

Unit 4

GLOBAL BUSINESS

22 GROWING ECONOMIES

ACTIVITY 1

CASE STUDY: ITALY AND THE DEMOCRATIC REPUBLIC OF CONGO (DRC)

1 Which of these two nations is the most developed? Explain your answer.

Italy is an example of a developed country. According to the data in Table 2, people in Italy experience a high literacy rate of 99.2 per cent, a high life expectancy of 82.3 years and high average levels of income at \$38 000 p.a. These are all characteristics of developed economies. In contrast, the DRC is very much a developing nation. It has low literacy levels (77 per cent), low life expectancy (57.7 years) and low income per head (\$800).

2 Explain why there are differences in the size of the economic sectors in each of these two countries.

The pie charts in Figure 2 show that sources of GDP for Italy and the DRC are very different. For example, Italy only generates 2.1 per cent of its GDP from agricultural activity. This compares to 21.1 per cent for the DRC. Most of Italy's GDP, 73.9 per cent, is generated from the sale of services. In contrast, the DRC only generates 45.9 per cent of its GDP from the sale of services.

Finally, the proportion of GDP generated by industry is just 24 per cent for Italy and 33 per cent for the DRC. These patterns are typical for a developed country like Italy and a developing country like the DRC.

3 Explain why a business might prefer to market its goods in an emerging economy rather than a developed economy.

When businesses are looking to develop new markets, it is possible that they would prefer to enter a market in an emerging economy rather than that of a fully developed economy. The main reason for this is that economic growth rates are generally much faster in emerging economies than in developed economies. For example, economic growth in India was 7.2 per cent in 2017. In Japan, growth was only 1.2 per cent in the same year (according to the data in Figure 1).

Businesses often prefer emerging markets since they are likely to grow more quickly than more mature markets. Therefore, a business should be able to increase profits and dividends. Consumers in emerging markets tend to experience new wealth and, as a result, they want to buy more goods and services to help improve their living standards. Businesses are keen to exploit such spending patterns.

ACTIVITY 2

CASE STUDY: GROWTH IN CHINA

1 What are the key factors that are likely to have led to growth in GDP in China?

GDP measures the total value of all goods and services produced within a nation's borders, by domestic or foreign-owned firms, over one year. GDP can increase when a country is producing more goods and services, or because prices are rising. China's economy has expanded rapidly. Factors behind this include a large, increasingly educated population, a developing economy and changing employment patterns, resulting in greater productivity economic and cultural changes that have resulted in increased personal spending.

Recent growth in China was driven by robust consumption, property investment and exports. The annual figure for 2017 overshot the government's full-year target of 'around 6.5 per cent'. Some economists were surprised that China achieved this goal since policymakers also reduced credit growth. Economists had warned China about the risks building from years of aggressive credit stimulus.

While the industrial sector grew by 6.8 per cent in the first quarter of 2018, it was growth in retail sales which 'caught the eye'. For example, in March alone, retail sales increased by 10.1 per cent. The growth was driven by sectors such as building materials (10.2 per cent); furniture (10.9 per cent); home appliances (15.4 per cent); jewellery (20.4 per cent); cosmetics (22.7 per cent); and items of clothing (14.8 per cent).

However, it is hard to evaluate the real GDP of China. Because of the country's political situation, many local authorities inflate their growth rates to meet or exceed targets set centrally.

2 Discuss the advantages and disadvantages of high growth rates for China.

From China's point of view, high growth has mostly brought advantages. It has led to a much better standard of living for many Chinese citizens. It has brought better education, better healthcare and increasing employment opportunities. These social and economic benefits lead to further growth.

From a commercial point of view, a market with high growth rates allows firms to start small and expand as the country develops. This is true for domestic firms as well as those directly investing.

However, there can be disadvantages to high growth. High growth results in changes to society that can cause problems. China has moved from being essentially an agricultural, rural economy to an industrialised, urban one. Lots of people have migrated from the countryside to the cities, putting pressure on services and infrastructure. Additionally, high growth has led to serious pollution of land, air and water throughout China.

EXAM PRACTICE

CASE STUDY: INDIAN ECONOMY

1 Explain one reason why the human development index may be important to an economy such as India. (4 marks)

India was ranked 131st in the human development index (HDI). The HDI is an indicator of growth. It combines statistics on life expectancy, education and income for any particular country into a single rankable value. The HDI is published by the United Nations Development Programme and attempts to assess a country's people and their skills, rather than simply the economic conditions. It is quite different to GDP per capita, which just measures growth in output per head.

The index may be important to a country like India because it allows the government, for example, to watch improvements carefully and make comparisons with other countries. Although India's economy has been growing strongly in recent years, a HDI ranking of 131 out of 188 countries is fairly poor. This might encourage the government to introduce measures to help improve the country's ranking.

2 Discuss the possible benefits to individuals in India of rising international trade. (8 marks)

In recent years, India's economy has become a little more open. This has resulted in many overseas businesses experiencing significant success in the Indian market. Figure 7 shows that India's imports rose sharply between 2009 and 2011 from around US\$15 000 million to over US\$45 000 million. This is an increase of around 200 per cent. However, although exports have risen over the same time period, imports have generally exceeded exports. Many would say that this is quite common for fast-growing economies. When an economy grows rapidly, it is usual for consumers to 'suck in' imports.

International trade can benefit a wide range of groups. Individuals will benefit from increased international trade because they may be able to buy cheaper goods from overseas where production costs are lower. For example, cheaper manufactured goods from China, Bangladesh and Vietnam have entered markets in many Western developed countries. This means that individuals in these countries can buy more goods and services with their income. Increasing international trade also brings more choice for consumers. There is likely to be a considerable variety in quality, designs and product ranges as an increasing number of countries open up their economies. Greater choice resulting from growing international trade helps to increase the standard of living for individuals.

In India, incomes for many have risen sharply. For some, they will be able to afford cars, holidays, richer entertainment and better-quality clothes for the very first time. However, increased imports could pose a threat for others. For example, some Indian companies are likely to be threatened by competition from overseas as imports come in. This might result in some Indian businesses struggling and eventually collapsing. The people working for these businesses will be adversely affected.

3 Discuss the benefits to Indian businesses of the recent patterns of economic growth in India. (8 marks)

India is expected to have the world's fifth-largest economy in 2019 at US\$3.211 trillion. It is one of the world's fast emerging economies and has experienced some rapid economic growth in the last 10 years. Figure 6 shows India's economic growth rates between 2008 and 2018. In most years during this period, economic growth has exceeded 6 per cent. India's GDP grew by 7.2 per cent in the third quarter of 2017. This exceeded expectations and made India the fastest-growing economy in world. Growth in industrial activity, especially manufacturing and construction, and an expansion in agriculture, contributed significantly to the improving performance.

Most businesses are pleased about rapid economic growth. If the economy is growing, it means that businesses are producing and selling more output. This will drive revenues and increase profits. Businesses are likely to feel confident about the future and are more likely to consider investing in new products, more advanced technology and research and development. This will help businesses become more competitive and secure their future.

Rapid economic growth is also likely to encourage businesses growth. One of the aims of many businesses is to grow in size. Larger businesses can lower their costs by exploiting economies of scale, win a larger market share at the expense of their competitors and perhaps begin to dominate the market. As the economy grows, it is much easier for a business to achieve growth.

All stakeholders should benefit from a successful business as the economy grows. Owners will experience higher dividends and higher share prices and employees may get a pay rise and more job security. Suppliers will experience more orders and customers might get the benefit of new products and more choice in the market as new businesses arrive in the market. The government will collect more in taxation – from income taxes, corporation taxes and sales taxes. Local communities might benefit from more employment opportunities.

Some businesses are likely to benefit more than others. It might be argued that businesses selling products with income elasticity of demand would benefit the most. This is because demand for their products is more susceptible to changes in income. As Indian consumers experience higher levels of income, they are more likely to engage in discretionary spending. For example, they may spend more on non-essential items such as weekend breaks, meals out, toys for children and fashion clothes. However, businesses that produce products which are essential, such as some food items and energy, are not likely to see much of a sales increase because demand for their products will be income inelastic (i.e. where the percentage change in demand is proportionately less than the percentage change in income).

Finally, although most businesses are likely to benefit from India's consistently high levels of economic growth, there may be a disadvantage. For example, if growth is too rapid there may be an increase in inflation. This could increase business costs. Higher levels of inflation may also generate uncertainty in the business community. Higher inflation might also result in workers pushing for higher wages. This would also raise business costs and might lead to disagreements between employees and employers. Resolving such disagreements may waste business resources.

4 Assess possible threats to the Indian economy and how they might affect future economic growth. (12 marks)

Generally, India will be pleased with continuing economic growth because of the benefits it brings to individuals, businesses and the government. Future economic growth is predicted to be high. India is an emerging economy and the potential for further growth is significant. However, there are some threats to the Indian economy which could slow down economic growth.

India is an emerging economy and an increasing number of people are finding employment and enjoying better living standards. However, poverty is still a problem. The World Bank said that around 270 million people in India live below the poverty line. This is over 20 per cent of the population. Also, India ranked 131st out of 188 countries in the human development index in 2015. Regional disparities in education, health and living standards within India – or inequality in human development – are a problem. The Indian government needs to ensure that money is invested in the education system so that poor people can

develop the skills needed to find employment. Having a very large 'poor sector' will negatively affect the economy. Removing poverty will help to secure the future prosperity of the country.

India is also still relying heavily on the agricultural sector for employment and income. Figure 8 shows that the proportion of the workforce employed in agriculture was still over 40 per cent. In many developed countries, only around 2 or 3 per cent of people are employed in this sector. In many rural areas of India, farming is undertaken on a small scale by families and other small groups. This is not the most productive approach to farming, which will negatively affect future development. The Indian government needs to introduce measures to help improve agricultural productivity. For example, they could encourage the use of technology.

Another threat to the Indian economy is the price of oil. India is a huge importer of oil and some experts reckon that if the price rises above \$70 per barrel, India could suffer from inflation. The price of oil in May 2018 was \$76 per barrel, although some analysts were predicting that it was likely to fall in the future. If the price of oil does not fall back below \$70, business costs will rise, and many Indian businesses will struggle to compete in global markets. The situation would be made worse if the oil price actually rises further. Ideally, the Indian economy would benefit if it relied less on imported oil. However, achieving this would be a very long-term goal.

Finally, India has experienced corruption which acts as a barrier to economic growth because foreign businesses may be wary of setting up operations in India. There is a lack of transparency and a need to 'bribe' people in authority to 'get things done'. Corruption also has an impact on the development of domestic businesses. For example, it may be necessary to make a bribe in order to obtain planning permission for a new factory. Unless corruption can be removed, it will always act as a strong deterrent to engage in business activity.

The Indian government did take some measures in 2016 to reduce the level of corruption. It introduced a national Goods and Service Tax (GST) to replace regional sales taxes and forced people and businesses to open bank accounts by withdrawing Rs1000 and the Rs500 notes from circulation. People and businesses with these notes could only cash them in by depositing them in a bank account. These measures were intended to fight corruption, promote transparency, and encourage good governance. After some considerable criticism, the early signs are that these measures might be working. However, only time will tell.

In conclusion, the barriers to growth and the development of the Indian economy are significant. However, if the government is determined to remove corruption, invest in education, develop the Indian infrastructure and encourage business investment, these barriers may be overcome to a sufficient extent.

23 INTERNATIONAL TRADE AND BUSINESS GROWTH

ACTIVITY 1

CASE STUDY: ESTONIA

1 Look at Figure 2.

(a) Describe the pattern of exports in Estonia over the time period shown.

Estonia has seen the value of its exports rise from almost zero in the early 1990s to about €800 million just after 2008. There was a dip in 2008–09 at the same time as the financial crisis. However, exports have recovered since and grown to almost €1200 million. They have stayed at around €1100 million for about nine years recently.

(b) Consider what might account for the pattern identified in (a).

The huge growth in Estonia's exports are down to the break-up of the Soviet Union in 1991. The state became an open economy and encouraged the market system after the break-up and Estonia's economy has done very well since then. It is driven by its highly successful telecoms and electronics industries. Estonia's major export goods are textiles/clothes, machinery/equipment, food, wood and wood products, and chemicals.

2 Before 1991 nearly all of Estonia's exports were to Russia and other soviet partners.

(a) Outline why you think Estonia has redirected its exports since then.

Before 1991 Estonia did not have an open economy. It traded solely within the Soviet bloc. However, since the break-up of the Soviet Union, Estonia has developed new trading partners. These are shown in Figure 1. For example, they include Sweden, Finland, Latvia, Lithuania and Russia. These partners are Estonia's geographical neighbours so it is natural that they would redirect their trade towards this group.

(b) Why has Estonia developed a reputation for being a respected trading nation?

Estonia has enjoyed an economic revolution and has become a world leader in information technology. Estonian IT engineers developed the code behind Skype and Kazaa (an early file-sharing network). It also has one of the world's fastest broadband speeds and it only takes five minutes to register a firm. Entrepreneurs wishing to start a firm log in with their national electronic identity card and the confirmation arrives by email. This progress is admired by many.

Estonia also has a very liberal trading policy. For example, duties are levied only on tobacco products, alcohol and luxury items. Also, export licences are only required for a few natural resources, such as oil shale. The lack of trade barriers, the favourable exchange rate, and Estonia's positive attitude toward free trade all contribute to the country's reputation as a respected trading nation.

ACTIVITY 2

CASE STUDY: FDI IN INDIA

1 Explain what is meant by foreign direct investment (FDI).

Foreign direct investment is investing by setting up operations or buying assets in businesses in another country. The United Nations considers FDI to occur where a firm takes an equity stake of more than 10 per cent in a foreign enterprise. It is not the same as a foreign portfolio investment. This refers to holding stocks or bonds but not tangible assets such as buildings or machinery. However, the main identifying aspect of FDI is control. According to *The Economist*, 'The point about FDI is that it is far more than mere "capital": it is a uniquely potent bundle of capital, contacts, and managerial and technical knowledge. It is the cutting edge of globalisation.'

2 How is the Indian government encouraging FDI?

India is very keen to attract FDI. India is an emerging economy and in 2016–17 the country attracted a total of \$60.1 billion of FDI. It started in the 1990s, when the government began to encourage globalisation. It ended regulation at home and lowered barriers to foreign investment. The government deliberately targeted the IT services sector for growth, giving it special subsidies. As a result, foreign multinationals came to India. They were eager to take advantage of the cheap labour and the opening up of one of the world's biggest markets.

More recently, the government has relaxed some rules and regulations in industries such as civil aviation. For example, in 2018, changes were directed at the retail sector. However, rule changes also allowed overseas investors to acquire as much as 49 per cent of Air India in order to speed up its divestment.

Overseas retailers can now delay having to meet the 30 per cent local sourcing norm by five years. This removes a key barrier to FDI in this sector. Approvals for such investments have also been made automatic. One example of recent FDI in India include plans by IKEA to invest \$612 million in Maharashtra. It aims to set up multi-format stores and experience centres in 2018. Another example is Singapore's Temasek purchase of a stake worth \$156.16 million in Bengaluru-based Manipal Hospitals, which runs a hospital chain of around 5000 beds.

3 How might India benefit from rising FDI?

One of the main benefits of rising FDI in a country is that it will create jobs. With \$60.1 billion of investment in 2016–17, the potential for job creation would be significant. For example, IKEA plans to invest \$612 million in Maharashtra to set up multi-format stores and experience centres in 2018. Also, US footwear company, Skechers, plans to add 400–500 more stores in India over the next five years and to launch its apparel and accessories collection in India. This will help to create hundreds or even thousands of new jobs for Indian workers. This new employment will help drive economic growth in India. It would raise incomes and improve the living standards of many Indians.

Both current foreign investment and future foreign investment will also help improve the Indian infrastructure. The government reckons that around \$1 trillion of investment is needed to improve its infrastructure, which includes ports, airports and road networks. The government will also benefit from extra tax revenue, assuming the companies setting up operations in India make a profit in their new locations.

EXAM PRACTICE

CASE STUDY: INTERNATIONAL TRADE IN AUSTRALIA

1 Calculate the proportion of Australian FDI contributed by China in 2016. (4 marks)

The proportion of FDI contributed by China in 2016 is given by:

$$\frac{\text{China FDI}}{\text{Total Australian FDI}} \times 100$$

$$= \frac{\text{AUD15 400 million}}{\text{AUD64 825 million}} \times 100$$

$$= \mathbf{23.76 \text{ per cent}}$$

2 Explain one reason why invisible exports may be important for the Australian economy. (4 marks)

Invisible trade includes sales and purchases of intangible products. These are non-physical items such as financial services, advisory services, training and consultancy. Australia's main source of income from invisible trade is tourism. Australia has a well-developed tourist industry and attracts visitors from all over the world. People are attracted to Australia by its vibrant cities, its developing cuisine, areas of outstanding natural beauty (including the world-famous Great Barrier Reef), its history and its unique wildlife. Invisible exports are important to Australia in order to provide balance in the nation's trading activities. Although Australia exports a lot of primary goods, it would not want to be entirely reliant on such a narrow range of goods. Growing its invisible trade will help to avoid over-specialisation.

3 Explain one reason a country like Australia may be increasing specialisation. (4 marks)

Australia is rich in natural resources. As a result, it specialises quite heavily in the production of commodities, much of which are exported. Australia has a comparative advantage in the production of commodities. This means that Australia can produce them more efficiently than many other countries in the world.

Generally, if countries all over the world specialise in the production of those goods and services in which they have a comparative advantage, global output and economic prosperity will increase. In this case, Australia will generate higher earnings by increasing their specialisation in the production of primary goods. This is because the country can produce them more efficiently than many others.

4 Discuss the potential reasons for a changing pattern of international trade in Australia between 2008 and 2018. (8 marks)

Like most developed nations, Australia has established trade links with many countries around the world. Rich in natural resources, Australia specialises in the export of

commodities including iron ore, coal, natural gas, beef, wheat and wool. The main invisible export for Australia is tourism. Figure 4 shows that Australia's exports continued to rise between 2008 and 2018, from around AUD20 000 million to about AUD35 000 million. This is an increase of 75 per cent in just 10 years.

Australia imports quite a lot of manufactured goods. The country does not produce cars and relies on imports to meet the growing demand for vehicles. Australia's key imports include motor cars, goods vehicles, telecommunications equipment and parts, consumer goods, machinery and industrial equipment, computers and medical products. Figure 5 shows how Australia's imports have continued to grow between 2008 and 2018, from around AUD22 000 million to AUD34 000 million. Both imports and exports fell just after 2008 but recovered well shortly after. This dip was probably due to the global financial crisis and recession in many parts of the world. Finally, the growth in imports appears smoother than the growth in exports. This growth pattern in exports may have been caused by small changes in the prices of commodities – however, there is no evidence in the case to prove that this is true.

Australia trades with many countries but its key partners are China, the USA, Japan, Germany, Thailand and South Korea. In 2016, according to the pie chart in Figure 6, about 60 per cent of Australia's imports came from these countries. China is a very important trading partner to Australia. In recent years, China has been a substantial customer for many of its commodities.

As well as the trade in goods and services with foreign countries, Australia also attracts a significant amount of FDI. In 2016, Australia was the seventh most popular destination in the world for FDI. Figure 7 shows that in 2016 FDI in Australia was AUD64 825 million. China is Australia's biggest source of FDI. In 2016, Chinese businesses invested a total of AUD15 400 million in Australia. This represented 75 per cent of all FDI in Australia. The graph in Figure 7 shows levels of FDI between 2008 and 2016. The average annual FDI is about AUD50 000 million. However, there was a significant dip in 2015 for which there is no explanation.

5 Discuss the benefits of China Resources investing in the Australian economy. (8 marks)

In 2016, Chinese businesses invested a total of AUD15 400 million in Australia. This represented 75 per cent of all FDI in Australia and included a record 103 deals between Australian and Chinese businesses. Most of this investment was channelled into commercial property, infrastructure development and health care. More than a third of all Chinese FDI found its way into commercial property. However, investors were moving funds away from office investment, more towards residential construction and favouring medium density greenfield projects. Chinese investors also spent AUD1.7 billion on hotel assets.

One Chinese business making a significant investment in Australia was Macquarie-backed China Resources. In 2016 the company bought Genesis Care for AUD1.7 billion. Genesis Care is Australia's largest provider of cancer and cardiac care, and the biggest private provider of cancer care in the UK and Spain. The new owners hope to carry on expanding the business into Europe and provide Genesis Care with easier access to the growing Chinese healthcare market.

