Chapter 4

Competing in Global Markets

PHOTODISC/GETTY IMAGES

Learning Goals

1. Explain the importance of international business and the primary reasons nations trade.
2. Discuss the concepts of absolute and comparative advantage in international trade.
3. Describe how nations measure international trade and the significance of exchange rates.
4. Identify the major barriers that confront global businesses.
5. Explain how international trade organizations and economic communities reduce barriers to international trade.
6. Compare the different levels of involvement used by businesses when entering global markets.
7. Distinguish between a global business strategy and a multidomestic business strategy.

These Boots Are Made for Working—Internationally

LON C. DIEHL/PHOTOEDIT

A U.S. shoe manufacturer that can make work boots trendy among young European and Asian consumers must be unusual, and Red Wing Shoe Company certainly is. The 100-year-old firm, which is based in the small Minnesota town that shares its name, has become a standout in its industry, and not just for its growing fashion sense. About 98 percent of the footwear sold in the United States today is imported from somewhere else in the world, which means Red Wing is one of the very few domestic shoe manufacturers still making its products on American soil.

It hasn't always been a smooth ride for the company, which is privately owned and profitable, with annual sales at about $375 million. Competition from lower-priced merchandise has been eating into its market, and Red Wing has worked hard to control costs and expand its product lines in order to remain competitive. Other boot makers such as Timberland and Doc Martens have pushed ahead on the fashion frontier, while Red Wing has stayed close to the blue-collar workers who have always made up the largest part of its customer base. "Would I say we're the best-looking boot in the world?" asks president and CEO David Murphy. "No, but we're getting better."

Getting better, however, means branching out from the company's classic designs, many of which have remained the same for decades. With new designers on board, the company is now making women's shoes and motorcycle boots. The steel-toed boots needed by young blue-collar workers also come styled like hiking shoes or sneakers. And Red Wing has succeeded in cracking the international market with a new brand of footwear called "Euro Classics," which use special leathers and distinctive stitching to appeal to fashion-conscious youth in Europe and Asia. Says Murphy, "The reason they sell so well in those places is because we're such a genuine American name; you can't create that—it just is or it isn't." About 15 percent of Red Wing's annual sales now come from international markets, and the company recently created a new position—vice president of international and strategic development—to highlight the growing role of international sales in its corporate strategy.

The company makes about 200 different boot models, some of which are tailored for the needs and hazards of particular jobs and industries. For instance, boots for ironworkers have soft soles so that wearers can feel the steel beams under their feet while working on building construction sites. Farmers in the southeastern United States need boots that grip despite slippery floors but don't pick up the sticky clay of the region. But regardless of the industry, one of Red Wing's biggest selling points is the fact that its products come in enough sizes to fit almost anybody—from 4B to 18EE in some models.

Although it's very conscious of the importance its U.S. customer base places on Red Wing's homegrown pedigree, the company also imports some shoes from China that it markets under other brand names, and it imports some of the leather uppers used to make its Red Wing brand products. But Red Wing's managers know that its U.S. customers include many union workers who appreciate products "Made in the U.S.A." The company plans to keep serving them, even though they are, ironically, a customer base that's shrinking as manufacturing jobs continue to move overseas, where labor is cheaper. And, in fact, "the willingness of the American worker to buy American . . . gets less all the time," says Murphy. "In today's world, the young consumer has never worn a shoe made in America." But "we do look beyond pure economics. I think most great companies do."[1]

Chapter Overview

Consider for a moment how many products you used today that came from outside the United States. Maybe you drank Brazilian coffee with your breakfast, wore clothes manufactured in Honduras or Malaysia, drove to class in a German or Japanese car fueled by gasoline refined from Venezuelan crude oil, and watched a movie on a television set assembled in Mexico for a Japanese company such as Sony. A fellow student in Germany may be wearing Levi's jeans, using a Dell computer, and drinking Coca-Cola.

U.S. and foreign companies alike recognize the importance of international trade to their future success. Economic interdependence is increasing throughout the world as companies seek additional markets for their goods and services and the most cost-effective locations for production facilities. No longer can businesses rely only on domestic sales. Today, foreign sales are essential to U.S. manufacturing, agricultural, and service firms as sources of new markets and profit opportunities. Foreign companies also frequently look to the United States when they seek new markets.

Thousands of products cross national borders every day. The computers that U.S. manufacturers sell in Canada are **exports,** domestically produced goods and services sold in markets in other countries. **Imports** are foreign-made products and services purchased by domestic consumers. Together, U.S. exports and imports make up about a quarter of the U.S. gross domestic product (GDP). U.S. exports recently set a record high of more than \$1.1 trillion, and annual imports hit another new high of nearly \$1.8 trillion. That total amount is more than double the nation's imports and exports from just a decade ago.[2]

exports domestically produced goods and services sold in other countries.

imports foreign goods and services purchased by domestic customers.

"They Said It"

"No nation was ever ruined by trade."
—Benjamin Franklin (1706–1790) American statesman and philosopher

Transactions that cross national boundaries may expose a company to an additional set of environmental factors such as new social and cultural practices, economic and political environments, and legal restrictions. Before venturing into world markets, companies must adapt their domestic business strategies and plans to accommodate these differences.

