# CHAPTER 1

# MULTINATIONAL MANAGEMENT IN A CHANGING WORLD

## Learning Objectives

Define multinational management

Understand the characteristics of a multinational company

Understand the nature of the global economy and the key forces that drive globalization

Know the basic classification of the world’s economies

Identify the characteristics of the next generation of multinational managers

## Introduction

Businesses of all sizes increasingly see the entire world as a source of business opportunities

* The world is becoming one connected economy
* Any company from any country can become a competitor
* The internet crosses national boundaries
* A company’s success in their home market doesn’t always equate to long-term profitability

There are significant opportunities for most companies despite challenges and threats such as terrorism, wars, and recessions.

Managers of the next century will need to be multinational in outlook and strategies

* Students of business should have at least a basic background in multinational management

Multinational management – the formulation of strategies and the design of management systems that successfully take advantage of international opportunities and that respond to international threats

***Introduction – Textbook Components***

This book introduces students to the latest information on how managers throughout the world respond to the challenges of globalization

Chapter Features

* *Preview Case in Point* – shows examples of how multinational companies deal with a key issue discussed in the chapter
* *Cases in Point* – give information on how actual multinational companies handle other issues raised in the course of the chapter
* *Multinational Management Briefs* – give further details and examples that extend the discussion
* *Multinational Management Challenges* – describe problems and dilemmas that real multinational managers face and for which there are no easy answers
* *Comparative Management Briefs* – provide examples of management issues that are influenced by a unique cultural or social institutional setting
* *Focus on Emerging Markets* – reflects the sustained importance of emerging markets in world trade

## The Nature of the Multinational Company

Multinational company (MNC) is broadly defined as any company that engages in business functions beyond its domestic borders

Most multinational companies are also multinational corporations; that is, publicly owned through stocks

What kinds of activities might make a company multinational?

* The most apparent activity is international sales
* Crossing national borders opens up more international options than simply selling internationally

Exhibit 1.1 Largest Companies in the World

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

Exhibit 1.2 Locations of Global 500 Companies

(Lists selected countries with most Fortune Global 500 companies)

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

Globalization – the worldwide trend of cross-economic integration that allows businesses to expand beyond their domestic boundaries.

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

### Countries of the World: The Arrived and the Coming, and the Struggling

Exhibit 1.3 Selected Economies of the World

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

1. Developed countries – countries with mature economies, high GDPs, and high levels of trade and investment
2. Developing countries – countries with economies that have grown extensively in the past two decades (i.e. Hong Kong, Singapore, and Taiwan)
3. Transition economies – countries in the process of changing from government-controlled economic systems to capitalistic (i.e., Central & Eastern Europe – Czech Republic, Hungary, Poland, and Russia)
4. Emerging markets – countries that are currently between developed and developing countries and are rapidly growing (i.e. India, China, Brazil, and Russia)
* The term *emerging markets*, coined by the World Bank around 25 years ago, represents those markets that present tremendous opportunities for all multinationals
1. Less developed countries (LDCs*)* – the poorest nations, often plagued with unstable political regimes, high unemployment, and low worker skills

Exhibit 1.4 The Globalizing Economy

(Illustrates the driving forces of the new world economy)

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

1. General Agreement on Tariffs and Trade (GATT) – tariff negotiations among several nations that reduced the average worldwide tariff on manufactured goods
* Beginning in 1947, negotiations began which ultimately reduced average tariffs on manufactured goods from 45% to less than 7%
1. World Trade Organization (WTO) – a formal structure for continued negotiations to reduce trade barriers and a mechanism for settling trade disputes
* Continued negotiations in Uruguay from 1986 – 1993 established the WTO
* There are over 150 nations now in the WTO, including 29 of the UN-classified least developed countries. Thirty more countries, including Russia, seek WTO membership
* In March 1997, trade ministers from countries representing 92% of world trade in IT products agreed to end tariffs on trade in software, computer chips, telecommunications equipment, and computers
* By 2005, this $500 billion a year trade should be mostly tariff free
* With tariff eliminated, high-tech exports to Europe from Asia and the U.S. should double
* Developing countries will also benefit from reduced prices on products such as phones, faxes, and computers that are produced in tariff-free locations
* Is free trade working?
* The WTO thinks so – data shows that world trade has grown at more than four times the world’s gross domestic product
* Critics argue that the WTO favors more developed nations because poorer nations have more difficulty competing in an unregulated environment
* Environmentalists argue that commercial interests have priority over environment, health, and safety
* Labor unions warn of migration of jobs to lower-wage countries
1. Regional trade agreements – agreements among nations in a particular region to reduce tariffs and develop similar technical and economic standards (also called *free trade areas*)
* Such agreements have usually led to more trade among the member nations but are criticized for harming poorer nations who are left out of agreements
1. The three largest groups – EU, NAFTA, and APEC – account for nearly half of the world’s trade
* European Union (EU) – includes 27 members, namely Austria, Belgium, Britain, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden. Croatia becomes the 28th member in July of 2013.
* Since 1992, the EU countries allow goods and services to move across borders without customs duties and quotas
* EU adopted a unified currency called the Euro
* North American Free Trade Agreement (NAFTA) – a multilateral treaty that links the United States, Canada, and Mexico in an economic bloc that allows freer exchange of goods and services
* The Free Trade Area of Americas (FTAA) will expand NAFTA to include most of the other Caribbean, Central American, and South American nations
* Asia-Pacific-Economic Cooperation (APEC) – a confederation of 21 nations with less specific agreements on trade facilitation in the Pacific region. However, the ultimate goal calls for total free trade in the Pacific Region by 2020.