China is a rapidly emerging economy and many Chinese businesses are looking for opportunities to expand all over the world. Since Australia is already an established trading partner and it is close to China, Chinese businesses are looking to expand in the country. Companies such as China Resources will enjoy a number of benefits. For example, many firms prefer FDI over exporting or licensing. This may be because managers want to keep tight control over operations in the other country or countries. The businesses may need to share a common culture or communications systems, or they may want to ensure that

agreements are enforced. Businesses such as China Resources may also prefer FDI because it wants to protect its intellectual property (such as patents, copyrights, trademarks and management know-how). Also, a business might need to be close to its customers or its products might experience high transportation and logistics costs. Finally, it is possible that it faces trade barriers or political opposition if it chooses exporting or licensing rather than FDI.

To conclude, businesses such as China Resources will seek out opportunities wherever they can. Many Chinese businesses are now looking to expand globally, perhaps because there aren't many opportunities remaining in domestic markets or because other opportunities offer greater rewards. Australia is the favourable target for expansion due to the strength of the existing relationship between the two nations.

24 FACTORS CONTRIBUTING TO INCREASED GLOBALISATION

ACTIVITY 1

CASE STUDY: BRAZIL VS THAILAND TRADE DISPUTE

1 What is this dispute about?

The trade dispute between Brazil and Thailand is about the payment of subsidies by Thailand to sugar producers. In 2016, Brazil filed a complaint to the World Trade Organization (WTO) claiming that Thailand had given subsidies to cane producers and sugar mills. The effect of these subsidies was to reduce the global price of sugar and reduce Brazil's share of the market from 50 per cent to 44.7 per cent in four years. Giving subsidies to domestic producers is a form of protectionism (i.e. an approach used by a government to protect domestic producers) and is not allowed if countries are members of the WTO. Brazilian sugar producers gathered evidence which showed that they were losing \$1.2 billion per year in revenue as a result of subsidies paid to Thailand and India. They also argued that Thailand's share of the global market had risen from 12.1 per cent to 15.8 per cent in the past four years.

2 Explain the role played by the WTO in settling this dispute.

The WTO will have to look at the claims made by Brazil. It will have to analyse the information which Brazil presents and also consider any defence provided by Thailand. The WTO will then have to make a judgement and decide on a course of action. This might involve imposing penalties on Thailand if the case is allowed to continue.

3 What is meant by a free trade agreement?

Free trade agreements (FTAs) aim to stop all trade barriers between participating nations. Barriers such as tariffs, quotas and administrative barriers must be completely removed for free trade to exist. There are three main types of agreement. First is bilateral, which involves an agreement between two countries to allow free trade. Second is regional, where agreement exists between several countries, usually with close proximity to each other, to allow free trade. Third is multilateral, where there is an agreement between a wider range of countries to allow free trade.

4 What might be the consequences if trade agreements did not exist?

If countries did not negotiate trade agreements, there would be less free trade. There would be more protectionism and trade would be restricted. This would have a negative impact on consumers because goods might be dearer and there would be less choice. Reduced international trade would also reduce global employment, growth and living standards. Trade agreements also encourage the spread of globalisation, which many would argue is a good thing.

ACTIVITY 2

CASE STUDY: THE SCOURIE BAY GUEST HOUSE

1 What is meant by globalisation?

Globalisation is the growing integration of the world's economies. Many markets today are global. This means that some firms expect to sell their products anywhere in the world. A firm could have a head office in London, borrow money from a bank in Japan, manufacture products in China, deal with customers from a call centre in India and sell goods to countries all over the world. Firms and people are acting as if there is just one market or economy worldwide. In this case, the Scourie Bay Guesthouse can use the Internet to advertise its services to any person in the world with internet access.

2 Assess the factors that have contributed to globalisation in this case.

In this case, Carol and Martin McDonald have exploited opportunities that are contributing to globalisation.

First, they have taken advantage of new technology to promote their business globally. They built a website to promote the Scourie Bay Guest House and have attracted visitors from Europe, Japan and Australia. They are also using social media to direct traffic towards their website. The use of modern IT has had a big impact on globalisation. For example, businesses can transfer complex data instantly to any part of the world. It also means that more people can work at home, or in any other location they choose. This makes it easier for businesses to have operations all over the world. The Internet also allows consumers to gather information and buy goods online from businesses located in different parts of the world. Businesses can reach out to global markets by promoting their activities and products online using websites. This is the feature that has helped the success of the Scourie Bay Guest House.

Carol and Martin McDonald have also benefited from the growing popularity of low-cost flights. In 2014, the business made a record profit of £105 000, with more than 55 per cent of the guests coming from overseas. International transport networks have also recently improved.

In particular, the cost of flying has fallen, and the number of flights and destinations has increased. This means that people can travel to business meetings and holiday destinations, like Scotland, more easily. For example, a number of low-cost airlines have entered the market and brought air travel to the masses. In the UK, easyJet, Ryanair and Flybe offer flights to a wide range of European destinations that are affordable to the majority of the population. India has also begun to experience low-cost air travel. Airlines such as SpiceJet, Go Air and Jet Airways offer cheap internal flights, and some provide services to nearby countries.

It could be argued that the most important development contributing to the success of the Scourie Bay Guesthouse is the Internet. The business can advertise its services to anyone in the world with Internet access. This provides the business with a massive potential market. However, the owners will need to appreciate that their business will face very strong competition. This is because other guesthouses and hotels in the Scourie area will be able to do the same. Also, due to increasing globalisation, other holiday destinations around the world will be advertising their similar services.

EXAM PRACTICE

CASE STUDY: BANGLADESH AND GLOBALISATION

1 Explain one benefit of globalisation to a business like TBS. (4 marks)

TBS might benefit from globalisation because it can sell into larger markets. If businesses are able to grow by selling more output to larger markets, they may be able to lower their costs. This is because as firms grow, they can exploit economies of scale. When TBS announced its plans to invest in Bangladesh it was attracted by cheaper labour. Globalisation allows businesses to scan the world and identify locations where production costs can be minimised. TBS said that it was attracted to Bangladesh's business-friendly environment, cheap labour, the availability of raw materials and the low duties charged to Vietnam. This will help lower costs and improve the financial performance of the business.

2 Discuss the World Trade Organisation's role in globalisation. (8 marks)

The World Trade Organization plays an important role in the growth of globalisation because it promotes free trade. One of the main benefits of the WTO is that it persuades countries to abolish tariffs and other trade barriers. The WTO is the only international agency overseeing the rules of international trade. It polices free trade agreements, settles trade disputes between governments and organises trade negotiations.

Another benefit of the WTO is that it aims to reduce or remove trade barriers through negotiation. It does this by encouraging countries to produce trading agreements covering matters such as anti-dumping, subsidies and product standards. The WTO aims for trade liberalisation and outlines procedures for settling disputes. The agreements reached between countries may change over time. Changes are needed because businesses operate in a dynamic world with new products and technologies being developed all the time.

Another important benefit of the WTO is the role it plays in settling trade disputes between nations. Trade disputes between members are not unusual. The WTO's procedure for resolving trade disputes is vital for enforcing the rules and making sure that trade flows smoothly. Countries bring disputes to the WTO if they think their rights under their agreements have been broken. The WTO appoints independent experts to make judgements about disputes after the arguments from both sides have been presented. WTO decisions are final, and every member must follow its rules.

The WTO is generally trusted by its members to police trade agreements and enforce rules. This will help to benefit all countries as more and more free trade is encouraged.

3 Discuss how lower transport costs might contribute to further globalisation. (8 marks)

A wide range of factors have contributed to the increase in globalisation in the last few decades, including cheaper transport.

Reductions in the cost of transport can definitely help globalisation. International transport networks have improved considerably in recent years. In particular, the cost of flying has fallen, and the number of flights and destinations has increased. This means that people can travel to business meetings more easily and goods can be transported more cheaply. Figure 6 shows that the number of passengers carried by airlines between 1980 and 2015 has grown at a faster and faster rate. Between 1980 and 2016 passenger growth has been 476 per cent.

This growth has been influenced by a sharp fall in the global oil price in 2014 which has helped to keep fuel costs down since then; improvements in aviation technology which have helped to lower operating costs and improve the efficiency of aircraft; increased competition in the industry – particularly from a number of new entrants operating as ‘budget’ airlines; and improvements in IT which has aided online booking.

In the future, there are likely to be further reductions in the cost of transport because new technology will eventually deliver breakthroughs – driverless vehicles, for example, which will reduce the labour costs of transport.

However, developments in technology are uncertain and irregular. There may also be a hike in oil prices which will make transport more expensive.

4 Assess the likely impact of globalisation on an emerging economy such as Bangladesh. (12 marks)

Most of the emerging economies such as Bangladesh have accepted globalisation. The improvement in the performance of the Bangladesh economy, which has begun to grow quite rapidly, suggests that the nation has become more open. Bangladesh coped quite well with the financial crisis in 2008. It is now benefiting from strengthening investment and a recovery of exports. Growth will be sustained at 6.8 per cent in 2017, compared with the officially reported 7.1 per cent in 2016.

Evidence of Bangladesh’s involvement in globalisation is shown by its rising popularity as a destination for FDI. Figure 4 shows that FDI in Bangladesh has grown steadily since 2008. FDI grew from US\$748 million in 2008 to US\$2003.53 million in 2016. This is an increase of 168 per cent. In a recent report, the government in Bangladesh said that investors were pleased with the investment environment in the country.

The government has taken measures to provide businesses with incentives to invest. For example, the Bangladesh Investment Development Authority (BIDA), a new authority, was making rules and regulations for investment much easier. The country is experiencing a period of political stability and the government is establishing technical schools in every *upazila* (administrative region) across the country. This will help people to gain a range of work-related skills. These measures suggest that Bangladesh is committed to global business involvement.

Another benefit to Bangladesh of globalisation is the trend for Bangladeshi workers to find work overseas. In this respect, Bangladesh benefited from trade liberalisation, especially the free movement of labour around most of the world. Bangladeshi overseas workers send money back to Bangladesh. These remittances are significant, as shown in Figure 5. In 2017 a total of US\$13.53 billion was sent back to Bangladesh by people working in places like India, the UK, Saudi Arabia, Kuwait, Oman and the UAE. In the last seven years these remittances have exceeded US\$12 billion every year.

In the future, Bangladesh may be able to benefit more from globalisation. There are currently significant infrastructure gaps in the country and an inadequate energy supply. Bangladesh is also a country where the cost of doing business is relatively high. The government needs to address these issues quickly. They need to invest more money in the public sector and remove or simplify rules and regulations to make business transactions easier. If the government can deliver these changes, Bangladesh is likely to further benefit from globalisation.

25 PROTECTIONISM

ACTIVITY 1

CASE STUDY: RAINBOW CHICKEN LTD FOODS

1 Explain what is meant by dumping.

Poultry producer RCL Foods said that chicken meat was being dumped in South Africa. This means that foreign producers were selling chicken meat in South Africa below cost at heavily subsidised prices. A spokesperson for RCL Foods said, 'Tens of thousands of tons of surplus chicken are dumped in the South African market monthly, and the EU is one of the main sources of this meat.' It was also pointed out that smaller abattoirs and poultry farmers would be forced to close down. This was because costs were rising, and they could not charge enough to recover the costs. Chickens dumped in the market from overseas were driving down prices.

2 Analyse the impact imports have had on employment in South Africa.

The people of Hammarsdale have been negatively affected by cheap imports in South Africa. In 2016, Rainbow Chicken Limited Foods (RCL Foods), planned to cut 1200 jobs. It also added that there may be more job cuts as the company struggled to compete with cheap imports from the USA, Brazil and EU countries. However, Hammarsdale has suffered from job cuts caused by cheap imports before. Historically, the industrial area had a big textile industry. However, as a result of the new democracy and the relaxation of trade barriers between South Africa and other countries, the Hammarsdale area lost more than 40 000 textile jobs. This was mainly because of cheap imports from China. These new job losses affected the Mpumalanga township in Hammarsdale hard, leaving thousands of households without a livelihood.

3 A government might respond to dumping by using protectionism. Explain one other reason why a government might use protectionism.

Another motive for the use of trade barriers is to protect infant industries. Infant industries are new industries that are not established yet. Many argue that infant industries should be protected from strong overseas rivals until they can grow, become established and exploit economies of scale. Infant industries will lack experience, market share and resources compared to those that are already up and running with established trade links and loyal customers. However, it is also argued that this approach may not be successful because governments have a poor record when it comes to identifying infant industries with potential.

ACTIVITY 2

CASE STUDY: MALAYSIAN TARIFFS

1 Explain the difference between a tariff and a quota.

Both tariffs and quotas are used as trade barriers. A tariff is a tax imposed on imports. The imposition of a tariff will make imports more expensive so demand for them will fall. This will help to control the flow of imports into a country.

Another way of reducing imports is to place a physical limit on the amount allowed into the country. This is called a quota. By restricting the quantity of imports, domestic producers face less of a threat. They will have more of the market for themselves.

2 A Taiwanese exporter sells a MYR50 000 consignment of CRSS to a Malaysian importer. Calculate the amount the Malaysian importer would have to pay for this consignment including a tariff of 111.61 per cent.

The amount paid by the Malaysian importer is given by:

$$= \text{MYR}50\,000 + 111.61\%$$

$$= \text{MYR}50\,000 + \text{MYR}55\,805$$

$$= \text{MYR}105\,805$$

3 Why has Malaysia imposed tariffs on imports of CRSS?

Tariffs are a form of protectionism. In this case, Malaysia's decision to impose the tariffs was designed to protect the domestic steel industry from overseas companies charging unfair prices. In 2018, Malaysia imposed anti-dumping tariffs on a range of steel imports from Taiwan, South Korea, China and Thailand. It was claimed that these countries were selling their products at unfair, low prices in Malaysia. Tariffs of up to 111.16 per cent were placed on cold-rolled stainless steel (CRSS) for five years by Malaysia's Ministry of International Trade and Industry (MITI). The ministry said that an investigation would be carried out over this time period to make the pricing policies used by businesses in these countries clearer. The tariffs would raise the prices of steel products in Malaysia making it easier for domestic producers to compete.

EXAM PRACTICE

CASE STUDY: US TARIFFS

1 Explain how a government might use legislation rather than tariffs to control imports. (4 marks)

One way to avoid the use of tariffs to control the level of imports is to insist that imported goods meet strict regulations and specifications. In some cases, legislation can be passed to prevent entry. For example, a shipment of toys might be returned if they fail to meet strict safety regulations that are imposed by legislation. These are often referred to as administrative barriers.

Goods that fail to reach cultural or environmental standards may also face administrative barriers. For example, in the EU some products cannot be imported on such grounds. For some other products there are restrictions, or the Food Standards Agency has issued advice saying that particular food products should not be eaten. The most common examples of legal import bans aim to protect consumers from dangerous goods.

2 Discuss one impact that US protectionism might have on the US trade balance. (8 marks)

One of the reasons why the USA imposed a range of import controls in 2018 was to bring under control the rising trade imbalance between the USA and China. Many of the tariffs

proposed in 2018 were aimed at Chinese goods. Figure 2 shows clearly that the US trade deficit with China has grown substantially between 2000 and 2017. In 2000 the trade deficit between the two nations was less than \$100 billion. By 2017, this had grown to \$375 billion. The use of protectionism by the USA might be justified in order to reduce this deficit. Indeed, the trade war between the USA and China was put on 'hold' in May 2018 while the USA tried to persuade China to buy more US goods and services. This will help to reduce the huge trade gap.

However, the imposition of tariffs on Chinese imports will increase the price of these goods. Some of the goods imported from China are intermediate goods (used in the production of other goods). This means that the price of the final goods produced by US businesses will rise because their costs increase. Consequently, overseas demand for some of these goods may fall, which will have a negative impact on the US trade balance.

The overall impact is difficult to estimate, but it might be argued that the US trade balance will improve since not all of the goods produced in the USA using Chinese intermediate goods will be sold abroad.

3 Evaluate whether or not US tariffs will benefit US businesses such as Whirlpool and Harley Davidson. (20 marks)

The tariffs proposed by the USA in 2018 were chiefly designed to protect US businesses. During the 2016 US election campaign, Donald Trump said that he would 'put America first' when it came to trade deals. He felt that a number of historic trade deals made on behalf of the USA were not good for the country and that he would protect US jobs by imposing trade restrictions if elected.

The imposition of tariffs would help to protect US businesses by making imported goods more expensive. As a result, tariffs would help to redirect spending in favour of US-produced goods. This should help US business increase their sales, revenues and profits. For example, in January 2018, the US government announced that it would impose tariffs on solar panels and washing machines. These specific tariffs should help protect US businesses that produce washing machines and solar panels. Indeed, Whirlpool, the US business which campaigned for protection against rivals Samsung Electronics and LG Electronics after years of anti-dumping cases, was one of the businesses relieved at the action. Whirlpool's share price rose 1.8 per cent immediately after the announcement.

In March 2018 Trump imposed tariffs of 25 per cent on imports of steel and 10 per cent on imports of aluminium. This was in response to a government report which concluded that foreign shipments of metals were threatening national security interests. Clearly, US businesses in these industries would benefit from the higher prices that foreign rivals would now have to charge. In the short term, some would argue that these trade barriers will benefit the US businesses threatened by cheap imports.

However, a number of countries have criticised the tariffs and said that they would retaliate. For example, the EU said that the tariffs broke international trading rules and promised to retaliate if they were imposed. They proposed restrictions on imports of Harley Davidson motor bikes and selective beverages. China also said it would retaliate with around \$3 billion of tariffs. It promised to suspend tariff concessions on 120 US food products. Fresh and dried fruits, almonds and pistachios would be subject to an additional 15 per cent tariff and eight other items, including some frozen meat products, would be subject to a 25 per cent tariff. If these tariffs were imposed in full, a number of US businesses could be negatively affected.

Another issue is the rising price of imported components. Jason Andringa, who runs the agricultural and construction equipment maker, Vermeer, in Iowa, says that tariffs could have

a negative impact on businesses. For example, Vermeer imports cabs, assembled in China, that it uses for its drilling vehicle made in Iowa. This helps the company to keep costs down so that it can compete with international rivals. However, these components would be negatively affected by the new tariffs which would raise costs, reduce competitiveness and threaten jobs. 'We have 600 jobs at our Iowa factory as a result of being able to import products, and we have American production sold into global markets,' Mr Andringa says.

Many Chinese products faced US tariffs and many of them were components and other intermediate goods. This was to avoid tariffs on consumer goods such as phones and clothes. However, if the production of these imported items were to be carried out in the USA, costs would rise, businesses would be adversely affected and jobs would be lost. The pressures on US manufacturers caused by the proposed tariffs are made worse by the threatened retaliation by China against US exports, including soya beans and aircraft.

Figure 2 shows how US businesses might be affected by Chinese tariffs. For example, according to the graph, California and Washington State would be worst affected. However, businesses in many other US states will also feel the impact of the Chinese tariffs. According to the first graph, California could lose around 300 000 jobs and Washington State 150 000, as a result of retaliatory tariffs. The second graph shows that the most negatively affected industry would be the plastics industry, where businesses will lose around 300 000 jobs.

This evidence, if correct, supports the view of many economists. They say that if import controls are used there is the threat of an all-out trade war. This would be detrimental to both nations. Many economists would argue that no one can win a trade war and the only outcome will be lower income and employment for every country involved. Many economists say that in the long term, businesses are likely to benefit more from free trade. Therefore, protectionist policies will harm businesses.

Free trade encourages competition which can motivate domestic businesses to improve efficiency. If they become more efficient, they will win a bigger market share and become more prosperous. Free trade also leads to increased specialisation, where a country only produces goods that they are efficient at, i.e. in which they have a lower opportunity cost. Specialisation raises levels of output, which means that businesses experience higher sales levels and more profit.

There is general agreement among economists that countries, businesses and consumers will all benefit in the long run if trade barriers are eliminated. This suggests, then, that US businesses are more likely to suffer if the proposed tariffs are not withdrawn. Indeed, concerns must be high even in the USA. This is because in May 2018 China and the USA said they would delay the imposition of many of the tariffs. The decision to 'hold' was taken after negotiations between the two nations took place. The USA tried to persuade China to buy around \$200 billion more goods and services from the USA. If China does decide to buy more US goods, companies like Whirlpool and Harley Davidson are likely to benefit from higher levels of sales.

26 TRADING BLOCS

ACTIVITY 1

CASE STUDY: CROATIA AND THE EU

What is the purpose of the EU?

The EU was formed just after the Second World War with the aim of developing economic co-operation. However, since then membership has grown from six countries to 28. The EU now has common policies in a wide range of areas in addition to trade agreements. The EU has developed common policies on matters such as climate, the environment, health, migration, justice and security. Since it was formed in 1958, the EU continues to aim to deliver peace, stability and prosperity.

2 How will businesses in Croatia benefit from EU membership?

Croatian businesses that export goods to the EU are likely to benefit most from EU membership. One business owner, an olive oil producer in the north of the country, said that the EU was working in their favour. It was now easier to sell larger quantities to the EU, there was less paperwork and Croatian businesses are being pressured into being more professional. The owner also said that the outlook for the younger generation is much better. For example, they realise that investment and support for rural products is beginning to emerge. However, some domestic industries may suffer from competition as more imports arrive into Croatia from the EU. They may have to become more competitive to survive.