This chapter travels through the world of international business to see how both large and small companies approach globalization. First, we consider the reasons nations trade, the importance and characteristics of the global marketplace, and the ways nations measure international trade. Then we examine barriers to international trade that arise from cultural and environmental differences. To reduce these barriers, countries turn to organizations that promote global business. Finally, we look at the strategies firms implement for entering foreign markets and how they develop international business strategies.

USED WITH PERMISSION. HSBC BANK USA, N.A.

Businesses that are thinking of going global need to understand and appreciate local customs and culture. Banking firm HSBC has offices in 77 countries and territories—in Europe, the Americas, the Middle East, and Africa. The company uses its local knowledge to provide personal service no matter where its banks are.

WHY NATIONS TRADE

As domestic markets mature and sales growth slows, companies in every industry recognize the increasing importance of efforts to develop business in other countries. Wal-Mart operates stores in Mexico, Boeing sells jetliners in Asia, and soccer fans in Britain watch their teams being bought by U.S. billionaires. These are only a few of the thousands of U.S. companies taking advantage of large populations, substantial resources, and rising standards of living abroad that boost foreign interest in their goods and services. Likewise, the U.S. market, with the world's highest purchasing power, attracts thousands of foreign companies to its shores.

International trade is vital to a nation and its businesses because it boosts economic growth by providing a market for its products and access to needed resources. Companies can expand their markets, seek growth opportunities in other nations, and make their production and distribution systems more efficient. They also reduce their dependence on the economies of their home nations.

International Sources of Factors of Production

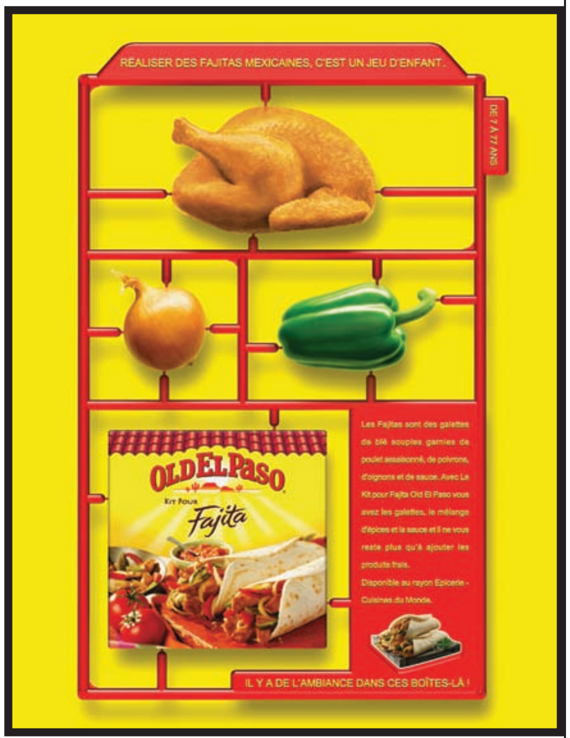
Business decisions to operate abroad depend on the availability, price, and quality of labor, natural resources, capital, and entrepreneurship—the basic factors of production—in the foreign country. Indian colleges and universities produce thousands of highly qualified computer scientists and engineers each year. To take advantage of this talent, many U.S. computer software and hardware firms have set up operations in India and many others are outsourcing information technology and customer service jobs there, as we'll see later in this chapter.

Trading with other countries also allows a company to spread risk because different nations may be at different stages of the business cycle or in different phases of development. If demand falls off in one country, the company may still enjoy strong demand in other nations. Companies such as Toyota and Sony have long used international sales to offset lower domestic demand.

Size of the International Marketplace

In addition to human and natural resources, entrepreneurship, and capital, companies are attracted to international business by the sheer size of the global marketplace. Only one in five of the world's nearly 7 billion people lives in a relatively well-developed country. The share of the world's population in the less developed countries will increase over the coming years because more developed nations have lower birthrates. But the U.S. Census Bureau says the global birthrate is slowing overall, and the average woman in today's world bears half as many children as her counterpart did 35 years ago.[3]

As developing nations expand their involvement in global business, the potential for reaching new groups of customers dramatically increases. Firms looking for new revenue are inevitably attracted to giant markets such as China and India, with respective populations of nearly 1.3 billion and 1.1 billion each. However, people alone are not enough to create a market. Consumer demand also requires purchasing



Even the French have a taste for Tex-Mex food—chicken fajitas, to be specific. Old El Paso sells its fajita kits there, saying it's "child's play" (*un jeu d'enfant*) to make them.

