years of partnership, their businesses formally merged in 1926 as the Daimler-Benz Company. In the 1980s, Daimler-Benz pursued a strategy of diversification, acquiring MTU, AEG, the airplane company Dornier, MBB, and Fokker, the latter completing the aviation arm of Daimler-Benz. The vision of the chairman, E. Reuter, was to transform the firm from a car manufacturer into an integrated technology group along the lines of General Electric or the Japanese Mitsubishi conglomerate. His vision included generating cross-border synergies between the automobile, the airplane and electronics industry, exchanging skills and knowledge, and spreading the company's risks over the many businesses in its portfolio.

Daimler's first acquisition gathering

This gathering of acquisitions soon ran into trouble. The electronics industry was put under pressure by cheap components from Asia; the civil aviation industry was badly affected by the recession of the late 1980s to early 1990s, and the market for military airplanes collapsed after the end of the Cold War. Furthermore, many of the acquired businesses had needed restructuring to make them internationally cost competitive. Few of the newly acquired firms had proven to be cash cows for Daimler. Profits were absorbed as the company invested heavily in restructuring. In terms of Porter's 'parenting advantage concept', it would seem that Daimler provided neither benefits to its acquired businesses nor gained competitive advantages or other benefits from them. Daimler, for example, proved unable to provide readily transferable skills from its core automobile business to units like AEG or Fokker. The outcome was that AEG, one of the best known and well-established German companies, was divided up, the brand being sold to Electrolux, some parts integrated into other Daimler businesses and most others closed down. Fokker's (airplanes) outcome was similar, as they were on the edge of bankruptcy after Daimler withdrew financial support in 1996. Arguably, Daimler not only destroyed shareholder value but also destroyed whole companies with its attempt to build a conglomerate based on unrealistic expectations of planned synergies.

Daimler's first round of acquisitions ended with the highest loss since its foundation (DM 5.8 billion) being announced in 1995, mainly owing to restructuring expenditure. Applying M & A success measurements, it would seem that the

strategy had failed. Many of the acquired firms had been sold off or closed down and, in terms of stock market figures, the market value of Daimler had plunged during the diversification period from DM 53 billion in 1986 to DM 35 billion in 1995.

Daimler's merger with Chrysler

On May 6, 1998, a new chapter in Daimler's M&A history began. Daimler-Benz AG and Chrysler Corporation announced their merger and the creation of the new Daimler Chrysler AG. To understand this merger, one must first consider all the environmental factors. The automobile industry is becoming increasingly mature with only certain regions (especially Asia) offering higher than average growth opportunities.

If a car manufacturer wants to survive, it must have a global reach and be established in all markets of the triad, (for example, the number of independent car manufacturers has halved in the last 30 years). A second factor involves the time dimension. Those who wish to sustain their position must react rapidly to changing demands and renew their product portfolio more frequently. As a result, they are forced to share expensive fixed overheads (e.g. gain synergies in research and development), and use economies of scale and scope to keep variable costs down. Arguably, only large, globalized companies can fulfill these criteria.

The Daimler-Chrysler management engaged international merger experts to assist in all the vital steps of the pre- and post-merger phases. The merger with Chrysler was undertaken with a view to capitalizing on core competencies. The companies, both car producers, sought to keep their core business in the automobile sector. Other expressed reasons involved, such as increasing market power and sharing infrastructure, are identified in Figure 7.8 as 'real term' issues. Figure 7.10 outlines some of the product range synergies stated by the participants as relevant to this particular merger.

Table 10: Product Range Synergies in the Daimler and Chrysler Merger

	Small Class	**Medium Class**	**Upper Class**	**Luxury Class**	**Pickup**	**Mini-van**	**Off-road**
High price	A-class	C-class	E-class	S-class		Town & Country	M-class and Grand Cherokee

	Small Class	Medium Class	Upper Class	Luxury Class	Pickup	Mini-van	Off-road
Medium price	Neon	Cirrus/ Stratus	Intrepid/ Concorde	LHS/ 300 M	Ram	Caravan	Durango/ Cherokee
Low price	Neon	Breeze			Dakota	Voyager	Cherokee/ Wrangler

Source: Created on behalf of IU (2015).

As can be seen in Figure 7.10, except for the 'off-road' segment, there were no product overlaps; the respective product portfolios complemented one another. This was also the case in terms of their geographical markets, showing Chrysler as a strong player in the NAFTA region and Daimler-Benz as a leading company in Europe. Daimler Chrysler AG subsequently acquired a third leg in the Asian market in order to consolidate its position in all regions of the triad.

Further synergies were identified in fields such as procurement, common use of parts, and sales. Synergies totaling DM 2.5 billion were stated as having already been obtained in those fields within one year of the merger. Going forward, more synergies were targeted in sales, production, research and development, and sales. For example, Chrysler brands were expected to gain entry into the European market by using the market knowledge acquired by the established Daimler sales network and some of their distribution outlets.

Pilot plants in South America were already being used as test beds to combine the production of Daimler and Chrysler vehicles, with standardized parts being used in the different models wherever possible. Common R & D efforts were also undertaken in the field of future drive concepts. Further synergies of DM 6.4 billion were expected by 2001. When these projected savings were compared with the estimated merger costs of DM 550 million, the advantages then became obvious.

The chairman, Mr Barnevik, highlighted a number of critical success factors:

In the pre-merger phase

- Act quickly and keep it secret. The company tries to limit the number of people involved and acts rapidly to achieve surprise and momentum. It is better to concentrate on essentials rather than be distracted by less important details.

- Approach M & A as a project. The whole merger and subsequent integration should be carried out as a series of mini-projects. Therefore, strong project managers are necessary.
- Negotiation teams need to be kept as small as possible. This helps to keep the negotiations confidential and decisions are made more quickly.

The post-merger phase

- Find key people. They are important in accelerating projects, integrating people and cultures.
- Walk to talk. Top management must engage directly with staff to make sure they participate in the overall vision.
- Maintain centralized control. The use of centralized control systems make information available fast and facilitate quick decisions.

The Daimler-Chrysler merger seemed to incorporate many of these factors. The merger was undertaken in record time, with only six months elapsing between the announcement and the actual flotation of Daimler-Chrysler shares. The whole preparation took place without any leaks from the negotiation team and with the global auto industry being caught unawares by the announcement of the transatlantic alliance. Key people were found and more than 90 projects for integration defined.

Daimler-Chrysler installed special post-merger integration (PMI) teams and a PMI network enabled all participants worldwide to access a 24-hour information base in order to obtain details on the various integration projects. As well as the PMI teams, issue resolution teams (IRT) were installed. Their objectives included supervising and coordinating the PMI projects. Speed, accuracy, reliable communication, transparency, and clear goals were the objectives of these developments. The achievement of synergy potential was monitored all the time. Accordingly, the PMI teams encouraged the sharing of existing resources and, where necessary, the raising of new resource allocation. Synergy value of more than DM 2.5 billion was reported to have been achieved overall in the first year of operation.

Daimler-Chrysler also introduced a new Integrated Controlling System (ICS) using common concepts and data to help compare the different business. This approach helped to eliminate contradictory rules regarding definition and foster rationalization and integration. A vital element for successful cross-border integration, and arguably the most difficult, was recognized as being the creation of one common culture and corporate identity, especially where the new business involved different national and corporate cultures.

Chrysler perceived German companies as too comfortable, less innovative, and less project-orientated than U.S. companies. On the other hand, Daimler-Benz thought its American partner too capitalistic and insensitive towards the German social security system.

In an attempt to combine these different cultures and mentalities, a conscious effort was made to create a culture of discussion. A senior management figure was appointed to communicate the goals company-wide, to field emails and respond to the enquiries of concerned employees.

Interchange programs took place to facilitate intercultural understanding, involving brief information visits, shared projects, seminars, or even longer stays abroad. Daimler-Chrysler sought to clarify from the outset that this was a genuine merger of equals. It kept two bases: one in Auburn Hills, USA, and one in Stuttgart, Germany. The respective CEOs, Robert Eaton and Jürgen Schrempp, led the company together. Both companies were equally represented at board level with equal rights in order to avoid the victor/vanquished syndrome.

Of course, there were some negative aspects. Several high-profile former Chrysler executives left the new company, taking with them valuable skills and personal knowledge. Nevertheless, many of the critical factors for a successful merger seem to have been applied.

Yet many of these initial expectations for the merger ultimately proved too optimistic, leading to a Daimler and Chrysler demerger in mid-2007. However, many years earlier, the problems within the merged company had already become increasingly apparent as many of the German executives and workers resented the loss of “Benz” in the new corporate name. Although the mantra throughout the merger process was of a “merger of equals”, most people thought this a ploy to gain acceptance to the merger by the U.S. government and Chrysler employees, rather than reflecting reality. It was noted at the time of the demerger in 2007 that the Daimler Chrysler Board had changed from the equal number of 1998 to a ten-to-one ratio in favor of Daimler. Cultural differences in business practices began to emerge in many aspects of the new company with regard to employee reward structures. The ‘Chrysler’ element venture saw the need to increase employee incentives to match those of rivals GM and Ford, including a range of bonus and health care payments, estimated at as much as $ 2000 per vehicle produced in the years subsequent to the merger.

Source: Wall/Minocha/Rees 2010, pp. 270–274.

4.1 Strategy in Globalized Business Operations

This unit starts with some basic ideas of strategy and developments in the ongoing debate about strategy. Originating in the military arena, the term ‘strategy’ is defined as long-term planning in order to achieve certain aims and includes elements such as anticipation and forecasting. With regard to business administration, strategy traditionally described the long-term direction of a company that was developed to provide competitive advan-

tages in the market. However, owing to increasing complexity in management, strategy is gaining further meaning in terms of obtaining competitive advantages. These additional elements are (Johnson/Scholes/Whittington 2008, p. 2):

- the scope of a company's activities
- its compatibility with the political, cultural, and economic environment
- strategy emerging from organizational resources, competencies, and networks
- strategic orientation towards values and expectations of key stakeholders

The scope of activities reflects decisions required in terms of the areas in which a business wants to be active. Strategic compatibility takes into account the increasing complexity of influencing factors, which may guide and sometimes limit a firm's opportunities. Emerging strategies relate to the relatively unique set of a company's resources, competencies, and networks. Strategic orientation towards the values and expectations of stakeholders describes the increasing interconnectedness and dependability on any individuals and groups with which the company engages.

Broadly speaking, it may be stated that strategy has experienced a shift from market orientation, as represented by Porter's concept of competitive advantages (1980, p. 34), towards a resourced-based view of strategy and, to some degree, to a relationship-based view of strategy (Barney 1991, pp. 99–120). While the market-oriented view on strategy is an **ex-ante** approach and based on future projections and estimates, resource- and relationship-based views adopt an **ex-post** approach and draw on existing information about markets. They are based on the recognition of specific resources and networks available in an organization.

Ex-ante and ex-post
Ex-ante refers to future events while ex-post refers to past events; an ex-ante estimate is based on forecasts because the event in question has not yet occurred while ex-post assessments are based on actual results.

Let us discuss the shift from market-based views on strategy (tradition) to resource and relationship-based perspectives (emergent) to understand the direction the strategy debate has taken in recent decades (Wall/Minocha/Rees 2010; Prahalad 2000). The market-based view was focused on compatibility between resources and strategy, while emergent strategies examine resources and consider how to stretch and leverage them in order to identify a successful strategy. The traditional perspective tried to position the company and its products and services in existing industrial markets, while emergent strategies seek to develop new markets. They demand that strategy be regarded as a process in which the entire organization is involved. By contrast, the market-based view was rather narrow in that strategy was considered a task for top management. Strategy has developed from a singular analytical process to an activity that contains analytical and operational elements. It is fair to say that strategy development used to mean extrapolating the past; today, strategy is about creating the future.

Strategy development in international business is influenced and even somewhat driven by four key aspects (Johnson/Scholes/Whittington 2008):

- governmental aspects
- market aspects
- cost aspects
- competition aspects

Governmental aspects, comprised of trade policies, technical standards and norms, and regulations and laws, must be considered when planning operations abroad. Market aspects include the needs of consumers in different countries, the existence of global consumers, and the potential for marketing approaches in several countries, thereby reducing costs. Cost aspects relate to economies of scale, logistical advantages, and other sources that help reduce expenditure when expanding business operations. Aspects regarding market competition include the marketing strategies of competitors to which a company needs to respond. Sometimes there are interdependencies between countries and their markets, which guide strategic decision-making.

Internally, a company's strategic development process is driven by the mindset prevailing in an organization. This brings us back to the last unit, in which we discussed the cultural aspects on a national, organizational, and individual level. In general, four perspectives may be distinguished (Beamish/Morrison/Inkpen/Rosenzweig 2003, p. 203):

- ethnocentrism
- polycentrism
- regiocentrism
- geocentrism

Ethnocentrism assumes superiority of the home country's systems and the company headquarters. Polycentrism emphasizes the necessity of keeping involvement in host countries to a low level, e.g. through indirect export, owing to difficulties in understanding local contexts. Regiocentrism relates to a regional orientation; foreign markets are considered interesting provided they are relatively similar to the home environment. Geocentrism is an understanding of global contexts and their integration in a similar global organization. Geocentrism does not specifically focus on certain countries or regions but takes international contexts into account. The company needs to be prepared to optimize global resources systematically. This mindset does not support national or regional superiority but tries to identify best practices wherever they occur.

It is worth mentioning that these mindsets are never found exactly as described above but rather as a mix, although with a tendency towards one orientation or another. These tendencies have a great impact on the selection of strategic choices. Therefore, it is advisable to assess the organization's pre-conditions for strategy development. If organizational resources and the prevailing mindset are not taken into account, the strategic direction of an organization might remain disconnected from the people inside the organization. This would result in a lack of commitment and the increased probability of strategy failure.

International strategy development is performed to achieve certain global synergies that help to sustain corporate existence and increase financial success. In order to be effective, international strategies must address a company's entire value chain (Wall/Minocha/Rees 2010, p. 254). Reflecting potential strategies along all points of the value chain also ensures a systematic approach, which clearly indicates possible shortcomings. The value chain generally consists of primary and secondary activities. Primary activities are logistics, operations, marketing and sales, services, and others. Secondary activities comprise an organization's infrastructure, human resources management, procurement, and research and development.

Global synergies of international strategies are (Wall/Minocha/Rees 2010, p. 255):

- localizing operations globally
- localizing core competencies globally
- economies of scale
- economies of scope
- international growth

Both localizing operations and competencies globally offer similar advantages. A company might obtain additional profit by accessing global resources instead of limiting its development by remaining in its home country. Economies of scale and of scope relate to the means of increasing efficiency by decreasing average costs or by optimizing business activities on an international level. International growth is a much sought-after advantage if the home country cannot provide potential for further growth.

Finally, it should be noted that strategy development is not an isolated process. In fact, every strategic development process must be based on a thorough analysis of the company's contexts. The analysis of political, legal, economic, and cultural environments has already been explained in unit two and unit three. It is worth mentioning that there are other sophisticated analysis models. One of the most well-known is the PESTLE Analysis (Wall/Minocha/Rees 2010, p. 240). PESTLE stands for political, economic, social, technological, legal, and environmental factors. It would go beyond the scope of this lecture to give a full account of this method. For the purpose of this lecture, the analytical framework as described in units two and three is sufficient as it entails all the components of a PESTLE analysis, provided that a broad understanding of our analysis factors is applied.

In summary, the meaning of strategy has changed considerably. Strategic approaches do not only take future states into consideration but also available resources, competencies, and networks. They are influenced by various aspects and depend on the prevailing mindset in an organization. International strategy development will eventually have to be conducted along the value chain and validated through realistic global synergies.

The following table summarizes the key aspects of this section:

Table 11: Basic Characteristics of Strategy in International Business

Shift in definition	Market-based view of strategy (Porter)	Resource and relation-based views of strategy (Barney)
Focus of strategy comprehension	Narrow understanding, search for competitive advantages	Broader understanding of strategy by means of: • scope of company activities • strategic match between the company and its environment • strategy emerging from resources and networks • strategic orientation towards stakeholders

Driving factors of international strategy development	• governmental aspects • market aspects • cost aspects • competition aspects
Prevailing mindset in organizations influences strategy development process	• ethnocentrism • polycentrism • regiocentrism • geocentrism
International strategy validation along the value chain	Considers primary and secondary activities in search of global synergies such as: • localizing operations globally • localizing core competencies globally • economies of scale • economies of scope • international growth

Source: Created on behalf of IU (2015).