3 What are the possible impacts of Croatia joining the EU?

Croatia joined the EU in 2013. After 12 months of membership Croatia was still in recession and awaiting access to EU structural funds. A government official said that people in Croatia had low expectations regarding the benefits of joining the EU. However, after just 12 months exports to the EU had risen by 15 per cent and business owners reported that it was now much easier doing business with EU countries. Figures 2 and 3 also suggest that things are getting better for Croatia. The current deficit between 2008 and 2018 has been reversed. In 2018 Croatia had a current account surplus (i.e. where the value of exports in goods and services is greater than the value of imports) of 3.9 per cent GDP. This compared with a deficit of -8.8 per cent in 2008. The economy is also growing now. Between 2012 and 2014 growth was often negative. However, at the end of 2017 it was around 1.5 per cent, although more recently economic growth has started to decline again. After a slow beginning the Croatian economy looks as though it might be benefiting from its membership of the EU.

ACTIVITY 2

CASE STUDY: BWD ENTERTAINMENT

1 Explain why there might be greater scope for marketing magazines in Croatia than in Germany or Italy over the next ten years.

Germany and Italy are 'mature' markets in terms of magazine sales, meaning that the overall market is unlikely to grow at a high rate, so the potential for sales growth for BWD in these

markets is low. Croatia, on the other hand, is not as developed as other European markets, so BWD can see the potential for consolidation as well as growth to increase sales.

2 By considering the possible advantages and disadvantages of each of the three strategic options, discuss which is likely to be the most successful for BWD. In your answer, identify what other information would be needed to make an informed choice.

The first strategy is to buy an established Croatian magazine company and use it to launch a number of new magazines based on ones that are already popular elsewhere. This is the safest strategy from a financial point of view. The target company must be thoroughly researched to make sure that the acquisition is a good fit with BWD, but the purchase will let BWD begin to trade in Croatia almost immediately. One disadvantage is that this is a top-down strategy involving a takeover of the Croatian company. This may result in conflict with existing employees and management, reducing the positive impact of some of the strategy's benefits.

The second strategy is to buy an established magazine company but allow it more autonomy. This has similar up-front costs and benefits to the first strategy, but it is arguably the one most likely to be successful – as long as the Croatian company has good management in place. If the existing management is good – and their strong market share indicates that it is – the best option would be to provide financial and technical support and advice, then leave them to continue with what they do well. This will also be better for BWD, as it could rely more on local knowledge and experience, with less potential for conflict.

The third strategy would be to set up a company from scratch. This is the riskiest strategy, but also has the potential for high rewards in the long run. This approach would require finding editors, workers and distribution staff from other offices. Unless BWD is willing to pay a premium to lure these staff in, it may be hard to get them to leave their current employers. If BWD does pay the premium to recruit high-quality employees, this will potentially cut its return on the investment, certainly in the short term. However, if BWD can't find an established company under the second strategy, this is a good alternative. It will require a long-term commitment, but BWD's time horizon of 10–20 years indicates that it may be willing to wait to achieve a good return on its investment.

EXAM PRACTICE

CASE STUDY: ASEAN AND BEMYGUEST

1 Calculate the total GDP for Vietnam and the Philippines to determine which has the highest. (4 marks)

	Population (million)	GDP per capita (US\$)	Total GDP (US\$ million)
Brunei	0.4	26 958	10 783.20
Cambodia	16	1269*	20 304
Indonesia	262	3878	1 016 036
Laos	6.7	2400*	16 080
Malaysia	32.1	9896	317 617.60
Myanmar	52.6	1264	66 486
Philippines	105	2978	312 690
Singapore	5.6	57 495	321 972
Thailand	69.1	6 591	455 438.10
Vietnam	93.6	2 355	220 428

The total GDP for Vietnam and the Philippines is given by:

Vietnam = 93.6 million × US\$2,355 = US\$220 428 million

Philippines = 105 million × US\$2978 = \$312 690 million

Therefore, the Philippines has a larger GDP than Vietnam.

2 Discuss the possible benefits to BeMyGuest of a more integrated digital economy in the ASEAN region. (8 marks)

Singapore's Minister for Trade and Industry said that the ASEAN region would benefit considerably from increased digital connectivity in the region. ASEAN is already the fastest-growing region in the world in terms of Internet adoption with 3.8 million new users per month gaining access to the Internet. He said that the region would prosper if all countries in the region supported digital connectivity and businesses keep pace with technological developments in digitalisation.

BeMyGuest is a company that would benefit considerably from the rising number of Internet users in the region. The company provides an online booking service for tours and other travel activities in Asia. A rise in the number of Internet users in the ASEAN region means that BeMyGuest will have access to a larger number of potential customers. As more people

get connected to the Internet, there are more people who are likely to use the company's online booking services. This means that BeMyGuest is likely to attract more traffic, which will help to drive up revenues and profits.

With a larger number of Internet users BeMyGuest might also benefit from a higher profile in the market. For example, the company might use social media to advertise its services. These adverts might be seen by a larger number of people if there are more Internet users. This again will help to drive up revenue and profit. BeMyGuest might also use social media to gather feedback from users. With a larger number of users, more feedback might be gathered. This might help the company to find out more about what people think of its services. It might also help to determine more accurately the needs of customers and generate more ideas for new products, for example.

Generally, online companies like BeMyGuest are likely to benefit considerably if there are more people connected to the Internet.

3 Assess the impact on companies like BeMyGuest of operating within the ASEAN trade bloc. (12 marks)

Trading blocs are likely to create both opportunities and drawbacks for businesses. One of the main benefits of operating inside a trading bloc is that all trade inside the bloc is free from trade barriers such as tariffs. This helps to keep the prices of goods and services lower for customers. As a result, demand and revenues should be higher. Another benefit is that the market for firms' goods and services should increase. Since trading blocs often do more than reduce tariffs – they may also improve capital flows, make regulations more efficient and improve competition – they may actually improve the market for non-members as well, even if not by as much as for members. For many businesses, as the volume of trade increases within the region, producers are able to benefit from economies of scale; this leads to lower costs for them and usually lower prices for consumers.

Inside a trading bloc, resources may be easier to source and labour easier to recruit. This will make it easier to run a business since production and transport costs may fall. Also, as the volume of trade increases, it may result in greater competition and thereby more efficiency in the market. Competitive pressure can help businesses to improve their products and be more innovative. Trading blocs may also provide a counterbalance against globalisation, protecting industries in an area against predatory competitors from more economically powerful regions. Moreover, being part of an RTA may give regions the power to negotiate for better deals in the global market.

For large, well-placed firms such as BeMyGuest and MNCs, ASEAN offers new potential markets as well as the prospect of higher efficiency and productivity through larger factories, lower overheads, and faster and possibly less costly logistics.

On the other hand, existing businesses within a trading bloc such as ASEAN, or those seeking to move to a country within ASEAN, could face drawbacks and problems. For example, trading blocs may actually harm overall trade because countries outside the region may be better placed to specialise or develop a competitive advantage in a product or service, and yet they are closed out of the market. Thus, blocs may lead to trade diversion rather than trade creation. For example, Indonesia may produce a crop more cheaply than countries in the EU, but the EU's agricultural subsidies and abolition of tariffs may make the price of the Europe-produced crop artificially low. There is also the possibility that inefficient producers may be protected from competition, thereby diverting trade away from more efficient producers and potentially harming consumers. For example, less efficient producers within regions may lobby for protection, so that they do not have to reform and compete.

The overall benefits from operating inside a trading bloc such as ASEAN may turn out to be small if an agreement limits the goods/services that are traded. Also, locally, some of the benefits may be distributed unequally, causing political and social tensions within the region. For example, according to the answers in (1) the ASEAN region is dominated by Indonesia. Its total GDP is far higher than all other countries in ASEAN.

Globally, the benefits accrued inside the bloc may lead to tensions with other regions, leading to possible retaliation which would cause further harm to global trade. For example, in 2018, trade wars between the USA and other countries such as China seemed probable. Also, members of RTAs, especially those in free trade agreements, may have different levels of economic power, causing long-term economic and political imbalance, and potential conflict.

Finally, for smaller businesses, opening up competition and the large market may result in more competitors. This can put pressure on their pricing strategies, since larger producers may be able to produce at a lower cost in a better location. Small firms often fear the consolidation of a trading bloc and the competitive changes in the market place that it brings.

To conclude, it is likely that the benefits of operating within a trading bloc are likely to outweigh the drawbacks. This is because many countries are keen to form and expand trading blocs. In the future, it may be that some businesses gain and others lose. For example, businesses that rely heavily on migrant labour may encounter severe difficulties filling job vacancies. In contrast, those businesses that feel constrained by EU rules and regulations may benefit if those rules and regulations no longer apply. However, even outside the EU, such rules and regulations might still apply because the government may feel that the nation benefits from such laws.

27 CONDITIONS THAT PROMPT TRADE

ACTIVITY 1

CASE STUDY: PREMIUM FRESH TASMANIA

1 Explain two reasons why nations trade.

International trade helps to raise living standards and results in higher levels of output, income and employment. However, many nations trade for more specific reasons. For example, some countries are unable to produce certain goods. This is because they lack the natural resources that enable such production. For example, Iceland cannot produce certain types of food because it does not have the right climate. France cannot produce gold or diamonds because the country does not have any deposits. Therefore, many countries are prompted to trade in order to obtain goods that cannot be physically produced domestically. In this case, Premium Fresh Tasmania exports some of its output to countries which are unable to produce certain types of fresh produce, such as asparagus to Japan, during the winter.

Another reason is that some countries can produce goods more efficiently than others. This may be because countries have cheaper resources or because they have become experts through specialisation. For example, China can produce manufactured goods more cheaply than many countries because it has a cheap labour force. It makes economic sense to buy goods from other countries if they are cheaper.

2 How important are push factors in Premium Fresh Tasmania's decision to increase exports?

Businesses are prompted to trade for a number of reasons. For example, some businesses are forced to export their output due to push factors. Push factors are adverse factors in the existing market that encourage a business to develop overseas markets in which to sell their products. A firm may be attempting to overcome weaknesses in its existing markets or looking to lower its costs. Push factors include saturated markets and competition. Competition may drive prices down due to lowered costs, or there may be declining demand for a product, due to changes in tastes, availability of substitutes or superseding technologies.

In this case, it might be argued that Premium Fresh Tasmania has been pushed into exporting. It sells over 20 per cent of its output and has won an Australian exporting award. During the harvesting season in Tasmania, there is always an abundance of certain types of fresh produce. This means that the market becomes saturated and prices are likely to be depressed. Premium Fresh sells some of its output to countries such as Japan and Europe. These customers cannot produce vegetables, such as asparagus, during their winter, so Premium Fresh can exploit this gap in the market. Premium Fresh takes advantage of Australia's counter-seasonality.

ACTIVITY 2

CASE STUDY: OFFSHORING IN CHARLOTTE, USA

1 Calculate the amount that Lowe's can potentially save by off-shoring 125 IT jobs to India (assume that IT workers cost \$80 000 p.a. in the USA).

The cost of 125 IT workers in the USA would be:

$$\text{US\$}80\,000 \times 125 = \text{US\$}10\,000\,000$$

The cost of 125 IT workers in India would be:

$$\text{US\$}60 \times 12 \times 125 = \text{US\$}90\,000$$

2 What is the difference between outsourcing and offshoring?

Put simply, outsourcing is moving jobs to other organisations, while offshoring is moving jobs to other countries. Companies do not have to outsource to go offshore – they might use companies in the same country. In more detail, outsourcing is the contracting out of an entire business function to a specialist external provider. A firm may outsource to cut costs, reduce staff, specialise or address legal issues.

Offshoring is where a separate provider carries out services overseas. Companies from higher-cost countries may offshore to lower-wage economies where they can make cost savings, and then export goods back. In this case, Lowe's transferred 125 IT jobs from Charlotte, USA to India – this is offshoring. However, in the case of retailer Ralph Lauren, it cut 107 jobs in Kernersville, Greensboro and High Point and the company did not say whether the IT jobs were moved offshore. It did say, though, that some of the eliminated jobs were outsourced to another business with offices all over the world, including in India. This means that some of the work was taken on by another business – this is outsourcing.

3 What might be the possible impact on companies like those described above in the case of continual offshoring and outsourcing?

Clearly the key motive for offshoring and outsourcing is to cut costs. In the case of IT work, the cost to Lowe's of 125 IT jobs in the USA is US\$10 000 000. However, by offshoring these jobs to India, the cost falls to just US\$90 000. This is an astonishing saving of US\$9 110 000. The pull factor here is very strong indeed.

In 2017, a number of businesses in Charlotte, USA announced plans to move jobs to new overseas locations, but offshoring has been used by US businesses for years. It is also showing no sign of slowing down, especially in businesses that are under pressure to increase profits.

However, despite the clear cost advantages, there may be some disadvantages of repeated offshoring and outsourcing. For example, outsourcing in particular has its risks. A firm is vulnerable through loss of expertise or knowledge if it relies too much on others. In addition, others' interests may not remain in agreement, so that the efficiencies sought by moving the jobs are not as great as expected. Poor communication issues can cause problems and become indirectly expensive to the business. There might also be problems with staff not

feeling motivated. If an increasing number of jobs are lost to other businesses and overseas operations, the remaining workers may feel insecure. This may affect their enthusiasm and performance. It could also encourage them to find more secure jobs elsewhere. This could mean that companies like Lowe's, Ralph Lauren and the Bank of America struggle to recruit and retain high-quality staff. This is likely to have a long-term negative impact on companies.

EXAM PRACTICE

CASE STUDY: ZARA

1 Calculate the proportion of sales Inditex generates in exports in 2017. You are advised to show your working. (4 marks)

The proportion of sales generated from exports is given by:

$$\frac{\text{€20 912 million}}{\text{€25 336 million}} \times 100 = 82.5 \text{ per cent}$$

2 Explain one reason why exports are important to Zara and Inditex. (4 marks)

According to the answer in part (1), 82.5 per cent of all Inditex sales are exports. This is a very high proportion. Zara was responsible for 66 per cent of Inditex's sales in 2017 so clearly exports are very important to both Zara and Inditex. The ability to sell goods in foreign markets helps companies to grow – increasing sales and profitability. It also helps to cut costs as businesses expand and exploit economies of scale. Global markets are obviously bigger than domestic markets so both Zara and Inditex will be happy about their business success abroad.

3 Assess the importance of push and pull factors in Zara's decision to expand in the EU. (12 marks)

Push factors are adverse factors in the existing market that encourage an organisation to seek international opportunities. They force a business to seek overseas markets in which to sell their products. A firm may be attempting to overcome weaknesses in its existing markets or looking to lower its costs. Push factors include saturated markets and competition.

Push factors were extremely important in Zara's initial decision to expand into the EU. After 13 years, Zara's home market of Spain was nearing saturation. In order for the business to continue growing, it needed new, untapped markets.

Pull factors entice firms into new markets. They are the opportunities that businesses can take advantage of when selling into overseas markets. There are many pull factors, and those that are the most important to a firm depend on the nature of the business and the current state of its home market.

Pull factors helped to shape the direction of Zara's subsequent expansion. The barrier-free EU market was attractive, as Zara could continue to use the strategies and operations that had made it successful in its home market. Likewise, the opportunities presented by such a huge consumer market gave it the scope for growth that it needed. Portugal, Zara's first market, was similar culturally and nearby geographically, allowing Zara to gain experience and to test its expansion strategy before moving into additional locations.

Zara continued to benefit from later expansion. It was able to spread its risks, as it could rely on additional markets for sales growth and was also able to learn from the new markets it was entering. Eventually, as the business grew ever larger, Zara could take advantage of economies of scale in design and production, and so improve its ability to competitively price its fashions. In 2017, 82.5 per cent of Inditex's sales (Zara's parent company) were from exports. This shows the importance of overseas trade to the group.

4 Evaluate whether or not the success of Zara results from its reliance on international trade. (20 marks)

There is no doubt that both Zara and Inditex (Zara's parent company) have enjoyed a great deal of financial success in recent years. Zara was set up in 1975 and has grown consistently ever since. Zara has become one of the largest clothing retailers in the world. Founder Amancio Ortega is also one of the wealthiest men in the world. Zara has established over 7000 stores since 1988, it has a successful and growing online operation and in the last 10 years Inditex's sales have increased from €10 407 million in 2008 to €25 336 million in 2017. This is an increase of 144 per cent. Further growth is also expected after Inditex reported a 14 per cent jump in sales to €5.6 billion in the first quarter of 2018. Inditex has repeatedly outperformed its retail rivals, including H&M.

There is also little doubt that Zara's success has resulted from its development of foreign markets. Zara's first big move was into the similar cultural environment of Portugal. Between 1989 and 1996, Zara opened stores in several European countries and Mexico, as well as the key fashion centre of New York in 1989. The New York expansion held risk, but also provided insight into competitor business models, such as Gap. After 1997, Zara began a rapid phase of international expansion that has made it into a globally recognised brand. More recently it has launched an online operation but continues to open new stores. For example, in 2018 it opened a new temporary click-and-collect store at Westfield Stratford in east London, UK. The temporary concept store was opened while Zara's main store was being improved. The new store has been adapted to cope with the growing number of click-and-collect orders. It will help customers with their online transactions – dealing with returns and exchanges for example. In 2017, Zara was ranked 24th on global brand consultancy Interbrand's list of best global brands.

However, Zara's success come from other factors. Its core values are: beauty, clarity, functionality and sustainability. These values appear to be popular with customers. The company also understands the importance of trends and changes in taste in the fashion industry. For example, Inditex has repeatedly outperformed its retail rivals, including H&M, as its fast-fashion model allows it to quickly respond to catwalk trends and replicate popular products in new colours and styles.

Zara also produces its clothes and other product lines closer to home than many of its rivals. It relies heavily on the strength of its European supply chains which allows the company to deliver new products to its shops faster than its rivals. In contrast, many of its competitors buy their clothes from factories in China, Indonesia and Bangladesh. Around 55 per cent of Zara's products are made in Spain, Portugal, Turkey and Morocco. This helps Zara to meet customer needs more effectively.

Inditex and Zara's success might also come from its multi-channel approach to marketing. Inditex continues to generate growth from store sales even though many of its rivals are facing difficulties in this market. For example, in 2017 it opened its largest Indian store in Mumbai. Zara's success is partly due to Zara's commitment to multi-channel and online strategies, with the firm expanding its online operations in Asia in the last quarter of 2017.

To conclude, further growth for Zara and Inditex is more than likely going to come from making further progress into foreign markets. For example, India's apparel market is expected to grow at 12 per cent to \$67 billion in 2017 from \$60 billion in 2016. This growing Indian market will clearly be important to Zara and Inditex going forward. However, if Zara was not committed to multi-channel distribution, sourcing its products from suppliers in neighbouring countries and bringing new products from the catwalk to customers swiftly, the volume of its international trade may be challenged. Zara's success has occurred for a number of reasons, all of which are important.

28 ASSESSMENT OF A COUNTRY AS A MARKET

ACTIVITY 1

CASE STUDY: EASE OF DOING BUSINESS

1 How useful might Table 1 be to a construction business considering the export of its services for the very first time?

When companies begin to market their goods abroad, they might be quite anxious about the outcome. Many businesses experience high initial costs when selling abroad for the first time. It is often risky because foreign markets are unfamiliar. For example, cultural differences might make selling certain goods more difficult. Fluctuations in the exchange rate could have an impact on sales and there may be worries about receiving payment.

However, to reduce the risk involved, a business could study the information in Table 1. This shows a selection of countries ranked according to how 'business friendly' they are. It is a lot easier to sell goods and services in some countries than others. The countries at the top of the rankings, such as New Zealand, Singapore, South Korea and Hong Kong, have maintained their high rankings for a number of years. These are the easiest places to do business. They tend to have a well-developed infrastructure, they provide proper legal protection, bureaucracy is minimal, and they have a good record for collecting taxes and offering credit. For example, if a construction business was concerned about obtaining the necessary permits associated with the industry, it might prefer to market its services in New Zealand. New Zealand is ranked at no. 3 in the world for this, which is very high.

2 Discuss the reasons why countries at the bottom of the World Bank's rankings are unattractive to businesses as markets.

Unfortunately, businesses will generally avoid certain countries when selling goods and services abroad. These tend to be those right at the bottom of the 'Ease of doing business' world rankings. Such countries are likely to provide difficult environments for businesses. The bottom five countries in the rankings are Somalia, Eritrea, Venezuela, South Sudan and Yemen. Clearly, these countries are not good locations for marketing goods and services. Countries at the lower end of rankings may have some features in common. For example, low GDP, political instability and high crime rates. For example, parts of Yemen are at war and Venezuela's economy has almost completely collapsed in recent years. Countries with high levels of corruption are also very risky for businesses. These tend to be near the bottom of the rankings.