Exhibit 1.5 Regional Trade Agreements Around the World

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

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

1. World trade among countries (imports and exports) has grown at an average rate of 6.5% per year between 1990 and 2000, but slowed to 4% by 2004, and grew again to 6 percent in 2005. The forecast for 2013 was 4.5 percent.

Exhibit 1.6 Change in Exports and Imports (Developed and Developing Economies)

(Shows the changes in exports and imports in developed and developing countries based on data reported by the WTO)

1. TRIAD – the world’s dominant trading partners: the European Union, the United States, and Japan.
2. Foreign Direct Investment (FDI) – multinational firm’s ownership, in part or in whole, of an operation in another country
* FDI, or cross-border ownership, occurs because multinational companies build global networks that link R&D, supply, production, and sales units around the globe
* FDI soared between 1996 and 2000 but has been declining, in part due to the declining rate of mergers and acquisitions
* Despite these declines, the importance of emerging markets is reflected in the growth of FDI in these economies.
1. Developing countries provide great opportunities, but pose significant risk
2. Two types of risk
* Political risk – anything a government might do (or not do) that might adversely affect a company
* Economic risk – all factors of a nation’s economic climate that may affect a foreign investor

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

1. Companies and individuals can shop and sell anywhere because anyone in the world can access any Web site.
2. Electronic communication vehicles allow communication around the world, and information technology expands the global reach of an organization
3. Organizations are becoming virtual – linked by networks of computers
4. Information technology is also spurring a borderless financial market
5. Information technologies make available many new tools that facilitate business operations

### The Rise of Global Products and Global Customers

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

### New Competitors are Emerging

* The free-market reforms in emerging countries are creating a potential group of new competitors in the world market
* Global trade has two important effects in developing new competitors
* First, when the large multinationals use developing countries as low-wage platforms for high-tech assembly, they facilitate the transfer of technology
* Second, aggressive multinational companies from emerging-market countries are also expanding beyond their own borders

### The Rise of Global Standards

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

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

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

Exhibit 1.7 Ethisphere’s Most Ethical Companies

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

## The Next Generation of Multinational Managers

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

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

## Multinational Management: A Strategic Approach

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

## Summary and Conclusions

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

# Chapter 1 Case Notes

# Foreign Direct Investment in the Middle East: Riyadh and Dubai

## Synopsis

This case deals with analyzing the key drivers of foreign direct investment (FDI) of U.S, Japanese, and European multinational financial services and other service providers investing in the Middle East. In this case, the focus is on investing in Riyadh, Saudi Arabia, and Dubai, United Arab Emirates. A sample of the foreign companies is interviewed to determine the key factors in their decision process, why they selected the form of operation they did, and what their business model is.

The case is in three sections: the first shows how laws, requirements, and regulations have changed and become more receptive to foreign investment in recent years – this is done by comparing several business environmental characteristic indices and their change over time. The second section examines the exchange arrangements and framework for financial and capital transactions in the countries. The third section examines the experiences of several multinational companies in the financial services sector that have invested in the region.

## Case Purpose and Objectives

1. This case describes the challenges of foreign direct investment in a volatile area of the world.
2. This case focuses on a particular industry – financial services – and other service sector businesses.
3. This case demonstrates the complexity of the decision-making process in questions regarding entry into a foreign environment, and the primary, driving reasons for a decision to invest.
4. This case illustrates a good example of the impact on the decision-making process of local governmental regulations, especially those limiting ownership control.