4.2 Strategy Concepts and Strategic Options

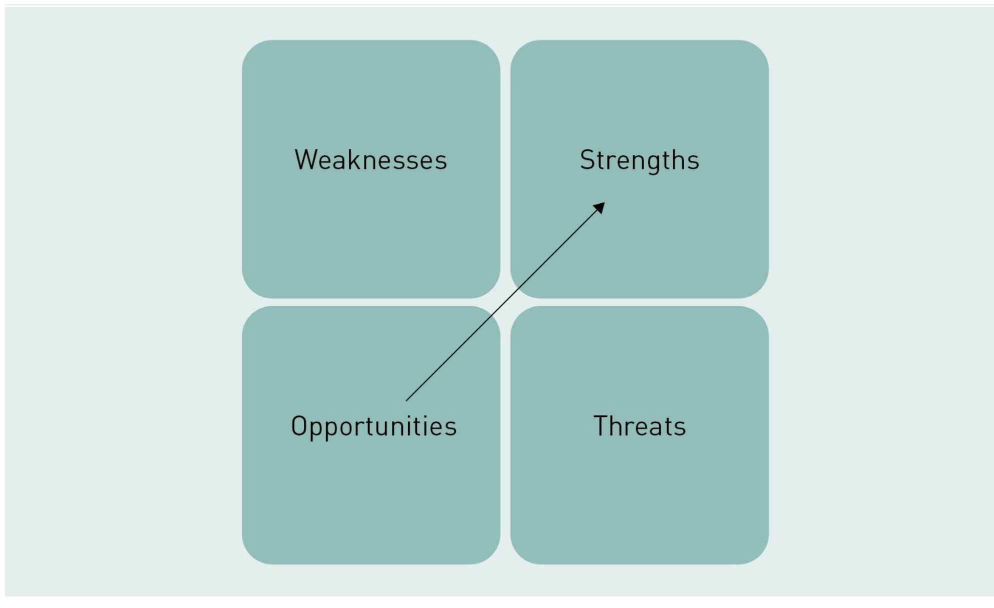
This section discusses various strategy concepts (or models). Some are generally applicable to national and international companies, others are specifically designed to address the needs of internationally operating firms. All models are used to structure and simplify the process of strategy development. They all apply the same criteria used to measure a company and/or its products. Various strategy options are proposed, depending on the position of the company and/or its products with regards to the criteria. We will look specifically at the following strategy tools:

- SWOT analysis
- Five Forces analysis
- portfolio analysis
- product-market strategy options
- competitive strategy options
- international strategies
- economic integration/national responsiveness strategies
- market entry strategies

SWOT analysis

SWOT stands for strength, weaknesses, opportunities and threats. This analytical tool helps to identify an organization’s key characteristics. It aims to reduce weaknesses and develop opportunities into organizational strengths.

Figure 4: SWOT Analysis



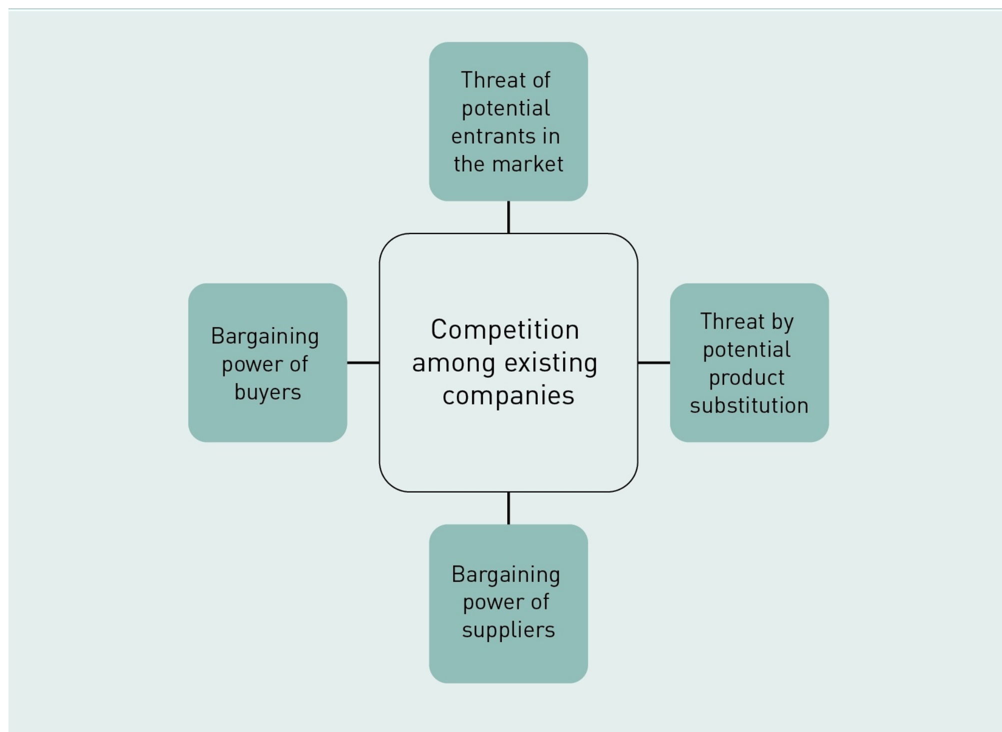
Source: Created on behalf of IU (2015) using Wall/Minocha/Rees 2010, p. 240.

Five Forces analysis

Porter's Five Forces analysis (1980) concludes that it is necessary to check the industry specifics in order to come up with a promising strategy for an organization. It is therefore important to analyze:

- the threat of potential entrants in the market
- the threat of potential product substitution
- the bargaining power of suppliers
- the bargaining power of buyers
- the competition among existing companies

Figure 5: Five Forces Analysis by Porter (1980)

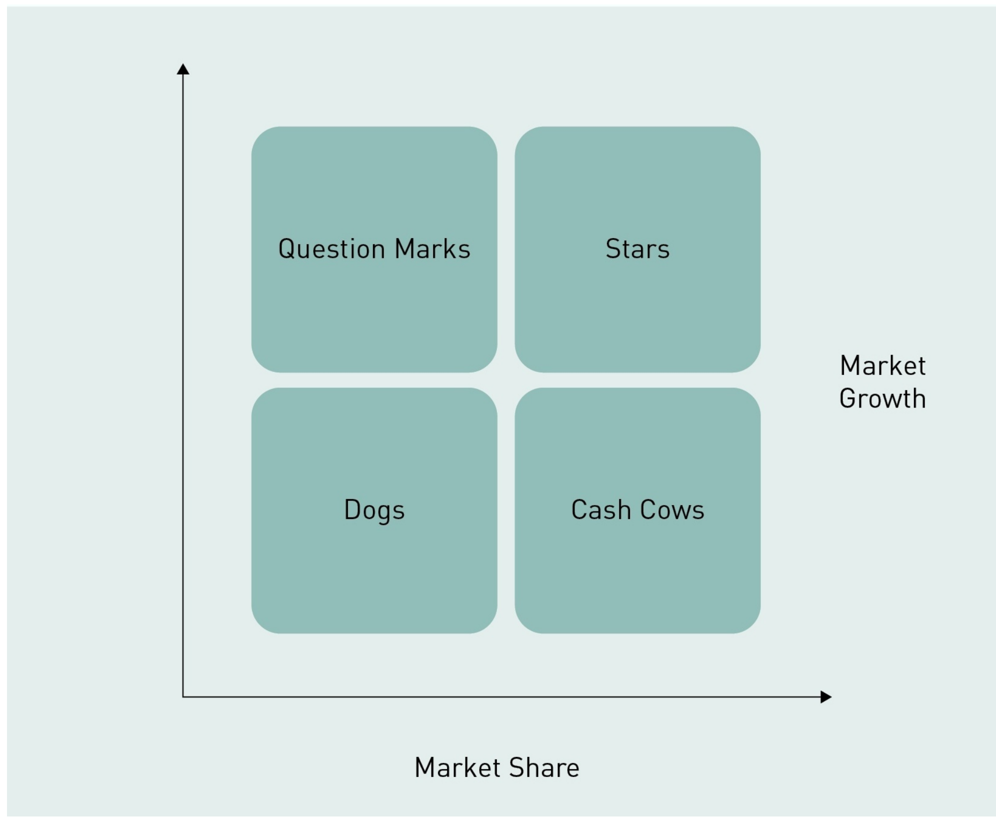


Source: Created on behalf of IU (2015) using Wall/Minocha/Rees 2010, p. 240.

Portfolio analysis

The Boston Consulting Group developed the concept of a portfolio matrix in which the organization's product portfolio is analyzed in terms of market growth and market share. The four categories of this matrix are 'dogs', 'cash cows', 'stars', and 'question marks'. Products (or services) of an organization are allocated to one of these categories, depending on their market position. 'Stars' are characterized by high market share and high market growth, 'cash cows' also have a high market share but a low market growth, 'dogs' have a slow market growth and a low market share, and 'question' marks show a rapid market growth but a low market share (i.e. these products/services cannot provide enough cash flow to warrant an investment in achieving a higher market share).

Figure 6: Growth-Share Matrix by the Boston Consulting Group (Portfolio Analysis)



Source: Created on behalf of IU (2015) using Wall/Minocha/Rees 2010, p. 242.

Product-market strategy options

Ansoff's (1968) model looks at different product market strategies. It states that products and markets are either new or existing and make various recommendations for action. It distinguishes between market penetration, product development, market development, and diversification.

Table 12: Product-Market Matrix (Ansoff 1968)

		Products	
		Present	New
Markets	Present	market penetration	Product development
	New	Market development	Diversification

Source: Created on behalf of IU (2015) using Wall/Minocha/Rees 2010, p. 244.

Competitive strategy options

Porter's competitive advantages (1980) evaluate the strategic target industry-wide or in a particular segment. The matrix also reflects the potential strategic advantage for a product, be it the low cost or the uniqueness of a product. Depending on this analysis, the strategies may be differentiation, cost leadership, or a focus strategy.

Table 13: Competitive Advantages (Porter 1980)

		Strategic advantage	
		Uniqueness perceived by customer	Low cost position
Strategic target	Industry-wide	Differentiation	Overall cost leadership
	Particular segment	Focus strategy	

Source: Created on behalf of IU (2015) using Wall/Minocha/Rees 2010, p. 244.

International strategies

Regarding the specific international strategies, there are four key approaches (Wall/Minocha/Rees 2010, p. 255):

- global strategy
- transnational strategy
- international strategy
- multi-domestic strategy

Selecting a strategy depends on two important aspects: the cost competitiveness pressure and the local responsiveness pressure. A global strategy is recommended when cost competitiveness pressure is high, while local responsiveness pressure is low. Global strategies are applied to highly standardized products, which allow economies of scale and scope. Low local responsiveness pressure means that the company does not need to differentiate products to satisfy local demands. Consumer goods such as Coca Cola are good examples of applying global strategies; another example is the semiconductor industry.

Transnational strategies are appropriate when cost competitiveness pressure and local responsiveness pressure are high. This means that a cost effectiveness of production must be achieved, even though the products have to be differentiated in order to meet local demands. Today's car industry is a good example. Car manufacturers around the globe, in particular those who produce for mass markets, use platforms to tailor to respective markets.

International strategies are suitable in markets with low cost competitiveness pressure and low local responsiveness pressure. They are accompanied by a strong focus on the home country production and a tight control of product development and marketing by headquarters. This strategy may be a comfortable option for companies but it entails the risk of being unaware of changes in foreign markets that require action.

Multi-domestic strategies are applied when there is little pressure in terms of cost effectiveness but a high local responsiveness pressure. Normally, this is accompanied by a relatively high level of freedom for local subsidiaries in their decision-making. Customization of products is decided on locally as coordination between the main headquarters and the subsidiaries would be too expensive. This is why independence is granted to local branches.

Table 14: International Strategies

		Local responsiveness pressure	
		Low	High
Cost competitiveness pressure	High	Global strategy	Transnational strategy
	Low	International strategy	Multi-domestic strategy

Source: Created on behalf of IU (2015) using Wall/Minocha/Rees 2010, p. 244.

Economic integration/national responsiveness strategies

Another strategy model for international business activities distinguishes two key categories (Wall/Minocha/Rees 2010): national responsiveness pressure and economic integration pressure. National responsiveness pressure relates to the necessity for a company's response to national or regional standards and to varying consumer demands. Economic integration pressure is the pressure on companies to exploit economies of scale, location, and experience, and to increase the control activities of internationally dispersed operations.

Table 15: Economic Integration/National Responsiveness Framework

		National/regional responsiveness pressure	
		Low	High
Economic integration pressure	High	Strategy 1	Strategy 2
	Low	Strategy 4	Strategy 3

Source: Created on behalf of IU (2015) using Wall/Minocha/Rees 2010, p. 244.

The matrix shows four strategies:

- Strategy option one seeks cost competitiveness but does not require a response to national or regional standards. Often mergers and acquisitions are undertaken to put this strategy into practice.

- Strategy option two requires both cost competitiveness and response to national or regional standards. This is challenging as both aims are contradictory in nature. Therefore, this calls for a highly flexible and responsive organization that is capable of adapting to local market demands. It is assumed that the subsidiaries of these international businesses operate independently.
- Strategy option three places little emphasis on cost competitiveness but focuses on the response to local standards. This is often the case in the food industry and designer product markets. Adopting national or regional standards and responding to consumer demands is crucial for business success.
- Strategy option four directs relatively little attention to cost competitiveness and response to national and local standards. This strategy provides companies with the opportunity of marketing highly standardized products by means of a centralized, often home country-based distribution system.

Market entry strategies

Various strategies are possible when entering markets (Johnson/Scholes/Whittington 2008, p. 312). They are closely related to the operational patterns in international business that were discussed in unit two of this course. For the purpose of this dicussion, we will distinguish between:

- exports
- joint ventures and alliances
- licensing
- foreign direct investment

Unit two explained these market entry strategies in detail. Therefore, we will only summarize some key characteristics.

Exporting is normally the starting point for international business operations, requiring little initial investment and no operational facilities abroad. Economies of scale can be exploited and first-hand experience in foreign markets gained. However, these experiences are limited as the company and the market abroad remain disconnected.

Joint ventures and alliances with an experienced local partner provide assistance in entering a foreign market; therefore, the risk of investment is reduced, while synergies from the partners' competencies can be exploited. However, it should also be taken into account that dealing with foreign partners increases coordination costs. In addition, it often proves difficult to find appropriate and trustworthy partners.

Licensing is a strategy that limits the financial risks of an organization's international approach. Income is generated from selling production and marketing rights. Nevertheless, finding the right partner is again an issue of concern and the risk of imitation is high, thereby jeopardizing a company's competitive advantage.

Foreign direct investment requires the highest resource investment and also entails the greatest risk. However, the company remains in full control of all foreign operations and is therefore able to fully integrate its international operations. This strategy helps by exploiting economies of experience. At the same time, it requires a long-term commitment to the host country.

4.3 Managing Strategy

This section explores how to manage the development and implementation of strategies efficiently. First, we will discuss the development of strategies in a narrow sense. Then we will look at an organization's gradual approach to adopting an international strategy.

As explained in the first section of this unit, strategy has been conceptualized in the past as a predictive, market-oriented process to achieve competitive advantages. This understanding has shifted of late towards a retrospective, resource- and relationship-based view, as strategy is seen to be partly determined by the current resources of an organization. However, these two definitions are not mutually exclusive. Organizations can—and indeed should—try to use both views in order to come up with comprehensive strategies.

The market-based view can be interpreted as an intended strategy development. It contains two key elements (Johnson/Scholes/Whittington 2008, p. 400):

- strategic leadership
- strategic planning

Strategic leadership

This term relates to an individual or a group of individuals steering the strategy process. It requires strong personalities, or at least personalities that are perceived as strong, with a powerful position in the organization. It goes beyond the scope of this lecture to elaborate on the characteristics of strong leaders but it is obvious that strategy development is impossible without strong leadership. So what then is leadership in the sense of strategy development? It is definitely a leader's vision, motivation, inspiration, position, and analytical capacity that dictates and implements a strategic direction. Leadership requires not only hard and soft skills to develop strategies but also a formal or informal position to push forward strategy development.

Strategic planning

This term relates to the method of developing strategies, that is, the orderly, systematic, and gradual procedure through which a strategy is developed. It usually starts with an analysis of the organization's environment as well as its current internal status. The actual strategy development is then gradually undertaken by establishing corporate vision, mission, and goals. These are then translated into the targets for specific business units, product segments, or other suitable sub-categories of the organization.

The resource and relation-based views of strategy see strategy as developing, or rather emerging, from an organization’s routines and procedures to then determine the future direction of a company. As previously mentioned, this strategy development process is founded on retrospection. Four key factors can be used to explain this strategizing procedure (Johnson/Scholes/Whittington 2008, p. 408):

- logical incrementalism
- resource allocation
- organizational politics
- organizational culture

These four factors warrant further explanation. Logical incrementalism is basically strategy development through experimentation. Often only limited resources are committed at early stages. The intention is to generate experience and lessons learnt to help avoid costly mistakes. Previous resource allocation processes also determines emergent strategy development—strategy is not an independent linear process but instead emerges from allocation decisions made in the past. Facilitating this strategy development process requires establishing negotiation on all organizational levels concerning the most efficient investment areas. This leads to the third explanatory approach of emergent strategy development: organizational politics. Strategies result from political processes in which internal, and to some extent external, stakeholders negotiate issues relevant to the organization’s strategy. Similarly, organizational culture determines emergent strategies. The understanding of culture as “the way we do things here” (Deal/Kennedy 1982, p. 4) influences strategy development as it inherently favors certain strategic directions over others.

Regardless of the way strategy development is conducted, a systematic approach is needed to adopt the strategy in the context of international business. Limitations in resources, cultural obstacles, and the availability or lack of capacities must be taken into account. There are six major steps to a structured approach to strategy adoption (Beamish/Morrison/Inkpen/Rosenzweig 2003, p. 156):

- perform proper analysis
- identify potential economies
- identify other internationalization benefits
- develop managers’ capacities for international business
- adapt performance and reward systems
- balance analysis with vision

Perform proper analysis

Analyzing the opportunities and challenges of international strategies is essential to avoid unnecessary risks which could potentially harm the organization’s existence. As logical as this may seem, it is vital to bear in mind that data sources are often questionable in their accuracy. This is particularly true in emerging markets, which offer huge business opportunities. African countries, for example, have huge potential for market growth for certain goods such as mobile phones and cars. The available data coencerning these markets is

often unreliable, however the temptation to invest there is high. Managers must therefore invest relatively high amounts of money in collecting data from primary and/or secondary sources rather than relying on a single source of information.