ACTIVITY 2

CASE STUDY: VORMER DIAMONDS

1 Calculate the change in the price of the diamonds to Indian customers between May 2017 and May 2018.

The price of the diamonds in rupees in May 2017 and May 2018 is given by:

May 2017:

$$€2 \text{ million} \times \text{Rs}72 = \text{Rs}144 \text{ million}$$

May 2018:

€2 million × Rs80 = Rs160 million

Therefore, the increase in price of the diamonds to Indian customers is Rs16 million. This is in excess of 10 per cent.

2 Why might exchange rates cause difficulty for businesses engaging in international trade?

Fluctuating exchange rates cause businesses problems. They create uncertainty because currency movements are unpredictable and can be quite sharp. For example, after the UK voted to leave the European Union in June 2016, the value of the pound fell by about 15 per cent almost overnight. If a business does not know what is going to happen to exchange rates in the future, it does not know what prices customers in overseas markets will have to pay. In this case, Vormer Diamonds was hit by an appreciation in the euro against the Indian rupee. The euro strengthened by more than 10 per cent in a single year. This increased the price of the diamonds to Indian customers. As a result, the business struggled to break even on the deal in its first year of export.

The impact of fluctuating exchange rates can be both positive and negative. For example, if the euro had weakened against the Indian rupee, Vormer Diamonds would have benefited. This is because the price to Indian customers would have been lower and they may have demanded more. However, the uncertainty of not knowing what will happen in the future makes business planning very difficult.

3 How might businesses protect themselves from fluctuations in the exchange rate?

A business might want to protect itself from movements in the price of currencies. Larger businesses such as multinationals are more likely to engage in these measures than small businesses. One measure a business might consider when the exchange rate changes is to adjust its prices. For example, if the exchange rate appreciates, a business could lower the price in its own currency to compensate for the appreciation. This would keep the price to overseas customers the same. However, if the business is operating on very slim margins this may not be possible. Also, if exchange rates fluctuate frequently and sharply, constant price changes become impractical.

Another approach is to take out an insurance policy to protect the business from any financial loss resulting from sharp currency fluctuations. There are likely to be specialist insurance companies with experience in the field that manage such protection.

Some businesses deal in foreign exchange markets to buy and sell currency when prices are favourable. For example, a business might buy stocks of a currency when the price is relatively low. However, this may be risky and should be avoided by the majority of inexperienced businesses.

Finally, some businesses use financial instruments, such as hedging, to try and hedge against the financial risks. This involves purchasing financial instruments whose prices move in completely the opposite directions to unfavourable currency movements. However, again, involvement in such measures should be taken with caution.

EXAM PRACTICE

CASE STUDY: ASSESSING UGANDA AS A POTENTIAL MARKET

1 Explain one reason why infrastructure is important to a business entering a new overseas market. (4 marks)

The quality of a country's infrastructure is an important factor in any decision to move into a new market. Exporters need sound infrastructure when entering a new market. Goods require distribution, which needs a certain level of communication and adequate transportation links, for example. Many developing countries have underdeveloped and unreliable transportation infrastructure, and this can add significantly to a company's production and operating costs. For example, there may be awkward or inefficient entry points (airports, sea ports), few or unreliable trains or shipping lanes, incomplete road networks or limited warehousing facilities. A delay or failure to deliver due to poor infrastructure can lead to lost sales and increased costs, which can make a market less attractive to a business.

In this case, some of Uganda's infrastructure is inferior. For example, Uganda has one of the poorest road networks in East Africa. The poor state of its roads is holding back growth, regional trade and development. Heavy rains have started to destroy bridges and roads, cutting off rural areas at times. Problems like this may discourage a business from entering the Ugandan market.

2 Explain one reason why corruption might influence the decision by a business to enter a market. (4 marks)

In some countries, corruption is more commonly widespread. For example, gaining planning permission for a new distribution centre in a particular country may require a bribe to a planning official. In other countries, corruption of this nature is less common. Therefore, when entering a new market, it is often difficult for a business to measure the level of corruption. Businesses also have to decide whether they are happy to trade in countries where corruption is more common. Many businesses are likely to avoid trading in countries where corruption is high. In contrast, some businesses just treat bribes, and other types of corruption, as a cost that needs to be built in to the decision-making process.

Businesses can obtain information about corruption around the world. For example, Transparency International is a non-governmental organisation established to fight corruption. Every year, it publishes the global Corruption Perceptions Index, which measures the perceived levels of public sector corruption in countries and territories around the world. This provides a useful starting point for businesses to help them understand whether a country is seen by others to be corrupt.

3 Discuss how a business like the Xinlan Group might use Porter's Five Forces model when assessing the potential of a market. (8 marks)

Porter's Five Forces model can be used to assess the potential of an overseas market. It can help businesses to look at the 'balance of power' in a market between different types of organisations, and to determine whether entering into such a market will be profitable. Porter's model is a strategic tool designed to give a global overview, rather than a detailed business analysis technique. It helps review the strengths of a market position, based on five key forces. These include the bargaining power of suppliers, the bargaining power of

customers, the threat of new entrants into the market, product substitutes and the rivalry that exists between firms in the market.

However, sometimes not all the information is available, and businesses may need to make assumptions. For example, it may be difficult to get specific market information on parts of the Middle East and China.

Xinlan Group plans to make smartphones and sell them in Uganda. It may have used Porter's Five Forces model to help assess whether the market is likely to be profitable. As a result, it might conclude that the biggest threat to the company if it entered the market would be the threat of new entrants. For example, if the company established itself in the Ugandan market and started to make a big success, other smartphone manufacturers are very likely to express an interest. Some of the smartphone companies around the world are quite powerful multinationals. They might try to enter the Ugandan market and make trading difficult for Xinlan Group.

A summary of the conclusions resulting from the application of Porter's Five Forces model might be as shown below.

- competitive rivalry or competition (moderate force)
- bargaining power of consumers (strong force)
- bargaining power of suppliers (weak force)
- threat of substitutes or substitution (weak force)
- threat of new entrants or new entry (strong force).

A strong force shown above is the bargaining power of consumers. This force might be strong because customers in Uganda are likely to have quite limited budgets. Therefore, they are not likely to buy a smartphone unless they can be convinced that it is worthwhile. The business would have to work hard to overcome this possible barrier. By applying Porter's model, a business like Xinlan Group may be able to design an effective marketing strategy to help enter the new market.

4 Assess the attractiveness of Uganda as a potential market for a European computer manufacturer. (12 marks)

Businesses are often keen to find new markets for their products. Emerging economies and some of the less-developed countries, such as Uganda, are likely to prove more attractive in the future. This is especially the case for computer manufacturers. While there are many countries where the residents already own or have access to computers, in Uganda, according to Figure 7, a huge 97 per cent of the 41.5 million population do not own a computer. Initially, this suggests that entry into the Ugandan market could be quite successful.

Not only is the population of the country already 41.5 million, it is expected to grow to around 214 million by 2100. This suggests a great deal of market potential going forward. However, perhaps more important is the level of incomes in Uganda. Policy decisions made by President Yoweri Museveni's government and a heavier reliance on the private sector has helped to lift many of the nation's residents out of poverty. In the last three decades, Uganda has been one of Africa's fastest-growing economies. Figure 5 shows that GDP has grown from 46 522 billion shillings in 2011–12 to 57 971 billion shillings in 2016–17. This is an increase of around 25 per cent. If this pattern continues, Ugandan residents will have growing amounts of money to spend on items like computers.

One important factor that a business must take into account before entering a new market is the ease of doing business. If a business faces problems with its goods entering a country, setting up premises or dealing with everyday trading activities in a particular country, it is likely to look at alternative markets. Such problems are likely to cause delays in sales, increase costs and potentially affect other parts of the business in the distribution chain. Uganda is ranked 122 in the world rankings for the ease of doing business. This is quite low. However, when looking at the African nations alone, Uganda is ranked 13, which is in the top quartile of countries.

Another factor to be taken into account is the quality of infrastructure. A computer manufacturer will need port facilities and a good road network to distribute computers to stores and other outlets. Uganda has one of the poorest road networks in East Africa. Reasons for this include slow government action concerning procurement and construction and climate change. Heavy rains have started to wash away bridges and roads cutting off rural areas at times. This could be a problem.

The political situation in a country is also important. Political decisions and events can have a significant effect on a country's business environment and can cost investors some or all of the value of their investment. A country with a calm political situation can reduce uncertainty, which might make that country attractive as a potential market to businesses. In this case, since gaining independence in 1962, Uganda has had mixed fortunes. Economic development has been negatively affected by a military coup and there has been political instability in the north of the country. However, in recent years a period of political stability has provided an environment in which businesses could develop.

Finally, the exchange rate between nations can influence the decision whether to enter a market. If the exchange rate between the euro and the Ugandan shilling was strong and likely to appreciate in the future, this would make the European computers more expensive in the Ugandan market. According to Figure 6, the euro has appreciated by around 10 per cent in just one year (although it fell back a bit towards the end). This might also be a problem, particularly if the appreciation continues.

To conclude, assessing a country as a market is never easy. You need a huge amount of research to make a decision about making a good investment in a place. You also need a full understanding of the company's competitive advantages and whether the investment, if successful, will improve these. Even then, many companies make a wrong decision. In this case, there is some evidence to suggest that it is perhaps a little too soon to start selling computers in Uganda. Although the market seems large and set to grow, and few people in Uganda have a computer, it is likely that many would not be able to afford one. This is unless the company can lower its prices and profit margins in this particular market. The infrastructure is also poor, and the exchange rate is currently strong. These are both significant negative factors, as is Uganda's position at 122 out of 190 in the world ease of doing business rankings. It may be better to focus on less risky markets at the current time.

29 ASSESSMENT OF A COUNTRY AS A PRODUCTION LOCATION

ACTIVITY 1

CASE STUDY: INTERNATIONAL PRODUCTION COSTS

1 A German producer is planning to shift 2400 manufacturing jobs to the Philippines. Using the information in Table 2, calculate the amount of money that could be potentially saved in manufacturing wages (assume employees work 35 hours per week, 48 weeks per year on average).

Wage costs in Germany is given by:

$$2400 \times 35 \times 48 \times \text{US}\$43.18 = \text{US}\$174\,101\,760$$

Wage costs in the Philippines is given by:

$$2400 \times 35 \times 48 \times \text{US}\$2.06 = \text{US}\$8\,305\,920$$

Therefore, the saving would be US\$165 795 840 (US\$174 101 760 – US\$8 305 920)

2 Why is China losing its position as the lowest-cost manufacturer?

China is no longer the world's cheapest place to manufacture goods. This is because of a change in focus by many of China's manufacturers. China is the second-largest economy in the world, rising from 9th position in 1980 to its current position in 2010. One of the main driving forces behind this rise was its role as a low-cost manufacturer. However, China is now focusing more on medium to hi-tech manufacturing. This has given other nations the opportunity to fill the gap left by China as a low-cost producer. Deloitte predicts that countries like Malaysia, India, Thailand, Indonesia and Vietnam (the 'Mighty 5' or MITI-V countries) will provide lower-cost environments in the future. Another reason for the change is due to rising wages in China. For example, between 2008 and 2017 the average yearly wage rose from US\$29 229 to US\$74 318.

3 Explain why, in the future, cheap labour may not be such an important factor when assessing a country as a production location.

Labour is just one example of the many production costs faced by a manufacturer. Others include raw materials, components, energy, machinery, premises, advertising, transport, marketing and administration, for example. However, for manufacturers of labour-intensive commodity products like apparel, toys, textiles and basic consumer electronics, the cost of labour may still be important. But it may be less so in the future. This is due to rapid developments in technology and, in particular, the ability of machines to replace people in factories. With robots becoming ever more flexible and sophisticated, business analysts are predicting that the number of people employed in manufacturing will fall significantly in the future. Martin Ford's bestselling 2016 book *The Rise of the Robots: Technology and the Threat of Mass Unemployment* suggests that whole swathes of professional-sector jobs will be lost. This is in addition to those in low-cost manufacturing where the level of automation is

rising rapidly. Consequently, in the future, other factors might be more important than labour costs when assessing a country as a production location.

ACTIVITY 2

CASE STUDY: EASE OF DOING BUSINESS

1 Businesses prefer to locate operations where it is 'easy to do business'. What does this mean?

When choosing a suitable location, a very important consideration is the commercial environment in a country. This is often referred to as the 'ease of doing business'. It is a lot easier to do business in some countries compared with others. It is important to choose a location where it is relatively easy to do business. This is because trading restrictions and additional costs can be both frustrating and expensive. For example, if it takes too long to get connected to the electricity supply, this can hold up production.

The ease of doing business may depend on factors like the ease with which businesses can be started and closed down, the efficiency with which contracts are enforced, the amount of red tape that exists, the ease with which permits can be obtained (for example, for construction projects) and the availability of trade credit. Setting up a large production facility in an overseas country is a difficult enough task, even when the commercial environment is favourable, so businesses are likely to steer clear of countries where doing business is not encouraged.

2 What are the possible attractions of a business looking at Singapore as a suitable overseas location?

According to Table 4, Singapore is ranked 2nd place in the world for ease of doing business. This is a respected title. Singapore scores highly when some of the factors used in the rankings are analysed. For example, it is the second-best country in the world for enforcing contracts. It also scores well when it comes to protecting minority investors, starting a business and paying taxes, where it was ranked 4th, 6th and 7th in the world respectively. In addition, Singapore claims to have an excellent infrastructure, transparent laws, a sound economy and convenient online portals. There are a number of important attractions here, which suggest that Singapore would be a good place for overseas businesses to locate their operations.

However, a wide range of other factors would have to be considered before making the final decision to locate in Singapore. Factors such as production costs, the availability of skilled workers, the availability of natural resources and the expected rate of return are all important.

EXAM PRACTICE

CASE STUDY: LOCATING PRODUCTION IN MALAYSIA

1 Explain one reason why a business might use quantitative decision-making methods when assessing a country as a production location. (4 marks)

Businesses looking for locations for production are likely to consider a number of different options before making their final decision. Many factors, such as the ease of doing business, political stability, production costs and quality of infrastructure are likely to be considered, depending on the nature of the industry a business operates in. During the decision-making

process, SWOT analysis and PESTLE analysis can help to assess the suitability of different locations. These will help assess the strengths and weaknesses of particular locations and help assess the possible impact that external factors might have on location decisions.

However, businesses are also likely to apply quantitative techniques to help make the final location decision. Quantitative techniques can aid evaluation of the financial costs and benefits of investing in particular locations. Quantitative techniques are particularly helpful because they allow direct comparisons between different locations. For example, a business might calculate the ARR for three different locations. If they are 11 per cent, 13 per cent and 21 per cent, the business is likely to choose the site with a 21 per cent return because it is clearly the highest.

2 Discuss how governments can influence business location decisions. (8 marks)

Most governments around the world are keen for businesses to set up operations in their countries. This is because of the benefits it brings, such as income and employment. Governments can influence industrial location by providing incentives to businesses to locate their production facilities in their country. Generally, governments may offer financial incentives, such as tax breaks, lower rates of company tax, interest-free loans, cheap land and better rates on business premises. For example, Bangladesh offers some of the most attractive packages of fiscal, financial and other incentives to foreign entrepreneurs in South East Asia.

In this case, the Malaysian government offers a range of incentives to businesses to entice investment. Established in 1967, the Malaysian Industrial Development Agency (MIDA), is the government's main agency for the promotion of manufacturing and services in the country. It provides support and guidance for businesses wishing to invest in manufacturing and service provision in Malaysia. Some of the incentives on offer to foreign investors include no restriction on foreign equity ownership, a liberal expatriates employment policy, free movement of funds for foreign investments in Malaysia, protection of intellectual property rights and a company tax rate of 25 per cent.

The Malaysian government also emphasises some of the attractive facilities that foreign investors might be interested in. For example, Malaysia provides a complete system of vocational and industrial training, financial assistance for the training of workers, a well-developed financial and banking sector providing credit to industry and a fully developed collection of industrial parks for industry (including high-tech parks and free zones for export industries).

Governments can also attract businesses by investing in the nation's infrastructure. In this case, the Malaysian government promises foreign businesses a good electricity and water supply at reasonable costs, high-quality telecommunications network and services, well-equipped seaports and airports connected to the world and a network of well-maintained highways and railways. Such amenities can be very important to a business when assessing a country as a production location.

3 Assess the likely factors that make Malaysia an attractive location for production for Toyota. (12 marks)

There is quite a lot of evidence in the case to suggest that Malaysia is an attractive location for production. This might help to explain why a company like Toyota wants to locate a new factory there. The country is politically stable, and incomes are growing steadily. Figure 4 shows that between 2008 and 2016 GDP per capita rose from US\$9020.4 to US\$11 028.2. Rising incomes in the country suggests that residents will be able to afford the products produced by a business that decides to set up operations in Malaysia.

The commercial environment is a very important consideration for a company like Toyota when choosing a location. This is often referred to as the 'ease of doing business'. It is a lot easier to do business in some countries than others. It is important to choose a location where it is relatively easy to do business because trading restrictions and additional costs can be both frustrating and expensive for businesses. In this case, Malaysia is a business-friendly country and was ranked 24th in the World Bank's ease of doing business rankings in 2017. It scored particularly highly on protecting minority investors (4th), getting electricity (8th) and dealing with construction permits (11th).

Businesses like Toyota might also prefer to locate in countries which belong to trading blocs. This helps to avoid trade barriers, such as tariffs and quotas. The output of a business located inside a trading bloc will be free from trade barriers when sold to any member of that bloc. In this case, along with nine other South East Asian countries, Malaysia is a member of ASEAN, an important trading bloc in the region. It also signed the 12-nation Trans-Pacific Partnership (TPP) free trade agreement in 2016. However, the future of this agreement looks uncertain since the USA withdrew in 2018.

Government incentives can also help to attract businesses like Toyota to a particular country. This is because they usually help to keep costs down and projects to run more smoothly. In this case, the Malaysian Industrial Development Agency (MIDA) provides support and guidance for businesses wishing to invest in manufacturing and service provision in Malaysia. Some of the incentives on offer to foreign investors include the free movement of funds for foreign investments in Malaysia, protection of intellectual property rights, a company tax rate 25 per cent, individual tax rate from 0–26 per cent and trade unions and friendly industrial relations.

Another key factor is the quality of infrastructure in a country. A poor infrastructure can act as a barrier to business development. However, in this case Malaysia seems to have a well-developed infrastructure. For example, it offers fully developed industrial parks for industry (including high-tech parks and free zones for export industries), plenty of electricity and water supply at reasonable costs, high-quality telecommunications network and services, well-equipped seaports and airports and a network of well-maintained highways and railways.

On the down side, Malaysia has a very low level of unemployment. It was just 3.4 per cent in 2017. Toyota's new plant, which is to be located on the Bukit Raja Industrial Estate, Klang, may require large numbers of workers. Therefore, Toyota might struggle to recruit a sufficient number of high-quality people. Another issue is the population size. Malaysia's population is 31 million. This is considerably less than the populations of China (1.4 billion) and India (1.2 billion). Combined with the current factory, Toyota's Malaysian production volume will be around 90 000 to 100 000 units per annum. The cars produced by the new plant will be for the domestic market. Consequently, Toyota might be better locating production in these countries (if it hasn't already). Finally, Malaysia does not feature in the top 10 most competitive nations as shown in Table 1. This might suggest that costs generally are relatively high in Malaysia.

To conclude, most would agree that Malaysia has a lot to offer businesses as a production location. The benefits almost certainly outweigh the drawbacks. Toyota has already made the decision to locate a plant there in 2019. It will cost around RM2 billion to build and will have an initial annual capacity of 50 000 units a year. The cars produced by the new plant will be for the domestic market. Toyota believes that the Malaysian auto market will grow in the mid to long term. The country offers a skilled and affordable labour force and the English language is used which also helps. Therefore, Malaysia does seem to be an attractive production location.

30 REASONS FOR GLOBAL MERGERS, TAKEOVERS OR JOINT VENTURES

ACTIVITY 1

CASE STUDY: TAKEOVER OF MEAD JOHNSON® BY RECKITT BENCKISER®

1 How might Reckitt's acquisition of Mead spread risk?

Reckitt sells a number of high-profile brands around the world such as Dettol®, Scholl®, Harpic® and Vanish® products. It also supplies over-the-counter (OTC), non-prescription products such as Nurofen®. One of the main reasons why Reckitt bought Mead was to develop a new market outside of its current area of expertise. Mead Johnson is an influential supplier of nutrition products for babies, children and pregnant women. Critics of the acquisition say that the products made by Mead are outside Reckitt's areas of expertise. However, by taking over a baby-food supplier, Reckitt is diversifying and spreading its risk. Companies which are extensively diversified can cope more easily when a particular market starts to perform less successfully. Such companies have other markets which can help to support the business when difficulties occur. This helps to reduce the risk of business enterprise.

