China is famous for its love of tea. Over thousands of years, tea has been the beverage of choice. This, however, did not deter Starbucks from entering one of the fastest-growing consumer markets in the world. The company’s global expansion actually began when Starbucks opened its first store outside the United States in Vancouver back in 1987. Today there are over 21,000 locations in 66 countries, including more than 7,000 in the United States and over 1,000 in Canada.

Winning over customers in Canada, with a recipe that works in the United States, is a bit easier than winning over diverse global consumers; but Starbucks has clearly managed to learn a few lessons along the way and understands the process better than most. Starbucks opened in Taipei, Taiwan, in 1998 and the first mainland store was opened in Beijing in 1999. By 2015 there were over 1,500 locations in 90 Chinese cities and over 25,000 employees in the country.

Starbucks analyzed the Chinese market and found that their brand was valued, not only for their food and beverage offerings, but also for the atmosphere. Chinese consumers enjoyed the opportunity to meet with friends and business partners in a relaxed environment.

Not My Cup of Tea

Starbucks has made a name for itself in China and the company is integrating into the Chinese landscape.
partners in a comfortable location and appreciated the upbeat music and sleek interiors. While kiosks have become popular in the United States and Canada, some Chinese Starbucks locations are as large as 350 square metres.

Starbucks has customized its product offerings by introducing products like the Green Tea Frappuccino® Blended Créme. However, not all Chinese consumers are fans. Cheng Xiaochen, an English teacher who likes to meet students at Starbucks, exclaims, “It’s a good place to meet people, but the coffee is so bitter it tastes like Chinese medicine.” Responding to Mr. Cheng and others like him, the company offers mint hot chocolate and red bean Frappuccino. Food offerings have also been customized to the Chinese market, with Hainan chicken sandwiches and rice wraps.

Starbucks is constantly looking to uncover needs and adapt to local tastes. It recently partnered with Tingyi Holdings (China’s #2 soft-drink seller) to manufacture and distribute ready-to-go drinks. Tingyi has an existing, highly developed distribution network that can reach across the entire nation (rural and urban). In addition, Tingyi provides real insights into local consumer tastes.

Starbucks acknowledges that employees are at the centre of its success and makes a considerable investment in training, developing, and retaining these employees. However, it faced a challenge in an achievement-oriented Chinese culture, where parents aspire for their children to take jobs in traditionally successful fields such as financial services and banking. In response, it launched a family forum, which provided stories from managers who have worked their way up the career ladder with the company.

Starbucks has worked to extend every component of its corporate culture into its expansion. The company has brought its long tradition of community involvement to China. Through a $5 million grant to the Starbucks China Education Project, it aims to give students and teachers in rural areas more access to clean drinking water, and provide relief from natural disasters like the Sichuan earthquake. Starbucks has demonstrated that long-term commitment and sensitivity to international market conditions are the keys to success.

Finally, the lessons learned around the world inspire new products and new opportunities back home. A few years ago, Starbucks bought the Teavana retail brand along with their 300 retail stores for over US$ 600 million. Currently, the brand has locations only in the United States, Canada, and Mexico; but for the next few years, it at least has an asset to battle growing local North American tea brands (like David’s Tea here).
Can Starbucks sell the Teavana brand in China? You can bet that at some point they will try, but first they might want to build the brand name closer to home.

### QUESTIONS FOR DISCUSSION

1. What motivates companies like Starbucks to expand into international markets with little perceived interest for their product?

2. How has Starbucks adapted to Chinese culture?

3. Are you concerned that Starbucks’ expansion into China threatens their traditional culture? Why or why not?

4. If China wished to slow Starbucks’ expansion, what legal barriers would be most helpful? How would these barriers affect Chinese consumers and businesses?

### THE CONTEMPORARY GLOBAL ECONOMY

The total volume of world trade is immense—nearly $19 trillion in merchandise trade each year. The world economy is increasingly transforming into a single, interdependent system in a process called globalization.

Even so, we often take for granted the diversity of goods and services available as a result of international trade. Your tablet, smartphone, clothing, and even the roast lamb on your dinner table may all be imports—that is, products made or grown abroad, but sold in Canada. At the same time, the success of many Canadian firms depends on exports—products made or grown domestically and shipped abroad.

Major companies like McDonald’s, Apple, and Bombardier have found international markets to be a fruitful area for growth. But firms sometime stumble when they try to expand abroad. Home Depot closed most of the stores it opened in China, for example, because labour costs are so low there few homeowners are interested in do-it-yourself projects. Similarly, Best Buy closed its stores in China because consumers there tend to buy their electronics goods at lower prices from local or online merchants.

And the impact of globalization doesn’t stop with firms looking to open locations abroad or having to close locations that fail. Small firms with no international operations (such as an independent coffee shop) may still buy from international suppliers, and even individual contractors or self-employed people can be affected by fluctuations in exchange rates.

International trade has become increasingly central to the fortunes of most nations of the world, as well as businesses. In the past, many nations followed strict policies to protect domestic companies, while today most countries are aggressively encouraging international trade. They are opening their borders to foreign businesses, offering incentives for their own domestic businesses to expand internationally, and making it easier for foreign firms to partner with local firms through various alliances. Today, it is not simply a question of Western nations pushing trade abroad. China is making major inroads and increasing its economic and political influence in Africa with major deals with Nigeria, South Africa, Ethiopia, and Zambia. China is now the largest trading partner in the region with trade totalling more than $114 billion, just ahead of the United States. It also took the title from Germany as the world’s top merchandise exporter a few years ago with total exports of over $2 trillion annually.

Several forces have combined to spark and sustain globalization. For one thing, governments and businesses have simply become more aware of the benefits of globalization to their countries and stockholders. For another, new technologies have made travel, communication, and commerce easier, faster, and cheaper. The cost of overseas phone calls and seaborne shipping costs per tonne have both declined sharply over the past several decades. Likewise, transatlantic travel takes only a few hours by air. The internet has torn down barriers for large and small companies. Finally, there are competitive pressures; sometimes a firm simply must enter foreign markets just to keep up with its competitors.

Globalization has critics who claim that businesses exploit workers in less-developed countries and avoid domestic environmental and tax regulations. They also charge that globalization leads to the loss of cultural heritage and benefits the rich more than the poor. As a result, many international gatherings of global economic leaders (such as the G8 and G20) have been marked by protests. But despite fears, globalization is part of our evolving existence.
LO-1 The Major World Marketplaces

Managers involved with international businesses need to have a solid understanding of the global economy, including the major world marketplaces. This section examines some fundamental economic distinctions between countries based on wealth and then looks at some of the world’s major international marketplaces.

DISTINCTIONS BASED ON WEALTH

The World Bank, an agency of the United Nations, uses per-capita income, average income per person, to make distinctions among countries. Its current classification method consists of four different categories of countries.\(^5\)

1. **High-income countries.** Annual per-capita income greater than US$12,746. They include Canada, the United States, most countries in Europe, Australia, Japan, South Korea, Israel, Kuwait, the United Arab Emirates, and Oman.

2. **Upper-middle-income countries.** Annual per-capita income between US$4,126 and US$12,745. This group includes China, Colombia, Lebanon, Turkey, Argentina, and South Africa.

3. **Low-middle-income countries.** Annual per-capita income between US$1,046 and US$4,125. This group includes Ukraine, Philippines, Armenia, Guatemala, and Vietnam.

4. **Low-income countries** (often called developing countries). Annual per-capita income of US$1,045 or less. Malawi, Bangladesh, Haiti, and Afghanistan are among the countries in this group. Due to low literacy rates, weak infrastructures, unstable governments, and related problems, these countries are less attractive for international business.

GEOGRAPHIC CLUSTERS

The world economy is evolving quickly with emerging markets playing an ever-increasing role. However, it still revolves greatly around three major marketplaces: North America, Europe, and Asia. These clusters include relatively more of the upper-middle-income and high-income nations, but relatively few low-income and low-middle-income countries. For instance, because Africa consists primarily of low-income and low-middle-income countries, it is not generally seen as a major marketplace. The three key geographic regions are home to most of the world’s largest economies, biggest corporations, influential financial markets, and highest-income consumers.

**North America** The United States dominates the North American business region. It is the single largest marketplace and has been the most stable economy in the world for decades, but the U.S. has major problems due to many issues (e.g., a huge increase in the nation’s debt load). Canada also plays a major role in the global economy. Moreover, the United States and Canada are each other’s largest trading partners. Many U.S. firms, such as General Motors and Procter & Gamble, have maintained successful Canadian operations for decades, and many Canadian firms, such as Scotiabank, are also major international competitors.