Identify potential economies

The expansion of economies is one of the most important reasons for companies to opt for internationalizing business operations. However, deriving a proper forecast of the financial benefits is difficult. Multiple factors influencing potential outcomes need to be taken into account. For example, economies of scale in a centralized production are likely to occur but consideration must also be given to taxes and customs in the host country. It is also important to understand potential changes in the political environment, e.g. the likelihood that a foreign government will increase import duties. If production is shifted abroad, similar considerations are necessary. Will labor costs remain stable? Are necessary supplies available at reasonable prices and will this situation continue in the future? These and other questions must be answered in order to establish a solid foundation from which to develop a robust international strategy.

Identify other internalization benefits

Besides scale economies, internationalization leads to other benefits, which also need to be understood. Can marketing be applied in the same way across regions or does it need to be adapted? Are product features and designs appropriate for all markets or is product diversity required in order to satisfy local customer expectations? The platform strategy of global car manufacturers, for example, is necessary to be able to realize scale economies in order to remain profitable. At the same time, car manufacturers need to adapt their cars to local and regional customer demands in order to successfully sell their products. Questions relating to product design, product features and quality, and marketing therefore lead to the adoption of international strategies.

Develop managers' capacities for international business

A further aspect to consider in strategy adoption is how to develop those indispensable competencies necessary to become a truly global manager. Companies are challenged by the fact that talented staff who possess a global vision are a rare resource and often approached by other companies. Additionally, in order to develop a sense of global perspective, managers must be sent to more than one country or region. Obviously this entails considerable implications for the respective individuals and their families.

In order to ensure the long-term commitment of key staff and support the wellbeing of their families, companies must take certain needs of these staff members into consideration. These range from relocation assistance to questions of housing, potential employment of spouses, and assistance with choosing the right school for children. If these issues are not sufficiently addressed, companies are less likely to attract and retain those competent, experienced managers who adopt successful global strategies.

Adapt performance and reward systems

Closely related to a global manager's practical and personal needs are issues regarding performance measurement and reward systems. Increasing complexity in international business operations has made it more difficult to establish fair and widely accepted indicators for performance and appropriate reward systems. For example, if a company decides to market only a few of its products in a certain country, the country manager has fewer responsibilities than a manager offering a full product portfolio in another.

The question of how to set up a performance measurement system, how to remunerate managers in various positions, and how to honor achievements is not easy to answer. In addition, there might be political, cultural, or economic obstacles to business in one country, which could make it more difficult to achieve certain targets. It certainly is a challenge to establish systems that reflect these context factors in a fair manner. Successful global strategies depend on committed managers; therefore, companies must consider these issues carefully to avoid aggravating good managers in difficult environments.

Balance analysis with vision

Finally, adopting successful international strategies calls for a balance between analysis and vision. What does this statement mean? As already discussed, proper analysis is mandatory for strategy adoption. It relies heavily on quantitative data, however these 'hard facts' alone are not sufficient for strategic decisions. Instead, qualitative influences must be included in the process. This means that, despite the collection and analysis of key data, there will always a degree of unpredictability. Therefore, corporate leaders need a vision; they must be able to anticipate possible future states and have an idea of where the company is headed in the months and years to come. Decision-making is definitely not straightforward in a corporate environment – it is probably the greatest challenge managers have to face. It requires the ability to implement hard facts whilst skillful dealing with foreign markets and future developments.

The following table summarizes key aspects of this section:

Table 16: Managing Strategy Development

<table>
<tr><td>Market-based view of strategy:
• intended strategy
• desired future states</td><td>Resource and relation-based view of strategy:
• emergent strategy
• retrospective view</td></tr>
<tr><td>Key elements:
• strategic leadership
• strategic planning</td><td>Key elements:
• logical incrementalism
• resource allocation
• organizational politics
• organizational culture</td></tr>
<tr><td colspan="2">Structured approach to adopting international strategies:
• perform proper analysis
• identify potential economies
• identify other internationalization benefits
• develop managers' capacities for international business
• adopt performance and reward systems
• balance analysis with vision</td></tr>
</table>

Source: Created on behalf of IU (2015).

SUMMARY

In this unit, we discussed important issues related to strategy development in international business, starting with an explanation of the basic characteristics of international business strategies. In particular, the shift from intended to emergent strategy perspectives was explained, and internal and external influencing factors were discussed. The importance of a prevailing mindset within an organization was emphasized, as were the potential benefits of international strategy along the value chain.

The second section focused on the various strategy models and strategic choices that managers have to address. We first looked at the traditional strategy tools, namely SWOT analysis, five forces analysis, portfolio analysis, product-market strategy options, and competitive strategy options. Then we explored strategy approaches specifically designed for global business operations, those being international strategies, economic integration/national responsiveness strategies, and market entry strategies.

Finally, we discussed how international strategies are managed, starting with strategy development. It became clear that market-based strategy development differs from emergent strategy development. The unit concluded with a six-step approach to adopting an international strategy.

UNIT 5

INTERNATIONAL HUMAN RESOURCE MANAGEMENT

STUDY GOALS

On completion of this unit, you will have learned …

- the challenges of international human resource management.
- the different mindsets guiding the assignment of staff in international operations.
- key characteristics of successful expatriate managers.
- the most important instruments supporting expatriation.

5. INTERNATIONAL HUMAN RESOURCE MANAGEMENT

Introduction

MANAGING EXPATRIATES AT ROYAL DUTCH/SHELL

Royal Dutch/Shell is a global petroleum company with joint headquarters in both London and The Hague in the Netherlands. The company employs more than 100,000 people, approximately 5,500 of whom live and work as expatriates at any one time. The expatriates at Shell are a diverse group, made up of over 70 nationalities and located in more than 100 countries.

As a global corporation, Shell has long recognized that the international mobility of its workforce is essential for its success. By the 1990s, however, Shell was finding it harder to recruit key personnel for foreign postings. To discover why, the company interviewed more than 200 expatriate employees and their spouses to determine their biggest concerns. The data was then used to construct a survey that was sent to 17,000 current and former expatriate employees, expatriate spouses, and employees who had declined international assignments.

The survey registered a phenomenal 70 percent response rate, a clear indication that many employees considered it an important issue. According to the survey, five issues had the greatest impact on the willingness of an employee to accept an international assignment. In order of importance, these were (1) separation from children during their secondary education (the children of British and Dutch expatriates were often sent to boarding schools in their home countries while their parents worked abroad), (2) negative impact on a spouse's career and employment, (3) failure to recognize and involve a spouse in the relocation decision, (4) failure to provide adequate information and assistance regarding relocation, and (5) health issues. The underlying message was that the family is the basic unit of expatriation, not the individual, and Shell needed to do more to recognize this.

To deal with these issues, Shell implemented a number of programs designed to address some of these problems. To solve the education issues, Shell built elementary schools for Shell employees where there was a heavy concentration of expatriates. As for secondary school education, they worked together with local schools, often providing grants to help them upgrade the educational facilities. Shell also granted an education supplement to help expatriates send their children to private schools in the host country.

Backing spousal careers is a more troubling problem. According to the survey data, half of the spouses accompanying Shell staff on assignments were employed before the transfer. When expatriated, only 12 percent were able to secure a job offer, while a further 33 percent wished to be employed. Shell set up a spousal employment center to address the problem. The center provides career counseling and assistance in locating employment opportunities during and immediately after an international assignment.

The company also agreed to reimburse up to 80 percent of the costs of vocational training, further education, or reaccreditation up to $ 4,400 per assignment. Shell also set up a global information and advice network known as "The Outpost" to provide support for families contemplating a foreign posting. The Outpost has its headquarters in The Hague and now runs 40 information centers in more than 30 countries.

The center recommends schools and medical facilities, provides housing advice and up-to-date information on employment, study, self-employment, and volunteer work.

Source: Hill 2011, p. 612.

Most businesses, whether local or global, depend heavily on the capacity of their workforces. Given the huge investments necessary to set up international operations, it is understandable that human resources management is a key success factor in global business. This unit will focus on particular aspects of expatriate managers from a human resource management perspective. It aims at providing an overview on organizational requirements, characteristics of global managers, and means available to support successful expatriation processes.

5.1 Characteristics of International Human Resource Management

This unit starts with a general overview of the characteristics of international human resource management. It is generally fair to say that human resource management is concerned with an organization's activities, procedures, and structures, which help to employ workforces effectively (Hill 2011). Of course striving towards this aim is particularly challenging in international operations, owing to the increasing complexity of employment conditions caused by a variety of influencing factors. Examples of aspects that may differ from one country to another include:

- labor markets
- culture
- legal systems

- economic systems

Looking at the current situation in Europe, there are considerable differences in employment conditions between countries. In Spain, for example, many young people are unemployed, while in Germany a great number of industries are suffering from a lack of skilled workers. Law enforcement of equal opportunity recruitment is perhaps more strictly enforced in the UK than in Bulgaria. The likelihood of encountering surroundings conducive to work-life balance is probably higher in Scandinavian countries than in Germany. Compensation practices also vary. In the UK, salaries are frequently supplemented with a benefit package, which may include a variety of allowances for housing, insurance, and so on, while in Central Europe it is the rule to simply pay salaries without additional benefits. These few examples give an impression of how challenging human resources management can be in global business.

One of the key issues international companies need to address is finding ways to equalize the balance between local staff and expatriate employees. This is important as international operations need to transfer an organization's culture to its foreign subsidiaries. At the same time, it is vital that subsidiaries link up with the local environment. An expatriate manager can be defined as a "citizen of one country who is working abroad in one of the firm's subsidiaries" (Hill 2011, p. 604). The way companies implement their staffing policy is largely based on their specific strategy development, as dicussed in unit four. The prevailing mindset in a company also influences the company's staffing policy. For human resource management, the key prevailing mindsets are (Beamish/Morrison/Inkpen/Rosenzweig 2003, p. 203; Hill 2011, p. 606):

- ethnocentrism
- polycentrism
- geocentrism

We also looked at regiocentrism when discussing international strategy purposes, however it is not relevant to human resource management and is therefore omitted in the following section.

Ethnocentrism

The term refers to a relatively strong home country orientation. When ethnocentric policies are in place, all top management positions are likely to be filled by employees from the company's home country. This procedure often helps to transfer core cultural values to foreign subsidiaries and is also useful in cases in which qualified managers are not available locally. However, an ethnocentric approach to human resources can lead to a disconnection between foreign subsidiaries and the local cultural environment of the host country; resentment is likely to result in the host country if all key decisions are made by foreigners. Furthermore, it must be taken into account that relocating expatriate managers is more expensive than hiring local staff.

Polycentrism

This term refers to a strong host country focus where local managers are hired for a subsidiary's operations. It is easier for the managers and their local staff to deal with internal and external stakeholders as they are not impeded by cultural barriers; however, this procedure carries the risk of the company's headquarters becoming disconnected from its subsidiary, and management policy and cultural values not being communicated throughout the company. What also needs to be considered is that local managers might be less capable of meeting the standards of a global company, owing to a lack of international experience.

Geocentrism

This term refers to an understanding of global contexts and their integration in a global organization. In terms of human resources management, geocentrism neither focuses on a home country nor on a host country but simply on hiring the best candidate for a certain position, regardless of their nationality. This is probably the most suitable approach for a global company. It blends many of the advantages of ethnocentrism and polycentrism in order to achieve the most efficient use of human resources. It also helps to build a strong internal culture by enabling subsidiaries to connect culturally to local contexts. However, this approach incurs relatively high costs for preparing, relocating, and training staff. Moreover, national immigration regulations may constrain the responsibilities of geocentric human resource management.

The following table summarizes key aspects of this unit:

Table 17: General Features of International Human Resource Management

Human resource management: An organization's activities, procedures and structures that help to employ workforces effectively.
Expatriate manager: A citizen of one country who is working abroad in one of the firm's subsidiaries.
Influencing factors for international human resource management: • differences in labor markets • differences in culture • differences in legal systems • differences in economic systems
Prevailing mindsets for staffing policies: • ethnocentrism • polycentrism • geocentrism

Source: Created on behalf of IU (2015).

5.2 The Global Manager

In the previous section, we saw that ethnocentric and geocentric approaches to staffing focus on expatriate employment. Therefore, it is necessary to consider the key characteristics of expatriate managers and also possible reasons for failure in expatriate placements.

We stated that an expatriate manager is a “citizen of one country who is working abroad in one of the firm’s subsidiaries” (Hill 2011, p. 604). In order to cope with multifaceted challenges, expatriate managers require what we would like to call a ‘global mindset’. By this, we mean complex cognitive abilities and a cosmopolitan perspective. We cannot assume that a successful domestic manager will be just as successful once they are assigned to foreign operations. This unit will explore the ‘global mindset’ of expatriate managers and also address some of the most common reasons for failure in expatriate placements.

Expatriate Success

Four dimensions seem to constitute successful expatriate managers (Mendenhall/Oddou 1985):

- self-orientation
- others-orientation
- perceptual ability
- cultural toughness

Self-orientation

This relates to an expatriate manager’s strengths in terms of self-esteem, self-confidence, and mental wellbeing. Although these character traits may be crucial for all managers, regardless of their placement in either domestic or foreign operations, there can be no doubt of their particular importance when it comes to assignments abroad. Withstanding the pressure that is to be expected on being posted to a foreign country calls for experienced, grounded individuals.

Others-orientation

This refers to an expatriate’s capacity to connect with local staff and other stakeholders. It is a matter of effective communication in situations in which language and cultural barriers make it very difficult to interact. The most important aspect in terms of others-orientation is the ability to develop relationships and a willingness to communicate. An open-minded character, the desire to connect with others, and an attempt to learn at least the basics of the local language help to establish good relationships with local staff.

Perceptual ability

This is defined as the capacity to exercise a high level of empathy and understand why behavior and mindsets might be different in a foreign country. This ability contains an element of cultural appreciation. Managers with a high level of perceptual ability tend to accept differences in behavioral patterns and seek to understand underlying cultural reasons, rather than criticize customs that are different to what they are used to in their home countries. Flexibility and patience are definitely key requirements in this regard.

Cultural toughness

This is the ability to adapt to foreign cultures and to tackle the challenges and difficulties associated with living and working in certain countries. Imagine, for example, the lack of adequate health facilities in countries in which major health risks such as malaria, dengue fever, or tuberculosis are prevalent. It is often difficult to attract qualified personnel to positions in such countries, particularly those managers who have children. It is fair to say that attribute of cultural toughness indicates the degree to which a manager is able to cope with problematic circumstances, such as those stated above.

Figure 7: Expatriate Managers and the Global Mind-Set

Source: Created on behalf of IU (2015).

Expatriate Failure

It is obvious that selecting suitable managers is vital in international business. Expatriation is extremely expensive owing to the cost of flights, preparation courses for the new position, and additional expenditure. All these efforts are wasted in the event of expatriate failures, which are the result of an early termination of the contract and a return to the home country. Although human resource management needs to search for culturally sensitive personalities, there are also other aspects to consider. Let us explore the main causes of expatriate failure. It is worth noting that this failure is not necessarily the fault of the manager who was sent abroad; the blame may lie with human resource management's inability to recruit a suitable manager for a foreign position.

Research on expatriate failure in some countries shows a relatively high percentage of expatriates returning home earlier than the expiry date of the contract. Numbers vary from 10 % to over 50 %. The costs for the early termination of expatriate contracts can often amount to many times the annual domestic income of an expatriate. Although failure rates vary, they are extremely high in developing countries where cultural toughness is experienced most. Research has been conducted on the reasons for early termination of contracts; the findings reveal that the nationality of expatriate managers is the main reason for failure in international placements.

Other significant reasons are (Hill 2011):

- problems of spouses in adapting to the new environment
- family issues

- manager’s inability to fit into the new environment
- lack of competence with regards to new role and responsibilities
- personal issues

Looking at the causes of failure, it is interesting to note that the success of expatriate managers depends to a large extent on how spouses and family members adapt to the new environment. There are some lessons to be learnt from these findings. Firstly, the recruitment of expatriate managers needs to be carried out with caution. Cultural sensitivity and adaptability should not be underestimated during recruitment. Secondly, spouses and family members should also take part in the recruitment process and assessment. Thirdly, spouses and family members must be included in the preparation measures, which require a focus on the most likely challenges in the foreign country, such as linguistic and cultural barriers, disconnection from family and friends, loneliness, lack of appropriate jobs for spouses, feeling trapped at home, problems with children settling into new schools, and many more. While it may be difficult to find solutions to some of these problems, preparing for possible challenges is certainly the first step. Often, high expectations of a ‘new life abroad’ result in enormous disappointment and frustration soon after arrival.

Finally, concluding this section is a first-hand experience of preparing for a placement in a developing country:

CASE STUDY: EXPATRIATE PREPARATION IN DEVELOPMENT COOPERATION

After 15 successful years, a highly qualified senior manager decided to leave his company to his business partner in his home country to join a governmental development cooperation agency, which hired him to spend two years in a central African country. During the recruitment process, the manager was told that he would have to undergo a preparation phase of around eight weeks in Germany. This surprised him, as in his field of expertise he felt that he would not be needing any further contribution from the agency to his current knowledge base. Moreover, he felt well prepared for the challenges as he was already in his mid-forties and was an experienced, well rounded manager.