2 Explain one other motive for the takeover.

Takeovers can be quite an effective way to gain a strong reputation or to get access to intellectual property. In this case, Reckitt has purchased a strong brand name in Mead Johnson. It has about 14 per cent of the global baby-food market and only Nestlé has a bigger market share of around 20 per cent. The baby-food market is very large, valued at around US\$53.3 billion in 2015. It is forecast to grow to US\$76.5 billion by 2021. The purchase of this strong brand can help Reckitt to develop more brand loyalty and even stronger brand recognition. The acquisition will also mean that Reckitt avoids the high risk, cost and uncertainty of launching a new product independently.

ACTIVITY 2

CASE STUDY: JOINT VENTURE BETWEEN AAR® (USA) AND INDAMER® (INDIA)

1 Why is Indamer's involvement in the joint venture important to AAR?

Sometimes business partnerships are formed across borders because a particular company lacks the knowledge and expertise in order to enter a new foreign market. Setting up operations in a foreign market is very risky. One approach to reduce the risk is to form a partnership with a company inside the new country that already has knowledge of the market. A number of US and European companies have used this approach when setting up operations in different markets such as China, Vietnam and Thailand. These markets are often unfamiliar to foreign businesses. They often have different business practices and cultures. Joint ventures, partnerships and alliances are a common feature of foreign business ventures.

In this case, AAR has set up a joint venture with Indamer, an Indian company. The aim of the venture is to develop a new airframe maintenance, repair and overhaul (MRO) facility in Nagpur. The facility is designed to serve India's fast-growing commercial aviation market. One reason why AAR teamed up with Indamer was probably to benefit from Indamer's knowledge and experience of the Indian market. AAR said that it was looking forward to expanding its MRO expertise outside the USA with Indamer. Importantly, Indamer has the local market and cultural knowledge needed to make a success of the venture.

2 How has India's government influenced this joint venture?

Governments in some countries are concerned that foreign businesses will enter domestic markets and dominate them to the extent that the survival of local businesses is threatened. Consequently, some governments insist that firms entering their country do so in partnership with domestic operators. This helps to ensure that some of the benefits, such as income, exports and employment, are shared with domestic companies. It also helps to protect domestic companies.

In this case, the Indian government may have had an importance influence on the joint venture between AAR and Indamer. This is because the project works well with the Indian government's 'Make in India' initiative. This was introduced by Prime Minister Modi to encourage businesses to manufacture goods in India. The initiative also aims to create jobs, encourage innovation, enhance skill development and protect intellectual property. Consequently the new joint venture between AAR and Indamer will employ Indian nationals, some of whom already work for Indamer. Also, a training school will allow hundreds of students to gain skill sets and employment in Nagpur. Some of the initial training will take place in the USA.

EXAM PRACTICE

CASE STUDY: MIAOLI TOYS®

1 Calculate the loss made by Miaoli Toys from the joint venture with Twngo.com in the first year (if the venture went ahead). You are advised to show your working. (4 marks)

The loss made by Miaoli Toys in the first year from the joint venture would be given by:

$$\begin{aligned}
 \text{Profit} &= 50\% \times \text{trading profit} - \text{capital cost} \\
 &= 50\% (\text{TWD}14.4 \text{ billion} - \text{TWD}4.4 \text{ billion} - \text{TWD}2.1 \text{ billion}) - \text{TWD}12 \text{ billion} \\
 &= 50\% (\text{TWD}7.9 \text{ billion}) - \text{TWD}12 \text{ billion} \\
 &= \text{TWD}3.95 \text{ billion} - \text{TWD}12 \text{ billion} \\
 &= -\text{TWD}8.05 \text{ billion}
 \end{aligned}$$

2 Explain one way Miaoli Toys will benefit from economies of scale if it buys ToyStop. (4 marks)

One of the main motives for making acquisitions is to grow rapidly and reduce operating costs. Businesses often pursue inorganic growth strategies so that they can lower costs by exploiting economies of scale. In this case, if Miaoli Toys buys ToyStop, it may be able to

exploit some marketing economies in the distribution of its products in the European market. Miaoli already supplies shops in southern Europe, so it can make better use of those assets used to deliver goods from Taiwan to Europe by carrying larger loads. In transportation, particularly shipping, costs do not rise in proportion to the size of the loads carried. This should improve efficiency and lower distribution costs. Also, if the acquisition is a big success and ToyStop starts to sell very large quantities of toys, Miaoli may also enjoy some economies of scale in production such as the buying large amounts of raw materials and components.

3 Discuss how both of the proposed deals provide Miaoli Toys with access to cross-border distribution networks. (8 marks)

Both of the options in this case involve a business looking to develop its distribution network. Both the joint venture and the acquisition provide Miaoli Toys with additional distribution channels. This is an example of forward vertical integration. The joint venture involves the distribution of toys in China using online selling. In contrast, the acquisition of ToyStop involves distributing toys in northern Europe through a chain of stores.

The main motive for buying distribution networks is to guarantee outlets for produce. Manufacturers can reduce risk and operate more confidently if they know that they can sell output immediately using distribution channels that they own. The ownership of distribution channels also transfers the profit margins to the manufacturer, so the bottom line improves. Whichever option Miaoli chooses it will have more outlets for its toys.

It might be argued that the Chinese venture will help Miaoli Toys to gain a wider distribution overseas. This is because China has a much larger population than Europe. This will help to distribute toys to a much larger potential customer base.

4 Miaoli Toys could invest in a joint venture with Twngo.com or buy ToyStop. Evaluate which is the best option for Miaoli Toys. (20 marks)

One of the main advantages of the joint venture with Twngo.com, is that Miaoli Toys will enjoy the benefit of Twngo's experience in online selling in the Chinese market. Sometimes business partnerships are formed across borders because a particular company lacks the knowledge and expertise in order to enter a new foreign market. Setting up operations in a foreign market is very risky. One approach to reduce the risk is to form a partnership with a company inside the new country that already has knowledge of the market. Such markets are often unfamiliar. They often have different business practices and their cultures may be very different. In this case, although Miaoli Toys is based in Taiwan which is close to China, Miaoli may not have any experience of the Chinese market. Consequently, they will benefit from the venture in this way.

Another benefit of joint ventures is that the costs and risks associated with a business venture are shared. Miaoli is paying TWD12 billion to use Twngo's online platform and Twngo is meeting all of the IT costs. Developing foreign markets is notoriously risky because of their unfamiliar nature. Consequently, a business is more like to speculate in new markets if it can share the costs and risks with another. This might reduce the potential profits that a new venture might bring but more importantly, it reduces the costs and risks of the venture and any losses that are made if things go wrong.

An increasing number of shoppers are buying goods using the Internet so it could be argued that the joint venture with Twngo.com is important because it allows Miaoli Toys to update its

business model. Although Miaoli has little experience in online selling, this doesn't matter because Twngo will be handling this side of the business.

The main drawback of the joint venture is that the profits will have to be shared 50/50 with Twngo.com. This means that Twngo will share in the effort and resources that have been used in the past by Miaoli to design and manufacture a range of toys profitably. The project will also generate a heavy loss for Miaoli in the first year. According to the calculation in (1), Miaoli will make a loss of TWD8.05 billion. The owners of Miaoli Toys may not be very impressed with this – especially if dividend payments are threatened.

The purchase of ToyStop is quite a different business venture in a number of respects. It is more expensive but potentially more profitable. One advantage of this deal is that Miaoli might be able to generate some cost savings by exploiting economies of scale in distribution. This is because it already has outlets in southern Europe. Therefore, it can make better use of the assets used to deliver goods from Taiwan to Europe by carrying larger loads. In transportation, particularly shipping, costs do not rise in proportion to the loads carried. This should improve efficiency and lower distribution costs. Also, if the acquisition is a big success and ToyStop starts to sell very large quantities of toys, Miaoli may also enjoy some economies of scale in production such as buying large amounts of raw materials and components.

Another important benefit of buying ToyStop is that deal works well with Miaoli's current geographical exposure. Miaoli supplies customers in southern Europe but not in northern Europe. Since most of ToyStop's shops are in the north, this gap in the market will be filled.

Financially, the acquisition is more expensive. However, the chain is currently profitable and Miaoli's financial director believes that this deal will be better in the long term. There is also the benefit that any future profits do not have to be shared. It is also thought that a number of the stores could be sold and leased back. This would generate some cash for the business which could be returned to the owner.

However, the acquisition does have some worrying drawbacks. One problem with this option is the high cost – TWD19 billion (TWD7 billion more than the joint venture). There is no information in the case about Miaoli Toys' financial position but it will have to pay TWD19 billion to buy ToyStop. If the purchase is funded internally, dividend payments may be threatened. Alternatively, if funded externally, the company's debt will grow, and they will have to pay interest payments. This is an important issue that will have to be taken into account.

Finally, the future of high street retailing is uncertain. In 2018, a large US toy chain, Toys "R" Us, established since 1948, collapsed. The chain had struggled to deal with debt and finally went under when suppliers got scared. There is also the worry that a wider range of high street retailers have closed down in the West in recent years. An increasing number of shoppers all over the world are preferring to shop online and fewer people shop in high street shops. It may be just the wrong time to buy a chain store.

To conclude, the decision is not an easy one. There are advantages and disadvantages of both ventures. However, many would argue that the purchase of a chain store in the current retailing climate is very risky. It is also an important point that online retailing is growing rapidly all around the world. Perhaps Miaoli Toys should accept the joint venture and share the costs and benefits of online selling with Twngo.com. Also, the total population of Europe is about 350 million. This compares with a population of 1.4 billion in China.

31 GLOBAL EXPANSION AND UNCERTAINTY

ACTIVITY 1

CASE STUDY: NG MOTOR PARTS

1 Calculate the amount in JPY paid by the Japanese customer for a braking system.

The amount paid in JPY by the Japanese customer is given by:

$$500 \times \text{JPY}15 = \text{JPY}7500 \text{ per system}$$

2 Calculate the amount in CNY paid by Ng for the steel cable.

The amount paid by Ng in CNY is given by:

$$440\,000 \div 15 = \text{CNY}29\,333$$

3 Ng Motor Parts expects the exchange rate to fall in 12 months' time to CNY1 = JPY12. Calculate the effect of this change on the prices of exports and imports Ng Motor Parts.

The amount paid in JPY by the Japanese customer at the new exchange rate is given by:

$$500 \times \text{JPY}12 = \text{JPY}6000 \text{ per system}$$

The amount paid by Ng in CNY with the new exchange rate is given by:

$$440\,000 \div 12 = \text{CNY}36\,667$$

4 Explain how the price changes in (3) might affect demand.

In this case, the Chinese currency has depreciated. As a result, the price of exports (the braking systems sold to Japan) have fallen from JPY7200 to JPY6000. This is a significant fall in price, and one would expect demand for these braking systems to increase since they are much cheaper.

The price of the Chinese imports from Japan has increased from CNY29 333 to CNY36 667 after the depreciation. The cable is now more expensive to buy. This is likely to result in a fall in demand.

ACTIVITY 2

CASE STUDY: SKILLS SHORTAGES IN AUSTRALIA

1 Explain two possible effects of skills shortages in Australia.

One of the main effects of skills shortages is that wages usually increase. If the supply of a particular type of labour is restricted, the interaction of the supply and demand for labour forces wages up. The increase in wages will be exaggerated if the demand for that particular type of labour is also rising. Higher wages mean that business costs rise and profits may fall.

A shortage of skilled labour may result in lower levels of productivity. Lower productivity may be caused by production delays because it takes businesses much longer to recruit skilled labour. In extreme cases, a business may have to stop production altogether if it cannot recruit the required number of skilled workers. Alternatively, businesses may be using workers that do not have the required skill levels. This might result in a slower work rate and more mistakes, which take time to remedy. Either way, the impact on productivity will be negative.

2 How might the Australian government help to reduce skills shortages in Australia?

In the long term, the Australian government could invest in education and training to equip youngster with the skills needed by businesses. For example, it might need to give more resources to vocational education instead of academic education. Vocational courses help to develop job-related skills such as engineering, design, IT and management. However, investment in education is often very expensive. There is also likely to be delay in the returns on investment in education. It can take several years before fully-trained people are available in the labour market.

A short-term solution might be to relax immigration controls. The government could allow more immigrants into the country to help fill the skills gap. For example, it can draw up a list of job skills that are required by businesses and make it much easier for foreigners with these skills to obtain visas. This measure may be able to attract workers with the right skills fairly quickly. However, there is often a political price to pay if immigration increases too rapidly. Many people are unhappy with high levels of immigration and may vote against a political party that allows immigration to increase.

EXAM PRACTICE

CASE STUDY: DUBAI INTERNATIONAL AIRPORT

1 Explain one reason why exchange rates may fluctuate for the UAE dirham. (4 marks)

The exchange rate is the price of one currency in terms of another. For example, in Table 2 the price of AED1 in 2017 is JPY1.60 and CNY1.90. Like all prices, they can change. This is because prices are determined by market forces and at any time supply and demand conditions can change. For example, if the UAE government were to raise interest rates there is likely to be an increase in the demand for dirhams as foreign savers take advantage by depositing their savings in UAE banks. To do this, they have to buy dirhams. This increases demand and therefore raises the exchange rate.

2 In 2017, an airport trader sold goods worth AED250 to a Japanese traveller. Calculate the cost in yen to the Japanese customer. You are advised to show your working. (4 marks)

The cost of AED250 in JPY is given by:

$$250 \times \text{JPY}1.6 = \text{JPY}400$$

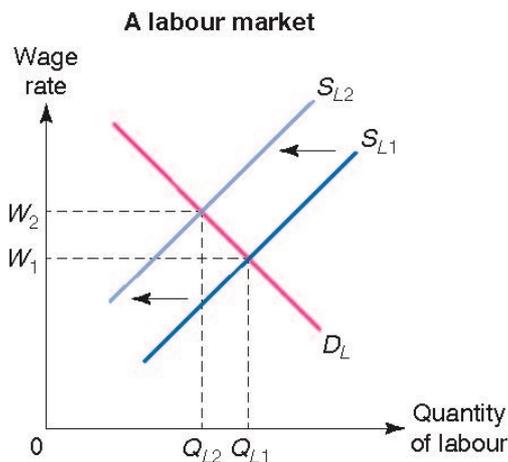
3 An airport trader needs to purchase 10 new tills from a Chinese manufacturer. The cost in yuan would be CNY500 000. Calculate whether the trader should buy the tills now or wait until 2018. You are advised to show your working. (4 marks)

In 2017 the tills cost $500\,000 \div \text{CNY}1.9 = \text{AED}263\,158$

In 2018 the tills will cost $500\,000 \div \text{CNY}1.6 = \text{AED}312\,500$

The trader would be advised to buy the tills in 2017. In 12 months' time the price will have increased due to the fall in the AED.

4 Construct a supply and demand diagram to show how wages are increased by skills shortages. (4 marks)



5 Discuss the possible impact of skills shortages on the international competitiveness of businesses operating in the Dubai International Airport. (8 marks)

A number of countries around the world are suffering from skills shortages – especially the USA, Australia, Canada, the UK, New Zealand and also countries in the Middle East including the UAE. In a survey carried out by recruitment firm Robert Walters, it was found that 72 per cent of respondents in the UAE had been affected by shortages of talent. About a third said they could not find the right people to interview for roles. Even companies with an effective HR department said they were having staffing problems – 50 per cent said it was a problem recruiting professionals from both abroad and other talent pools. Even the offer of higher pay was failing to attract sufficient numbers of quality staff

Skills shortages can have a negative impact on the international competitiveness. For example, some of the businesses operating in Dubai International Airport may be forced to pay higher wages to their staff. Skills shortages usually lead to wage increases, as shown in

(4). When the supply of labour is restricted, the supply curve shifts to the left and increases the equilibrium wage rate. If the demand for labour is also rising, the increase in wages will be even harsher. Higher wage rates will raise business costs and make businesses less competitive. Businesses may be forced to raise their prices to cover the higher labour costs. This might result in a loss of demand. For example, some of the products sold inside the airport can be bought elsewhere such as on-board aircraft.

In coping with skills shortages, UAE businesses inside the airport might be forced to recruit unskilled and inexperienced workers. This could also have a negative impact on their international competitiveness. This is because the quality of output or service is likely to be badly affected when unskilled workers are employed. This could threaten the reputation of such businesses. For many businesses, in some countries the quality of service is a unique selling point. If the quality starts to decline inevitably customers will be lost. Quite often the products sold inside airports can be purchased very easily elsewhere – online, for example.

If labour shortages are prolonged there is a danger that some of the airport businesses will lose customers. This is because customers may be kept waiting or service might be inferior. There is a limit to how long customers are prepared to wait and if it is too long customers are likely to find alternative suppliers. Once a customer is lost to a rival it is very difficult to tempt them back. In the long term this could threaten the international competitiveness and survival of businesses operating inside the airport.

6 Assess the possible impact of changes in the exchange rate (between 2017 and 2018) between the AED and the JPY on future airport trade. (12 marks)

The UAE currency is expected to appreciate against the JPY according to the information in Table 2. It is expected to rise from AED1 = JPY1.60 to JPY1.80 between 2017 and 2018. When the exchange rate appreciates the prices of exports will increase. For example, the price of the Japanese goods purchased at the airport will rise from JPY400 to JPY450 ($250 \times \text{JPY}1.8$). When prices rise, demand is expected to fall. Therefore, airport traders in Dubai might experience a fall in demand for their goods if the AED does actually appreciate in 2018.

Generally, when a currency appreciates against another, it represents a general trend. Consequently, this might mean that the UAE currency is appreciating against a wide range of other currencies. If this is the case, then the prices of nearly all goods on sale at the airport will be more expensive. If this appreciation lasts for a long time, some of the traders inside the airport might start to struggle. Passengers might respond to the higher prices by spending less. They might buy less or buy gifts and other duty-free goods from elsewhere. For example, many airlines offer an in-flight duty-free service. Passengers can look through a brochure, select goods and pay for them whilst sat in their seats during a flight.

However, airport traders may react to the rising exchange rate by cutting other costs in order to avoid raising prices. For example, they may find new suppliers or improve their working practices. Alternatively, they may find a way of adding value to their goods to make them more competitive – offering a gift-wrapping service for example. Traders might also decide to take a cut in their profit margins to avoid raising prices. Whether they do this may depend on the current size of margins.

Many businesses use fixed contracts to counter fluctuations in the exchange rate. This means that temporary changes in the exchange rate will have a smaller impact. The price of buying raw materials is often set 12 to 18 months in the future. Exporters may also use future options to hedge against dramatic changes in the exchange rate. It is these fixed contracts that help to reduce the uncertainty around exchange rate fluctuations. It also means that

there are delays between changes in exchange rates and the impact on business. Some of the traders that operate inside Dubai airport are branches of large multinationals. Such companies are very likely to have the resources needed to fight currency fluctuations.

Finally, the impact that the appreciation in the UAE currency might have depends on the price elasticity of demand for the goods sold in the airport. Generally, if demand for exports is relatively inelastic, an appreciation in the exchange rate will only have a limited impact on demand. However, if demand for exports is price elastic, an appreciation in currency could result in a fall in demand. In this case, it is quite likely that demand for many of the goods sold by airport traders is relatively elastic. This is because they are non-essential items, such as gifts, confectionery, electronic gadgets and other discretionary items. Consequently, price increases resulting from the appreciation in currency could reduce demand significantly.

To conclude, the impact of the appreciation in the UAE dirham may be limited. This is because exchange rates are fluctuating all of the time. Although they may be 10 per cent higher between 2017 and 2018, they may fall in the next year. Also, in this case, the 2018 rate is estimated. Like all estimates, they could be inaccurate. Therefore, there may be no need to worry. However, if the increase in the exchange rate lasts for a long time, or gets even stronger, airport traders may have to make adjustments in their pricing, marketing and other business strategies to deal with the increase.

32 MARKETING

ACTIVITY 1

CASE STUDY: RED BULL®

1 What is meant by 'ethnocentric marketing' (use Red Bull as an example)?

Ethnocentric marketing involves selling the same products in overseas markets as those that have been successful in the domestic market. A business makes few, if any changes, to the product. The product is not radically adjusted to consider the needs of foreign customers. Red Bull appears to have used an ethnocentric marketing strategy. The Austrian energy drink was developed by Dietrich Mateschitz in the 1980s and first launched in Austria in 1987. The launch was not just a new drink but a whole new product category. By 2017 Red Bull was available in over 170 different countries and sold more than 6.3 billion cans. Red Bull does not change the flavour of the drink to cater for local tastes, although it does now offer a wider range of brands including Monster[®], Lucozade[®], Boost[®], Gatorade[®], NOS[®] and Rockstar[®].