Mexico has become a major manufacturing centre, especially along the U.S. border, where cheap labour and low transportation costs have encouraged many firms from the United States and other countries to build factories. The auto industry has been very active, with Daimler, General Motors, Volkswagen, Nissan, and Ford all running large assembly plants, and major suppliers have also built facilities in the region. But Mexico’s role as a low-cost manufacturing hub has been threatened as some companies have shifted production to China instead.\(^6\)

**Europe** Europe was traditionally divided into two regions—Western and Eastern. Western Europe, dominated by Germany, the United Kingdom, France, Spain, and Italy, has long been a mature but fragmented marketplace. But the transformation of this region, via the European Union (EU) (discussed later in this chapter), into an integrated economic system has further increased its importance. Major international firms such as Unilever, Renault, Royal Dutch Shell, Michelin, Siemens, and Nestlé are headquartered in Western Europe. Eastern Europe, once primarily communist, has also gained importance, both as a marketplace and as a producer. Multinational corporations such as Nestlé and General Motors have set up operations in Poland, Ford, General Motors, and Volkswagen have built new factories in Hungary. However, governmental instability has slowed development in Bulgaria, Albania, Romania, and other nations. In recent years, the traditional view of Europe has been severely altered by the European Union, the common currency, and a clear divide between Northern Europe (led by Germany the Netherlands and, to a lesser extent, France) and Southern Europe (including Spain, Italy, Greece, and Portugal).

**Pacific Asia** Pacific Asia consists of Japan, China, Thailand, Malaysia, Singapore, Indonesia, South Korea, Taiwan, the Philippines, Vietnam, and Australia (which is technically not in Asia, but is included because of proximity). Fuelled by strong entries in the automobile, electronics, and banking industries, the economies of these countries have grown rapidly in the past three decades.

As the trends indicate, Asia Pacific is a growing force in the world economy. The Japanese dominate the region through firms like Toyota, Toshiba, and Nippon Steel. However, South Korea (Samsung and Hyundai), Taiwan (China National Petroleum Corporation and manufacturing for foreign firms), and Hong Kong (a major financial centre) are also successful players in the global economy. China, the world’s most densely populated country, has emerged as an important market and now boasts the world’s second-largest economy behind that of the United States, after recently surpassing Japan.\(^7\) In all three key regions, technology is playing an increasingly important role.

LO-2 Emerging Markets: BRICS and Beyond

The term **BRIC** denotes a group of four increasingly important nations in global trade: Brazil, Russia, India, and China. The BRIC concept was first used by Goldman Sachs in 2001; since that time, BRIC investment funds have become an important group for money managers and international analysts. These four nations have begun to act like a unit, holding unofficial summits and discussing common strategies.

The status of these four nations has risen in international trade for different reasons. Brazil is strong in commodities and agriculture, Russia is a powerful energy supplier, and China is a major hub of manufacturing activity. India has become a leading service provider at various levels ranging from basic customer service call centres to engineering solutions providers. The growth and quick market development of the consumer market in these nations is also providing great
The old international trading patterns and activities are changing. In the past, Western companies used less-developed markets to acquire natural resources supplies and to carry out simple assembly tasks. But the BRIC nations now demonstrate relationships that are much more complex. A clear signal of this shift was evident a few years ago when Indian carmaker Tata acquired Jaguar and Land Rover from Ford. This was not quite business as usual in the traditional sense.9

A few years ago, the initial group of four extended an invitation to South Africa to form a group called BRICS. The move was surprising to many analysts, because there seemed to better candidates for admission. However, it was clear that the informal group was developing into an important political club with its own goals. South Africa is rich in minerals and other resources, something that these emerging markets need to sustain growth. In addition, the new member, with over a billion potential consumers, serves as a gateway to the African continent.10

In an even stronger sign of the changing times, a formal BRICS meeting was held in Durban, South Africa, to negotiate a $100 billion reserve fund to protect their currencies and a $50 billion seed-capital plan (i.e., to promote new businesses). In addition, they negotiated details for the creation of a development bank to compete with the World Bank. Emerging economies are clearly not relying on “old world” economies, and the BRICS nations clearly have their own, independent agenda. The New Development Bank (as it is called) will be based in China with the first regional office in South Africa. The first chair of the board of Governors will be Russian and the first chair of the board of directors will be from India.11

While the BRICS nations have received a lot of publicity, there are tremendous opportunities in other emerging nations, including Thailand, Indonesia, South Korea, and Ukraine, to name just a few. According to the Global Institute of Research, the opportunity in emerging markets amounts to annual projected consumption of $30 trillion by 2025.12 A new world order is evolving, and “old” economic powers like the United States, Japan, Germany, and even Canada are going to need to adapt.

LO-3 Forms of Competitive Advantage

No country can produce all the goods and services its people need. Thus, countries export products they can make more efficiently or cheaper than other countries. The proceeds are then used to import products they cannot produce effectively. However, this principle does not fully explain why nations export and import. Such decisions depend on the kinds of advantages a particular country may enjoy regarding its abilities to create and/or sell various products and resources.13 Traditionally, economists have focused on absolute and comparative advantage to explain international trade. But because this approach focuses narrowly on such factors as natural resources and labour costs, the more contemporary view of national competitive advantage has emerged.

BRICS A term denoting a group of five important and powerful emerging markets in the business world: Brazil, Russia, India, China, and South Africa.
**ABSOLUTE ADVANTAGE**

An **absolute advantage** exists when a country can produce something more efficiently than any other country—in other words, if it can produce a larger output of goods or services using the same or fewer input resources. The concept was first proposed by economist Adam Smith in 1776. Saudi oil, Brazilian coffee beans, and Canadian timber approximate absolute advantage. The theory is simple; countries should focus on producing goods and services that they have an absolute advantage in and buy products that they do not produce more efficiently than other nations. Canada exports timber because of its natural strengths, and imports bananas because the climate here does not permit farmers to grow bananas efficiently. If trade were limited to two countries, you might negotiate which nation should produce which items for the greater good. However, the global economy is a complex network and most decisions are not that simple. In addition, true absolute advantage is very rare; the vast majority are actually relative.

**COMPARATIVE ADVANTAGE**

A country has a **comparative advantage** in goods that it can produce more efficiently or better than other goods. For example, if businesses in a given country can make computers more efficiently than they can make automobiles, that nation’s firms have a comparative advantage in computer manufacturing. Canada has a comparative advantage in farming (because of fertile land and a temperate climate), while South Korea has a comparative advantage in electronics manufacturing (because of efficient operations and cheap labour). As a result, Canadian firms export grain to South Korea and import electronic equipment from South Korea.

Developed countries tend to have a comparative advantage in making high-tech products, while developing countries tend to have a comparative advantage in making products that require lots of low-cost labour. For example, in the past two decades, most of the textile manufacturing jobs in Canada (and elsewhere) have moved to China. But the race to the bottom (in terms of labour costs) now sees countries like Cambodia, Bangladesh, and Vietnam taking manufacturing jobs away from China. Why? In Cambodia, textile workers are paid $76 for a 60-hour week, while in China the wages range from $280 to $460. In other words, Cambodia is just like China was 20 years ago—bad news for Chinese manufacturing.

This race to the lowest cost has not come without consequences. In 2013, a building that housed garment manufacturers in Bangladesh collapsed suddenly, killing over 1000 people. A year later, Bangladesh was still producing more than US $22 billion in garment exports, but many of the companies (like H&M) that they supplied were asking new safety questions. An international group inspected and found flaws in over 1000 additional garment plants. Seventeen of those plants were shut down and major repairs were completed on more than 100.

**NATIONAL COMPETITIVE ADVANTAGE**

In more recent years, the theory of national competitive advantage has become a more widely accepted model of why nations engage in international trade. National competitive advantage is based on four conditions:

1. **Factor conditions** are the factors of production that we identified in Chapter 1 (labour, capital, entrepreneurs, natural resources, and information).
2. **Demand conditions** reflect a large domestic consumer base that promotes strong demand for innovative products.
3. **Related and supporting industries** include strong local or regional suppliers and/or industrial customers.
4. **Strategies, structures, and rivalries** refer to firms and industries that stress cost reduction, product quality, higher productivity, and innovative new products.

When all of these conditions exist in an industry, the companies in that industry are motivated to be very innovative and to excel. This also increases the likelihood that they will engage in international business. Japan, for instance, has strong domestic demand for automobiles. Its automobile producers have well-developed supplier networks, and Japanese firms have competed intensely with each other for decades. This set of circumstances explains why Japanese automobile companies such as Toyota, Honda, Nissan, and Mazda are generally successful in foreign markets.

**International competitiveness** refers to the ability of a country to generate more wealth than its competitors in world markets. Every year, the World Economic Forum publishes a global competitiveness ranking. The ranking is based on both hard economic data and a poll of business leaders. In 2015, the top three countries on the list were Switzerland, Singapore, and the United States. Canada ranked 15th; its high taxes, regulated industries, relatively large bureaucracy, and overly conservative capital market structure were listed as reasons for a lower rating.

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**Chinese textile workers are learning what North American textile workers learned years ago. Manufacturers are increasingly moving textile manufacturing to lower-cost locations like Cambodia, where workers (like the ones seen in this photo) earn on average $76 for a 60-hour week as opposed to $280–$460 in China.**

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**ABSOLUTE ADVANTAGE** The ability to produce something more efficiently than any other country.

**COMPARATIVE ADVANTAGE** The ability to produce some products more efficiently than others.

**NATIONAL COMPETITIVE ADVANTAGE** International competitive advantage stemming from a combination of factor conditions; demand conditions; related and supporting industries; and firm strategies, structures, and rivalries.