This time of preparation seemed to awaken concerns. Courses on how to behave in African countries, tedious workshops on stakeholder inclusion in decision-making processes, hours of lectures on the host country’s cultures and traditions, governmental policy, and the economic situation, and courses on change management and organizational development made him realize that he had considerably underestimated his capacity and professional experience.

The manager later confessed to having been close to resigning during this period owing to a feeling of just not being able to fit into ‘such a slow paced’ organizational culture in which ‘information that I could have read within 45 minutes is explained over a period of ten hours.’

Three years later, after having extended his initial contract by another two years, this manager had a completely different view of his preparation phase. He admitted that it had prepared him for an environment in which things do not work the way one is used to. He learned to be patient, to accept failures, and appreciate cultural behavior different to his own. Moreover, he learned to take the concerns of others seriously, when previously he would have responded harshly. He remarked that the information about the history, culture, and politics of that foreign country helped him understand how people think. He also felt that the mixture of people newly hired for foreign posts and others preparing for their third or fourth foreign assignment proved to be a great benefit. He was able to learn from the experience of others and now even appreciates the inclusion of spouses and children in the preparation phase. While living in the country, he encountered many distressed spouses of expatriates who were unemployed. They expressed the feeling of being imprisoned in a gilded cage. However, despite these incidents, the manager confirmed that his organization must have done a good job at preparing their employees as expatriate failure rates were no higher than failure rates in normal domestic employment.

Source: Case study developed on behalf of IU (2015)

5.3 Instruments in International Human Resource Management

This section will review the most important instruments a company should apply in international human resource management. From what we discussed earlier in this unit, it is clear that these instruments mainly focus on supporting expatriate staffing (Hill 2011). The following key areas will be addressed:

- selection process
- training and management development
- performance assessment
- compensation

Selection Process

We have already discussed the reasons for expatriate failure; it is clear that the selection process must include certain aspects that would not otherwise be reviewed when recruiting domestic workforces. Technical expertise, domestic experience, and achievements are significant; however they are not sufficient criteria for selecting expatriate employees. It is imperative that the four dimensions of the global mindset of managers—self-orientation, others-orientation, perceptual ability, and cultural toughness—be assessed during the selection process, which requires a degree of expertise and experience.

The following key factors should be reviewed (Hill 2011):

- self-esteem
- self-confidence
- mental wellbeing
- ability to connect and communicate with people from other cultures and levels
- ability to acquire at least a basic knowledge of a foreign language
- ability to understand and appreciate foreign cultures
- ability to overcome frustration caused by cultural and behavioral differences
- ability to settle into uncustomary cultural environments and to cope with the many possible obstacles and drawbacks

This list indicates that the selection process should include some form of psychological testing. It may be assumed that an assessment of the candidate's ability to cope with ongoing stress and frustration should take two or three days, instead of two hours. The selection process becomes even more complex when taking one of the most important reasons for expatriate failure into consideration, namely the problems of spouses adapting to a new environment, therefore including spouses and, to some extent, other family members in the assessment is essential. While assessment procedures may pose ethical and legal problems with regards to children, it is crucial that spouses be included; how they respond to challenging situations and how they behave when their partners are undergoing a stressful selection process may reveal how both will interact in a challenging environment abroad. It is also essential that the problems a spouse may face in a foreign country be communicated clearly. Open and honest testimonials by people who have previously accompanied expatriate managers to their foreign posts can help draw a realistic picture of what spouses can expect abroad.

Obviously, expatriate selection is likely to be a complex and costly process. However, compared to the possible losses resulting from expatriate failure, this money is well spent on ensuring the smooth integration of managers and their families into foreign operations.

Training and management development

The instruments of training and management development should be applied continuously. We can distinguish between training which is skill development in a narrow sense and management development which is skill development in a broader sense. In terms of international human resource management, training should address specific needs associated with an expatriate posting. Basically, three important types of training should be offered to expatriate managers and their spouses: cultural training, language training, and practical training.

We have discussed the importance of understanding the host country's culture in enabling everyone to settle in comfortably. Cultural training helps familiarize the manager and his family with the history, culture, religion, behavior, and traditions, and the social and political system of the host country. Similarly, language training plays a significant role for all members of the family. Even if English is the language of the workplace, it is still very useful to have at least a basic knowledge of the local language; it is highly appreciated when foreign managers address the local staff in their own language, thereby showing respect

and making an effort to build good working relationships. There is also no doubt that family members will benefit from a working knowledge of the local language when making the transition to the new environment.

Practical training is basically the introduction phase in the host country. It allows expatriate managers and their families to spend time arranging everything necessary on arrival in their new location, such as housing, registering children in schools, and obtaining residence and employment permits. Familiarizing themselves with the geographical surroundings is indispensable to a family experiencing the feeling of a new 'home'. Whenever possible, companies should also try to integrate managers and their families in existing expatriate networks, where they can contact people who have gone through the same emotional ups and downs upon arrival in their new home country. Other expatriates are normally an excellent source for all kinds of useful information for newcomers.

Management development goes beyond the immediate preparation for expatriation. During this process, organizations support the development of the skills their managers need in order to perform in different countries and cultures. This process, also called development of a global mindset, helps to build strong networks across national borders and to transfer the organizational culture to the various subsidiaries. Rotating managers from one country to another and regularly organizing meetings between managers from different countries are ways of achieving these aims. The exchange of ideas and experience contributes to a shared knowledge base.

A further aspect of management development is repatriation. Managers often face huge challenges on returning to their home countries, such as readapting to the routines in their former organizational departments. Many return home, only to discover that no suitable positions are available. Moreover, a number of privileges that were enjoyed abroad are not offered in their home country. As one expatriate manager put it: "When working abroad I was somehow important. I was obviously different, being the foreigner among local staff. My family and I enjoyed a comfortable life with numerous privileges, such as a high salary and expensive private schools for the kids. When I came back, people did not even know where to place me. There seemed to be no interest in the experiences and skills I had acquired abroad and for quite some time I really felt lost. Today, I believe one should not only be prepared for expatriation—repatriation is probably even more challenging."

The best way for companies to address this source of frustration is proper planning of both expatriation and repatriation. Reintegrating managers previously placed abroad should be a well-planned process. The roles assigned to returning managers in their home organization should be clear before the expatriation process starts. This should include how experience gained abroad can be used when managers re-enter their previous work environments. In addition, organized meetings with colleagues to discuss working in foreign countries and regular meetings with other returning managers can be helpful in overcoming the initial frustration. Again, it is crucial that family members also be taken into consideration. Therefore, it is useful to allow time at the beginning for the managers to take care of their spouse and children and help them readapt.

Performance assessment

This is a particularly difficult task in international operations. The question of how to measure a manager's performance is not easy to answer, given the multifaceted influences on business activities in foreign countries. Often, managers at the company's headquarters do not realize just how challenging foreign operations can be. Solely relying on quantifiable data may lead to evaluative results that do not fully reflect the actual achievements on site. Many international companies have introduced 360-degree feedback programs. These programs are intended to gather appraisals from a manager's superior as well as his/her junior staff members. In Africa, for example, it is uncommon to evaluate superior managers. Therefore, if feedback is requested from junior staff, the results may not reflect the actual situation. It should be assumed that home country managers lack insight into the political, social, and economic landscape of a foreign market. In the case of a manager abroad adhering to the organization's anti-corruption regulations in a country in which corruption is rife, then his/her performance might be assessed incorrectly by host country managers and negative feedback sent back to the parent company. These 'soft' factors must be reflected in order to arrive at an informed evaluation outcome.

To overcome these problems concerning expatriate manager performance appraisal, there is basically one key recommendation: any evaluation should include comments from managers from the host country. Once the feedback has arrived at headquarters, an experienced expatriate manager, preferably someone who has worked in the same country or region, should be included in the analysis. While home country managers ensure a credible basis of objectivity, host country managers contribute to the understanding of the specific challenges in the host-country.

Compensation

In general, the remuneration of expatriate managers in international companies is difficult to calculate. When managers are sent to foreign placements, companies must not only ensure an appropriate salary compared with the income in the home country but also a fair distribution of compensation packages commensurate with the various duties performed abroad. Typically, expatriate payments comprise a basic salary equivalent to the one earned in the home country plus additional payments for relocation efforts. This is often referred to as a Foreign Service Premium.

Certain expenses are only incurred abroad and must be covered. This compensation is normally called an allowance. Expatriate compensation has to cover living costs, possibly higher than at home, e.g. housing at their international placement. Where would you think housing is most expensive? If you guessed New York, Shanghai, Moscow or Sydney, you were definitely on the right track. But would you have expected the African city Luanda in Angola to be one of the world's most expensive places to live? The costs of living, e.g. purchasing western goods, vary considerably between expatriate placements. Many organizations therefore obtain available data on purchasing power (e.g. statistics available from the German Statistisches Bundesamt) to estimate the standard living costs in a placement. Finally, tax compensation and other benefits are offered to ensure equivalent income and insurance coverage, compared to the manager's home country.

The following provides an overview of additional monetary benefits that may be included in the total expatriate compensation package (Hill 2011):

- basic salary
- Foreign Service Premium
- allowances:
  - hardship allowance (placements with difficult health and/or safety conditions).
  - housing allowance (placements with high housing costs).
  - living cost allowance (covers higher living costs compared to home country).
  - education allowance (covers children's school fees).
- tax compensation
- benefits

SUMMARY

In this unit, we explored important issues of human resource management in international business operations. We started with a definition of an expatriate manager as a citizen of one country working abroad in one of the firm's subsidiaries, and then outlined the various challenges managers have to face in different countries. We also came to the conclusion that recruitment is driven by three major mindsets: ethnocentrism, polycentrism, and geocentrism.

This was followed by the key characteristics of expatriate managers, including in particular a global mindset. Four dimensions can be used to establish global mindset: self-orientation, others-orientation, perceptual ability, and cultural toughness. In order to gain further insight into the specific requirements for expatriate managers, we listed the most important reasons for the failure of foreign placements. Surprisingly, one large factor in expatriate failure is that spouses often have problems in adapting to the new environment. This can lead to family problems, resulting in resignation. Should the manager have difficulties settling into the new workplace environment, and meeting the demands of the foreign position, then this can result in early termination of his contract.

Bearing the key characteristics of expatriates and the reasons for failure in mind, we then looked at four instruments supporting international human resource management: selection process, training and management development, performance assessment, and compensation. Selection and training must be relevant to the foreign duty station and its cultural and social environment. We also concluded that spouses and children, the latter depending on current legislation, should be included in this process. Management development is a procedure that goes beyond training. It aims at establishing strong internal networks and developing a team of internationally employed managers who help transfer the organization's culture to the foreign subsidiaries. In order to avoid frustration upon returning to their home country, repatriation measures should also be dealt with. Performance assessment and compensation payment depend on the specific circumstances and contexts

of a foreign country. It is important that the challenges in a host country are understood and taken into account when assessing performance and calculating compensation payment.

International human resource management procedures may lead to higher expenditure but this is money well spent compared to the high costs of expatriate failure.

UNIT 6

ORGANIZATION IN INTERNATIONAL BUSINESS

STUDY GOALS

On completion of this unit, you will have learned …

- the different approaches to business organization.
- the traditional concept of organizational structures.
- the contemporary approaches to organization.
- what methods and mechanisms are used in organizational practice.

6. ORGANIZATION IN INTERNATIONAL BUSINESS

Introduction

IBM IN EUROPE

IBM is a case in point. Like many MNEs operating in Europe, IBM had pursued a multidomestic strategy supported by a geographic area structure that provided a subsidiary for each country. IBM relied on a regional office in Paris to oversee its national subsidiaries and consolidate operations wherever possible.

Integration within the European Union in the 1990s pushed IBM to move more decision-making from local subsidiaries to its regional office in the effort to develop a Pan-European strategy that would achieve greater cross-national integration. Then, in 2005, IBM announced it would lay off up to 13,000 workers, mostly in Europe, and hire up to 14,000 workers in India. This was part of an ongoing evolution in its strategy of globalizing its operations by moving back-office work such as accounting, compliance, call support, and procurement to low-cost locations.

Technological, regulatory and competitive pressure pushed IBM to dismantle the national and regional fiefdoms it had established in each country in Europe in the postwar years in favor of hiring Indian software engineers who could work on projects anywhere in the world via the internet. IBM reasoned that it no longer made sense to maintain traditional structures when, like its rivals, it could adopt a leaner, global style of operation that let managers send work digitally across the internet to where it could be done most efficiently. Dealing with the new realities of organizing international operations, IBM maintains that "the company is still going to have deep roots locally but will increase the globalization of their operations and processes".

Source: Daniels/Radebaugh/Sullivan 2009, p. 625.

6.1 Traditional Perspectives on Business Organization

Setting up an adequate organizational structure is a difficult task in international business. Owing to the increasing complexity of differences in social, cultural, economic, behavioral, and technological contexts, it has become a major challenge to find an approach that agrees with the various operational circumstances of companies, particularly those operating across continents. The opening case study provides an example of those questions managers must answer in this regard.

What is meant by the expression 'organization'? Organization consists of the formal structures and the coordination and control systems of an organization (Daniels/Radebaugh/Sullivan 2009). Some writers also include organizational culture, however for the purposes of this lecture, we will limit our explanations to the elements mentioned above. Unit three looked at the aspect of culture in detail. As the definition of organization relates directly to formal structures, we aim to establish a shared understanding of 'structure'. Structure is the formal arrangement of jobs specified by roles and relationships (Daniels/Radebaugh/Sullivan 2009). The opening case study gives an indication of the challenges that managers face when establishing organizational structures in international business operations.

Basically, two dimensions define a company's organizational structure (Daniels/Radebaugh/Sullivan 2009; Hill 2011):

- vertical differentiation
- horizontal differentiation

We will now explore these two types of organizational structures.

Vertical Differentiation

Vertical differentiation describes the choices made to centralize versus decentralize decision-making. In other words, an organization has to determine whether business decisions should be made by senior managers or junior staff members. In international business, this frequently boils down to the question of whether decisions are made at headquarters or in foreign subsidiaries.

Centralization requires senior managers to make decisions, as they are experienced and well qualified. Centralized decision-making ensures consistency in managers' actions. It also enables certain procedures to be replicated in various subsidiaries so that senior managers are informed of the results and can adjust their actions in the future. Overall, centralization entails great responsibility for decision-makers but also enables them to oversee the various subsidiaries and context factors. This helps facilitate change management in order to grant managerial authority to those who supervise the organization's operations. However, centralization can be discouraging for junior staff, particularly in international business. Members of staff working on site in foreign subsidiaries may feel that their local expertise is not appreciated. This can reduce motivation and commitment, which can potentially impact the financial results of subsidiaries negatively.

Decentralization can be seen as the opposite perspective to centralization. It aims to hand over responsibilities to those primarily involved in decision-making situations. Decentralization requires confidence in the ability of junior staff members and the belief that local staff know best how to deal with the specific environment of their business operations. This approach is encouraging for employees from lower levels, as they feel their expertise is appreciated.

Decentralization provides increased flexibility and, as a result, more adaptability to changes occurring on site. However, in return, it demands greater responsibility from managers in subsidiaries. Guiding and steering a highly decentralized organization can be challenging, owing to the risk of managers on lower levels making unfortunate decisions. This may even jeopardize a whole organization as it lacks the overall guidance of one senior manager making decisions from headquarters. Consequently, responding to problems occurring in subsidiaries may be too late.

Horizontal Differentiation

Horizontal differentiation refers to the set-up of an organization's formal structure. Basically, the formal structure defines the total set of tasks within an organization, the division of these tasks among jobs, departments, and subsidiaries, and the respective assignment of authority. Traditional organizational structures are (Daniels/Radebaugh/Sullivan 2009; Hill 2011):

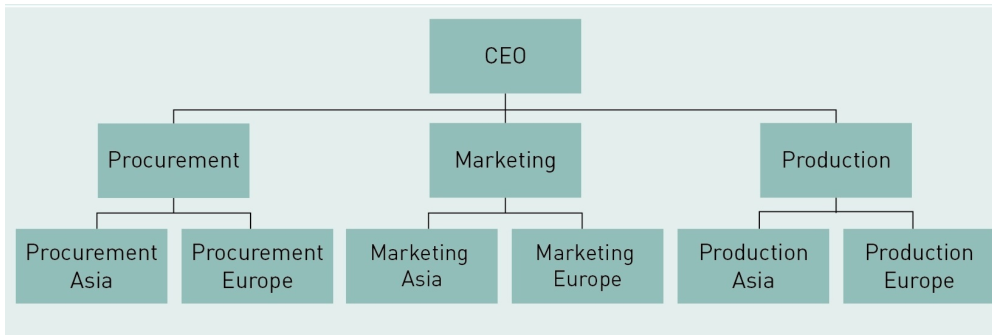
- functional structure
- divisional structure
- matrix structure

You are probably familiar with these structures from your previous studies so we will only explain them briefly here.

Functional structure

These structures are frequently used when companies has a relatively narrow product line. They help maximize scale economies as they focus on traditional business functions such as marketing, production, procurement, human resources, and others. However, changes that affect more than one department often cause problems owing to the inability of functionally structured organizations to respond quickly. In these situations, coordination between departments is time-consuming resulting in slow decision-making.