## Case Discussion Questions

1. **The global financial crisis of 2007-2009 caused several changes to be made in macroeconomic policy management in Saudi Arabia and the UAE in order to reduce the impact of the global crisis on the global economy. Compare and contrast the approaches to such regulation of the UAE and Saudi Arabia, the reasons for such differences, and the results of each on foreign direct investment.**
2. xxOne of the challenges of setting up a business in a foreign country is how much to adapt your product or service and company policies to local conditions. Make a case that companies must adapt to local tastes, traditions, and laws in order to survive.
3. One strategy Yahoo could use to deal with the Chinese government is to allow its local joint venture partner, Beijing Founder Electronics, to deal with the Chinese government. What are the benefits and risks of doing so?
4. A multinational company deals with many constituents. How should Yahoo respond to the criticisms from Human Rights Watch?

## Analysis

1. **The global financial crisis of 2007-2009 caused several changes to be made in macroeconomic policy management in Saudi Arabia and the UAE in order to reduce the impact of the global crisis on the local economy. Compare and contrast the approaches to such regulation of the UAE and Saudi Arabia, the reasons for such those policy choices, and the impact of each on foreign direct investment.**

In response to the global financial crisis, both the United Arab Emirates and Saudi Arabia stimulated their economies, and both used monetary and fiscal policy. Saudi Arabia tried to attract FDI for the purpose of natural gas investment and for investment in the petrochemical industry. They chose these actions to try and reduce their dependence on oil exports, in an attempt to stimulate domestic growth of demand. They took these steps for two reasons: first, because their economy was less integrated with the global financial markets than the UAE, and secondly, because they sought a local effect, an improvement in domestic demand.

In the UAE, when Dubai’s real estate market crashed in 2009, capital investment fled from the country. UAE quickly made several successful fiscal moves, including a $10 billion dollar rescue from Abu Dhabi, which stabilized the economic situation. Between 2007 and 2010, the real GDP growth was slightly higher in the UAE than in Saudi Arabia. Today, the UAE ranks higher on the Barra multi-factor risk scale than Saudi Arabia. In addition, the significant drop in rents for offices and housing which took place in 2008, make Dubai a more attractive location.

1. **Compare the controls on direct investment in Saudi Arabia and the United Arab Emirates. Which encourages more foreign direct investment?**

In Saudi Arabia:

* Approved foreign investments in KSA enjoy the same privileges as domestic capital.
* The foreign investment law allows foreign investors to make direct investment in most of the country’s economic sectors with or without local participation.
* KSA imposes a tax rate of 20% on most foreign company profits, except that:
	+ Profits on oil and hydrocarbons are 85%
	+ Taxes on natural gas are 30%
* There are, however, a list of sectors that are off limits to foreign investors, including drilling for oil, military equipment, explosives, some printing activities, some telecommunications, services, some transportation, real estate investment in Mecca and Medina, and others
* Licenses are granted to foreign insurance and reinsurance firms, but Foreign insurance companies are allowed to own only up to 49% of these local companies.
* There are no controls on the liquidation of direct investment.

In the United Arab Emirates:

* At least 51% of the equity of companies other than branches of foreign companies must be held by nationals of the UAE.
* GCC nationals are permitted to hold up to 75% of the equity of companies in the industrial, agricultural, fisheries and constructions sectors, and up to 1005 of the equity of companies in the hotel industry.
* GCC nationals are also permitted to engage in wholesale and retail trade activities, but not in the form of companies, or they are subject to company law.
* In free zones, foreign ownership of up to 100% is permitted.
* There are no controls on the liquidation of direct investment.
* There are additional provisions specific to the financial sector.

Neither system shows a preference for foreign investment in all cases. A decision whether to invest in Saudi Arabia or the UAE will depend first on the industry involved, and second on whether the investor is willing to share ownership. Each country has similar laws regarding the ownership of real estate, though those in Saudi Arabia may be slightly more generous to foreigners.

1. **In the case, several firms were surveyed to determine how they determined their choice of foreign country in which to invest. What was the single most important factor to them, and why?**

The single most important factor for the choice of location of foreign direct investment was market potential. Since the primary reason for investment was market-seeking, this was the primary factor, even in locations considered somewhat unstable or unfriendly. One way to minimize the risk was to locate in the same region as the primary, but risky target, and develop business from relative safety. After a time, some firms expanded their operations into the risky market. These findings are consistent with the Uppsala model of the company internationalization process which states that companies commit increasing amounts of resources to a market as their knowledge of the foreign market increases with experience.

## Lessons

* Illustrates some of the opportunities as well as challenges for companies seeking to directly invest in foreign countries
* Provides some understanding of what a multinational is and the inexorable pressure to continuously expand in new countries
* Demonstrates some of the difficulties associated with operating in different cultural and political environments