2 Give one advantage and one disadvantage to Red Bull of adopting an ethnocentric strategy when marketing its soft drink globally.

One of the main advantages of adopting an ethnocentric approach to global marketing is that costs are lower. For example, the costs of adapting products, such as research and development, packaging and testing, for different overseas markets is avoided. By selling more of the same product Red Bull can also exploit economies of scale more easily. For example, it can get discounts from bulk buying much larger quantities of the raw materials needed to make the product.

One of the possible disadvantages of an ethnocentric marketing approach in general is that products may fail to meet the needs of foreign customers. Products may not be to their taste. As a result, sales may be very bad and the venture into the market will be a failure. However, in this case, Red Bull has not experienced such problems. The brand's powerful event marketing strategy helps to promote the brand all over the world. The company has a clear product differentiation strategy and Red Bull is able to charge a premium price since the brand is perceived to provide consumers with additional benefits. Red Bull claims that consuming the drink can help people to lead a full and active lifestyle and enhance mental and physical performance.

ACTIVITY 2

CASE STUDY: NIKE

1 Which of Porter's strategies has been adopted by Nike in this example?

Porter's Strategic Matrix helps to identify the sources of competitive advantage that a business might achieve in a market. In this case, Nike has chosen to adopt a differentiation strategy. This means that Nike has designed products that are clearly different from those of rivals. For example, in 1979 Nike introduced a pair of trainers with gas-filled plastic membranes which made running more comfortable. Eventually, rivals introduced their own versions of this technology and caught up with Nike. However, in 1987 Nike launched Air Max[®]. This shoe contained two independent airbags to absorb the shocks from running and

jumping. Nike has continued to adopt this strategy and enjoys strong brand recognition around the world as a result.

2 What methods have been used by Nike to distinguish its products from those of rivals?

Businesses can use a range of methods to differentiate its product from those of rivals. The differences can be real or perceived. In this case, Nike first designed a pair of trainers that were more comfortable. They did this by producing a pair of trainers with gas-filled plastic membranes in 1979. However, as rivals began to copy Nike's products, the company introduced more differences. In 1987 Nike launched Air Max. This shoe contained two independent airbags to absorb the shocks from running and jumping. Customers could see the bags through small windows in the heel or toe of the shoe. Nike also customised the product by adjusting the size of bags depending on the pressure exerted by individual users.

In later years, Nike began to focus on digital gadgets and make further developments with Nike's idea that everyone was an athlete. In 2006, Nike introduced Nike+ iPod Sports Kit[®] in the US market. This mass-produced gadget was a device to measure the distance and speed of a run or a walk. Since then Nike has continued this connection with technology and introduced products such as Nike+ Sportband Kit[®], Nike+ Sportwatch[®] and a running app that could be used in the latest iPhones. All this was based on a small chip which was inserted in Nike footwear. Nike also used social media by giving each Nike+ product its own Facebook page.

3 What might be the consequence for a business that fails to adopt one of Porter's strategies when selling in a global market?

This example shows how Nike developed a competitive advantage in its markets through differentiation. However, according to Porter, a business that fails to adopt one of the three generic strategies in the matrix is 'stuck in the middle' and unlikely to succeed. This means that a business fails to concentrate on a specific clearly defined strategy and is therefore unable to make any impact in the market. The business will lose out to those that choose a cost-cutting or product-differentiation strategy in mass markets or focus on cost cutting and differentiation in niche markets. If firms do get 'stuck in the middle' by failing to concentrate on a specific strategy they may struggle and go out of business. In this case, Nike has become very successful by adopting the differentiation strategy.

EXAM PRACTICE

CASE STUDY: DUNKIN' DONUTS[®]

1 Explain one reason why global marketing is important to Dunkin' Donuts. (4 marks)

Global marketing involves the planning, producing, placing and promoting of a business's products in a worldwide market. This process can involve a business having offices in different countries, but the process is also facilitated by the growth of the Internet. In this case, Dunkin' Donuts is an example of successful global marketing. Dunkin' Donuts has adapted its successful US business model for use in overseas markets and now has over 12 000 restaurants in over 45 countries.

2 Explain one benefit of using Ansoff's Matrix for Dunkin' Donuts. (4 marks)

Ansoff's Matrix can be used to help a business achieve growth. It allows the owners of a business to consider a number of factors that will determine its corporate strategy, such as the level of investment in existing and new products, the exploitation of different markets, the growth strategy for the business and the level of risk the business is willing to accept.

Ansoff's Matrix reveals four possible strategies that a business might adopt. The key issue is that risk becomes greater the further a firm moves from its existing products and consumers. In this case, Dunkin' Donuts has mainly pursued a market development growth strategy. This involves the marketing of existing products in new markets, such as new countries. This is not always simple, as customers from different regions of the same country, let alone a different country, may have different tastes and preferences. A market development strategy relies heavily on understanding local habits, tastes and needs. Dunkin' Donuts has done this by adapting some of its products to suit local needs.

Dunkin Donuts now has 12 000 stores in 45 different countries but it is also actively penetrating existing markets and developing some new (but related) products to boost sales growth even further.

3 Discuss the advantages and disadvantages to Dunkin' Donuts of using a geocentric approach to marketing. (8 marks)

It could be argued that Dunkin' Donut is pursuing a geocentric approach to marketing. This involves using a combination of the ethnocentric and polycentric marketing approaches. This 'glocalisation' approach is used by many multinational corporations, and is summed up by the phrase, 'think global, act local'. The business's strategy is to maintain and promote the global brand name, but to tailor its products to local markets. For example, Dunkin' Donuts has modified many of its products to satisfy its global customers in each country. For example, Dunkin' Donuts discovered that many Lebanese people adore chocolate and consume large quantities of fruits like Mango. As a result, they created the Mango Chocolate Donut. In Russia, Dunkin' Donuts added Dunclairs and in Korea, they developed the Grapefruit Coolata. These products were tailored to appeal to foreign consumers.

One of the main advantages of this approach is that it carries less risk than adopting a polycentric approach where entirely new products are developed for the new markets. New product development is notoriously risky. This is because a business does not know for sure that new products will be accepted by consumers. If they are rejected, the money invested in product development has probably been wasted. New product development is also very expensive. It involves expenditure at many stages of development, including generating new ideas, the analysis of ideas, the physical development of the product (making prototypes for example) and test marketing. The geocentric approach adopted by Dunkin' Donuts does involve some product development, but it is not likely to be too expensive. This is because the new products are adaptations or modifications of existing successful products.

Another advantage of the geocentric approach to marketing is that Dunkin' Donuts may be able to exploit economies of scale. If the majority of products sold in the different markets are standardised, the production scale will be larger and therefore costs will be lower. There may also be economies of scale to be had in distribution as Dunkin' Donuts opens more and more shops in a particular country.

4 Assess which of the 4Ps in the marketing mix is being emphasised by Dunkin' Donuts. (12 marks)

To make a success of global marketing, a business must give very careful thought to its marketing mix. The nature of the marketing mix when penetrating new overseas markets will probably vary enormously between different businesses. In this case, Dunkin' Donuts appears to have placed a great deal of emphasis on the product. To begin with, some of the products that were successful in the US market may not be acceptable in some foreign markets. One of the reasons for the success of Dunkin' Donuts is its ability to understand the needs of foreign customers. Dunkin' Donuts has modified many of its products to satisfy its global customers in each country. For example, Dunkin Donuts discovered that many Lebanese people adore chocolate and consume large quantities of fruits like mango. As a result, they created the Mango Chocolate Donut. In Russia, Dunkin' Donuts added Dunclairs and in Korea, they developed the Grapefruit Coolata. These products were tailored to appeal to foreign consumers. Dunkin' Donuts carried out market research and analysed foreign markets carefully. They then followed up this research with effective product development.

In addition to market research and product development, Dunkin' Donuts has also been innovative in the fields of mobile and digital technology. It has also introduced loyalty programmes and developed one-to-one marketing to help the organisation grow and differentiate itself from other coffee shops and quick-service restaurants (QSRs). For example, the DD Perks Rewards programme was very important when differentiating its service from that of rivals in the competitive coffee shop market. Dunkin' Donuts now has over 8 million DD Perks Rewards programme members. This is one of the fastest-growing loyalty programs in the QSR industry

Dunkin' Donuts also has plans to develop its products and services in the future. For example, new beverages such as Cold Brew, Iced Coffee and Frozen Dunkin' Coffee, will be pushed harder and there are also plans to extend its premium tea and frozen beverage lines and introduce more espresso products. Also, morning sandwiches are being emphasised with both new and returning 'favourites'. In 2017, some stores introduced donuts without artificial dyes. The company wants to eliminate the use of artificial dyes from its entire national US menu by the end of 2018. These new developments show that Dunkin' Donuts is always focusing on the product in an effort to make improvements.

Although the product is clearly an important factor in the marketing mix for Dunkin' Donuts, other factors are important. For example, the business has a very specific pricing policy. It aims to deliver products at affordable prices. This suggests that Dunkin' Donuts charges competitive prices and perhaps below those of key competitors in the market such as Starbucks and Costa Coffee.

Dunkin' Donuts has shown some innovative touches with its marketing mix. Most of its products are sold through coffee shops. However, in 2016, Dunkin' Donuts introduced on-the-go ordering. According to Dunkin' Donuts, this was one of the most revolutionary initiatives in the history of the company. Dunkin' Donuts is also pushing to provide more 'drive-thru' stores. These are very popular with customers and they generate greater levels of sales for the company.

There is not very much evidence in the case about the level of global promotion carried out by Dunkin' Donuts. However, the loyalty programme is an important new promotional tool and it seems to be going well. The company also plans to offer more 'value deals'. For example, one deal included two egg and cheese Wake-up Wrap sandwiches for US\$2, to help increase afternoon trade.

To conclude, it is clear that Dunkin' Donuts attaches a great deal of importance to the product in the marketing mix. Care is taken to ensure that the product meets the needs of

customers in new overseas markets and the company is always updating and modifying. However, price, promotion and place are not ignored. This can be seen from the rising revenue shown in Figure 2 – Dunkin' Donuts seem to have got the mix right.

33 NICHE MARKETS

ACTIVITY 1

CASE STUDY: AIRSTREAM®

1 Using Airstream as an example, explain what is meant by a global niche market.

A niche market is a small segment of a much larger market. In some markets, there is often a subculture of consumers with a set of common needs and wants that mainstream suppliers either ignore or are not prepared to meet. For example, these groups may be customers with common interests or hobbies. In global niche markets, the customers live in more than one country and have particular needs that are not met fully by the global mass market. In this case, Airstream supplies retro caravans to a number of countries in the world. Even the domestic market for such vehicles is small, only a small fraction of the population use caravans as a leisure activity but only a fraction of such enthusiasts buy retro caravans. This is the same globally. However, by selling its retro caravans in global niche markets, companies like Airstream can generate much higher levels of sales.

2 How might cultural diversity impact on Airstream's attempt to penetrate global niche markets?

When breaking into new markets overseas, Airstream will need to recognise that groups of people living in different countries may have different cultures which can impact on their consumption patterns. They may have different interests and values. For example, in this case Airstream is attempting to penetrate the Chinese market. However, there is no culture of using caravans in the country. Airstream CEO, Bob Wheeler, says that there are not even any campsites. Nevertheless, combined with the country's love of Americana and a huge investment in China's road network which has made road travel easier, luxury products like Airstream trailers and Harley-Davidson motorcycles have become very popular. Sales of RVs in China exceeded those in the USA a couple of years ago and China has the fastest growing market for RVs in the world. Another cultural variation, in this case, is differences in legal systems. The customs officials in China did not know how to treat the arrival of the Airstream trailer because there were no rules and regulations relating to the import of RVs. This caused some confusion and delays.

ACTIVITY 2

CASE STUDY: MERCEDES-BENZ

1 Give two features of a global niche market using examples from Mercedes-Benz.

Once the needs of a small customer group have been identified, a business can then develop products which satisfy them in a way that rivals have failed to recognise. However, niche markets do not have to be small. If these relatively small groups of consumers with specialised needs and wants exist in other countries, then global niche marketing becomes possible. One of the features of global niche markets is that it may be possible for a business to develop strong brand loyalty. This might be because the needs and wants of customers are met more precisely and therefore customers are inclined not to go elsewhere. It may also be because customer service is more personal, and it is possible to build stronger relationships with customers in niche markets because there are fewer customers to accommodate.

In this case, Mercedes-Benz cars meet the needs of global customers who value the luxury of the product and who have a strong sense of brand loyalty to the business. The business works hard to ensure that its brand is distinguished from other car manufacturers. This stems from a strong emphasis on quality, drawn from expertise in the area of luxury car making.

Businesses can often charge premium prices in niche markets. In this case, Mercedes-Benz cars can be more expensive than other cars in the same sector. Customers in this global niche are prepared to pay for the brand name and the luxury this brings. Demand for such luxury products is often price inelastic. This is a real advantage for businesses that serve such niche markets.

2 Why is the demand for Mercedes-Benz cars price inelastic?

Price elasticity of demand refers to the sensitivity of demand in response to changes in price. The main reason for the price inelasticity of demand for Mercedes-Benz cars is branding. A key factor influencing the elasticity of a product is the availability of substitutes. The strong brand name of Mercedes-Benz means that consumers build extremely strong brand loyalty and are therefore less likely to react to changes in price.

3 Give one advantage to Mercedes-Benz of demand for its cars being price inelastic.

For a brand such as Mercedes-Benz, consumers have strong brand loyalty. This has obvious advantages for the business. Higher prices can be charged due to the loyalty demonstrated by consumers and the will to purchase such a trusted, perceived high-quality product. The result of this is that profit margins are higher than would be the case with a lesser brand. With larger profits, Mercedes will be able to reinvest in the product and its marketing, which might increase brand loyalty even further.

EXAM PRACTICE

CASE STUDY: VINYL RECORDS

1 Explain one benefit to Sony Music of identifying a global market niche. (4 marks)

An important advantage is that this establishes an extension of any domestic niche markets, leading to the potential for higher sales and increased profits. The nature of a niche market is that excessive competition does not exist, so higher prices can be charged than rival, possibly domestic, products. In this case, for example, the average price of a vinyl record is US\$25. To download the same album online costs much less.

2 Explain one possible drawback to Sony Music of the pattern of revenues in the music industry as shown by Figure 2. (4 marks)

The total revenue generated by the music industry fell quite sharply after 1999. According to Figure 2, the music industry generated a total of US\$23.8 billion in 1999. However, this fell to US\$14.3 billion in 2014. There has been a slight increase since then and in 2016 a total of US\$15.7 billion was generated by the industry. Sony is one of the important 'players' in this market so it will feel the impact. One of the main reasons for this pattern is changes in technology. It is now possible for consumers all over the world to access music very cheaply, sometimes free, from streaming sites such as Spotify, Deezer, SoundCloud and Jango. Most of these sites make money by selling advertising which listeners are subjected to when

downloading free music. Other revenues are generated from subscription fees for premium listening services. Unfortunately, although artists get royalties from the music streamed by these sites, the amount they get is much less than from sales of their albums and singles that they used to get. Sony, which also sells music, has been negatively affected by this development. According to Nielsen, a company that provides information about what people watch, listen to and buy, on-demand audio streams exceeded 400 billion streams in 2017. This compared to 252 billion in 2016.

3 Calculate the percentage contribution made by sales of vinyl records to total revenues generated in the music industry in 2016. You are advised to show your working. (4 marks)

In 2016 the total revenue generated by the music industry according to Figure 2 was US\$15.7 billion. In the same year, sales of vinyl records was US\$831 million. Therefore, the percentage contribution to the total made by vinyl is given by:

$$\frac{\text{US\$831 million}}{\text{US\$15 700 million}} \times 100 = 5.29 \text{ per cent}$$

4 Discuss the factors that might have influenced growth in the global market for vinyl records. (8 marks)

The global market for vinyl records is a niche one. In 2016, the value of the market was US\$830 million. This was just 5.29 per cent of the total revenue generated by the music industry in that year. However, it is growing quite rapidly. Sales of vinyl grew by 9 per cent to 14.3 million in 2017, up from 13.1 million in 2016. That means vinyl, which has seen 12 straight years of growth, now accounts for 14 per cent of total physical album sales. Figure 3 shows the pattern of global sales for vinyl records. According to Deloitte Global, vinyl sales, which peaked in the late 1970s, will rise to over US\$1 billion in 2017 for the first time this millennium. Sony generates significant revenues from the sale of music, so it is likely to benefit from this growing trend.

Demand is being driven by consumer interest in collectibles. Deloitte said that new and used records will account for more than 90 per cent of this revenue, with sales of turntables and accessories making up the rest. For some musicians, vinyl sales will represent around 10 per cent of total album sales. Many vinyl record buyers believe that vinyl records have become collectible. They are an iconic physical format in an otherwise digital world. Many collectors appreciate vinyl records for their cover art, sleeve notes, posters, stickers and other physical content. Indeed, according to a survey, around half of those who purchased a vinyl record had not even played it. About 7 per cent of buyers didn't even have a turntable on which to play it! However, this does not appear to matter, many people buy vinyl records for their aesthetic appeal. They may even have a copy of the music in digital format to listen to on their iPhones, for example.

The rising demand might also be helped by rising disposable incomes across the world. Increasing numbers of people have more money to spend on leisure products. Although vinyl records cost a lot more than their digital equivalent, enough music lovers are prepared to pay the premium price to make supply in the market worthwhile. Sony looks set to cash in on this trend. Sony Music said it would start making vinyl records for the first time since 1989. According to a report, Sony has equipped its Tokyo studio with a cutting machine which is needed in the production process for manufacturing vinyl records.

5 Evaluate whether or not there is potential for further growth in the global market for vinyl records. (20 marks)

The global niche market for vinyl records has grown by 2344 per cent from US\$34 000 in 2006 to US\$831 000 in 2016. It is expected to break the US\$1 billion ceiling in 2017. This is dramatic growth for a market that was considered almost 'dead' at the end of the last millennium. The market niche is made up of three specific consumer groups – millennials who enjoy the aesthetics and production quality of vinyl records, collectors who purchase new premium releases of albums they already own and middle-aged consumers who are buying records to replace the ones they threw away years earlier in favour of CDs.

Whether the size of this market will grow further in the future is debatable. Deloitte Group seems to think that the scope for future market growth is limited. The organisation says that the records are expensive to buy – around US\$25 per album on average. Also, the price of a boxed set of vinyl records often exceeds the annual subscription for a streaming service offering millions tracks. The high price could act as a barrier to growth. However, the high price could also suggest that the rising demand is driving up prices and there is much demand to be satisfied.

Deloitte also suggest that production problems might limit growth in the market. The production of vinyl records is slow and costly – each record takes 30 seconds to print. It is also made from a master pressing that takes hours to produce. This compares negatively to the short amount of effort needed to produce and deliver digital recordings online. Although it is possible to produce vinyl records using a 3D printer, the quality is inferior and not likely to match the quality of traditional production methods for 10 to 20 years.

However, in 2017, music industry giant Sony Music said it would start making vinyl records for the first time since 1989. According to a report, Sony has equipped its Tokyo studio with a cutting machine which is needed in the production process for manufacturing vinyl records. If such an important operator in the music industry is planning to step up production of vinyl records, this suggests that there is some scope for further growth. It is unlikely that a company like Sony would go to the trouble of investing in a dated technology if it did not think the market would continue to grow. However, Sony was struggling to find older engineers with the skills and knowledge needed to make vinyl records. This might act as a barrier to growth.

The distribution channels for vinyl records also seem to be growing. Vinyl records are distributed by fashion retailers, food retailers, department stores and supermarkets. Some of these outlets also sell turntables which make popular gifts. Digital channels have also aided distribution. Some music sites sell vinyl records globally online. There is also an increasing amount of information relating to the prices paid for deleted records. This helps buyers and sellers to better understand what prices might be paid for different albums. The rapid development of distribution channels for vinyl records should help the market to grow further in the future. The sale of vinyl records online will surely provide a boost – online sellers have a global reach.

Vinyl might have an attractive future in music from a financial and aesthetic point of view, but according to Deloitte it is unlikely to ever be a major growth or profit engine. Nevertheless, the vinyl format will probably survive for years to come, and as with bands that first started touring in the 1970s and 1980s, the outputs will likely continue to be enjoyed for years to come, albeit by a minority of fans. But with Sony showing an interest, rising global incomes and the boost provided by global online sellers, Deloitte's forecasts might prove a little conservative.

34 CULTURAL/SOCIAL FACTORS

ACTIVITY 1

CASE STUDY: CORDEX® □

1 How was Cordex ethnocentric in its approach to the process of integrating the two firms?

Ethnocentrism is the way some people view their own cultures, ethics and norms as normal or superior. Cordex was ethnocentric in effectively trying to transport a version of its British self to Vietnam.