Figure 8: Functional Structure

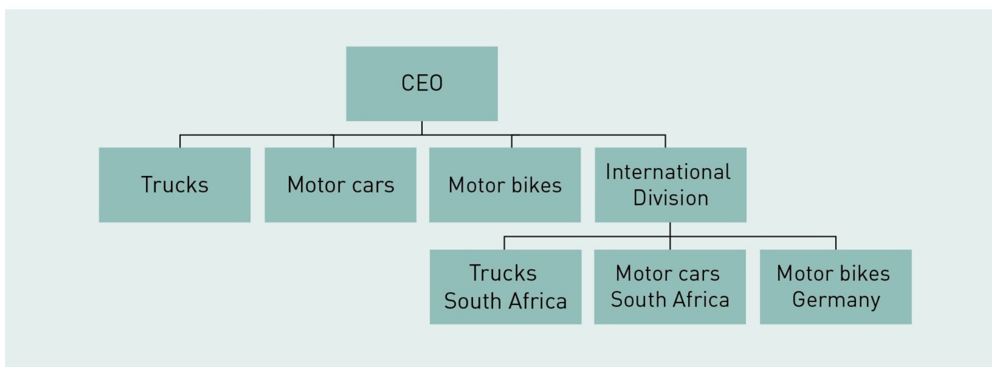


Source: Daniels/Radebaugh/Sullivan 2009, p. 621.

Divisional structure

These structures do not focus on functions but on products, client groups, or geographical regions. Each division is then subdivided into functions such as marketing, procurement, production. This organizational set-up is ideal if a company offers a wide range of products or operates in diverse markets as it attempts to concentrate its expertise in producing certain products and/or in dealing with markets within each division. However, divisional structures can cause duplicity of functions and coordination among divisions and its respective functions may prove difficult given the complexity of its various activities.

Figure 9: International Divisional Structure



Source: Daniels/Radebaugh/Sullivan 2009, p. 621.

Matrix structure

These structures intentionally create dual reporting lines across functions and divisions, while functional and divisional structures try to avoid overlapping responsibilities. It may be rightly assumed that greater effort is required in coordinating such structures. Decision-making is also more time-consuming as it requires a consensus among managers. At the same time, it is anticipated that matrix structures help to employ the expertise of both divisional and functional managers to optimize the outcome of decision-making processes. The biggest challenge of matrix structures is the lack of a clear single-command

line in which ultimately one person can be held accountable for success or failure. Professional experience shows that managers fail in their responsibilities if these are not clearly assigned to one person.

Table 18: Matrix Structure

Regional management	Productmanagement		
	Motorbikes	Motor cars	Trucks
Asia	Joint decision-making	Joint decision-making	Joint decision-making
Europe	Joint decision-making	Joint decision-making	Joint decision-making
Africa	Joint decision-making	Joint decision-making	Joint decision-making

Source: Daniels/Radebaugh/Sullivan 2009, p. 621.

The advantages and disadvantages of the three traditional organizational structures have led to the development of mixed structures in order to encourage managers to customize organizational structures to the particular needs of a company. This flexible approach facilitates the response to environmental changes. For example, if a foreign company is integrated in the existing structure, it may be helpful to initially require direct reporting to top management instead of following the usual reporting line to a line manager responsible for that particular region. Thus, top-management can monitor and guide the integration process.

6.2 Modern Views on Business Organization

We have considered the various characteristics of traditional organizational structures. Despite the differences between the approaches, one element is common in all these setups: all structures seem to be relatively static. In today's dynamic business environment with its constantly changing opportunities and challenges, static structures are no longer sufficient as they are too slow and inflexible. The needs of internationally operating companies have changed and so has technology. Since internet access and telecommunication are available in almost all corners of the globe, organizations must be able to respond more quickly than in the past.

In order to achieve this, an understanding of modern organizational structure recognises a single critical feature: the removal of structural boundaries. This means that knowledge-generation and decision-making should not be limited by structures that block the information flow within the organization. More specifically, eliminating structural boundaries means removing

- vertical boundaries
- horizontal boundaries
- external boundaries

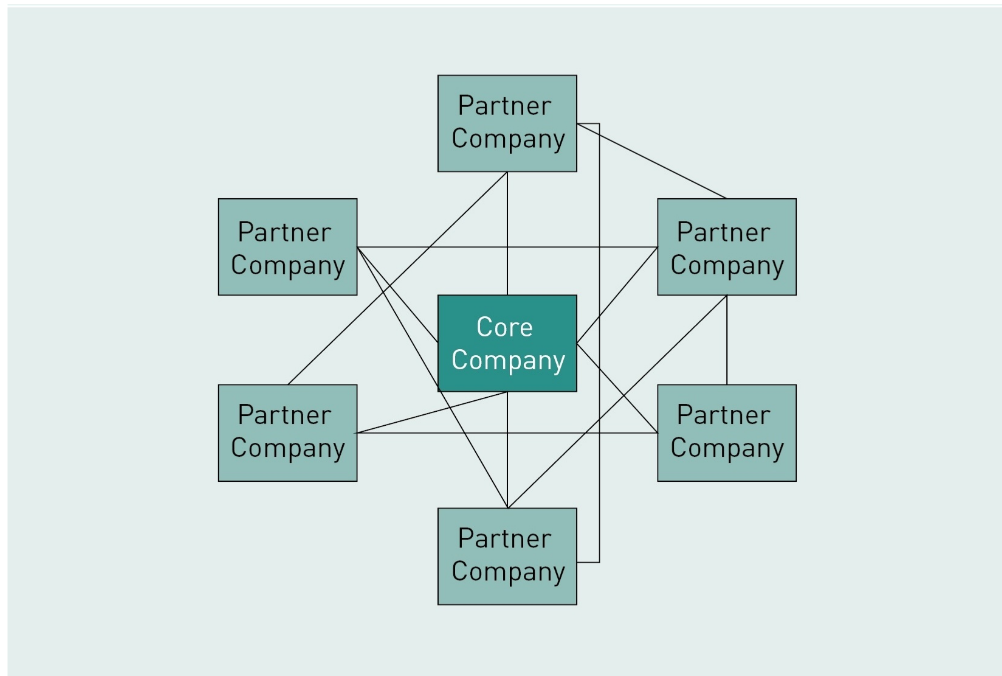
Vertical boundaries assign employees to hierarchical levels of an organization, while horizontal boundaries allocate jobs to employees and units. External boundaries make allowance for the relationships between the organization and its environment, namely its key stakeholders.

Eliminating these structural constraints has practical aspects, e.g. the lines of responsibilities and reporting structures (the key features of traditional organizational structures) are no longer fixed, which it creates a flexible environment that encourages information flow and the establishment of self-organizing teams. These structures enable organizations to become more responsive in today's dynamic economic environment.

One contemporary organizational approach that purposely limits the existence of structural boundaries is the concept of network structures. This model largely employs outsourcing as a strategy. Network structures contain a core organization, which outsources activities along the value chain to those companies with expertise. The basic idea is to let every organization within the network do what it does best. The network itself does not merely consist of a core company and a range of subcontractors but rather it creates a network of companies that share a common purpose.

Networks are essential in international business. The expertise of Foreign Service providers or production companies can be crucial for the success of global business operations. The link between the network partners clearly goes beyond simple order and order fulfilment relationships. Networks normally allow managers from the core company to interact directly with staff from the network partner companies. A good example of this kind of relationship is a call center that is legally an independent entity but allows managers of the core company to engage directly with call center agents on work-related issues.

Figure 10: Network Structure



Source: Created on behalf of IU (2015) using Daniels/Radebaugh/Sullivan 2009, p. 626.

Such examples of networking actually exist. In Japan, Keiretsu is a structure based on informal personal relationships and formal mutual shareholding in each of the network companies. These networks can either revolve around a core company heading the network or they can be a group of equal companies that collaborate. Over a long period, major companies in Germany held mutual shares. This informal network was often referred to as 'Deutschland AG'. However, owing to the liberalization of the financial markets over the last decade and the pressure from corporate governance demands, this network is no longer as strong as it was before.

The development of information technology has led to the creation of an even more sophisticated structure, known as a virtual organization. It can be described as "a temporary arrangement among partners that can be easily reassembled to adapt to market changes" (Daniels/Radebaugh/Sullivan 2009, p. 627). Key characteristics of virtual organizations are contrary to those of vertical hierarchical set-ups. Virtual organizations do not seek ownership and control along the value chain but try to secure availability of resources and capabilities in temporary networks. Contemporary information technology is crucial for virtual organizations in order to share knowledge and adapt quickly to environmental changes.

Virtual organizations take flexible approaches to meeting the challenges of fast-paced business contexts. The partners come together on a contractual basis but the ties are loose compared to hierarchical structures with clear command lines and responsibilities. Virtual organizations are fairly responsive to errors and weak conduct by network partners. Companies with higher capabilities can easily replace network firms that perform

poorly. The set-up is based on contractual agreements rather than hierarchical orders and assigned command authority. Time-consuming decision-making processing up and down the hierarchy ladder is not a characteristic of virtual organizations. Instead, these organizations are fast, flexible, and responsive to changing needs. As a result, such organizations are often more innovative as they allow for space and independence in decision-making. Ideally, virtual organizations have little overhead costs compared to traditionally structured companies. They are able to hire the organizations and individuals who are most competent for particular tasks along the value chain, thereby optimizing the quality of products and services and increasing competitive advantages.

The absence of boundaries in modern organizational approaches, however, comes with a range of disadvantages, which must be taken into account. While this structure might encourage free information flow, there is still a possibility that managers may not be able to realize the ideas of network and virtual organizations; this could result in withholding critical information in order to increase personal power over other managers and processes. Furthermore, there are indications that the absence of a formal hierarchical structure does not necessarily mean that there is no hierarchy. In fact, there are often informal hierarchies, which work against the actual aims of the network or virtual organization. In addition, the increase of independence in decision-making is accompanied by a decrease in direct control over processes. In cases where relations between partners in networks and virtual organizations are based on contracts and not on hierarchies, direct intervention by managers of the core company is likely to be more difficult.

6.3 Coordination and Control of Intra-Organizational Collaboration

Owing to the vast range of tasks carried out in international businesses, coordination has become crucial. The question arises of how to facilitate the activities properly along the value chain.

Coordination

Basically, coordination covers all activities in a company. While this might be a relatively easy task in a department, it becomes highly complex and challenging in the dealings between headquarters and foreign subsidiaries. An adequate coordination system must take into account the different locations, responsibilities, hierarchy levels, cultural mindsets and personalities. Therefore, it is necessary to establish relationships between managers and employees to ensure a smooth flow of knowledge and consistent decision-making throughout the organization. Insufficient coordination may lead to careless mistakes or deliberate wrongdoing throughout the company.

How can coordination be streamlined? Let us discuss three approaches to coordination in greater detail at this point (Daniels/Radebaugh/Sullivan 2009):

- coordination by standardization

- coordination by plan
- coordination by mutual adjustment

Coordination by standardization

This approach is based on universally applied rules throughout the organization. This means that headquarters establishes mandatory standards for all international subsidiaries. The underlying understanding is that company rules and regulations apply invariably, regardless of the various environments and contexts. The advantage of coordination by standardization is consistency in business conduct and predictability of behavior. Furthermore, it enables internal and external stakeholders to understand how a company acts.

Standardization also helps transfer core values from headquarters to subsidiaries. However in exceptional circumstances, this approach may prove complicated when universal rules do not provide guidance for sufficient management responses. Moreover, coordination by standardization can be difficult in international operations when standard company rules contradict local legal systems or business customs.

Coordination by plan

This approach tries to counter the disadvantages of coordination by standardization; namely its limitations in complex environments. It aims to offer management in subsidiaries greater discretion to enable them to respond to specific challenges in local contexts. It does not establish rules and regulations that are to be followed on local levels. Instead, it provides general objectives and guidelines that stipulate headquarters' expectations, however the way they achieve these aims can—and indeed should—be decided locally. This lets managers of subsidiaries decide how to match local business patterns with the overall goals laid down by headquarters. Coordination by plan grants business units and managers abroad greater independence, however, it calls for managing staff who can cope with this higher level of independence in decision-making. Coordination by plan requires head managers to accept more responsibilities and be accountable for decisions. In order to be successful, coordination by plan must be accompanied by efficient communication between headquarters and subsidiaries should exceptional circumstances threaten the achievement of goals on local levels. The adjustment of plans owing to changing contextual factors is an important aspect which should be anticipated in coordination by plan procedures.

Coordination by mutual adjustment

This approach tries to overcome the relatively static features of the two previous approaches. It relies on ongoing personal interaction between managers within the organization. Unlike the formal characteristics of coordination by standardization and coordination by plan, coordination by mutual adjustment is based on the provision of informal mechanisms that allow interaction among managers on a case-to-case basis. The focus of this approach is on flexibility and adaptability in response to managerial needs in given situations. This could mean, for example, the ad-hoc establishment of a team to manage a particular project as a response to a challenge cropping up in the course of business.

Coordination by mutual adjustment does not exclude features of coordination by standardization and coordination by plan approaches. In fact, coordination by mutual adjustment should not be interpreted as a stand-alone approach. It can be seen as a complementary system, allowing greater flexibility and faster decision-making processes in cases where static approaches would fail to generate an appropriate response. However, mutual adjustment also means that headquarters must allow more discretionary freedom in decision-making on the subsidiary level. It also requires managers to share a similar mindset based on problem-solving orientation rather than on hierarchy and reporting-line focus. The emphasis on mutual adjustment through personal interaction also means that management is capable of establishing effective working relationships across the organization. Therefore, the ability to connect with people from different social and cultural backgrounds, a key characteristic discussed in the previous unit, is a prerequisite for coordination by mutual adjustment.

Control

Control systems are established in order to support the coordination system of an organization. Control is necessary to monitor appropriate allocation of resources and proper procedural conduct in accordance with the coordination system. Lack of control has led to tremendous losses and even failure of multinational companies. Many banks throughout the United States and Europe almost collapsed as a consequence of the financial crisis a few years ago. Insufficient control measures allowed bank managers to invest in subprime mortgages putting the existence of the entire banking sector at risk. Control is a key element of corporate governance which strives to balance the information asymmetries between management and owners of an organization.

In broad terms we distinguish between following control methods (Daniels/Radebaugh/Sullivan 2009; Hill 2011):

- market control
- bureaucratic control
- clan control

Market control

This method of control is based on external mechanisms which include falling share prices, and the inability to meet targets and benchmarks. On an operational level market control is facilitated through assessments of price competitiveness, generated profit, and relative market share. Market control focus on external indicators, thus it can be seen as relatively objective.However market-based indicators can also be subject to influences beyond managerial control. Therefore, the economic context of the generated figures must be taken into account in order to reach an informed judgment.

Bureaucratic control

This method of control is based on a central authority normally at headquarter level establishing and monitoring a set of rules and regulations to which all sections and subsidiaries must adhere. In the case of non-compliance, senior management is informed and

considers various corrective measures. Bureaucratic control has advantages as it is a systematic and structured way of facilitating control. However it lacks the flexibility to correspond with the needs of widespread international operations taking place in complex and varying environments.

Clan control

This method of control focuses on a set of shared values among staff members. These values are guidelines for behaviour, and non-compliance is restricted and sanctioned by social control rather than by written rules and regulations. This approach requires clearly established and well-communicated values and employees who identify with these values and associated moral standards. Clan control can only be effective when employees have a clear understanding of the behaviour expected. A commonly accepted idea of what determines right behaviour must be shared among staff members, as a lack of clearly communicated values can lead to problems in decision-making. This approach has the potential to attract highly dedicated personnel.

It should be noted that there is hardly any organization relying on only one of these control methods. Mixed systems are the rule, however these are typically instituted with an emphasis on one of the three approaches. Clan control is the method most often used; if not the main mechanism of control, then it can typically be found as a complementary measure. Every organization must consider the right mix of these methods which suits its organizational set-up.

Once the control methods are established, it is necessary to decide which control mechanisms should be applied. Control mechanisms help guide the activities of employees towards achieving the targets of the organization.

Some of the most important mechanisms include (Daniels/Radebaugh/Sullivan 2009):

- reports
- personal visits
- performance of management control
- cost and accounting control
- evaluative measurements
- information systems

Reports

Reports are certainly the most common control mechanisms. There are countless ways they can be designed, but these are not subject to discussion here. Ideally, reports represent a valid picture of reality and are produced and circulated at an opportune time to be of use to management. Reports are intended to provide information which management can respond to and therefore they must have a certain format which enables senior managers to easily obtain key information. This can be challenging in international business operations due to the vast number of reports produced. A standard format is therefore

desirable in most cases. Readers then have access to key data and can accumulate data from many reports without too much explorative effort. Furthermore, reports can be saved and data analysed in electronic systems.

Personal visits

Even in companies with a number of subsidiaries around the globe, personal supervision remains an important if not essential control mechanism, as it is impossible to record every piece of information in structured reports. Visits help to monitor activities on site and to compare information given in reports with daily business in foreign subsidiaries. They must be planned in a way that managers in foreign operations are able to appreciate the efforts of controlling officers. An atmosphere marked by distrust must be avoided by all means. Instead, controlling officers should make local staff aware that their visits are meant to help reach targets. In general, a good mixture of analysis and social activities can contribute to a positive supervisory visit.

Performance of management

Management performance control is a mechanism aiming at evaluating a manager's personal performance rather than the results of the subsidiaries he is managing. This is done in order to achieve a just assessment that reflects his achievements and excludes contextual influences beyond his or her control. Separating personal performance from the effects caused by environmental factors such as political decisions, local economic developments, changes in exchange rates, cost hikes due to union activities, etc is a difficult task, however measuring a manager's achievement in a fair manner is necessary in order to identify those individuals doing a good job, even under harsh circumstances.