**INTERNATIONAL COMPETITIVENESS** Competitive marketing of domestic products against foreign products.
The Balance of Trade

A country’s balance of trade is the difference in value between its total exports and its total imports. A country that exports more than it imports has a favourable balance of trade, or a surplus. A country that imports more than it exports has an unfavourable balance of trade, or a deficit. In 2014 Canada had a trade surplus of $4.6 billion. As you can see from Table 5.1, the main reason for surplus is the trading relationship with the United States. Canada exports more to the United States than it imports from it. For years, economists had warned against Canada’s dependence on the United States. A few years ago, this was clearly proven when the Canadian dollar rose sharply (and actually surpassed the U.S. dollar); Canada’s nearly $47 billion surplus in 2008 turned into a deficit because of a major decline in exports to the United States. Deficits were also registered in 2009, 2010, 2012 and 2013. It was no coincidence that the trade deficit returned to a surplus in 2014 when the Canadian dollar fell from near-parity to the $0.80 cent range that year.

The Balance of Payments

Even if a country has a favourable balance of trade, it can still have an unfavourable balance of payments. A country’s balance of payments is the difference between money flowing into the country and money flowing out as a result of trade and other transactions. An unfavourable balance means more money is flowing out than in. For Canada to have a favourable balance of payments for a given year, the total of our exports, foreign-tourist spending in this country, foreign investments here, and earnings from overseas investments must be greater than the total of our imports, Canadian-tourist spending overseas, our foreign aid grants, our military spending abroad, the investments made by Canadian firms abroad, and the earnings of foreigners from their investments in this country. Canada has had an unfavourable balance of payments for the past two decades; in 2014, it amounted to $44 billion.

Exchange Rates

An exchange rate is the rate at which the currency of one nation can be exchanged for another. For example, if the exchange rate between

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**TABLE 5.1** Canadian Balance of Trade (Total + Selected Country Breakdown), 2014

<table>
<thead>
<tr>
<th>Country</th>
<th>Exports to (Billions)</th>
<th>Imports from (Billions)</th>
<th>Balance of Trade (Surplus or Deficit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>$400</td>
<td>$350.7</td>
<td>+$49.3</td>
</tr>
<tr>
<td>European Union</td>
<td>$40.5</td>
<td>$49.3</td>
<td>−$8.8</td>
</tr>
<tr>
<td>China</td>
<td>$20.6</td>
<td>$35.6</td>
<td>−$15</td>
</tr>
<tr>
<td>Mexico</td>
<td>$6.8</td>
<td>$17.2</td>
<td>−$10.4</td>
</tr>
<tr>
<td>Japan</td>
<td>$11.1</td>
<td>$9.2</td>
<td>−$1.9</td>
</tr>
<tr>
<td>All others</td>
<td>$49.8</td>
<td>$62.2</td>
<td>−$12.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$528.8</strong></td>
<td><strong>$524.2</strong></td>
<td><strong>+$4.6</strong></td>
</tr>
</tbody>
</table>

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**FIGURE 5.1** Attributes of national competitive advantage

**FIGURE 5.2** Canadian imports and exports of merchandise
Canadian dollars and British pounds is 1 to 1.85, this means that it costs $1.85 in Canadian dollars to “buy” one British pound. Alternatively, it would cost only 0.54 of a British pound to “buy” one Canadian dollar. This exchange rate means that 0.54 of a British pound and one Canadian dollar should have exactly the same purchasing power.

The value of one country’s currency relative to another varies with market conditions. For example, when many English citizens want to spend pounds to buy Canadian dollars (or goods), the value of the dollar relative to the pound increases, or becomes “stronger,” and demand for the Canadian dollar is high. It is also “strong” when there is high demand for goods manufactured in Canada. Thus, the value of the Canadian dollar rises with the demand for Canadian goods. Exchange rates typically fluctuate by very small amounts on a daily basis. More significant variations usually occur over greater spans of time.

EXCHANGE RATES AND COMPETITION

Companies that conduct international operations must watch exchange-rate fluctuations closely, because these changes affect overseas demand for their products and can be a major factor in international competition. In general, when the value of a country’s domestic currency rises—becomes “stronger”—companies based there find it harder to export products to foreign markets and it is easier for foreign companies to enter local markets. It also makes it more cost-efficient for domestic companies to move production operations to lower-cost sites in foreign countries. When the value of a country’s currency declines—becomes “weaker”—the opposite patterns occur. Thus, as the value of a country’s currency falls, its balance of trade should improve because domestic companies should experience a boost in exports. There should also be a corresponding decrease in the incentives for foreign companies to ship products into the domestic market.

These dollar fluctuations have also had a huge impact on businesses. Canadian companies find it harder to compete internationally when the dollar rises (because Canadian products become more expensive in foreign currencies). However, on the flip side, companies, like Nova Scotia–based High Liner Foods (which buys most of its raw fish on the world markets in U.S. dollars) sees a net benefit from a stronger Canadian dollar.  

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The world economy is slowly transforming into one large global village. As Figure 5.3 shows, several factors enter into the decision to go international. One overriding factor is the business climate in other nations. Even experienced firms have encountered cultural, legal, and economic roadblocks, as we shall see later in this chapter. In considering international expansion, a company should also consider at least two other questions: Is there a demand for its products abroad? If so, do those products have to be adapted for international consumption?

GAUGING INTERNATIONAL DEMAND

Products seen as vital in one country may be useless in another. Snowmobiles are popular for transportation and recreation in Canada...
and the northern United States, but there would be no demand at all for them in Central America. Although this is an extreme example, the point is quite basic to the decision to go international. Specifically, foreign demand for a company’s product may be greater than, the same as, or weaker than domestic demand. Even when there is demand, advertising may still need to be adjusted. For instance, in Canada, bicycles and small motorcycles are mainly used for recreation, but in many parts of Asia they are seen as transportation. Market research and/or the prior market entry of competitors may indicate whether there is an international demand for a firm’s products.

Some products—like smartphones, Hollywood movies, and video games—are popular all over the world. Movies like *The Hunger Games* and *The Avengers* earn significant revenues in North America, but generate even more revenues overseas.

**ADAPTING TO CUSTOMER NEEDS**

If there is international demand for its product, a firm must still figure out whether to adapt the product. If they decide to do so, they must figure out how to change the product to meet the special demands and expectations of foreign customers. For example, New Brunswick–based McCain Foods Limited has worked hard to build market share in South Africa. It even developed single-sized portions of frozen vegetables to serve customers that do not have proper refrigeration. KFC’s dishes in China come with a side order of rice and hot soy milk. They must be doing something right, because, at last count, the company had over 4800 outlets in China. Likewise, McDonald’s restaurants sell beer in Germany and meatless sandwiches in India to accommodate local tastes and preferences.

**Levels of Involvement in International Business**

After a firm decides to go international, it must decide on the level of its international involvement. Several options are available. At the most basic level, it may act as an exporter or importer, organize as an international firm, or operate as a multinational firm. Most of the world’s largest industrial firms are multinationals.

**EXPORTERS AND IMPORTERS**

An exporter is a firm that makes products in one country and then distributes and sells them in others. An importer buys products in foreign markets and then imports them for resale in its home country. These approaches represent the lowest level of involvement in international operations and are excellent ways to learn the fine points of global business. Exporters and importers tend to conduct most of their business in

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**EXPORTER** Firm that distributes and sells products to one or more foreign countries.

**IMPORTER** Firm that buys products in foreign markets and then imports them for resale in its home country.
their home nations. It is not just large companies that are exporting: small firms also export products and services.

Canada ranks first among the G8 countries in the proportion of its production exported (almost 40 percent).27 Large and small Canadian firms export products and services. McCain Foods began in New Brunswick, but the company has a worldwide presence. For example, McCain holds a 75 percent market share for “oven fries” in Germany.

On a smaller scale, Target Marine Hatcheries, based in Sechelt, British Columbia, is Canada’s lone producer of certified-organic farmed sturgeon. Their tanks have over 200 000 Fraser River sturgeon, and the company can produce between 1 and 2 tonnes of caviar per year. The product retails anywhere from $88 (for a 30 gram tin) to $4320 (for a 1.8 kilogram tin) and they are sold to clients as far away as Japan, Europe, and Australia.28

INTERNATIONAL FIRMS

As firms gain experience and success as exporters and importers, they may move to the next level. An international firm conducts a significant portion of its business abroad. Hershey, for example, sells its products in 90 foreign countries, and it buys ingredients for its chocolates from several foreign suppliers. But it manufactures the vast majority of its products in the United States (there is one plant in Mexico). In fact, most of that manufacturing occurs in Pennsylvania.29 So an international firm may be large and influential in the global economy, but remain basically a domestic firm with international operations. Its central concern is its own domestic market.

MULTINATIONAL FIRMS

Most multinational firms do not think of themselves as having domestic and international divisions. Instead, planning and decision making are geared toward global markets.30 The locations of headquarters are almost irrelevant. Royal Dutch Shell, Nestlé, IBM, and Ford are well-known multinationals.