Cordex's management clearly did not take the time to understand Vetex's point of view. Management may have assumed that it could impose change from the top down, rather than through sympathetic and patient integration of very different business practices. Cordex also had an ethnocentric staffing point of view, filling key positions with home-country nationals. It also failed to recognise that its London-based staff were entering a very different culture, rather than operating in a uniform international commercial environment. This had professional and personal consequences for all concerned.

2 Explain the approach that Cordex could have taken.

Even in the same country, cultures and practices can be very different from one business to another. Successfully acquiring another business always needs careful and patient integration. This need is even more evident when the businesses are in different countries. In this case, even greater sensitivity and patience is required.

Cordex could have taken a different approach and employed Vetex staff in key parts of the business. This would have allowed Cordex to learn how to manage better on a local level, with an understanding of Vietnamese practices and norms. Cordex could also have brought some Vetex staff into the London headquarters, to make sure the process of integration worked both ways, and that Vetex staff saw themselves as part of an evolving team.

ACTIVITY 2

CASE STUDY: TRANSLATION ERRORS IN INTERNATIONAL MARKETING

1 How might language differences impact on a business that markets its products in a range of different countries?

One important area when launching products abroad is to ensure that operating instructions are written in a language that consumers in the target market can understand. This is particularly important for electrical and mechanical products. For example, if instructions are needed, to ensure that consumers operate the new product safely without injury or other negative effects.

The labelling of products will need to be changed when exporting to many countries. In some countries there are laws relating to the labelling of goods. For example, it is necessary in some countries to show a list of ingredients used in the product – particularly if the product contains additives.

Businesses also need to ensure that the language used in marketing for product names, slogans and tag lines, for example, are correctly translated. As the examples in the case

show, ineffective research or errors in translation, can lead to misunderstandings which might cause offence or send out inappropriate messages.

2 What might be the consequences for a business of the errors described above?

Failing to consider language and other differences when exporting to new overseas markets can be very costly to businesses. In one of the examples above, HSBC bank had to spend US\$10 million redesigning an advertising campaign following an error. HSBC bank used an advertising campaign in the US which featured the tag line 'Assume Nothing'. However, when using the same campaign in Europe, in some countries the tag line was understood to say, 'Do Nothing'.

Such errors could be even more costly. If consumers in overseas markets are offended by the language used by businesses in their marketing, they may be discouraged from buying the product. This might mean that a business has to withdraw the product, rename it, relabel it or completely change an advertising campaign. Clearly, if the product has to be withdrawn, this would be a very costly error for a business. For example, it is difficult to imagine that Italian consumers would ever want to buy a bottle of 'toilet water' from Schweppes after their error described in the case.

EXAM PRACTICE

CASE STUDY: SUNBEAM HOLIDAYS

1 Explain one possible difference in tastes and preferences between the US and the Japanese consumer. (4 marks)

Different countries around the world are likely have different tastes and preferences. As a result, businesses that export goods and services into different countries may have to adapt their products in order to meet the needs in these new markets. If they fail to do this, they may not be as successful in their ventures.

Sunbeam Holidays hopes to attract Japanese tourists to the USA. The company carried out some research to see what previous Japanese tourists thought about the USA. Based on this research, the travel company might be able to meet the needs of the Japanese tourists more effectively. For example, if they place them in hotels that provide well-lit rooms and offer free toothbrushes. These are just two small differences in the tastes between the USA and the Japanese.

2 Discuss the benefits to Sunbeam Holidays of taking into account the cultural differences that may exist between Japan and the USA when doing business. (8 marks)

It is important to recognise that there are likely to be some quite significant cultural differences when doing business with people from other countries. In this case, US travel company Sunbeam Holidays is sending representatives to Japan to organise a marketing campaign. Before the group of four employees left, they attended a briefing which addressed Japanese business customers.

In the USA, people are direct in their communication and say what they are thinking. A lack of directness might suggest that a person is disorganised or unprepared. However, in Japan people are more indirect. Communication that is too direct might be considered rude. They may use more non-verbal communication and assume that they have been understood. Also,

the 'hard-sell' approach in Japan does not work. This means that the Sunbeam employees must try to use methods of non-verbal communication and not push too hard when negotiating a contract.

Another issue is the use of facts and opinions in communication which is common in the USA. Although this is also acceptable in Japan, the Japanese will tend to avoid disagreements. Disagreements are more likely to be discussed indirectly. It is rare that a Japanese businessperson will speak out against the group's consensus. This helps to create a sense of unity in the group. This means the US delegates must try to avoid direct conflicts and appreciate that the Japanese business people they deal with will all have the same views and position.

Sunbeam will also need to appreciate that the speed of decision making in Japan will be slower than that in the USA. Making decisions more quickly is believed to save time and money – this is the approach in the USA. However, in Japan the process of decision making is much slower. There is likely to be more discussion, more documents and a greater number of meetings, for example. This is to avoid errors and ensure that the 'right' decision is reached. Sunbeam's people will have to be patient and avoid putting pressure on the Japanese to speed up.

There are other differences. For example, the Japanese are a private people. They expect business people to dress formally and the exchange of small gifts might be appropriate. Finally, the Japanese are also very particular about the way business cards are exchanged. Business cards are important in Japan and they are seen as an extension of the individual. Therefore, they must be treated with respect.

If Sunbeam Holidays take into account the differences discussed above, the business is more likely to enjoy a successful venture into the Japanese market. The company's efforts are more likely to be rewarded with higher sales, more revenue and higher profits.

3 Assess the benefits to Sunbeam Travel of employing a Japanese marketing agency to produce an advertising campaign. (12 marks)

One of the main advantages of using a Japanese advertising agency to produce an advertising campaign is that the agency is more likely to understand the Japanese people. The agency will know what types of content are likely to be successful in Japan. They will be able to advise Sunbeam Travel which advertising medium is most appropriate for the promotion of overseas holidays. A Japanese marketing agency will have more expertise in the Japanese market than Sunbeam Holidays. They may even be able to advise Sunbeam on the holiday features which might be important to the Japanese. This could help to improve the product and ensure that the needs of Japanese tourists are met more effectively. This will help Sunbeam to gain a competitive edge over rivals in the market.

A Japanese marketing agency is also likely to have well-developed contacts when buying media. This might help to speed up the marketing process and lower costs. Japanese agencies may be able to negotiate better terms with media owners due to the business relationships that already exist. There is also likely to be fewer errors if the Japanese produce the campaign. This is because they will appreciate the differences in culture, taste and preferences of Japanese consumers. They will also be able to advise on appropriate branding and promotion. If mistakes are avoided a great deal of money may be saved. The reputation of the company will also be protected. An error in translation could have serious consequences in other markets. For example, a television advert which contains an amusing or an offensive remark could go 'viral'. This means that it could be sent and resent

electronically by millions of people all over the world. This could have a damaging impact on sales if the reputation of Sunbeam is ruined.

One of the drawbacks of using a marketing agency is cost. Marketing agencies are specialists and the work they carry out is likely to be superior to in-house work. However, the fees could be huge. Sunbeam will have to be confident that the sales generated by the advertising campaign are sufficient to cover the high costs of advertising. Another problem is that Sunbeam may lose some of the control over the whole campaign. Since the Japanese agency are experts in their field, they may overrule Sunbeam on issues of content and media. Sunbeam might get frustrated by this loss of control. This will be exaggerated if the final campaign fails to reflect Sunbeam's corporate marketing strategy.

To conclude, selling goods and services in new overseas markets is always risky. If the risk can be reduced by employing a marketing specialist in the target market, the higher cost is likely to be worthwhile. The probability of mistakes in reading the market, and errors in translation for example, will be reduced almost to zero. However, Sunbeam will have to be sure that projected sales are adequate so that costs can be recovered, and a profit made. Employing a Japanese marketing agency to produce the advertising campaign in this case is probably very wise. The role played by the Sunbeam delegates visiting Japan will also be crucial. They need to create a good impression and try to develop a lasting business relationship.

35 THE IMPACT OF MNCs

ACTIVITY 1

CASE STUDY: PANASONIC®

1 What might be the possible impact on the local community of the new Panasonic factory in Binh Duong province, Vietnam?

The arrival of an MNC in a local community is generally welcomed. This is because, a new factory, for example, is likely to create employment, provide work for businesses in the supply chain, give a boost to the local economy and provide an opportunity for people to learn new skills. In this case, Panasonic, which is one of Japan's largest producers of electronic goods, opened a new factory in Binh Duong province, Vietnam.

One of the main impacts an MNC has on a local economy is the creation of jobs. For many people the opportunity to work in a full-time job with the possibility of training, a regular income, financial security, and the opportunity to build a career are very appealing.

In this case, the new factory created 670 jobs for the local area. As a result, wages in the locality may rise, because the demand for workers in the Binh Duong province is likely to drive up rates.

If unemployment is relatively low, and other employment opportunities already exist in the locality, wages are much more likely to go up. It is also possible that the jobs created will have favourable working conditions. This may be because MNCs often have a modern approach to business. Their facilities are likely to adopt the latest technologies and their working practices are likely to be modern and efficient. Most MNCs are also likely to adopt internationally recognised standards for health and safety and employee welfare.

The new Panasonic factory might also have a positive impact on local businesses. Initially, local businesses may have been involved in the construction of the factory. There may be jobs for builders, carpenters, plumbers, electricians and welders in the Binh Duong province, for example. Once a new factory is 'up and running' there may be a need for local businesses to supply materials, components, commercial services and utilities. As a result, local businesses may benefit from an increase in trade, higher revenues and more profit.

However, some MNCs get criticised for creating low-value jobs. For example, sometimes the majority of jobs in a new factory may be unskilled – ones that require little training or expertise. Where there is a need for highly skilled personnel, some MNCs transfer or recruit staff from their home countries. As a result, there are often limited opportunities for local workers to develop high-level skills. There is no information in this case about the quality of the 670 jobs created.

Although these new developments are likely to create employment in those locations, they will also take trade away from local rivals. Some local rivals may struggle to compete and be forced out of business. This means that some people will lose their jobs. However, the competition from an MNC might put pressure on local businesses to make improvements. This might provide some longer-term benefits, such as more efficient and more innovative local enterprises. In this case, Panasonic is committed to the principle of using local production for local use. Factory output will help to meet the increasing demand for electrical construction materials and equipment in Vietnam.

Finally, there is always the worry that the arrival of an MNC will bring with it environmental problems. However, in this case the factory is said to be environmentally friendly. It has adopted Panasonic's energy-saving and energy-creating products, including solar power

generation systems, LED lighting products, and motion sensor lighting control systems. It also uses fast and flexible Japanese processes and technologies. Panasonic will also use the factory as a showroom to allow visitors to experience high-quality manufacturing.

All this suggests that the benefits from the arrival of Panasonic to the region will outweigh the drawbacks.

ACTIVITY 2

CASE STUDY: EMPRESS CONSTRUCTION®

1 Explain the benefits to Malaysia of FDI, such as the investment made by Empress Construction.

When an overseas business locates a new facility in a foreign country, the amount of money spent on establishing that facility is classified as foreign direct investment (FDI). For example, in this case, Empress Construction, the US-based MNC, has invested US\$25 million in the construction of a factory in Malaysia. This inflow of money from Empress Construction is likely to be welcomed by Malaysia. This is because the national economy will benefit. For example, flows of FDI should result in higher levels of GDP. The extra output and employment will increase economic growth and should help raise the living standards for people in Malaysia. The profits made by Empress Construction are likely to be taxed by the Malaysian government. This increases tax revenue, which can be spent to improve government services such as healthcare, education, housing and transport networks.

The flow of FDI creates new jobs in Malaysia. For example, the factory was expected to create about 500 jobs once the factory was in full production. This will help to reduce unemployment and save money paid out in benefits to the unemployed.

Businesses in the host country may also get a boost when an MNC invests in a project. This is because a range of suppliers will be needed. For example, Empress Construction may need supplies of raw materials, components, utilities, telephone services, commercial services, distribution services, maintenance crews and cleaning contractors. Such demands will help to sustain and expand businesses in Malaysia, creating more jobs, income and wealth in the national economy.

Finally, some of the money received by the Malaysian government from FDI might be used to reduce Malaysia's national debt. This will have a positive impact on Malaysia's finances. If a country can reduce its debt, it sends out a message to the rest of the world that the country is more financially stable. Interest payments will be lower, and the country will find it easier to borrow in the future.

2 Assess the possible impact on the Malaysian balance of payments of the investment by Empress Construction.

The US\$25 million investment by Jones Construction will have a positive impact on Malaysia's balance of payments. There will be a double impact. Initially, the flow of FDI when a project is being established will boost money flowing into Malaysia. In this case, it will be the US\$25 million used to build the factory. Once the factory is 'up and running', there may be a further boost to the balance of payments. This is because Malaysia will receive a further flow of money if any of the output from the new factory is sold abroad, although it is not clear in this case how much output will be sold overseas – it may be minimal. This boost in the balance of payments will help a host nation to 'pay its way' when trading internationally.

For some less-developed countries, the impact on the balance of payments from MNC investment may be even more significant. This is because they often find it difficult to get established in global markets and FDI allows them to boost overseas sales. This might be the case for Malaysia. Even though it is a fast-growing economy, it still has a long way to go before it can match the overseas sales of some other countries.

Finally, if Empress Construction buys resources from overseas, such as machinery, tools and equipment, this will have a negative effect on Malaysia's balance of payments. This is because money will flow out of Malaysia. There will also be a negative impact if Empress Construction's profits are repatriated to the USA. Repatriated profits represent a flow of money away from the host country. The overall impact on the balance of payments is difficult to determine without more information.

EXAM PRACTICE

CASE STUDY: FDI AND MNCS IN NIGERIA

1 Explain one reason why General Electric can help to foster a business culture in the countries where they locate operations. (4 marks)

The growth and spread of MNCs can have an impact on the business culture in the countries where they set up operations. In some cases, people who are employed by MNCs may eventually leave their jobs and start their own businesses. This might happen because individuals may have saved some money from employment which can be used for start-up capital.

Workers may have developed some skills which they think could be put to better use working for themselves. An MNC may encourage workers to set up businesses and become a supplier. If quality standards can be maintained, it could provide an MNC with more flexibility. In this case, General Electric (GE) plans to invest US\$150 million in Nigeria's railway system. GE said that it was the beginning of a long-term US\$2 billion investment project in Nigeria's infrastructure. This might mean that GE will work closely with some local businesses over a long period of time. They are likely to employ some local workers who might get some good quality training. As a result, they might set up some new business enterprises in future.

2 Discuss possible reasons for the pattern of FDI in Nigeria between 2008 and 2018. (8 marks)

According to the graph in Figure 2, FDI between rose quite steadily between 2008 and 2013. This may have been due to the expanding successful oil industry at the time. However, since 2013 it has fallen significantly. One of the main reasons for this drop was the fall in oil price. A significant proportion of the FDI arriving in Nigeria is channelled into oil production. Oil accounts for about 90 per cent of Nigeria's exports.

However, the low oil price is not the only problem. Nigeria's infrastructure has often held back economic development in the country. The value of Nigeria's stock of infrastructure is about 25 per cent of GDP. For a middle-income country the size of Nigeria it should be more like 70 per cent. Inside Nigeria's main port, boats queue for days waiting to enter a port. Then, once the cargo is unloaded, the trucks leaving the port are held up for hours in crowded streets. It can be time-consuming and expensive.

According to Figure 1, the oil price fell sharply in 2014. However, FDI in Nigeria had started to decline before then. FDI peaked in 2013. After that, it started to fall steadily. This suggests

that the oil price fall may not have been the main reason. It is more likely to be the poor infrastructure.

The poor state of Nigeria's infrastructure has been recognised by the government and it has started to take some action to make improvements. It has been estimated that about US\$3 trillion will be needed over the next 30 years to bring Nigeria's infrastructure up to scratch. The government has devised a plan which identifies the key investment requirements. They include energy; transport; agriculture, water and mining; housing and regional development; information and communication technology; social infrastructure and security. Energy and transport are currently a priority.

In 2016, US MNC General Electric (GE) announced that it would be investing US\$150 million in Nigeria's railway system. GE said that it was the beginning of a long-term US\$2 billion investment project in Nigeria's infrastructure. This suggests that improvements are beginning to take place and that the poor infrastructure is probably the main reason for the decline in FDI in Nigeria. The oil price has started to rise again, reaching US\$80 per barrel in 2018. This could also provide a fresh boost to the Nigerian economy. It results in rising FDI and an increase in MNC activity.

3 Evaluate whether MNCs such as Shell have had a positive impact on the local and national Nigerian economy. (20 marks)

Evidence in the case here suggests that Nigeria has experienced both positive and negative effects from MNC activity in the country.

One of the main benefits of FDI is the employment created when MNCs arrive in Nigeria and develop business facilities. If MNCs set up operations overseas, income in those countries rises. MNCs create new jobs in developing countries. Local suppliers are also likely to get work when a MNC arrives. The extra output and employment made by MNCs will increase economic growth and raise living standards for people in these countries.

Also, from the workers' point of view, jobs created by FDI are often good because they pay higher wages. For example, evidence from Hungary and Brazil suggests that wages offered by foreign businesses are between 4.5 and 6 per cent higher than those offered by domestic employers. Between 2008 and 2018, FDI owes a total of between US\$50 and US\$60 billion. This scale of investment would create thousands of jobs in Nigeria.

Nigeria exports most of its oil. This will help to boost the current account on the balance of payments. Nigeria will be able to support itself when trading internationally and possibly generate reserves of foreign currency. The government will also benefit from MNC activity. MNCs will have to pay taxes on their profits and the wages paid to workers will also be taxed. This will provide a contribution to the funds needed to develop the infrastructure in Nigeria.

Another benefit of FDI is that MNCs are likely to provide training and work experience for workers when they locate operations in foreign countries. Also, governments in less developed countries often spend more on education to help attract MNCs. This happened in India, as the government invested heavily in IT education and training.

The arrival of MNCs may also encourage local people to set up businesses. MNCs may have provided the skills and motivation needed for enterprise. For example, a new MNC may encourage locals to supply services such as transport, accommodation, maintenance, cleaning and leisure activities. MNCs may also provide foreign suppliers with technical help, training and other information. They may also help local suppliers to learn new skills, methods and working practices. Much of the FDI in Nigeria is channelled into oil production,

which is an important industry. It is likely that people employed in this industry will have been trained by an MNC.

Unfortunately, MNC activity can have drawbacks. Many environmentalists are suspicious of them because they may cause environmental damage. One reason is because MNCs are involved in the extraction industries such as coal, oil and gold mining. Mining is often destructive. According to a report by the United Nations, it was reported a few years ago that the cost of pollution and other damage to the natural environment caused by the world's biggest companies would destroy more than one-third of their profits if they were held financially accountable. This amounted to about US\$2.2 trillion.

In Nigeria, between 2008 and 2009, two large oil spills damaged the environment in the Niger Delta. The spills, which were the largest ever in the Niger Delta, caused very serious damage to thousands of hectares of mangrove. This polluted water supplies, crops and destroyed the livelihoods of thousands of farmers. Following the spills, which were caused by MNC Shell, there was a legal battle between local communities and the company. Shell would not take responsibility for the damage. However, in 2015 the case was settled. Court documents showed that Shell knew that their pipes and equipment could fail. Shell admitted that its figures were wrong and that it had underestimated the amount of oil spilled. The court forced Shell to pay out US\$84 million in compensation. The 15 600 farmers and fishermen affected by the spills were to receive about US\$2000 each. However, the money will not reverse the damage done to the environment which the community relies on for water, food and their livelihood. This is the sort of impact an MNC can have in a country.

To conclude, the benefits of MNC activity such as Shell's are likely to outweigh the drawbacks. The people of Nigeria will welcome the thousands of jobs created, the training provided and the opportunity to earn more money. The government will welcome the tax revenues and the improvements in economic performance. However, the people affected by the pollution caused by Shell, in this case, have suffered. In the future, the government might try to do more to protect the environment so that the negative effects of MNCs are minimised. If they can do this, then MNC activity will be even more welcome.

36 INTERNATIONAL BUSINESS ETHICS

ACTIVITY 1

CASE STUDY: SUGAR CONTENT IN PRODUCTS

1 What is the disagreement that appears to exist between consumers and shareholders in relation to sugar content in products?

The needs of stakeholders in a business organisation are often different and may also come into disagreement. Shareholders generally want high financial returns on their investment. This means that businesses should minimise their costs and maximise their revenues. Consumers generally want fairly priced, good-quality products that are safe to consume. They may also want clear and accurate information about products and high-quality customer service.

In this case, it appears that many businesses are making shareholders a priority over those of consumers. Businesses have been accused of putting too much sugar in food products. Although there may be a need for some sugar (for example, to enhance flavour and act as a preservative) many health organisations believe businesses are using too much. As a result, the health of consumers is at risk. For example, eating and drinking high levels of sugar can cause weight gain and increase the risk of heart disease, diabetes, cancer, depression and cellular aging. Too much sugar has also been linked to acne, a fatty liver, low energy and the skin aging process.