Cost and accounting control mechanisms

These mechanisms are utilized to draw comparisons between the various foreign subsidiaries. Again, this a challenging task given the many different influences that are beyond the control of local managers. Costs can be considerably higher in one country as compared to another due to higher minimum wages. Accounting standards may also vary. An example would be allowing a depreciation of assets within five years in one country while in another country the law would require a period of ten years. Comparing costs and accounting results therefore demands a thorough understanding of law and regulations in foreign contexts.

Evaluative measurements

This mechanism of control refer to the various indicators applied in order to control foreign subsidiaries. What we have seen so far is that it is not effective to employ only one indicator to justly assess the performance of both manager and subsidiary. In order to gain a valid picture of the achievements, it is beneficial to apply both financial and nonfinancial indicators. An example of a financial indicator is the comparison of budgets against profits generated. Nonfinancial information can help understand under which circumstances a subsidiary has achieved certain results.

Information systems

The range of control mechanisms described here requires collecting, compiling, analysing, and storing vast amounts of information. Based on the huge amount of data generated from internationally widespread operations, information systems can be seen as an overarching control mechanism which help structure the data in order to reach a comprehensive summary of operations. Information systems are useful as they coordinate information and channel it into specified directions, e.g. some data may be needed for external purposes, such as tax authorities and external auditors. There is a constant systematic flow of information from subsidiaries to headquarters and feedback from headquarters to subsidiaries. Additionally, certain information is shared among subsidiaries to support organizational know-how.

The following table summarizes the key findings of this chapter:

Table 19: Coordination of Intra-Organizational Collaboration

Coordination Systems		
Coordination by standardization	Coordination by plan	Coordination by mutual adjustment
Control Methods		
Market control	Bureaucratic control	Clan control
Control Mechanisms		
Information systems	• reports • personal visits • management performance control • cost and accounting control • evaluative measurement	

Source: Created on behalf of IU (2015).

SUMMARY

This lecture dealt with organizational issues in international businesses. It first described the traditional organizational structures. In terms of vertical differentiation, we discussed centralized and decentralized systems. With regards to horizontal differentiation, we looked at three traditional organizational designs: functional structures, divisional structures and matrix structures.

We then explored other contemporary organizational set-ups. Modern structures share one key element: the removal of horizontal, vertical, and externally structured boundaries. Next, we focused on network structures and virtual structures. In general, it is fair to say that modern

organizational designs provide greater flexibility and a faster adaptation to changing environments. However, management and control of such structures is complex and difficult.

Finally, we discussed coordination systems, which help facilitate the activities along the value chain. Coordination can be carried out in three ways: coordination by standardization, coordination by plan, and coordination by mutual adjustment. We concluded that companies normally employ a combination of these three approaches. We also looked into control systems and discussed three control methods: market control, bureaucratic control, and clan control. These are different control mechanisms which can be used to carry out control tasks, those being reports, visiting subsidiaries, management performance control, cost and accounting control, evaluative measurements, and information systems. We concluded that a mixture of control mechanisms is ideal in order to make an informed judgement on the performance of a subsidiary. We also stated that it is helpful to employ a mix of financial and nonfinancial information for control purposes.

UNIT 7

INTERNATIONAL MARKETING

STUDY GOALS

On completion of this unit, you will have learned …

- the approach to marketing in international business.
- what strategic choices are required in international marketing.
- the various marketing mix choices.

7. INTERNATIONAL MARKETING

Introduction

VARIATIONS IN THE INTERNATIONAL MARKETING MIX

International businesses are increasingly aware of consumer differences between countries and regions, even though these consumers otherwise have similar profiles, e.g. in terms of age, income, and occupation. As a result, businesses aspiring to act in the global marketplace are devoting more resources to identifying these differences before selecting the appropriate international marketing mix for that country or region.

Regina Maruca (2000) reported on some research led by Dawn Lacobucci of Northwestern University’s Kellogg Graduate School of Management. This research aims to identify the cultural differences that might skew consumer responses with regard to identical surveys in different countries. In other words, the research seeks to identify differences in consumer behavior that are ‘real’ rather than ‘apparent’ between nations and regions. In a recent test of their model, the researchers found important differences between consumers in four major geographical market segments, namely Asia, Latin America, and Northern and Southern Europe in rating the products and services of a given company:

- Price was seen as a key indicator of quality in Asia, and Northern and Southern Europe but not in Latin America;
- Product quality was regarded as driving a company’s repeat purchasing in Asia, Northern Europe, and Latin America but not in Southern Europe;
- Product after-sales service was seen as influencing repeat purchasing in Asia, Latin America and Southern Europe but not in Northern Europe;
- Product value for money was only seen as driving repeat purchasing in Latin America;
- Promotion was regarded as having the greatest impact on repeat purchasing in Latin America and Asia, and the least impact on Northern Europe and Southern Europe; here the number of sales representatives was used as a proxy variable for promotion in the sales of a given product in the different areas.

Lacobucci concluded that “companies that probe deeper to figure out how their global customers think and feel create smarter branding strategies.”

Source: Wall/Minocha/Rees 2010, p. 353.

Unit seven deals with selected operational aspects in international business. This unit will start by looking at international marketing to clarify the most important decision in this area. Marketing is a vast academic field that we cannot cover entirely as this would clearly go beyond the scope of this course. Instead, we will focus on the specifics of marketing in international operations. This will equip you to seek further information whenever your professional work requires it.

7.1 Marketing in International Business

The opening case study in this lecture illustrates why it is reasonable to consider marketing issues in international business operations. It seems to be an opportunity to optimize results from global business efforts. Understanding the particular needs of customers in foreign markets helps to enhance market shares.

Before considering the marketing-mix options for global business, let us elaborate on the most important reasons for international marketing (Wall/Minocha/Rees 2010). We will consider the following advantages:

- increased size of the market
- extended product life cycle
- international specialization
- employing first-mover advantages
- faster investment amortization
- decreased costs of stock-holding

One of the most important reasons for international marketing is to find new markets for products and services that have achieved an maximal domestic market potential. Foreign markets can help reduce average costs of production by employing economies of scale. This is a particular priority for companies active in highly competitive mass markets in which the price is the most important determinant for market success. Furthermore, industries that need to invest heavily in research and development depend on market sizes, which often exceed the potential of domestic markets.

Closely connected to increasing the size of the market is a desire to extend the product life cycle. When domestic markets are saturated, foreign markets offer the potential to increase the sales of products, thereby generating profits in a mature state of the product life cycle.

International specialization also supports international marketing approaches. A previous lecture on this course discussed the fact that it is often beneficial to produce in different countries to achieve optimized overall costs and source competencies globally. At the same time, an international specialization approach requires international marketing activities. This is because the initial costs of global specialization are high and global specialization calls for huge efforts in coordination. Therefore, marketing products internationally may be necessary to generate a return on investment.

Moving into foreign markets can also mean being the first to exploit the market potential. This so-called first-mover advantage is often extremely beneficial for the company. As there is no or only little competition in the new market and customers are less price conscious, the company can attempt to sell at comparatively high prices. Being the first in a market may also help in establishing strong customer relationships. The buyers' loyalty can help sustain market success even when competitors enter the market. As a result of this international marketing, the pay-back period of investment is likely to be reduced. Higher sales volumes, extended product life cycles, and employment of scale economies help achieve amortization at an earlier stage. An improved financial situation facilitates further investments. The resources available can help increase the research and development efforts. Consequently, the organization may improve its market position by offering new products or entering new domestic and international markets.

Finally, it should be mentioned that international marketing may reduce stock-holding costs. A higher turnover in warehouses can lower the costs of stocking goods considerably, provided that an efficient production and distribution system has been established.

Bearing these advantages in mind, let us focus on the key decisions that constitute an informed international marketing approach. The results should be based on proper research. As previously mentioned, data is not always easily accessible. Therefore, creativity in generating important information is essential in order to reach a decision based on facts and understand the opportunities and challenges of international marketing. Basically, five questions must be answered (Wall/Minocha/Rees 2010):

- Should the company go international?
- Which markets should it enter?
- How should it approach these markets?
- What form should the international marketing mix take?
- What implementation, coordination, and control measures should be used?

The question of whether to enter foreign markets is based on two broad dimensions: the company's competencies with regard to international activities, and the potential of the global market for the firm's products and services. A thorough assessment of the specific market and its potential is required to decide which markets to enter.

The strength of actual and potential competitors should be evaluated. To a large extent, market entry strategies will depend on the nature of the product(s) that the company intends to launch internationally. The marketing mix design largely reflects the foreign market, the behavior of customers, and the legal context. Finally, implementation, coordination, and control are influenced by the company's systems and also by the cultural environment in the foreign market.

The following table summarizes the content of this section on international marketing:

Table 20: Reasons for International Marketing and Questions to Consider in International Marketing Decision-Making

Reasons for international marketing	Questions to consider in international marketing decision-making
• increased size of the market • extended product life cycle • advantages of international specialization • employing first-mover advantages • faster investment amortization • decreased costs of stock-holding	• Should the company go international? • Which markets should it enter? • How should it approach these markets? • What form should the international marketing mix take? • What implementation, coordination, and control measures should be used?

Source: Created on behalf of IU (2015).

7.2 Strategic Choices in International Marketing

We will now discuss the most relevant decisions in international marketing. Basically, a set of eight aspects should be considered (Daniels/Radebaugh/Sullivan 2009).

The following table displays these aspects and allocates them to the sections of this unit:

Table 21: Overview: Marketing in International Business

Operations in international business – 1: Marketing in international business (Unit 7.1)	
Strategic choices in international marketing (Unit 7.2)	• general marketing orientation • market segmentation and target markets • managing the marketing mix
Marketing mix choices in international marketing (Unit 7.3)	• product policy • pricing strategy • promotion strategy • branding strategy • distribution strategy

Source: Created on behalf of IU (2015).

This unit focuses on the strategic choices in international marketing. We will start by looking at a company's general marketing orientation. Then we will move onto questions of market segmentation and the identification of target markets. Finally, we will consider how to manage the marketing mix in international business operations.

General Marketing Orientation

The general marketing orientation may focus on one of the following five dimensions:

- production
- sales
- customers
- strategic marketing
- social marketing

Production orientation means a company's main focus is on the production process. This is appropriate in industries concentrating on sales of commodities. Passive exports tend to result in a production focus as, in many cases, companies simply respond to demand from foreign markets but undertake no efforts to explore new markets themselves. Similarly, foreign niche markets may attract domestic products owing to an information spillover from the company's home country to a foreign market.

Sales orientation is a more active engagement in foreign markets, however it is based on the assumption that customer demands are similar to the domestic market. The approach therefore presupposes little or no product alterations and similar communication strategies.

Customer orientation goes one step further, taking customers' lifestyles and specific demands in various regional markets into account. Consequently, products are altered significantly in order to meet the expectations of potential clients in foreign markets. A precondition to customer orientation is an in-depth analysis of customer needs to which the company then must try to respond.

Strategic marketing orientation is an approach that aims for a mix of production, sales, and the consumer orientation mentioned above. Why should a company engage in strategic marketing orientation? Because it needs to focus on specific customer demands while covering regional markets and because it must produce cost-efficiently. However, it might not be able to finance operations in every local market as production and distributional costs need to be taken into account.

The social marketing orientation approach follows from a company's conviction to having more than just financial responsibilities. Corporate social responsibility translates to social marketing orientation. It calls for the environmental and social impact of a company's production and marketing to be taken into consideration. Social marketing orientation helps attract those consumers who are aware of these issues and also responds to increasing public demands from civil society groups who closely scrutinize the social and environmental impact of a company's conduct.

Market Segmentation and Target Markets

Market segmentation and identifying target markets are among the most crucial marketing decisions; no doubt you will have already dealt with these issues in a marketing course. Please note that in general marketing, segmentation is normally carried out on the basis of demographic data, such as income, gender, age, and religion. In international business, these criteria are still valid but they constitute a second step.

The first steps that lead to three broad approaches for international segmentation (Daniels/Radebaugh/Sullivan 2009; Hill 2011):

- segmentation by country
- segmentation by global category (segment)
- segmentation by multiple criteria

Segmentation by country is a simple decision to enter a certain national market (or a few national markets) and then to segment these markets further. This approach is useful for companies that are obliged to focus on one or few foreign markets, owing to limited resources. However, they miss out on opportunities for generating scale economies, which may arise from similar market characteristics in markets other than the targeted foreign ones.

Segmentation by global categories (segments) is an approach that looks at a certain market segment globally and then endeavors to cover this particular segment in as many foreign markets as possible. This approach provides economies of standardization. At the same time, entering certain country markets can be expensive if the segment is too small. Segmentation by multiple criteria combines the two approaches mentioned above as it firstly identifies countries as segments and then ventures out to find segments in each of the countries. As a result, a company can identify the most potentially beneficial cross-country segments, thereby generating large scale economies.

Finally, a company must decide whether to focus on niche markets or mass markets in a foreign country (Wall/Minocha/Rees 2010). This decision affects numerous other marketing decisions, such as product standardization vs. adaptation, distribution channels, and communication strategies among others.

It is important to understand that a product can target a niche market in one country and a mass market in another. One example of mass production in Europe would be the BMW 3 Series. In developing countries such as Southeast Asia, BMW would target a niche market in this case, rather than a mass market.

Managing the Marketing Mix

It is considerably more complex to manage the elements of a marketing mix in international business than in purely domestic operations. Management must closely assess the relative importance of the marketing mix elements — product, price, promotion, brand, and distribution — in order to allocate resources adequately where they are needed most. This can be done with the help of a gap analysis, which should focus on the following issues (Daniels/Radebaugh/Sullivan 2009):

- usage gap
- product line gap
- distribution gap
- competitive gap

The prerequisite for a gap analysis is a reliable estimate of the overall market potential, as well as the recent overall sales figures for all competitors in this particular market. The usage gap indicates the degree to which competitors utilize the market potential for a particular product and the markets that still offer substantial room for expansion. Product line gaps indicate where companies lack certain product lines or variations that would help increase sales in particular markets.

An example of this would be that a company decides to offer a basic model of its product to attract consumers in markets where income levels are relatively low. Distribution gaps indicate where companies miss out on market opportunities owing to insufficient coverage of certain geographical areas. A distribution gap occurs when a company does not employ distributional channels common in particular markets because they are not available as in the case of the home market. Finally, competitive gaps describe the first-mover advantage of a competitor present in a market for a long time.

In summary, managing the marketing mix in international business basically entails a market-by-market analysis of differences between market potential and actual company sales. Once gaps have been identified, managers can allocate resources to those marketing mix elements in order to close the gaps. Managing the marketing mix calls for a thorough market analysis and marketing efforts should be prioritized in order to achieve optimal results.

7.3 Marketing Mix Choices in International Marketing

In this section, we will explore the marketing mix choices facing companies in international business (Wall/Minocha/Rees 2010). We will focus on the elements: product, price, promotion, brand, and distribution.

Product Policy

Product policy decisions address the question of whether to enter foreign markets with a standardized marketing mix. Any alterations in terms of product, price, promotion, branding, and distribution that result in additional costs are taken into account and compared against the potential gain.

With regard to the products, there are basically three reasons for making alterations when entering foreign markets (Daniels/Radebaugh/Sullivan 2009; Wall/Minocha/Rees 2010):

- legal reasons
- cultural reasons
- economic reasons

Legal reasons

These reasons for alterations result from regulations in foreign markets that must be considered. Standards often vary and national laws constitute a certain level of protection with regard to health and safety risks. Packaging regulations and environmental laws are the most common legal reasons for altering products, e. g. placing warnings on cigarette packs in Germany, which are not required by law in other countries. Packaging and labelling pharmaceuticals are other examples that vary considerably from country to country. Environmental laws also have an impact on the way goods are packed, e.g. in Germany, very few beverages are still sold in cans. Supermarkets in many cities around the world produce plastic bags for customers' convenience — not so in Los Angeles, US where they are not permitted, or in Rwanda, Africa where plastic bags are even banned.

Cultural reasons

Accommodating local habits and tastes is a cultural reason for product alterations. For many years, German car makers had relatively little success selling compact cars in the United States where customers tended to buy spacious vehicles. By contrast, the interior of an American car, equipped with convenience items such as cup holders, lacked appeal for many German customers. This has changed to some extent but differences in preferences still exist and must be taken into account when launching operations in foreign markets. Regarding the food industry, the problems of standardized products are obvious: dairy products common in European countries are not favored by Chinese customers, traditional Indian food is too hot and too spicy for many Europeans, and pork would fail to sell in Islamic countries.

Economic reasons

These reasons for product alterations mainly relate to the income of potential consumers and the infrastructure available in target countries. A producer of refrigerators might consider only selling a cheaper model from their range of products to a developing country as the income of the majority of people would not allow them to purchase a more sophisticated version. Furthermore, infrastructure is rather poor in many developing countries compared to Europe. This refers not only to roads but also to the electric power supply. In countries with numerous power cuts and instable power voltage, electrical appliances are delivered with equalizers. These prevent damage caused by high voltage when power is re-established after an outage.

Pricing Strategy

Although a company's pricing strategy must reflect the costs of the entire supply chain in international business, it also needs to factor in price acceptability in certain foreign markets. It would go beyond the scope of this course to discuss generic pricing strategies at this point; however we will discuss the factors that influence pricing in international marketing (Daniels/Radebaugh/Sullivan 2009).