The economic importance of multinational firms should not be underestimated. Consider the economic impact of the 500 largest multinational corporations: they employ millions of people; buy supplies, parts, equipment, and materials from thousands of other firms; and pay billions of dollars in taxes. Moreover, their activities and products affect the lives of hundreds of millions of consumers, competitors, and investors (sometimes not in a very positive way). Organized protests against the activities of multinational corporations have become quite common. In 2014, Walmart ranked first in the Fortune 500 Global rankings of multinational with $476 billion in revenues.31

International Organizational Structures

Different levels of involvement in international business require different kinds of organizational structure. For example, a structure that would help coordinate an exporter’s activities would be inadequate for the activities of a multinational firm. In this section, we briefly consider the international organizational strategies, including independent agents, licensing arrangements, branch offices, strategic alliances, and foreign direct investment.

INDEPENDENT AGENTS

An independent agent is a foreign individual or organization that agrees to represent an exporter’s interests in foreign markets. Independent agents often act as sales representatives—they sell the exporter’s products, collect payment, and ensure that customers are satisfied. Independent agents often represent several firms at once and usually do not specialize in a particular product or market. Levi Strauss uses agents to market clothing products in many small countries in Africa, Asia, and South America.

LICENSED ARRANGEMENTS

Canadian companies seeking more involvement in international business may choose licensing arrangements. Firms give individuals or companies in a foreign country the exclusive right to manufacture or market their products in that area. In return, the exporter typically receives a fee plus ongoing payments called royalties.32 Royalties are usually calculated as a percentage of the licence holder’s sales. For example, Can-Erg Manufacturing, Canada’s largest supplier of industrial furnaces, exports its furnaces under licensing arrangements to Japan, Brazil, Germany, Korea, Taiwan, and Mexico. Franchising is a special form of licensing that is also very popular.33 McDonald’s and Pizza Hut franchise around the world. Similarly, Accor SA, a French hotel chain, franchises its Ibis, Sofitel, and Novotel hotels.

BRANCH OFFICES

Instead of developing relationships with foreign companies or independent agents, a firm may simply send some of its own managers to overseas branch offices. A company has more direct control over branch managers than agents or licence holders. Branch offices also provide a more visible public presence in foreign countries. Potential customers tend to feel more secure when a business has branch offices in their country.

When a business operates branches, plants, or subsidiaries in several countries, it may assign one plant or subsidiary the responsibility for researching, developing, manufacturing, and marketing one product or line of products. This is known as world product mandating.

STRATEGIC ALLIANCES

The concept of a strategic alliance was introduced in Chapter 2. In international business, it strategic alliance means that a company finds a partner in a foreign country where it would like to conduct business. Each party agrees to invest resources and capital in a new business or else to cooperate in some way for mutual benefit. This new business—the alliance—is then owned by the partners, which divide its profits.

The number of strategic alliances among major companies has increased significantly over the past decade and is likely to grow further. In many countries, including India, and China, laws make alliances
Bugatti-Sedona: Charting a New Path

When you think of entrepreneurs, you might have an image of someone creating a start-up company who is bringing a new concept to market. You might not instantly think about the entrepreneurs behind established companies, like Montreal-based Bugatti-Sedona that has been designing, importing and selling business bags, accessories, briefcases, and luggage since 1940. But to stay in business that long requires entrepreneurial passion and key ingredients such as time, effort, creativity, and adaptability.

In 2013, when Julius Lis decided to sell his company, he searched for individuals that could move the company forward. He sold it to two ambitions entrepreneurs, Andrew Hattem (President) who brings 30 years of import and sales experience to the table and Benoit Larose (Executive Vice-President) who has over 15 years of business experience with Reebok-CCM’s hockey division; he is also a former Detroit Red Wing draft pick, so he knows battle in the trenches. From day one of the new regime, it was clearly not business as usual; the goal was international expansion and building upon the current base.

Acquisitions and Strategic Alliance

Acquiring the Bugatti name was just the first step. The partners sought to significantly increase the value of the company and maximize selling opportunities by purchasing licences to open up markets and by purchasing other companies and brands to expand the product and retail account base:

- In 2014, Bugatti-Sedona acquired Stebco and Bond Street Ltd., a company that sells business bags and luggage primarily in the United States.
- In 2014, they concluded an exclusive distribution deal with Traveller Gmbh of Manheim, Germany.
- In 2015, Bugatti-Sedona and Joanel Inc. (owners of Mouffon, Joanel, and Ugo Santini brands) formed a strategic alliance in which Joanel would help Bugatti in the marketing campaigns.

EDC Support + Building Buzz

To achieve their expansion goals, Bugatti-Sedona applied for and received support from Export Development Canada in the form of $1.5 million dollars in financing guarantees. The EDC essentially enabled their bank (Desjardins) to manage the capital risk. According to Christian Dallaire (Vice-President of Small Business Solutions EDC) “This is a great example of what going global can do for your business.”

In 2015, the company also got an unexpected brand-building boost when one of their bags was selected for the prestigious Golden Globe Ceremony Gift Bag.

So what’s next? How will the firm capitalize on the additional products, brands, and market access? Time will tell. But if the first two years, under new ownership, is any indication, it should be interesting to follow.

CRITICAL THINKING QUESTIONS

1. Based on what you have read, how does this case demonstrate the complexity of being an entrepreneur in a global context?
2. Describe the various forms of international expansion discussed in this case and list the pros and cons of each tool.

FOREIGN DIRECT INVESTMENT

The term foreign direct investment (FDI) means buying or establishing tangible assets (e.g., a manufacturing plant) in another country. For example, Bombardier built a manufacturing facility in Casablanca, Morocco. The Royal Bank of Canada recently purchased Los Angeles-based City National Corp. for US$5.4 billion. However, despite such moves, a debate has been going on for years about how FDI by foreign firms in Canada affects Canadians. Recently, foreign buyouts of major Canadian firms like Inco, Four Seasons Hotels, Cirque du Soleil, and Alcan have caused some Canadian business leaders to express concern. The most general fear is that such buyouts will damage the economy because head offices will move to foreign countries and major decisions will be made there, not in Canada.

Investment Canada has a mandate to help attract foreign investment to the nation and, in the past three decades, foreign direct investment in Canada has been growing steadily; it now averages over $600 billion annually. More than half of that amount is flowing from the United States; however, nearly half of FDI flowing from Canadian firms goes to the United States as well.
Whether a business is selling to just a few foreign markets or is a true multinational, a number of differences between countries will affect its international operations. How a firm responds to and manages social, economic, and political issues will go a long way toward determining its success.

Social and Cultural Differences

Any firm involved in international business needs to understand something about the society and culture in the countries it plans to operate in. Unless a firm understands these cultural differences—either itself or by acquiring a partner that does—it will probably not be successful in its international activities.

Some differences are relatively obvious. Language itself can be an important factor. Beyond the barriers posed by people who speak different languages, subtle differences in meaning can also play a major role. Language barriers can cause inappropriate naming of products. For example, Imperial Oil markets gasoline under the brand name Esso in Canada. When the firm tried to sell its gasoline in Japan, it learned that esso means “stalled car” in Japanese. Many differences are discovered the hard way. In Japanese, the word hai (pronounced “hi”) means “yes.” In conversation, however, this word is used much like people in the United States use “uh-huh”; it moves a conversation along or shows the person with whom you are talking that you are paying attention. So when does hai mean “yes” and when does it mean “uh-huh”? This turns out to be a relatively difficult question to answer. If a Canadian manager asks a Japanese manager if he agrees to some trade arrangement, the Japanese manager is likely to say, “Hai”—but this may mean “Yes, I agree” or “Yes, I understand” or “Yes, I am listening.” Many Canadian managers get frustrated in negotiations because they believe that the Japanese continue to raise issues already settled (because the Japanese managers seem to have said yes). What many of these managers fail to recognize is that yes does not always mean yes in Japan.

The average physical stature of people in different countries can make a difference. For example, the Japanese are slimmer and shorter on average than Canadians, an important consideration for firms that intend to sell clothes. Differences in the average age of the local population can also impact product development and marketing. Countries with growing populations tend to have a high percentage of young people. Thus, firms are often fuelled by nations across the globe. For instance, luxury goods manufacturers can see major benefits as economies grow and a taste for global brands increases. Swiss watchmaker Patek Philippe experienced growth of approximately 20 percent in two consecutive years, due largely to growing demand in China, where Swiss watches are often given to government officials.

NAVIGATING THE ECONOMIC DIFFERENCES

Economic Differences

Although cultural differences are often subtle, economic differences can be fairly pronounced. In dealing with economies like those of France and Sweden, firms must be aware of the extent of government involvement. For example, the French government is heavily involved in all aspects of airplane design and manufacturing. Similarly, a foreign firm doing business in a pure command economy must understand the unfamiliar relationship of government to business. Another very important consideration is the level of economic development and the financial infrastructure in a country. What percentage of retail transactions are completed by credit card? Is financing readily available? Is it a cash economy? And so on.

Navigating the economic differences and identifying the global opportunities is a major challenge for today’s corporations. Growth is quite often fuelled by nations across the globe. For instance, luxury goods manufacturers can see major benefits as economies grow and a taste for global brands increases. Swiss watchmaker Patek Philippe experienced growth of approximately 20 percent in two consecutive years, due largely to growing demand in China, where Swiss watches are often given to government officials.

Legal and Political Differences

Legal and political differences are often closely linked to the structure of the economic systems in different countries. These issues include tariffs and quotas, local-content laws, and business-practice laws.