However, although businesses are aware of these dangers, many choose to ignore them. Many try to hide the amount of sugar their products contain. They do this by calling sugar by a different name, such as glucose, fructose and sucrose; using many different types of sugar (there are around 59 different types to choose from); and adding a health claim to products such as those labelled as 'healthy', 'low fat', 'diet' or 'light'. They do this to maintain sales levels and protect profits. This quite strongly suggests that the interests of shareholders are being placed above those of consumers.

There is a conflict of interests between shareholders and consumers in this case. This is probably the main reason why some governments have acted to protect consumers by imposing legal limits on the sugar content in food products.

2 Do you think that businesses should be free to choose the sugar content in food products?

In a minority of countries, governments have placed legal limits on the amount of sugar that food-processing businesses can add to products. This is to help reduce the dangers to consumers posed by high levels of sugar consumption. However, in most countries such legal limits are not imposed. Therefore, businesses can choose the amount of sugar they add to their products. This means that sugar levels in processed food becomes an ethical issue.

Ethically minded businesses may reduce sugar levels to help protect consumers, even though the perceived quality of their products may be affected. However, most might carry on using high levels of sugar because of the financial benefits. Many are actually hiding the amount of sugar they include in their products. This means that many consumers will continue to eat dangerous levels of sugar.

Many people, and most health groups, would argue that businesses should not be free to choose the sugar content in their food products. In the long term, people may become ill due to eating too much sugar without government control.

Also, many people are aware that too much sugar is bad for your health. However, they may find it difficult to reduce their consumption of products that contain high levels of sugar. Government controls would particularly help these people.

ACTIVITY 2

CASE STUDY: NISSAN'S SUSTAINABILITY REPORT

1 What is the purpose of a sustainability report?

A sustainability report addresses the economic, environmental and social impacts of a company's daily business activities. The report helps to provide evidence of transparency and accountability, improves internal processes and engages stakeholders. Some of these are very detailed. For example, in 2017 Nissan's sustainability report was 142 pages long. Most reports are based on a framework produced by the Global Reporting Initiative (GRI) in 2000.

A sustainability report should help to make a business more sustainable. This is because it usually publishes quantitative data which shows whether specific environmental targets have been met. Many businesses publish a sustainability report to emphasise their 'green credentials'.

2 Why is sustainability an ethical issue?

Many countries have laws to help prevent the exploitation of the environment. In some countries, laws are clear and well enforced. In others, the laws may be outdated, ineffective, poorly policed or non-existent. Businesses can operate without concern for the environment if there is no legislation. They can choose production methods that maximise profits but are highly unsustainable. For example, a business that uses large amounts of energy may choose to use non-renewable sources because they are cheaper. In contrast, ethically minded businesses may choose to use renewable sources even though they may be more expensive.

If there is no legislation, business can choose to what extent they are sustainable. It is an ethical decision. However, even if there is legislation to protect the environment, some businesses will go further to help safeguard sustainability. For example, Nissan uses wind power to provide energy at some of its factories. Nissan may not be required by law to use its own wind power but chooses to do so because it is more sustainable. Nissan has decided to adopt an ethical stance in this case.

3 To what extent can a car manufacturer like Nissan reduce environmental damage?

Many would argue that cars do a lot of damage to the environment. For example, the CO₂ emissions from cars have contributed to global warming and climate change. Therefore, car manufacturers could help to reduce environmental damage by producing cars that have lower levels of emissions. Car manufacturers could also use more sustainable production methods – making more use of 'green energy', for example. In this case, according to Nissan's sustainability report, the company aims to limit its environmental impact and use

fewer resources in production. It also aims to produce more environmentally-friendly vehicles. In particular, Nissan focuses on three specific areas: reducing CO₂ emissions, promoting resource recycling and preserving air, water, soil and biodiversity. For example, in relation to recycling, Nissan treats resources as limited, believing that they should be used as efficiently as possible and minimising environmental impact. It aims to make effective use of resources at every stage of its vehicles' lifecycles to be more sustainable.

Also, Nissan, like many other car manufacturers, are trying to increase sales of electric vehicles (EVs). This could have a very big positive impact on the environment. If all vehicles in the world were EVs, the reduction in CO₂ emissions would be huge.

ACTIVITY 3

CASE STUDY: STARBUCKS

1 Which might be more important for an upmarket coffee retailer: providing a high-quality brew or paying more for coffee beans?

For a business like Starbucks, providing quality coffee is the most important thing. If the quality of Starbucks' coffee is undermined, this will harm the brand. Starbucks' brand is central to its competitive advantage. The amount that the business pays its coffee producers is linked to its ethical stance, which is a more subtle and complex matter.

2 To what extent do you agree with this statement? – 'You can never keep all stakeholders happy.'

Many of the objectives of stakeholders directly oppose each other. For example, someone owning property next to a potential mast site may strongly object to the mast being put there, but customers may be keen for the mast to be set up because they want to improve their local mobile phone coverage.

EXAM PRACTICE

CASE STUDY: KHROMA TEXTILES

1 Explain one way misleading product labelling could be an ethical issue. (4 marks)

In many countries, there is quite strict legislation relating to product labelling. This is to protect consumers from exploitation. For example, labelling laws might prevent businesses from making false claims about their products.

However, if there is no legislation, businesses have to decide what information they should provide to customers about their products. For example, an ethically minded food-processing company might be open about the ingredients used in a product. It might show very clearly the sugar and salt content of the product on the label.

In this case, the labelling on some clothes produced by Khroma Textiles was inaccurate. It could be argued that this was not an unethical practice – it could have been an error in translation. Khroma responded positively to the reports by saying that they would investigate the problem. The company also promised to help customers by offering them €50 vouchers.

2 Discuss the possible impact of the publicity surrounding child labour on KhromaTextiles. (8 marks)

Publicity can affect business activities. Articles in the news and social media and the actions of committed campaigners may influence the reputation of a company. This might harm its sales and brand. In the case of Khroma Textiles, publicity appears to have had a direct impact in changing its approach to outsourcing production.

Khroma outsourced its production to third parties in developing countries to reduce its costs and to achieve scale economies. In the process, it handed over control of the working conditions of the people who made its products. The evidence was clear that these employees were treated very badly, but Khroma said that this was nothing to do with them.

Khroma's defence failed to stop the bad press or the pressure against them. The negative publicity brought about a change in Khroma's labour practices. As a result, it made a code of standards for suppliers. It now aims to ensure that these standards are met through independent audits and annual reports.

3 Assess the influence of pressure groups on changing the behaviours of businesses such as Khroma. (12 marks)

Pressure groups are organisations that try to change decision making or influence policy. They now have considerable influence on the behaviour of businesses such as Khroma. Social media means it is easier to find out about poor business behaviour. This information can be publicised immediately to audiences around the world through various routes.

Businesses know that negative publicity can damage their sales in the short term and eventually cause long-term harm to their brands. Once a brand gets bad publicity, it is extremely hard to repair the damage, even if the bad publicity was unfair. This means businesses take the activities of pressure groups very seriously.

However, a business's initial response to pressure group activity will depend on many factors. Khroma first attempted to say that the poor labour practices were nothing to do with it – a strategy often used by firms facing initial accusations. A business may also try to wait for the negative publicity to stop, either by staying silent or by building a defence of its activities. Where these strategies do not work, a business may either try to ignore the consequences or address the issues.

However, the actual changes in behaviour that follow pressure group campaigns will depend on a number of factors. To begin with, the nature of the targeted business or practice. Certain industries may be expected to behave to a higher standard than others. For example, the powerful campaign against Shell's plans to drill in the Arctic was not successful (though Shell has since abandoned Arctic drilling plans), but those against Nike's labour practices have been.

The nature and organisation of the pressure group will also be influential. Some groups are well established and can quickly call on supporters to take action in response to poor business behaviour. However, some pressure groups have religious or political interests. Therefore, their influence may be complicated.

Finally, the extent to which a pressure group is willing to pursue its aims may have an effect. Some public campaigns have a wide reach and last a long time. However, some campaigns may gain a lot of initial support, only to disappear with minimal results, as seems to have been the case with the Occupy Wall Street movement.

If there is no legislation, the role of pressure groups is important. They can draw attention to unethical behaviour such as exploitation and poor working practices. Without pressure groups, it is very likely that unethical business practice would be more common. The practices used, in this case, by Khroma, for example, might be more widespread. Some of the powerful international pressure groups such as Greenpeace and Friends of the Earth have been quite influential over the years.

37 CONTROLLING MNCs

ACTIVITY 1

CASE STUDY: THE NATIONAL COMMISSION OF MARKETS AND COMPETITION (SPAIN)

1 Using this case as an example, what is meant by an anti-competitive practice?

Anti-competitive practices or restrictive trade practices are attempts by firms to prevent or restrict competition. In this case, 21 car manufacturers and two consultancy firms were fined €171 million for anti-competitive practices. GM and Ford were hit the hardest with fines of €22.8 million (GM) and €20.2 million (Ford). The CNMC said that the firms acted like a cartel. They exchanged information relating to car sales, repairs, maintenance activities and car parts to avoid competition. For example, some of the information included details of price incentives to avoid a price war for new-car sales.

2 What is the role of the CNMC in Spain?

In many countries, the government appoints a body to ensure that markets remain competitive and the interests of consumers are protected. In Spain, the CNMC is responsible for monitoring industry and ensuring that markets are sufficiently competitive. It is responsible for supervising and monitoring a range of economic sectors in Spain (such as electricity and gas, electronic communications and audio visual, railway and airport), enforcing competition law which addresses anticompetitive behaviour, merger control and state aid. It also resolves trade disputes between a range of organisations and promotes competition throughout the economy.

3 How might consumers benefit from the action taken by the CNMC?

Consumers often need protection from businesses – particularly when firms are large and in control of the market. In this case, consumers have been exploited as a result of anti-competitive behaviour by firms selling cars in Spain. As a result of the action taken by the CNMC, anti-competitive activities by the 21 car manufacturers and two consultancy firms has been detected and penalised. This should stop the practices and result in more competition, which should lead to more choice and lower prices for consumers in Spain. The fines may also be a warning to other companies that may be considering using anti-competitive practices in the future.

ACTIVITY 2

CASE STUDY: ONLINE CUSTOMER REVIEWS

1 Explain two ways in which consumers can influence MNCs.

One way in which consumers can influence MNCs is by writing an online review for a product. Some of the information in this case suggests that online reviews can be quite influential. This is because of the large numbers of consumers that engage with online reviews. For example, 60 per cent look at online reviews at least once a week and 93 per cent said that online reviews influence their purchasing decisions. If consumer reviews result in continually low ratings for companies, they would be foolish to ignore them. It seems that

negative reviews will result in lower sales levels and good reviews are trusted by large numbers of readers.

Another way that consumers can influence the behaviour of MNCs is to make protests. For example, in 2016, luxury perfumes and cosmetics brand Lancôme® (owned by L'Oréal®, the French cosmetics group) cancelled a marketing event in Hong Kong. The event was due to feature a Cantonese pop star. However, Chinese consumers were angry because of the singer's political views, which were disagreeable to China. The event was cancelled because China is L'Oréal's second-biggest market.

Consumers can use social media to communicate their views about businesses and products. These can be quite influential, even devastating, if they go viral. Therefore, MNCs are likely to take customer protests seriously if they are well founded.

2 How might MNCs use online reviews?

Figure 3 shows that 35 per cent of consumers write reviews to share their experiences and 26 per cent to help other consumers to make decisions. However, 24 per cent write reviews to inform businesses about their experiences. This provides valuable feedback for MNCs and other businesses about whether products are meeting customer needs.

According to the Podium survey, 82 per cent of consumers pay careful attention to the content of reviews. This suggests that businesses should do the same, then they could improve their products and meet the needs of customers more effectively. Also, MNCs should be alerted if their ratings fall below 3.3 on review sites. This is because consumers won't engage with a business if ratings fall below 3.3.

One useful item of information which might be attractive to MNCs is that 68 per cent of consumers would pay up to 15 per cent more for a product if it had favourable reviews. This suggests that businesses can charge higher prices if they satisfy customers.

EXAM PRACTICE

CASE STUDY: WALMART

1 Explain one way that pressure groups might help to control MNCs. (4 marks)

It is possible that the behaviour of MNCs may violate what many people consider to be acceptable standards, but those behaviours may not break any laws. Pressure groups act as another control on MNCs in that they can publicise bad behaviour and thereby threaten to damage the image of the firm. Pressure groups are generally voluntary organisations that operate at all levels of society, including international levels, and aim to change either political or commercial decision making. They may take direct action, name and shame MNCs that behave badly or lobby local and central governments.

In this case, trade unions have applied pressure on Walmart. However, Walmart reacted by closing down the store where unionisation was being organised. As a result of this, Walmart was eventually forced to pay the workers who lost their jobs when the Canadian factory was closed.

2 Discuss whether governments should change taxation policy so that businesses cannot avoid paying their 'fair share' of tax in the future. (8 marks)

The strategy of tax avoidance makes sense to businesses, as taxes are an extra cost of doing business. Also, avoiding taxes is not, in most cases, illegal. This means many businesses may consider the practice to be an obligation owed to their owners/shareholders.

However, taxpaying businesses resent those who do not pay their 'fair share' and in not doing so have a cost advantage. This conflict can only be resolved by clarifying government policy. There are numerous arguments for and against a change. In this case, Walmart has been accused in the past of tax avoidance. It has been alleged that Walmart takes capital from the countries where it was earned and channels it through subsidiary companies in tax havens around the world. In 2017, it was estimated by campaign group Americans for Tax Fairness that around US\$76 billion was hidden in tax havens.

A strong ethical argument is that all businesses should be required to pay taxes in line with the income they make. Fairness, justice and equality before the law all point to the need to make businesses accountable for their full tax liabilities in whichever country they operate. Also, manipulating accounts and use of domicile arrangements is only available to big, wealthy firms such as Walmart. It discriminates against smaller firms in terms of the application of the law. It also skews the competitive playing field to favour the big and wealthy – something that is unfair and inefficient in a market economy.

Arguably, these wealthy, big international businesses provide products and services that people want at prices they are willing to pay. They also create jobs and opportunities and do generate tax revenues in the countries in which they operate. If they are forced to pay higher tax rates in one country, they will move operations elsewhere. They will take jobs and opportunities with them. They may also provide fewer products and services and at higher prices, and this will affect consumers.

However, both of these arguments can be criticised. In the first argument, the assertion that the tax system skews the competitive environment does not have much evidence in support of it. The second argument is even weaker: many of the tax-avoiding firms make huge profits and yet provide only low-wage jobs in many countries, and so a firm's threat to withdraw seems false. Finally, it might be argued that the majority of people would be unhappy if they thought that businesses were not paying their 'fair share' of taxes.

3 Assess whether MNCs such as Walmart have become too powerful. (12 marks)

Walmart is a US retail corporation that operates a chain of hypermarkets, department stores and grocery stores, with nearly 12 000 in countries all over the world. In 2017, it generated revenues of US\$485 873 million. MNCs such as Walmart are often criticised because they are too powerful and inclined to exploit a range of stakeholders. They can dominate markets and make it very difficult for smaller firms to survive. In developing countries, smaller rivals are often forced to close due to powerful MNCs.

MNCs aim to maximise profits and might be prepared to use working practices that pollute the environment or consume large quantities of non-renewable resources. Some MNCs control flows of revenues and profits through countries where tax rates are really low, such as Ireland, Luxembourg and Bermuda. As a result, they end up avoiding huge tax payments. Many MNCs are so well resourced that they can afford to defend themselves in court battles. There is some evidence in this case to suggest that this is true of Walmart.

Walmart is very large and powerful, forcing numerous small retailers out of business. It has made manufacturers to become more efficient and changed the way that even large

companies manage their operations. It has even caused some of its suppliers to relocate overseas.

Walmart is huge and, due to its involvement in a wide range of industries, it has influenced the behaviour of many companies. In particular, Walmart has a reputation for encouraging manufacturers to improve their efficiency in order to lower costs. For example, one story shows how, in the 1990s, Walmart asked one supplier to lower the price of a fan from US\$20 to US\$10. The manufacturer, Lakewood Engineering & Manufacturing Co., automated production and laid off workers. Eventually, it had to move production to China where, in 2003, workers were earning just 25 cents an hour.

Walmart has been accused in the past of tax avoidance. It has been alleged that Walmart takes capital from the countries where it was earned and channels it through subsidiary companies in tax havens around the world. In 2017, it was estimated by campaign group Americans for Tax Fairness that around US\$76 billion was hidden in tax havens. However, due to Walmart's power and global reach, it has been able to exploit some highly complex tax avoidance schemes.

However, Walmart contributes significantly to wealth and job creation all over the world. It often provides much-needed inward investment for developing nations and helps to build their foreign currency reserves. Because Walmart is so large, it can exploit economies of scale and produce goods and services more cheaply. This can benefit consumers and make more effective use of the world's resources. Some of the profits made by MNCs can be invested in useful research and development. Despite this, many would still argue that MNCs like Walmart are too powerful.

4 Evaluate whether or not governments should encourage more self-regulation in business such as Walmart. (20 marks)

Self-regulation means that a group of firms in the same industry, or perhaps the entire industry, agree to follow a set of rules and guidelines to ensure 'proper conduct'. The rules and guidelines are specific to that industry and are designed to ensure that companies maintain common standards in their operations. The regulations are likely to address issues such as health and safety, ethical behaviour, responsibility to employees and consumers and environmental practices.

Self-regulation also involves self-policing. This means that the businesses join up to an agreement and monitor their own activities. They might do this by measuring emissions, recording consumer complaints and listening to employee issues. It is likely that firms will be required to set performance targets. If these are not achieved, a business might have to explain its failure and show how improvements will be made.

There are some advantages of using self-regulation to control business behaviour. For example, government regulation can be avoided, which is likely to be more rigorous and expensive. Compliance costs can be a burden when the government imposes rules and regulations. Therefore, with self-regulation, costs will be lower and consumers might benefit from lower prices. Another benefit is that the needs of business stakeholders might be better served since those members which are signed up to an agreement will probably be more aware of the practices in a particular industry than an outside agency. For example, in pharmaceuticals, industry specialists are more likely to understand the specific needs of consumers and suppliers. Another advantage is that the reputation and image of businesses might be improved if consumers and employees witness a genuine attempt by an MNC to safeguard their interests.

It may also be easier for businesses to encourage its employees to adopt ethical behaviour and principles. This is because the rules are based on social norms and accepted practices. They are not forced upon them from above. Finally, self-regulation can also benefit the taxpayer. The cost of setting up government agencies to make rules, monitor business activity and enforce rules can be very expensive.

However, in contrast, some may argue that some MNCs are too irresponsible to self-regulate. There is a one clear disadvantage of self-regulation. There could easily be a conflict of interests. Businesses may find it very difficult to comply with an industry code of practice if its financial performance is seriously threatened.

There are many examples where a lack of regulation caused unpleasant outcomes. For example, the financial crisis in 2008 partly resulted from a lack of regulation in the financial sector. This led to a global recession and hardship for millions of people all over the world. The Internet is almost entirely self-regulated. As a result, it has been alleged that democratic elections have been weakened, personal data has been taken without the permission of individuals, and the safety of children has been put at risk. These outcomes, and others, have meant that Internet companies (for example, Facebook and Google) have come under increasing pressure to provide more safeguards for Internet users.

In this case, many would argue that Walmart could not be trusted to self-regulate. For example, it has been accused of using overseas suppliers where employees work in unsafe conditions. For example, in 2012, a factory belonging to a Walmart supplier in Bangladesh caught fire, killing 111 people. Another factory fire in 1990 killed 32. In 2010, it was alleged that one employee worked seven days a week in a supplier's factory, from 7.45 a.m. to 10 p.m. without a day off for six months. Walmart has also been accused of buying goods from suppliers that employ child labour.

Walmart has also been accused of discrimination. For example, in 2013 it was discovered that women get US\$1.16 per hour less than their male colleagues. There have also been reports of pregnant women being overworked and placed in dangerous positions by Walmart – some of these cases made it to court. With regard to disabled workers, in one year alone, Walmart paid US\$6 million to disabled workers following 13 court cases. In 2014, Walmart paid US\$363 419 to settle a law suit filed by the Equal Employment Opportunity Commission on behalf of a Walmart worker.

These are just a small number of examples to suggest that MNCs like Walmart could not be trusted to self-regulate. However, if legal controls are to be used, it is important for the government to find the 'right balance'. Too much intervention will discourage enterprise and deter foreign investment. This might prevent growth in national income, reduce job creation, decrease tax revenues and reduce consumer choice. Too little, and some stakeholders' best interests might not be given enough attention.