These factors are:

- government influences
- market characteristics
- export prices
- currency fluctuations
- price negotiation habits
- relationships with suppliers

Governmental influences

This factor, which includes regulations in the pricing of goods (e.g. minimum or maximum prices), may limit or prohibit certain pricing strategies. A good example is the market for pharmaceuticals in Germany. Owing to a number of regulations, a standard product like aspirin is sold at a much higher price in Germany than in the United States, for instance. The market for fuel is another example illustrating the influence of government. Petrol and diesel prices in Germany include a high fuel tax, making both very expensive compared to countries in which the government imposes a lower fuel tax for petrol and diesel.

Market characteristics

Simply put, consumers in certain countries may be more price conscious than in others. This means that the company must restrict price levels in one country but can charge a premium in another. From a wider perspective, a company can employ one of three pricing strategies (Wall/Minocha/Rees 2010). Applying a skimming strategy means introducing a product at a relatively high price and targeting those consumers initially interested in it. The prices are subsequently gradually reduced in order to make the product affordable for price-conscious customers. In contrast, a company tries to enter a market at a relatively low price using a penetration strategy in order to gain as many customers as possible in a short period of time. This strategy is useful in acquiring a high market share in the short term. Finally, the cost-plus-margin strategy is applied to simply calculate the costs of a product including a margin to attain the desired selling price.

Export prices

These also play an important role in international pricing strategies. Charges for transport, tariffs, and taxes add to the overall costs of the product. A company might face challenges with a simple cost-plus-margin strategy. If calculated in this way, products could prove too expensive for customers in foreign markets. While the cost-plus-margin pricing strategy is a simple approach, it may result in non-competitiveness and consequently lead to the failure of the company's internationalization if these additional costs are not considered in pricing decisions.

Current fluctuations

Similarly, currency fluctuations in foreign markets must factored in as they constitute an enormous challenge for international marketing efforts. The fact that prices must be recalculated in order to generate the same revenue in a stable currency increases the workload. Moreover, during the process of generating the revenue in a foreign market, exchanging currencies and transferring the funds into the company's home country bank

account, it is likely to have been devalued owing to high inflation in the foreign country. Adjusting prices upwards might be reasonable in order to generate the same revenue in hard currency terms, however it is important to remember that local consumers normally receive their income in their currency. Increasing prices could make selling goods difficult for a company and also multiple the risk of becoming uncompetitive.

Take the example of a developing country in central Africa. After releasing the local currency in a free float in international markets, a huge devaluation took place that diminished the currency's value against the US dollar by 50 %. The inflation rate subsequently remained stable at around 35 %. As a consequence, retailers of new cars had to increase prices in order to import the cars and were invoiced in US dollars. At the same time, local consumers were experiencing a disproportionate decrease in their salaries. With lower buying power, the developing middle class in the country (previously the main buyers of imported cars) increasingly lost its capacity to purchase these cars.

Price negotiation habits

While, in some markets, prices are always subject to bargaining, in others prices are fixed with very little negotiation. For example, bargaining for cars used to be very limited in Germany and has only become common in the past two decades. Car retailers still only have little leeway for granting discounts on new cars as manufacturers continue to dictate the prices. Most products in Germany cost what it says on the price tag. Many customers do not even ask for a discount but turn to other suppliers offering lower prices. In other countries, particularly in the developing part of the world, bargaining is "part of the game" during the process of buying and selling goods. Pricing strategies must adapt to these local customs. In conclusion, it can be inferred that the initial prices should be higher in countries with a bargaining culture in order to have some leeway for negotiations.

Relationships to suppliers

Companies with strong market positions and huge volumes of sales can demand lower prices from suppliers in return for a high turnover. Lower costs for supply can lead to lower selling prices and consequently to improved competitiveness and higher market shares.

Promotion Strategy

Promotion strategies can be distinguished as follows:

- push strategies
- pull strategies

They mainly depend on the selling techniques used (Daniels/Radebaugh/Sullivan 2009; Hill 2011).

Push strategies place the emphasis on direct selling approaches, while pull strategies employ more indirect techniques. Examples of push strategies are direct sales through sales personnel and agents. Indirect techniques include newspaper advertisements and TV commercials. Push strategies are commonly used when distribution or advertising is

restricted. Expensive products normally apply push strategies when directly compared with the income available. Consumers require more effort; direct attention and personal interaction between sales personnel and potential buyers are paramount. On the other hand, pull strategies are applied in markets with a high level of self-service selling points. If product prices constitute a minor share of a consumer's income, pull strategies are more common, as little personal interaction between sales agents and buyers is necessary. The same applies to highly standardized and popular goods, which simply do not need to be explained to customers. In these cases, it is useful to advertise the products in magazines and TV commercials.

Promotion strategies differ from country to country owing to local culture, customs, and national law. Today, TV commercials for cigarettes are prohibited in many countries but still permitted in others. Promoting pharmaceuticals also varies, often requiring the employment of promotion strategies. International promotion strategies need to consider the language used, as adapting promotional measures to each local language might be expensive and cause numerous misunderstandings. In general, the sense of humor varies considerably among countries and regions, as do customs and understanding. In addition, certain idioms and sayings cannot be easily translated into other languages. Moreover, using only one language, e.g. English, could pose a problem for those consumers who have difficulties understanding this language.

Branding Strategy

The question of whether to use a uniform brand globally must be decided in the context of international marketing strategy development (Wall/Minocha/Rees 2010). Some companies manage to establish one global brand. Sony is a good example as it sells all its products worldwide under this name. It is also possible to have one parent brand such as Apple and sell the products under a family brand name that can easily be recognized by consumers; typical Apple products include iPad, iPhone, and iPod which are globally recognized brand names.

In the case of global brands, problems may arise from different connotations of certain words or expressions varying from country to country. Did you know that Coca Cola calls its calorie-reduced product Coca Cola Light in Germany, while it is called Diet Coke in almost all other countries? This was necessary because German associates the word 'diet' with an attempt to lose weight, while in English it has a more general meaning of living a healthy life. Another good example would be the popular Croatian drink 'Pipi'. This brand would not qualify as a global brand, given the fact that in countries such as Germany, the name is associated with urine. More serious problems can occur when brand names have religious or cultural connotations.

In conclusion, it must be determined whether the brand name can be used internationally without prejudice or misunderstandings. This requires a thorough market analysis before launching internationally.

Distribution Strategy

Distribution is a difficult task in international marketing. Companies must understand the different distributional infrastructures in various countries. In addition, they need to consider differences within the regions of countries (Wall/Minocha/Rees 2010). Therefore decision-making in terms of distribution strategies is relatively complex. If we define distribution as the journey of a product from production to consumers, it becomes obvious that this path may vary from country to country and vary sometimes even within the same country. Let us consider the following example. If you aim to distribute a product meant for mass markets in various countries, you could opt for a country in which there are only a few small shops and the majority of mass products are sold in supermarkets. You may even encounter one or two intermediate dealers to arrange the distribution so that your company only needs to deal with a small number of partners who distribute your goods. In another country, you may find a majority of small shops owned by local people selling an assortment of products but no distribution agents. In such an environment, you would conclude that your company would have to carry out logistical services independently.

The internet and the rapid development of e-commerce are currently changing the context of distribution. In the fast-paced environment of the internet, consumers expect quick responses and immediate delivery. However, this is not always as easy as it might appear. E-commerce means that goods are literally only a mouse click away, even if consumers are located in remote areas. Think of developing countries as an example — delivering products to customers in these areas can be a huge challenge.

Generally, companies need to consider whether to carry out distribution internally or engage specialized distributors. Internal handling can be beneficial when products are quite expensive, technologically complex, and require intense after-sales services. This also applies when direct interaction with customers is important or necessary. In the food industry, some companies use internal distribution systems to ensure that the logistic chain and the cool chain, in particular, are not interrupted. Food producers seek to prevent foodstuffs becoming spoiled during distribution and thus avoid reputational damage as a possible consequence.

If a company opts for external distributional services, then it must consider which partner would be most reliable. Aspects such as the financial credibility of the firm, its reputation and trustworthiness, and the availability of sufficient resources to handle distribution must all be taken into account.

In international marketing, decisions regarding distribution do not stop once the product has been delivered to the consumer’s door. Many goods need intense after-sales services including the supply of original spare parts. As an example, should you ever experience a breakdown of a German luxury car in a developing country in Africa, you will immediately understand the importance of adequate and reliable after sales services. In many countries, you would have to wait for weeks until spare parts arrive. It is no surprise then that Toyota achieved a considerable market share in many African countries by managing to distribute a variety of cars ranging from simple to luxurious models, whilst at the same

time setting up networks of retailers and repair shop partners and made spare parts widely available. In doing so, Toyota has gained a reputation as an affordable and reliable car manufacturer.

The following table summarizes the key issues of this section:

Table 22: Marketing Mix Choices in International Marketing

Key marketing mix choices	Aspects to be addressed
Product policy	Alteration of the product program for: • legal reasons • cultural reasons • economic reasons
Pricing strategy	Influences on pricing strategy owing to: • government influences • market characteristics • export prices • currency fluctuations • price negotiation habits • relationships with suppliers
Promotion strategy	• push strategies • pull strategies
Branding strategy	• global brand • locally adapted branding
Distribution strategy	• distribution internally handled • distribution through external service provider

Source: Created on behalf of IU (2015).

SUMMARY

This lecture dealt with international marketing issues. The introduction familiarized us with the most important reasons for international marketing approaches. We then looked at five generic questions that a company has to answer on its road to international business. It became clear that international marketing depends on the capacity of a firm to operate internationally and the potential of international markets.

Then we explored the strategic marketing choices in international business, namely the general marketing orientation of a firm, questions of market segmentation and the selection of target markets, and managing the marketing mix elements sufficiently.

Next, we looked at the choices that a company must make in terms of applying a marketing mix. We discussed questions on the product line and appropriate pricing strategies, before listing the different approaches to promotion and branding, together with the opportunities and challenges.

Finally, we discussed the distributional aspects and realized that a key question here is whether a company should manage distribution internally or cooperate with specialized distributors. We concluded that the internet and e-commerce have changed the context of distribution significantly.

UNIT 8

SUPPLY CHAIN MANAGEMENT AND ACCOUNTANCY IN INTERNATIONAL BUSINESS

STUDY GOALS

On completion of this unit, you will have learned …

- what supply chain management means in the context of globalized business.
- the key areas of supply chain management.
- the challenges of supply chain management.
- the most important issues in international accountancy.

8. SUPPLY CHAIN MANAGEMENT AND ACCOUNTANCY IN INTERNATIONAL BUSINESS

Introduction

BUILDING THE BOEING 787

Boeing's newest commercial jet aircraft, the wide-bodied 787 jet, is a bold bet on the future of both airline travel and plane making. Designed to fly long-haul point-to-point routes, the 250-seat 787 is made largely out of composite materials, such as carbon fibers, rather than traditional materials such as aluminum. In total, some 80 percent of the 787 by volume is composite materials, making the plane 20 percent lighter than all traditional aircraft of the same size, which translates into a big saving in jet fuel consumption and costs. The 787 is also packed full of other design innovations, including larger windows, greater headroom, and state-of-the-art electronics on the flight deck and in the passenger compartment. To reduce the risks associated with this technological gamble, Boeing decided to outsource to an unprecedented 70 percent of the content of the 787 to other manufacturers, most of them based in other nations. In contrast, 50 percent of the Boeing 777 was outsourced, 30 percent of the 767 and only 5 percent of the 707. The idea was that, in return for a share of the work, partners would contribute towards the estimated $8 billion in development costs for the 787. In addition, by outsourcing, Boeing felt that it could tap into the expertise of the most efficient producers, wherever in the world they might be located, thereby driving down the costs of making the plane. Furthermore, Boeing believed that outsourcing some work to foreign countries would help it to garner sales in those countries. Boeing's role in the process was to design the plane, market and sell it, and undertake final assembly in its Everett plant in Washington State. Boeing also believed that, by outsourcing the design of so many components, it could cut down the time required to develop this aircraft to four years from the six that is standard in the industry.

Some 17 partners in 10 countries produce major parts of the aircraft. Vought Aircraft Industries in South Carolina makes the rear fuselage, while Alenia Aeronautical of Italy produces the middle fuselage sections and horizontal tailpieces. Three Japanese companies, Fuji, Kawasaki and Mitsubishi, produce the plane's wings. Toronto-based Onex Corporation makes the nose section. All of these bulky pieces are shipped to Everett for final assembly aboard a fleet of three modified Boeing 747 freighters called "Dreamlifters".

Until late 2007, the strategy seemed to be working remarkably well. Boeing had booked orders for over 770 aircraft, worth more than $100 billion, making the 787 the most successful aircraft launch in the history of commercial aviation. But behind the scenes, cracks were appearing in Boing's globally dispersed supply chain. In mid-2007, Boeing admitted that the 787 might be a few months late owing to problems with the supply of special fasteners for the fuselage. As it turned out, the problems were much more serious. By early 2008, Boeing was admitting to a delay of up to 12 months in the delivery of the first 787 and an additional $2 billion in development costs, and it was facing the possibility of having to pay millions in penalty clause payments for late delivery to its leading customers.

The core issue was that several key partners had not been able to meet Boeing's delivery schedules. To make composite parts, for example, Italy's Alenia had to build a new factory. However, the site that it chose was a 300-year-old olive grove. It faced months of haggling with local authorities over the property and had to agree to replant the trees elsewhere before it could break ground. To compound problems, the first fuselage sections delivered to Boeing did not meet the required quality standards. Then, when parts finally arrived at Everett, Boeing found that many components had not been installed in the fuselages (as required), and that assembly instructions were only available in Italian. Other problems arose because several partners themselves outsourced mission-critical design work to other enterprises. Vought, for example, outsourced the design and building of floor pieces for which it was responsible to an Israeli company. In turn, the Israeli company had trouble meeting Boeing's exacting quality standards. Nevertheless, because it was reporting to Vought, not Boeing, executives at Boeing did not learn of this problem until it had already become a serious bottleneck. Upon learning of the issue, Boeing rapidly dispatched engineers to Israel to work with the company but by then several months had been lost. Despite all these issues, Boeing remains committed to its outsourcing program. What the company has learnt, however, is that if it is going to outsource work to foreign suppliers, much closer management supervision and coordination is required to make it work.

Source: Hill 2011, pp. 564–465.

This unit consists of two thematic sections: supply chain management and accountancy. Please keep in mind that, owing to the limitations of this course, we cannot discuss all the relevant details of each topic. As in earlier units, we will refer to the most fundamental aspects in international business. This will equip you with the necessary understanding of the most important challenges and opportunities resulting from supply chain management and accountancy in global business. You will then be able to acquire additional knowledge, should your professional career or interest require it.

8.1 Supply Chain Management and International Business

Supply chain management is one of the most important issues that management has to address in international business. Let us start this lecture with a broad definition. Supply chain management is “the coordination of materials, information and financial resources from the initial raw materials supplier to the ultimate customer” (Daniels/Radebaugh/Sullivan 2009, p. 695). This definition implies that a company not only has to consider its suppliers and customers but also take into account the supplier’s supplier and the customer’s customer. Only then can we assume a comprehensive approach to supply chain management. In the context of global business activities, this is a challenging task. A smooth flow of materials, information, and financial resources must be ensured on an international level.

We have discussed in detail the various challenges in international business, such as different legal systems, different cultures, and different business customs among others. With these in mind, it becomes clear how much work is entailed in arranging an adequate supply chain management on a global scale. Looking at the definition of supply chain management mentioned above, it becomes clear why logistics is not the same as supply chain management, although the terms are sometimes used interchangeably. Logistics, the sufficient flow and storage of materials, services, and related information, is only part of a comprehensive supply chain management concept.

What key issues are involved in supply chain management? Chain management must be oriented to customer service needs, which means taking customer and supplier networks into account. Production sites and distribution centers need to be planned accordingly as well as inventory management. Logistics, in a narrow sense, must be arranged, business worked out and information systems set up. The whole organization should be structured in order to serve supply chain management and carry out training wherever needed. Finally, control systems have to be in place to monitor the processes.

To summarize, there are basically five important aspects that we will elucidate in this lecture (Daniels/Radebaugh/Sullivan 2009):

- manufacturing strategy
- information technology and the supply chain
- quality management
- supplier networks
- inventory management

As the center of supply chain management, the manufacturing strategy will be discussed in this section. We will also look at information technology systems. The other aspects are explained in the second section of this unit.

Finding an appropriate manufacturing strategy in international business requires adequate solutions in terms of the:

- compatibility,
- configuration, and
- coordination and control

of the manufacturing processes (Daniels/Radebaugh/Sullivan 2009).

Compatibility

Compatibility means that the manufacturing strategy fits the overall competitive strategy of the firm. To optimize cost efficiency, for example, it is suggested that production sites be opened abroad. Dependability is another important aspect for locating production. Companies can ensure a smooth flow of supplies by seeking to employ different sources. At the same time, proximity to customers is essential in order to meet the demand. Therefore, manufacturing should ideally be carried out where these requirements are met. Innovation and quality are also issues that call for reflection with regards to manufacturing. Supply chain management requires consideration regarding establishing research and development units abroad. Again, the question is to find the right location between headquarters and international production plants. Flexibility is an issue also closely linked to manufacturing e.g. global production plants need to have the flexibility to shift excess production to under-utilized sites. Another aspect to consider is accommodating production to local demands.