QUOTAS, TARIFFS, AND SUBSIDIES

Even free-market economies often use some form of quota and/or tariff that affects the prices and quantities of foreign-made products in those nations. A quota restricts the total number of certain products that can be imported into a country. It indirectly raises the prices of those imports by reducing their supply. The ultimate form of quota is an embargo, a government order forbidding exportation and/or importation of a particular product—or even all the products—of a particular country.

A tariff is a tax charged on imported products. Tariffs directly affect the prices of products, effectively raising the price of imports to consumers. Tariffs raise money for the government and somewhat
discourage the sale of imported products. Governments from around the world impose quotas and tariffs. For example, Italy imposes high tariffs on imported electronic goods. A couple of years ago, the Canadian government announced a reduction in tariffs on sporting goods and baby clothes, which could lead to potential annual savings of $76 million for consumers. However, at the same time, the government announced higher tariffs on goods imported from 72 countries which could lead to a $330 million increase in costs for Canadian shoppers. For example, the new rules will cost Danier Leather an estimated $1.2 million a year (or about $10–$20 per jacket). You can bet this extra cost will be passed along to the consumer.42

A subsidy is a government payment given to a domestic business to help it compete with foreign firms. When the government of a country pays subsidies to one of its domestic companies or industries, this can have a negative effect on producers in other countries. Bombardier has received subsidies from both federal and provincial governments. These funds, or sometimes low-interest loans, have helped the company compete and develop its major projects. The company and its main rival, Brazil-based Embraer, have accused each other of receiving excessive unfair government support, which has led to official disputes at the World Trade Organization (more information about the WTO is available at the end of the chapter).

Protectionism—the practice of protecting domestic business at the expense of free market competition—has advocates and critics. Supporters argue that tariffs and quotas protect domestic firms and jobs. In particular, they protect new industries until they are able to compete internationally. Some claim they are necessary because other nations have such measures. Still others justify protectionism in the name of national security and argue that advanced technology should not be sold to potential enemies.

But opponents of protectionism are equally vocal. They note that protectionism reduces competition and drives up prices. It is also a cause of friction between nations. The opponents maintain that while jobs in some industries would be lost if protectionism ceased, jobs in other industries would expand if all countries abolished tariffs and quotas.

Subsidies are designed to support domestic companies; however, in this free-trade era, governments are increasingly generous with foreign firms that can help develop local industries and provide local jobs. A few years ago Warner Bros. opened up a new studio to develop high-end video games in Montreal. Local talent, reputation, and knowledge were key factors, but government funding helped close the deal. The Quebec government provided $7.5 million to get the studio off the ground.

At times, protectionism takes on an almost comic dimension. Many of you may enjoy Cheetos Cheesy snacks, but you have probably never realized that the brand has been in trouble with the law. A few years back, the company, Frito-Lay, incorrectly labelled several shipments of Cheetos from the United States into Canada as cardboard boxes. When the company realized the error they immediately informed the authorities; but, since neither cardboard boxes nor Cheetos snacks were subject to tariff, they figured there was no real problem. They were wrong. The Canada Border Services Agency hit them with a retroactive 11 percent tariff on all the shipments going back three years. For five additional years, the agency refused to consider changing its decision. A tribunal eventually deemed this an excessive example of protectionism; Frito-Lay had been taken on an “administrative ride” for an innocent clerical mistake.43

LOCAL-CONTENT LAWS

A country can affect how a foreign firm does business there by enacting local-content laws that require products sold in a particular country to be at least partly made in that country. These laws typically mean that firms seeking to do business there must either invest directly or have a local joint-venture partner. In this way, some of the profits in a foreign country are shared with the people who live there.

Many countries have local-content laws. In a fairly extreme case, Venezuela forbids the import of any product if a similar product is made in the country are shared with the people who live there.

LOCAL-CONTENT LAWS Laws requiring that products sold in a particular country be at least partly made in that country.

SUBSIDY A government payment to help domestic business compete with foreign firms.

PROTECTIONISM Protecting domestic business at the expense of free market competition.
mining licences and stop issuing new ones to foreign companies. This move was designed to protect the many small, local miners. Oil and gas licences held by foreign companies had already been cancelled. These actions make foreign companies more reluctant to invest in Venezuela.44

Local-content laws might even exist within a country, and when they do they act just like trade barriers. In Canada, for example, a low bid on a bridge in British Columbia was rejected because the company that had made the bid was from Alberta; the job was given to a B.C. company. A window manufacturer from New Brunswick lost a contract in Nova Scotia despite having made the lowest bid; the job went to a company in Nova Scotia.

The Agreement on Internal Trade (AIT) requires all ten provinces to remove barriers to agricultural trade. However, internal conflicts are still common. According to Perrin Beatty, former president of the Canadian Chamber of Commerce, interprovincial trade barriers are putting Canadian companies at a huge disadvantage. This has to change if they are to survive and thrive in a global marketplace.45

**BUSINESS-PRACTICE LAWS**

Many businesses entering new markets encounter problems in meeting strict regulations and bureaucratic barriers. Such practices are affected by the business-practice laws that host countries set in their jurisdictions. They can be frustratingly effective. Walmart left Germany and South Korea because the company did not effectively adapt to local tastes or rules and was unable to achieve economies of scale.46 In Germany, for example, it had to stop refunding price differences on items sold for less by other stores because the practice is illegal in that country. In another case, Google agreed to pay $500 million to settle a case with the U.S. government over advertising revenue earned from Canadian online pharmacies; the government had accused the company of enabling the illegal importation of drugs.47

Bribes to government officials to get business is another problem abroad. In 2013, SNC-Lavalin executives Ben Aissa and Stefane Roy were accused of paying $160 million to Saadi Gadhafi and other Libyan officials (under the old regime) to secure over $2 billion worth of contracts in Libya (to build an airport, a prison, and a water filtration plant) over a ten-year span.48 Canada’s Corruption of Foreign Public Officials Act prohibits bribery of foreign officials; but as more Canadian companies do business abroad they find themselves competing against companies only too happy to pay bribes. In an attempt to create fairer competition among multinational companies, ministers from the Organisation for Economic Co-operation and Development (OECD) agreed in 1997 to criminalize bribery of foreign public officials.49

Transparency International (TI) publishes a “Corruption Perceptions Index,” which ranks countries on the basis of the amount of corruption perceived to exist according to ratings by business people, academics, and risk analysts. The index showed that the least corrupt countries are Denmark, New Zealand, and Finland, and the most corrupt Somalia, North Korea, Afghanistan, and Sudan. Canada ranked tenth.50

**Cartels and Dumping**

A cartel is an association of producers whose purpose is to control the supply and price of a commodity. The most famous cartel is the Organization of the Petroleum Exporting Countries (OPEC). It has given oil-producing countries great power in the past 40 years although it has been weakened in recent years. At various times, other cartels have been evident in diamonds, shipping, and coffee. While nothing much can be done when governments form a cartel like OPEC, private-sector businesses can be prosecuted for doing so.

Canada was involved in a potash cartel with Belarus and Russia (these three nations account for almost 80 percent of potash production), but when Uralkali (a Belarusian company) quit the cartel the price of Potash fell from $400 to $300 per tonne.51 Many countries forbid dumping—selling a product abroad for less than the comparable price charged in the home country. Antidumping legislation typically defines dumping as occurring if products are being sold at prices less than fair value, or if the result unfairly harms domestic industry. Recently, the U.S. imposed duties of 10.36 to 15.78 percent on steel pipes produced in China. China denounced this protectionist approach.52 However, the United States is not alone in its concerns; India has accused China of dumping products on the Indian market that it can’t sell elsewhere.53

**BUSINESS-PRACTICE LAW** Law or regulation governing business practices in given countries.

**CARTEL** Any association of producers whose purpose is to control supply of and prices for a given product.

**DUMPING** Selling a product for less abroad than in the producing nation.

**OVERCOMING BARRIERS TO TRADE**

Despite the barriers to trade described so far, international trade is flourishing. This is because both organizations and free-trade treaties exist to promote trade. The most significant of these are the General Agreement on Tariffs and Trade (GATT), the World Trade Organization (WTO), the European Union (EU), and the North American Free Trade Agreement (NAFTA).

**General Agreement on Tariffs and Trade (GATT)**

Governments typically view exports as good (because they create jobs in the country) and imports as bad (because they cause job losses in the country). Consequently, governments may be tempted to build trade barriers to discourage imports. But if every country does it, international trade is damaged. To avoid this problem, the General Agreement on Tariffs and Trade (GATT) was signed after World War II. Its purpose was to reduce or eliminate trade barriers, such as tariffs and quotas, by encouraging nations to protect domestic industries within agreed-upon limits and to engage in multilateral negotiations.