Configuration

The configuration of manufacturing distinguishes between centralized, regional, and multidomestic approaches. Centralized manufacturing simply means producing in a company's home country and then exporting the goods abroad. This is normally done when only a relatively small number of items are produced, e. g. aircraft. Regional manufacturing is the strategy used to cover the needs of a particular regional market and many companies opt for this strategy. They categorize markets regionally and produce within those areas, e. g. in Europe, the US, and China. Toyota's approach to meeting the needs of developing countries is a good example. They built regional factories and produced for regional markets. Multidomestic manufacturing is useful when the need arises to offer customized products to national markets in which a company operates. This approach allows a company to establish a close relationship with its customers, however the costs for coordination are normally higher.

Coordination and control

Finally, coordination and control must be carefully considered. Coordination ensures that the supply chain is functional in terms of purchasing materials, storage, production, assembly, and the delivery of products. Control is necessary to monitor coordination, detect deviations within the intended flow, and enable management to apply corrective measures.

Information technology is crucial in ensuring a sufficiently functional supply chain (Daniels/Radebaugh/Sullivan 2009). With regard to the global flow of materials, information, and financial resources in international business operations, it is evident that without

information technology systems the supply of goods and efficient production would not be possible. It may be assumed that these systems are a decisive factor for success or failure in international business; those companies whose systems are an optimal match for their global operational set-up have a clear competitive edge. Amazon is an excellent example—without an information technology system, it would be impossible to carry out thousands of deliveries every day. Another company is the retailer Wal-Mart—with more than 60,000 suppliers in 70 countries and shopping centers around the globe, information technology is their key to success. While this kind of technological development typically progresses in multiple steps, we will focus on four at this point (Daniels/Radebaugh/Sullivan 2009):

- electronic data interchange
- enterprise resource planning
- radio frequency ID
- e-commerce and extranets/intranets

Electronic data interchange

This is used to exchange information between the company and its suppliers, manufacturers, customers, and intermediaries. Electronic data interchange is a tailor-made solution, however it does not necessarily offer the option of including new partners. Owing to this circumstance and the fact that only basic information can be exchanged, the system has its limitations in an increasingly rapidly changing global business environment.

Enterprise resource planning

This has an enormous advantage as it uses standardized software solutions that are more flexible and adaptable in dynamic environments. In its extended version, it includes material requirement planning systems that help calculate the required materials and initiate the necessary purchasing processes in time; however, its focus is on internal back-office services. In other words, it lacks the connection to external stakeholders.

Radio frequency ID

This provides materials with electronic labels that help track materials along the supply chain. It captures data relating to origin, destination, and quantity of products, thereby informing companies of the exact location of certain goods in the supply chain at any given time. This reduces losses in production processes and allows for optimized resource planning in manufacturing.

E-commerce and extranets/intranets

E-commerce and the development of extranets and intranets all require access to the internet. E-commerce links companies with their suppliers on the one hand and customers on the other. Amazon is a good example of how this has been implemented by book and other media retailers. Literally with just one mouse click, customers can order books that are not stocked in bookshops as Amazon is linked to numerous suppliers. This enables Amazon to deliver books within a very short time; it typically takes just two or three

days to deliver to the customer's address. Extranets and intranets are used to enable external and internal partners to directly access a company's information system, thereby speeding up processes considerably.

The importance of information technology is accompanied by new challenges. The most important of these is often referred to as 'the digital divide'. As much as supply chain management today depends on the internet, we need to realize that there are still huge regions around the globe that lag behind the US, Europe, or parts of Asia in terms of digital development. Many developing countries lack the necessary infrastructure to support today's information technology. A simple credit card payment carried out with a very slow internet connection and interrupted by several power cuts can be tedious and often very expensive. With this in mind, you can imagine the challenges of complex software solutions that are designed to rapidly exchange a huge volume of data, e.g. between suppliers and a company.

Although it might seem unimportant for developing countries to be included in information technology for supply chain management, it should be noted that many businesses can only generate growth and reduce production costs if they are able to access those markets.

The following table summarizes the key aspects of this section:

Table 23: Aspects of Supply Chain Management and Related Information Technology

Supply chain management: The coordination of materials, information, and financial resources from the initial raw materials supplier to the ultimate customer.
Key aspects addressed in supply chain management: • manufacturing strategy • information technology and the supply chain • quality management • supplier networks • inventory management
Development in information technology supporting supply chain management: • electronic data interchange • enterprise resource planning • radio frequency ID • e-commerce and extranets/intranets

Source: Created on behalf of IU (2015).

8.2 Quality, Supplier Networks, and Inventory in Supply Chain Management

This section will discuss the issues of quality, supplier networks, and inventory management in the supply chain.

Quality

What is meant by quality? Quality can be defined as meeting or exceeding customer expectations (Daniels/Radebaugh/Sullivan 2009, p. 703). These expectations relate to specifications of the product, value, user-friendliness, and service and support by the company as well as the image of the product. There are two general views on quality:

- zero tolerance to defects
- acceptable quality level

While the former does not accept any defects, the latter accepts failure as long as it can be serviced and repaired.

There are several approaches to quality management but owing to the limited scope of this lecture, we will only look at two:

- total quality management (TQM)
- International Organization for Standardization (ISO) Quality Standards

Total quality management bases quality mainly on customer satisfaction. It demands continuous improvement efforts and proposes employee involvement in quality assurance. TQM shows a zero-tolerance-to-defect approach and strives for products that exceed customer expectations. TQM does not merely focus on production processes but aims at constantly improving quality on all levels of the organization. When a company strives for best practices and demands that their products are better than those of their competitors, it is adhering to the principles of TQM. Continuous improvement is essential to an organization's culture and must be the goal of every employee in daily routines. Research suggests that, although the initial costs of TQM are high, it is likely to be cost-efficient over a longer period owing to a decrease in defective products.

The International Organization for Standardization has defined certain quality standards, the ISO 9000 and the ISO 14000 standards. The latter sets the standard for environmental quality, requiring an organization to improve its ecological performance. ISO 9000 is a true quality standard, aiming to promote quality on all organizational levels. It requires companies to document employees' performances on quality-related duties. Companies must also install mechanisms to ensure compliance with quality regulations. Thus, ISO quality standard does not measure the quality of a product but rather focuses on management processes that help keep up standards. ISO 9000 allows companies to become certified on assessment of their quality performance. Particularly in Europe, this certification is a prerequisite for obtaining contracts, however it has been criticized that awarding a certification does not automatically result in better product quality. Perhaps the value of this concept lies in its promotion of a quality-oriented focus in an organization.

Supplier Networks

Supplier networks relate to which suppliers a company uses, where these suppliers are located, and how the collaboration is structured. To find adequate answers to these questions, companies should first consider the aspect of sourcing in the context of interna-

tional business. By sourcing, we mean that a company obtains the necessary materials or input from external suppliers for production purposes. It is part of a company's materials management, which also includes inventory management and transportation. Generally, domestic sourcing offers advantages. There are no language barriers, distances are normally shorter, and culturally or politically imposed problems (currency exchange, taxes, and negotiation culture) are less likely than when sourcing in foreign countries. Still, there are good reasons for global sourcing. Often costs are lower, components are of a better quality, and the necessary technology is available abroad. In fact, some materials may only be available in foreign countries and not domestically. When operating production sites abroad, supplies are more reliable when they are sourced close to production sites. International suppliers can also be used as a backup to local providers. This enables the supply chain to become more reliable as international sourcing complements local sourcing. On the other hand, global sourcing is obviously more expensive and increases the workload of coordinating the supply chain. It may also be difficult to maintain the quality as material from different sources often varies. Scandals in the food industry such as spoilt strawberries from China, horse meat sold as beef, and products made of fake fish emphasize the problem in maintaining certain standards when sourcing globally.

In light of the above problems, it is understandable that many companies try to integrate suppliers. Vertical integration is when a firm decides to take over a major part of its supplier. Vertical integration reduces transaction costs considerably. However, it will only prove beneficial if the company is able to develop the necessary competencies to manage supply services. Another way of improving sourcing can be described as forming industrial clusters. This refers to buyers and suppliers who are located in close proximity to each other in order to reduce transaction and transportation costs.

Purchasing in a company normally follows the overall patterns of internationalization processes, starting with domestic purchases and then moving on to purchasing abroad when the need arises. International purchasing subsequently becomes a part of the company's procurement strategy and multinational firms eventually employ an integrated global procurement strategy. Typically, this gradual process is accompanied by decisions on whether purchases should be carried out centrally at headquarters or independently by the foreign subsidiaries.

Similar to purchasing development, overall sourcing strategies evolve with a company's increasing international activities (Daniels/Radebaugh/Sullivan 2009):

- Domestic buyers set up international purchasing.
- Foreign subsidiaries (or agents) are mandated to purchase.
- International purchasing departments are established.
- Business units are established, which are responsible for global sourcing.
- Global sourcing becomes fully integrated and coordinated.

Although the latter stages are highly complex, they can help save costs in purchasing processes if they are carried out prudently. Therefore, it is no surprise that some companies, such as car manufacturers, decide to establish joint purchasing units.

Inventory Management

Inventory management has become increasingly difficult owing to global business activities. The storage of inventory and the flow of materials must be efficiently managed in a business environment in which necessary raw materials and parts are sourced domestically and internationally, and partly produced internally. Three key aspects contribute to the challenges involved in inventory management:

- distance
- time
- political and economic influences

In today's complex production processes, it can prove difficult to source materials from remote locations. Shipment over long distances, often through dangerous areas, and delivering on time can pose a risk to the reliability of the production. Political and economic influences can also contribute to these challenges (e. g. when tariffs or taxes are raised) and result in a significant increase in costs.

The manufacturer's dependence on the timely provision of materials and parts has become even more crucial in lean manufacturing systems. These focus on a continuous optimization of all processes, as discussed with regard to quality management. An important aspect of lean management is the just-in-time provision of materials and parts. This means sourcing the goods when they are needed, thereby reducing storage in order to save costs. Nevertheless, just-in-time can make the production process more vulnerable to delay in materials and parts supplies. Just-in-time systems make it even more crucial to have excellent, long-term relationships with suppliers. A company locating in close proximity to key suppliers or vice versa is a strategy used to avoid problems resulting from just-in-time deliveries. The more a firm sources globally, the less just-in-time can be employed without having a safety stock of inventory. Otherwise, production processes could be subject to interruptions caused by supply shortfalls.

To summarize this section, in international business, inventory management requires a balance between efficiency by means of globalized processes and reliability through local orientation.

8.3 Accounting in International Business

This section will briefly address key accounting issues in global business operations. To reiterate, this area could easily justify hundreds of pages, however this would go beyond the scope of this course. We will therefore focus on the most important issues.

In general, we can distinguish between (Wall/Minocha/Rees 2010):

- management accounting
- financial accounting

Management accounting is internally oriented. It is designed to assist management and enable informed decision making. Therefore, it is not as strictly regulated as financial accounting. It often includes predictions, scenarios, and estimates.

Financial accounting records financial transactions and provides summarized results to a variety of stakeholders, mainly outside the organization. In most countries it is regulated, although to varying degrees. External stakeholders include shareholders, tax authorities, potential investors, banks and other lenders, employees, the general public, suppliers and customers. They all have an interest in the performance and the financial status of the company.

Basically, accountants must draw up four major financial statements to summarize the financial information collected over a certain period:

- income statement
- balance sheet
- statement of changes in equity
- cash flow statement

In addition, regulations usually stipulate reports in which the most important accounting policies applied are described and, if necessary, justified.

The income statement displays the profits or losses of a period by comparing the expenditure with the revenue of a firm. It is important to remember that revenue and expenditure can either be on a cash or non-cash basis. Depreciation of assets, for example, is included in expenditure although no cash operation is involved.

The balance sheet summarizes the assets of a company, comparing them against the liabilities. The resulting difference constitutes a company's equity. Assets are divided into current and non-current assets. Non-current assets are those items intended to remain in the company for a longer period such as land, buildings, and machinery. Current assets are items that frequently change value within a financial period, such as cash, bank balances, and inventory. Liabilities are distinguished similarly. Current liabilities are subject to changes within a financial period such as bank overdrafts and payables. Non-current liabilities are normally long-term, e.g. a long-term loan for a production plant.

The statement of changes in equity states the reasons for those changes. It indicates, for example, an increase in total equity, based on a company's profit in the financial period. If dividends are paid to shareholders, then the statement will show a respective reduction (or a smaller increase) in equity.

The cash flow statement gives an overview of a company's liquidity and fluctuations over a financial period. Basically, liquidity means cash or cash equivalents available to meet owing liabilities. Please keep in mind that many companies do not go bankrupt merely because of losses but often owing to a lack of available cash at the time when payments are due.

These introductory explanations will help in exploring the necessity for generally accepted international accounting rules. Let us first look at an example from recent business history. Please read the following case study:

CASE STUDY: ROVER TROUBLE WAS AVOIDABLE

Sacked BMW chairman Bernd Pischetsrieder might have retained his job if he had persuaded colleagues not to impose harsh German accounting policies on Rover when the company bought the British car maker in 1994, an analysis by Accountancy Age has shown. Though the British company is now widely blamed as jeopardizing BMW's future as an independent business, Rover's results compiled under British accounting standards, quietly filed at Companies House, paint a picture quite different from the enduring story of huge losses that ultimately led to Pischetsrieder's downfall.

As shown in the table below, figures reveal that Rover made a profit of £147 m between 1994 and 1997. Headline figures from consolidated accounts published by BMW, which took the company over in March 1994, however, show Rover making a loss of £363 m in the same period. It is these figures that the press, analysts and indeed BMW's board have pounced on as proof of the British car maker's inefficiency.

(Losses in brackets)	Rover net profit using British accounting rules £m	Rover net profit using German accounting rules £m	Difference £m
1994	279	Unpublished	–
1995	(51)	(163)	-112
1996	(100)	(109)	-9
1997	19	(91)	-72
Total	147	(363)	-216

German accounting policies are notoriously harsh. Investments are depreciated faster; there are more possibilities for making provisions and different rules for valuing stocks. All these have the effect of depressing profits.

Source: Accountancy Age, cited in Wall/Minocha/Rees 2010, p. 416.

What this example demonstrates is that countries' accounting standards vary considerably. It is not always as dramatic as in the case of BMW, leading to a severe crisis during the integration of Rover. Nevertheless, differences in accounting standards are frequently used and misused to achieve the most favorable outcome for managers; usually to the disadvantage of the owners/shareholders of a firm.

There are basically four reasons for country-specific accounting rules:

- different law systems and legal regulations
- different patterns of ownership
- influences by authorities in the accounting profession
- historical reasons

Legal systems determine which accounting rules must be applied and vary from country to country. Depreciation of assets, for example, is carried out differently in many countries, thus leading to different results in financial statements. Ownership structures also determine accounting standards. In the US, for example, companies are mainly characterized by dispersed share ownership. Strong accountancy bodies have developed strict rules for companies to present reliable financial data. In Germany, there are numerous family-owned small and medium-sized companies on the one hand and relatively few large companies on the other. Therefore, in the US, financial information from independent accountants is relatively significant for the financial markets, which differs from countries like Germany. A country's history must also be taken into account. Germany is characterized by the principle of the 'diligence of a prudent businessman', meaning that assets have to be estimated at the lowest reasonable value and depreciation rates provided by tax laws. Other countries have more liberal accounting standards, allowing more flexible valuation.

Let us look at a very simple example to understand the rationale behind the movement towards globally accepted accounting standards. Assume that your company has a subsidiary in a foreign country that you need to include in your financial reporting. The subsidiary had expenditure (before depreciation) of 90 and revenues of 100. The assets, worth 500 at this point, have to be depreciated. In your home country, these assets must be depreciated by 3 % per annum, while the host country only permits 1 % depreciation. Clearly, in your home country, the financial statement of the subsidiary would show a loss of 5, while in the host country the same result would indicate a profit of 5.

It is against this backdrop that the International Financial Reporting Standards (IFRS) have been developed by the International Accounting Standards Board. The IFRS have been adopted by more than 100 countries, of which some mandate the use of these standards while other countries still allow companies to decide between the implementations of national standards and the IFRS.

The IFRS are comprised of:

- standards
- interpretations
- conceptual framework

Standards and interpretations are mandatory. The standards are established consistently and each standard is constituted by the following information:

- objective
- scope
- definition
- guidance
- disclosure and presentation
- transitional provision
- effective date
- appendices

The conceptual framework outlines the basic principles, general information and objectives of the financial reporting following IFRS. It specifically focuses on:

- objectives of financial reporting
- qualitative characteristics of financial reports
- elements of financial reports
- recognition of elements of financial reports
- measurement of the elements mentioned
- capital concepts and capital maintenance

If you wish to know more about accounting in international business, please refer to the literature indicated.

This section also concludes our course on 'Managing in a Global Economy'. Hopefully it has have contributed to your understanding of the opportunities and challenges in the globalized world of business.

SUMMARY

This unit is divided into two thematic sections. We first addressed issues of supply chain management in international business and then briefly discussed general questions of international accountancy.

We can define supply chain management as the coordination of materials, information, and financial resources from the initial raw materials supplier to the ultimate customer. The key aspects addressed with regard to supply chain management were manufacturing strategy, information strategy, quality management, supplier networks, and the management of inventory. Basically, all these issues require decisions as to whether activities are carried out and controlled in the home country of

a firm or in the subsidiaries abroad. The more decentralized an organization, the closer activities are adapted to local customer needs, resulting in considerably higher coordination costs.

In accountancy, we concluded that different accounting standards in the various countries can lead to problems in the interpretation of financial statements. Consequently, internationally accepted accounting standards were developed—the International Financial Reporting Standard (IFRS) is now accepted in more than 100 countries.

BACKMATTER

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