While 92 countries signed GATT, not all complied with its rules. The United States was one of the worst offenders. A revision of GATT went into effect in 1994, but many issues remained unresolved—for example, the opening of foreign markets to most financial services.
World Trade Organization

On January 1, 1995, the World Trade Organization (WTO) came into existence as the successor to GATT. The 160 member countries are required to open markets to international trade, and the WTO is empowered to pursue three goals:
1. promote trade by encouraging members to adopt fair trade practices
2. reduce trade barriers by promoting multilateral negotiations
3. establish fair procedures for resolving disputes among members

The WTO is overseeing reductions in import duties on thousands of products that are traded between countries. Canada, the United States, and the European Union are founding members of the WTO. Unlike GATT, the WTO’s decisions are binding, and many people feared that it would make sweeping decisions and boss countries around. Those fears were overstated. The WTO has served its role as a ruling body but appeals can often drag on for years. For example, Boeing won a ruling against Airbus because it received US$4.1 billion in loans from European governments while developing its A380 jets. Despite the ruling, there appears to be even more money being given to Airbus for development of the A350. It has been over five years since the case was first presented, and it might be years before Boeing sees any rewards from the ruling.

A recent wave of new free-trade agreements (e.g., the Canada–European Union’s Comprehensive Economic and Trade Agreement (CETA) and the Trans-Pacific Partnership with its 21 members) have senior trade officials openly questioning the long-term relevance of the WTO if the members don’t make adjustments. Many of the new agreements have more modern, faster rules. For example, the new trading agreements include better coordination of standards and regulations (which sometimes act as obstacles to trade). In this day and age, the WTO structure must adapt to the needs of its various constituents.

The European Union

Originally called the Common Market, the European Union (EU) initially included only the principal Western European nations like Italy, Germany, France, and the United Kingdom. But by 2015, 28 countries belonged to the EU (see Figure 5.4). Other countries are in the process of applying for membership, including Serbia and Turkey. The EU has eliminated most quotas and set uniform tariff levels on products imported and exported within its group. The EU is the largest free marketplace in the world and produces nearly one-quarter of total global wealth.

The North American Free Trade Agreement

On January 1, 1994, the North American Free Trade Agreement (NAFTA) took effect. Its objective was to create a free trade area for Canada, the United States, and Mexico. It eliminates trade barriers, promotes fair competition, and increases investment opportunities.

Surveys conducted before the deal showed a majority of Canadians opposed to NAFTA. They feared jobs would be lost or Canada’s sovereignty threatened, and that Canada would be flooded with products manufactured in Mexico, where wages are much lower. Supporters of NAFTA argued that the agreement would open up U.S. markets for Canadian products and create more employment, would create more employment possibilities for women, and would not threaten Canada’s sovereignty.

What has actually happened since NAFTA took effect? A group of economists at the Canadian Economics Association concluded that free trade has not been as good for Canada as predicted by its supporters, nor as bad as predicted by its detractors. Several specific effects are noticeable:

- NAFTA has created a much more active North American market.
- Direct foreign investment has increased in Canada.
- U.S. imports from (and exports to) Mexico have increased.
- Canada has become an exporting powerhouse.
- Trade between the United States and Canada rose sharply, and Canada enjoys a large trade surplus with the United States. Canada has become an exporting powerhouse.

In the past few years, there has been evidence that the benefits of NAFTA are slowly being eroded by ever-increasing delays at border crossings because of security concerns. The manufacturing drain continues, with most jobs being lost overseas. Meanwhile, between 2009 and
MANAGING IN TURBULENT TIMES

The Urge to Move

In today’s highly competitive global economy, businesses must strive for every possible advantage. Manufacturers, for example, locate their factories in countries in which there is an ample supply of low-cost labour. During the 1980s and 1990s, the place to be was Mexico. Hundreds of factories were built just cross the U.S.-Mexican border, and thousands of workers came to the region from other parts of Mexico for employment. But in the late 1990s the world started to shift.

Mexican prosperity, fueled by its role as a centre of manufacturing, led to increases in the cost of living, and that was followed by wage increases so workers could keep up. At about the same time, China emerged as an attractive manufacturing alternative, because wages in China were about one-sixth those in Mexico, and there was no shortage of workers eager to take steady jobs in Chinese factories. China’s boom was Mexico’s bust, as one company after another reduced or eliminated manufacturing in Mexico and moved to China.

But in recent years, things have started to tilt back in Mexico’s favour. Why? There are several reasons. First, as China’s economy flourished, its labour costs increased to the point that it was less of a bargain than it used to be. Whereas Mexican wages were six times higher than wages in China ten years ago, today they are only about 40 percent higher. Second, when shipping costs are factored in, producing in Mexico now costs about the same as in China. Third, time differences between North America and China can make it difficult to schedule videoconferences and telephone calls. Finally, several companies have been burned by China’s lack of protection for industrial and intellectual property.

Roger Moser is the president of Casabella, a company that makes a line of cleaning products and kitchen gadgets. Moser had all of the firm’s manufacturing centered in Mexico in the 1990s, but moved it to China in 2002. Now, however, Casabella is in the process of moving its manufacturing work from China back to Mexico. Another company, Manufacturing Marvel, produces toys in both China and Mexico, but it is considering moving everything to Mexico. A company official said that counterfeiting of its products in China was on the upswing, and that also played a role in its decision.

CRITICAL THINKING QUESTIONS

1. Consider the following statement: Because of intense international competition, companies really don’t have any alternative but to locate their manufacturing facilities in countries with low wages so that they can lower their cost structure and be more competitive in global markets. Do you agree or disagree? Defend your answer.

Other Free Trade Agreements

On January 1, 1995, a free-trade agreement known as Mercosur went into effect between Argentina, Brazil, Uruguay, and Paraguay; Venezuela became the fifth member in 2012. Within the first decade of its existence, tariffs had been eliminated on 80 percent of the goods traded between the original members.

Around the world, groups of nations are banding together to form regional trade associations for their own benefit. Some examples include

- the ASEAN Free Trade Area (see Figure 5.5)
- the Asia-Pacific Economic Cooperation (many nations of the Pacific Rim, as well as the United States, Canada, and Mexico)
- the Economic Community of Central African States (many nations in equatorial Africa)
- the Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates)
Study, practise, and explore real business situations with these helpful resources:

- **Interactive Lesson Presentations:** Work through interactive presentations and assessments to test your knowledge of business concepts.
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.

### LEARNING OBJECTIVES

**LO-1**  **DESCRIBE THE GROWING COMPLEXITY IN THE GLOBAL BUSINESS ENVIRONMENT AND IDENTIFY THE MAJOR WORLD MARKETPLACES.**

The world economy is changing and emerging markets are playing a bigger role. However, world trade still revolves greatly around three major marketplaces: North America, Europe, and Asia.

**LO-2**  **IDENTIFY THE EVOLVING ROLE OF EMERGING MARKETS AND HIGHLIGHT THE IMPORTANCE OF THE BRICS NATIONS.**

Old international trading patterns and activities are changing. In the past, Western companies used less-developed markets to acquire natural resources and to carry out simple assembly tasks. While this is still evident in international trade, the relationships have become much more complex, and many former have-nots are now exploiting relationships for their own gain. There are great opportunities in places like Thailand, Indonesia, South Korea, and Ukraine. However, the BRICS nations are getting most of the attention. BRICS stands for Brazil, Russia, India, China, and South Africa.

**LO-3**  **EXPLAIN HOW DIFFERENT FORMS OF COMPETITIVE ADVANTAGE, IMPORT-EXPORT BALANCES, EXCHANGE RATES, AND FOREIGN COMPETITION DETERMINE HOW COUNTRIES AND BUSINESSES RESPOND TO THE INTERNATIONAL ENVIRONMENT.**

With an absolute advantage, a country engages in international trade because it can produce a good or service more efficiently than any other nation. Countries usually trade because they enjoy comparative advantages; they can produce some items more efficiently than they can produce other items. A country that exports more than it imports has a favourable balance of trade, while a country that imports more than it exports has an unfavourable balance of trade. If the exchange rate decreases, our exports become less expensive for other countries, so they will buy more of what we produce. The reverse happens if the value of the Canadian dollar increases. Changes in the exchange rate, therefore, have a strong impact on our international competitiveness.

**LO-4**  **DISCUSS THE FACTORS INVOLVED IN CONDUCTING BUSINESS INTERNATIONALLY AND IN SELECTING THE APPROPRIATE LEVELS OF INTERNATIONAL INVOLVEMENT AND INTERNATIONAL ORGANIZATIONAL STRUCTURE.**

In deciding whether to do business internationally, a firm must determine whether a market for its product exists abroad and whether the firm has the skills and knowledge to manage such a business. Firms must also assess the business climates in other nations and the preferred level of international involvement: (1) exporter or importer, (2) international firm, or (3) multinational firm. The choice will influence the organizational structure of its international operations, specifically its use of independent agents, licensing arrangements, branch offices, strategic alliances, and direct investment.

**LO-5**  **DESCRIBE SOME OF THE WAYS IN WHICH SOCIAL, CULTURAL, ECONOMIC, LEGAL, AND POLITICAL DIFFERENCES ACT AS BARRIERS TO INTERNATIONAL TRADE.**

Social and cultural differences that can serve as barriers to trade include language, social values, and traditional buying patterns. Differences in economic systems may...
force businesses to establish close relationships with foreign governments before they are permitted to do business abroad. Quotas, tariffs, subsidies, and local-content laws offer protection to local industries. Differences in business-practice laws can make standard business practices in one nation illegal in another.

LO-6 **EXPLAIN HOW FREE TRADE AGREEMENTS ASSIST WORLD TRADE.**

Several trade agreements have attempted to eliminate restrictions on free trade internationally. The World Trade Organization (WTO) has 160 members with the mandate to help open up markets to international trade. The European Union (EU) has eliminated virtually all trade barriers among the 28 member nations. The North American Free Trade Agreement (NAFTA) eliminates many of the barriers to free trade among the United States, Canada, and Mexico.

**QUESTIONS AND EXERCISES**

**QUESTIONS FOR ANALYSIS**

1. What are the advantages and disadvantages of globalization from a Canadian consumer’s point of view? From a Canadian manufacturer’s point of view?
2. Assume you are the manager of a small firm seeking to enter the international arena. What information would you need about the market you’re thinking of entering?
3. Do you think a firm operating internationally is better advised to adopt a single standard of ethical conduct or to adapt to local conditions? Under what conditions might each approach be preferable?

**APPLICATION EXERCISES**

4. Explain how it is possible for a country to have a positive balance of trade and a negative balance of payments.
5. Explain how the economic system of a country affects foreign firms interested in doing business there.
6. The EU includes most of the Western European countries, but some (such as Switzerland) have chosen not to join. Why might that be? What are the implications for countries that do not join?

7. Interview the manager of a local firm that does at least some business internationally. Identify reasons why the company decided to “go international,” as well as the level of the firm’s involvement and the organizational structure it uses for its international operations.
8. Select a familiar product. Conduct some research of the culture of India and identify the problems that might arise in trying to market this product to India’s citizens.
9. What attributes of your province or region (cultural, geographical, economic, etc.) would be of interest to a foreign firm thinking about locating there? Visit provincial government sites and find resources that are available for businesses to help them invest in your province. Identify a company that has recently invested in your province. What reasons did it give for its decision?

10. Visit the website of a major global company such as Coca-Cola and enter some of its international sites. Make sure to choose countries from different parts of the world. What are some of the differences that you see in the websites? Identify some of the similar themes and report your findings.

**TEAM EXERCISES**

**BUILDING YOUR BUSINESS SKILLS**

**WEIGHING THE TRADE-OFFS**

**GOAL**

To encourage students to understand the reasons why companies shift labour offshore and to understand the perspective of all of the stakeholders in such a major decision.

**THE SITUATION**

Able Systems is a software company specializing in technology solutions for the food industry, including supermarkets and restaurants. All of your customers are located in Canada and operate nearly 24 hours a day. You provide excellent phone support for customers who have an issue, but your expenses are increasing and you’re looking for ways to contain costs.

Able Systems has tried to reduce ever-increasing phone support costs by limiting the number of specialists working on each shift, but long wait times have angered customers. Because of the technical and problem-solving skills needed to provide remote support, hiring less-qualified employees is just not an option. Looking at competitors, you’ve noticed that many have offshored their operations—hiring employees in other countries to provide support. Because of a large number of English speakers and an adequate supply of applicants with the education needed for a support position, you are considering setting up a phone support centre in Jamaica.

This solution is not without concerns. If you offshore your support operation, you will have to lay off most of the support employees. You’re willing to provide outplacement services to make sure that they can find new jobs, but you’re still concerned about the impact of layoffs on your remaining employees. A group of programmers who heard of this proposal have begun to wonder if their jobs are next. Additionally, local
elected officials are concerned about the impact of layoffs on the local economy. Your boss is pressuring you for a recommendation and you’re weighing the pros and cons of both options.

**METHOD**

**Step 1** Assemble a group of four students and assign each group member to one of the following roles:
- CEO of the Able Systems
- programmer at Able Systems
- liaison from a technical college in Jamaica who has graduates looking for jobs in their country
- local government official

**Step 2** Each member should write down notes to express the position of their particular role. Before hearing any of your group’s comments on this situation, and from the perspective of your assigned role, do you think that phone support should be offshored to Jamaica? Write down the reasons for your position.

**Step 3** Gather your group together and reveal, in turn, each member’s comments on whether phone support should be offshored. Appoint someone to record main points of agreement and disagreement within the group.

**FOLLOW-UP QUESTIONS**

1. Considering the interests of all stakeholders, what is the best option in this situation?
2. Develop a group response to the following question: Can your team identify other solutions to this dilemma?

**EXERCISING YOUR ETHICS**

**PAYING ATTENTION TO FOREIGN PRACTICES**

**THE SITUATION**

Assume you’re an up-and-coming manager in a regional Canadian distribution company. Firms in your industry are just beginning to enter foreign markets, and you’ve been assigned to head up your company’s new operations in a Latin American country. Because at least two of your competitors are also trying to enter this same market, your boss wants you to move as quickly as possible. You also sense that your success in this assignment will likely determine your future with the company.

You have just completed meetings with local government officials, and you’re pessimistic about your ability to get things moving quickly. You’ve learned, for example, that it will take ten months to get a building permit for a needed facility. Moreover, once the building is up, it will take another six months to get utilities. Finally, the phone company says that it might take up to six additional months to get high-speed internet access.

**THE DILEMMA**

Various officials have indicated that time frames could be considerably shortened if you were willing to pay special “fees.” You realize that these “fees” are bribes, and you’re well aware that the practice of paying such “fees” is both unethical and illegal in Canada. In this foreign country, however, it’s not illegal and not even considered unethical. Moreover, if you don’t pay and one of your competitors does, you’ll be at a major competitive disadvantage. In any case, your boss isn’t likely to understand the long lead times necessary to get the operation running. Fortunately, you have access to a source of funds you could spend without the knowledge of anyone in the home office.

**TEAM ACTIVITY**

Assemble a group of four students and divide the four into two pairs and answer the questions from one of the following perspectives:
- your perspective as an employee who is being tasked with the authority to complete the job
- the perspective of the boss (assume that despite your assumptions this manager is actually well aware of the business practices in this country)

**QUESTIONS TO ADDRESS**

1. What are the key ethical issues in this situation?
2. What do you think most managers would do in this situation?
3. What would you do?

**BUSINESS CASE 5**

**SCOTIABANK’S GLOBAL FOOTPRINT**

If you take a cruise to the Caribbean, you might be surprised to see some familiar Canadian banks at the major ports and as a visible presence in various towns. Scotiabank is a leader in the industry with over 370 branches in the Caribbean, including locations in Aruba, Jamaica, and Barbados. This is, however, just a small glimpse of the international reach of the company. Scotiabank has been conducting international business for well over 100 years and earns a great deal of its profits from these operations. The company profile proudly states that it is the most international of the big Canadian banks.

Scotiabank was founded in 1832 in Halifax, Nova Scotia, and now has over 3000 branches in 57 countries. It employs over 86,000 people while providing a wide range of services to more than 21 million customers (14 million in international markets). While competitors like TD and BMO have set their sights on expanding in the more familiar U.S. market, Scotiabank took a more speculative expansion approach. It continues to build a strong presence in Central America, Mexico, Latin America, and Asia. As you will see, Scotiabank has various models around the world, designed to respect local laws and adapt to local challenges.

For instance, in Mexico, the approach is direct and aggressive; Scotiabank has invested through a holding company called Grupo Financiero Scotiabank Inverlat, S.A. de C.V., which owns two subsidiaries. Scotiabank Inverlat is Mexico’s seventh-largest bank with over 600 full-service commercial branches and 1300 ATMs. The second is Scotiabank Inverlat Casa de Bolsa, an investment bank, which specializes in equity trading, investment advice, and corporate financing through 45 branches in major Mexican cities. Satisfying customers from different regions of the world requires knowledge of distinct local cultures and economic systems and respect for the unique needs of...
Part 1 Introducing the Contemporary Business World

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City. Why 19.99 percent? Doing business internationally often means navigating local rules and regulations. Foreign companies are not allowed to own more than 19.99 percent in any Chinese bank. This move followed a purchase of 14.8 percent of the Xi’an City Commercial Bank for $162 million two years earlier. Foreign laws must be understood and respected but even when that is understood it does not mean that the transactions are simple. After more than two years of negotiations Scotiabank actually withdrew its bid for the Bank of Guangzhou.

International growth must always be weighed against the specific challenges in each market (economic, legal, political, etc.). Regardless of the latest conditions, Scotiabank has shown its commitment to working with foreign companies, complying with foreign government rules in the quest to grow, and continuing to transform from Canada’s leading international bank into Scotiabank-Global bank.

QUESTIONS FOR DISCUSSION

1. In this chapter, you will read about the different ways a company can enter foreign markets. List and describe the effectiveness of various approaches used by Scotiabank across the globe.
2. Describe the key obstacles faced by banks when they try to do business in a foreign nation.
3. Free-trade agreements are simplifying trade across the globe, but clearly there are major challenges for Scotiabank in growing their footprint. Do you believe the banking industry needs to have more open regulations to allow companies like Scotiabank to expand further across the globe?
CRAFTING A BUSINESS PLAN

PART 1:

THE CONTEMPORARY BUSINESS ENVIRONMENT

GOAL OF THE EXERCISE

In Chapter 4, we discussed how the starting point for virtually every new business is a business plan. Business plans describe the business strategy for any new business and demonstrate how that strategy will be implemented. One benefit of a business plan is that in preparing it, would-be entrepreneurs must develop their idea on paper and firm up their thinking about how to launch their business before investing time and money in it. In this exercise, you’ll get started on creating your own business plan.

EXERCISE BACKGROUND: PART 1 OF THE BUSINESS PLAN

The starting point for any business plan is coming up with a “great idea.” This might be a business that you’ve already considered setting up. If you don’t have ideas for a business already, look around. What are some businesses that you come into contact with on a regular basis? Restaurants, childcare services, and specialty stores are a few examples you might consider. You may also wish to create a business connected with a talent or interest you have, such as crafts, cooking, or car repair. It’s important that you create a company from scratch rather than use a company that already exists. You’ll learn more if you use your own ideas.

Once you have your idea, your next step is to create an “identity” for your business. This includes determining a name for your business and a concept of what your business will do, and identifying the type of ownership your business will take, a topic we discussed in Chapter 4. The first part of the plan also briefly looks at who your ideal customers are, how your business will stand out from the crowd, and how the business will interact with the community and demonstrate social responsibility (these last topics were discussed in Chapter 3). Finally, almost all business plans today include a perspective on the impact of global business.

YOUR ASSIGNMENT

MyBizLab

STEP 1

To complete this assignment, you first need to download the Business Plan Student Template file from this text’s MyBizLab. This is a Microsoft Word file you can use to complete your business plan. For this assignment, you will fill in Part 1 of the plan.

STEP 2

Once you have the Business Plan Student Template file, you can begin to answer the following questions in Part 1: The Contemporary Business World.

1. What is the name of your business?
   
   Hint: When you think of the name of your business, make sure it captures the spirit of the business you’re creating.

2. What will your business do?
   
   Hint: Imagine that you are explaining your idea to a family member or a friend. Keep your description to 30 words or fewer.

3. What form of business ownership (sole proprietorship, partnership, or corporation) will your business take? Why did you choose this form?
   
   Hint: For more information on types of business ownership, refer to the discussion in Chapter 4.

4. Briefly describe your ideal customer. What are they like in terms of age, income level, and so on?
   
   Hint: You don’t have to give too much detail in this part of the plan; you’ll provide more details about customers and marketing in later parts of the plan.

5. Why will customers choose to buy from your business instead of your competition?
   
   Hint: In this section, describe what will be unique about your business. For example, is the product special, or will you offer the product at a lower price?

6. All businesses have to deal with ethical issues. One way to address these issues is to create a code of ethics. List three core principles your business will follow.
   
   Hint: To help you consider the ethical issues that your business might face, refer to the discussion in Chapter 3.

7. A business shows social responsibility by respecting all its stakeholders. What steps will you take to create a socially responsible business?
   
   Hint: Refer to the discussion of social responsibility in Chapter 3. What steps can you take to be a “good citizen” in the community? Also consider how you may need to be socially responsible toward your customers and, if applicable, investors, employees, and suppliers.

8. Will you sell your product in another country? If so, what countries and why? What challenges will you face?
   
   Hint: To help you consider issues of global business, refer to this chapter. Consider how you will expand internationally (e.g., independent agent, licensing). Do you expect global competition for your product? What advantages will foreign competitors have?

Note: Once you have answered the questions, save your Word document. You’ll be answering additional questions in later chapters.

VELOFIX

THE COMPANY

Chris Guillemet and Boris Martin, two Vancouver-based entrepreneurs, have built an interesting mobile bike repair business called Velofix. They do not have a traditional retail outlet, nor do they have the costs associ-
you. Call or make an online booking and they will fix your bike on location. Most repairs take 60–90 minutes. It’s quick, it’s convenient. A basic tuneup costs around $69, which is competitive with typical bike shops. According to the partners, pretty much anything that can be found in a retail store can be found in the van. For more details on the company, go to www.velofix.com.

The entrepreneurs have big plans, so if you don’t live in Vancouver, don’t worry—the Velofix franchising model is on the march. On this day, the entrepreneurs are joined by Canadian Olympic gold-medal triathlete Simon Whitfield, who owns the Victoria, British Columbia, franchise. This model costs the franchisee far less in start-up costs. The fee is $25 000, with another $50 000–$55 000 in buildup fees. In addition, there are royalties of 8 percent and an additional 2 percent for marketing fees. That compares favourably to the quoted costs of up to $750 000 for a prime retail location.

THE PITCH
Chris and Boris asked for $300 000 in return for 20 percent ownership in the company (valued at $1 500 000). This investment would help the entrepreneurs scale the business and increase marketing.

THE DRAGONS’ POINT OF VIEW
Clearly, the dragons were impressed with the model and interested in the proposal. Jim Treliving made them an offer of $300 000 for 25 percent, and that was quickly followed by an offer from Michael Wekerle of $400 000 for 25 percent. The other dragons quickly bowed out. Dave Chilton was worried that the model would be copied by others, which would make things more difficult for Velofix. In her final words Arlene Dickinson pointed out that she thought the 2% marketing fee was too low and they would not generate enough money. According to Arlene, Velofix would need to find significant marketing funds in the near future in order to achieve their desired expansion and to build brand equity.

THE OUTCOME
After going into the Velofix van for a quick huddle, the partners came out with a counteroffer for Jim Treliving. They asked him to reduce his percentage from 25 percent to 20 percent for $300 000; in other words, they went back to their initial pitch. After a few moments of consideration, Jim took the deal. Even though they had a better offer from Michael, it was clear that they wanted Jim’s franchising experience on their side.

QUESTIONS FOR DISCUSSION
1. After watching this video, describe the possible advantages and disadvantages of franchising as they relate to Velofix. Do you think it is a good investment for franchisees today?
2. In this section, we discussed the importance of selecting the right type of partners to work with. What lessons can we take away from this video? Do you think these entrepreneurs made the right choice?
3. Assume you were a traditional retail bike shop in your city, and conduct an external analysis. What are the primary threats and opportunities in the marketplace today? How might traditional bike shops deal with the threat from a new company like Velofix?
4. If you were one of the owners of Velofix, what tools and approaches would you use to help build your marketing presence across Canada and the United States?
5. Are the dragons angel investors or venture capitalists?


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MCDONALD’S EYEING NATURAL CHICKEN

Over the next two years, McDonald’s plans to phase out the purchase of chicken products treated with antibiotics commonly used by humans. Insiders believe McDonald’s is attempting to update its image and better compete with fast casual restaurants like Chipotle. This move seems to be in line with the trend toward healthy eating and the rise of consumer interest in natural ingredients.

In this chapter we discussed various approaches to dealing with social responsibility ranging from the obstructionist stance (in which an organization does as little as possible to solve social or environmental issues), to a defensive stance, to an accommodative stance, and finally to a proactive stance (in which an organization actively seeks opportunities to be socially responsible). With this latest move, it appears as though McDonald’s is making a choice to create positive change.

McDonald’s wants to create an image as a more health-conscious brand that is transparent with its customers. It has allowed the media to tour and film its many plants and allowed consumers to ask questions. Has any of this worked in McDonald’s favour? What else, if anything, can McDonald’s do to enhance its image as a health-conscious brand? Should it try to compete with the fast casual industry (e.g., Chipotle etc.)? Rick Newman, columnist for Yahoo Finance, discusses how this change might impact McDonald’s and the fast food industry.

QUESTIONS FOR DISCUSSION
1. What factors have contributed to this decision? In answering this question, relate your response to the external environment of business.
2. How will McDonald’s move toward natural chicken affect the fast-food industry? What are the ethical implications?
3. Do you think customers will respond positively to McDonald’s planned changes?

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AMAZON CRACKS DOWN ON FAKE REVIEWS

Do you check online reviews before purchasing an item? If you are like most people, you probably give them considerable attention, particularly when they are very positive or negative. The rating next to a movie listings might have a big impact on your choice. Have you ever told a friend “Don’t go see that movie—it is 5.5” (out of 10) even though you have not watched it yourself? We use online references and critiques to
guide our daily selections ranging from movies, to hotels, to appliances, to purchases on sites like Amazon.

But how valid are such reviews? Do you take them for granted? Do you look to see how many reviewers have actually evaluated an item? Clearly five reviewers should not carry the same weight as five thousand (to account for bias and to ensure we have a representative sample).

Beyond the numbers, there is another factor to consider. Would you be shocked to learn that between 10 and 30 percent of all reviews are fabricated? Many of those are written by unethical company owners (or their friends and family) in order to influence you to pick a particular hotel, bar, or restaurant. If a business has 16 reviews, and 10 are fake positive ones that might have a major influence on your decision, you might make a misguided choice based on false information.

Consumer reviews are one advantage online retailers have over physical stores. So this tool is of vital importance to companies like Amazon. As this video indicates, Amazon plans to use sophisticated new technology to comb through user writeups and weed out deceptive reviews. It cannot catch everything, but with its sophisticated programs the company will surely continue be a leader in fighting the villains in the fake-review game.

QUESTIONS FOR DISCUSSION
1. How does this video demonstrate the power of technology and the dangers that are ever-present in this technological age?
2. Briefly describe the concerns regarding online reviews and highlight the ethical implications from a consumer and a business point of view.
3. How is Amazon planning to alleviate the problem of fabricated reviews? Why are accurate reviews so important to online retailers?