Table 4.1 The World's Top Ten Nations Based on Population and Wealth

Country	Population (in Millions)
China	1,299
India	1,065
United States	293
Indonesia	238
Brazil	184
Pakistan	159
Russia	144
Bangladesh	141
Japan	127
Nigeria	126

Country	Per-Capita GDP (in U.S. dollars)
Luxembourg	$55,100
United States	$37,800
Norway	$37,800
Bermuda	$36,000
Cayman Islands	$35,000
San Marino	$34,600
Switzerland	$32,700
Denmark	$31,100
Iceland	$30,900
Austria	$30,000

Sources: Data from U.S. Census Bureau, International Database, "Top 50 Countries Ranked by Population," accessed June 11, 2006, http://www.census.gov; Central Intelligence Agency, "GDP—Per Capita," *World Factbook*, accessed June 11, 2006, http://www.cia.gov.

power. As Table 4.1 shows, population size is no guarantee of economic prosperity. Of the ten most populous countries, only the United States appears on the list of those with the highest per-capita GDPs.

Though people in the developing nations have lower per-capita incomes than those in the highly developed economies of North America and Western Europe, their huge populations do represent lucrative markets. Even when the higher-income segments are only a small percentage of the entire country's population, their sheer numbers may still represent significant and growing markets.

Also, many developing countries have posted high growth rates of annual GDP. For instance, over the past few years, U.S. GDP has grown at an annual rate of about 4.4 percent. By contrast, GDP growth in less developed countries is much greater—China's GDP growth rate was 9.1 percent, and Malaysia's was 7.1 percent.[4] These markets represent opportunities for global businesses, even though their per-capita incomes lag behind those in more developed countries. Many firms are establishing operations in these and other developing countries to position themselves to benefit from local sales driven by expanding economies and rising standards of living. Wal-Mart Stores is one of those companies. The retail giant has opened dozens of new stores in developing countries from China to Brazil. It is nearly doubling the number of its stores in China, planning to have more than 90 outlets there by the end of 2006.[5]

assessment check

1. Why do nations trade?
2. Cite some measure of the size of the international marketplace.

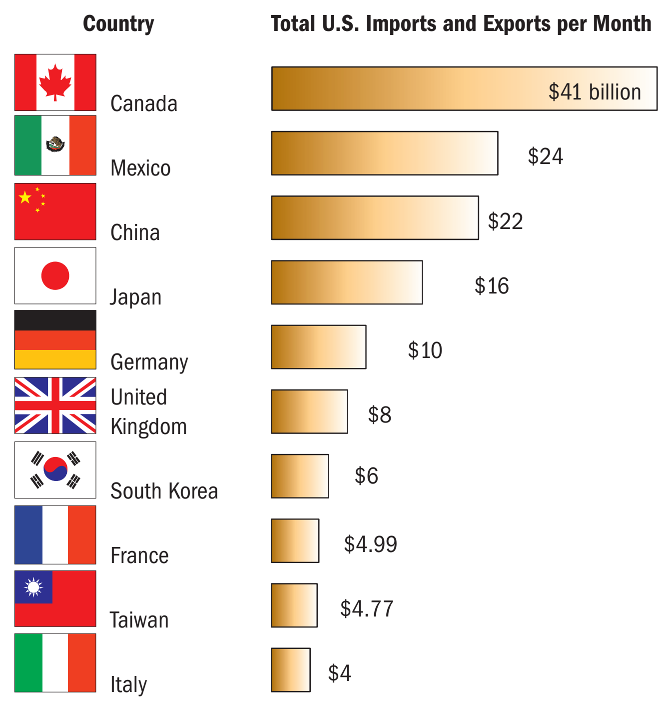
The United States trades with many other nations. As Figure 4.1 shows, the top five are Canada, Mexico, China, Japan, and the Federal Republic of Germany. With the United Kingdom, South Korea, France, Taiwan, and Italy, they represent more than two-thirds of U.S. imports and exports every year.[6] Foreign trade is such an important part of the U.S. economy that it makes up a large portion of the business activity in many of the country's individual states as well. Texas exports more than $117 billion of goods annually, and California exports more than $109 billion. Other big exporting states include New York, Michigan, Washington, Ohio, and Illinois.[7]

Absolute and Comparative Advantage

Few countries can produce all the goods and services their people need. For centuries, trading has been the way that countries can meet the demand. If a country focuses on producing what it does best, it can export surplus domestic output and buy foreign products that it lacks or cannot efficiently produce. The potential for foreign sales of a particular item depends largely on whether the country has an absolute advantage or a comparative advantage.

A country has an *absolute advantage* in making a product for which it can maintain a monopoly or that it can produce at a lower cost than any competitor. For centuries, China enjoyed an absolute advantage in silk production. The fabric was woven from fibers recovered from silkworm cocoons, making it a prized raw material in high-quality clothing. Demand among Europeans for silk led to establishment of the famous Silk Road, a 5,000-mile link between Rome and the ancient Chinese capital city of Xian.

Figure 4.1 Top Ten Trading Partners with the United States



Source: Data from U.S. Census Bureau, "Top Ten Countries with Which the U.S. Trades," accessed June 11, 2006, http://www.census.gov/foreign-trade/top/dst/current/balance.html.

Absolute advantages are rare these days. But some countries manage to approximate absolute advantages in some products. Climate differences can give some nations or regions an advantage in growing certain plants. Saffron, perhaps the world's most expensive spice at around $40 per ounce, is the stigma of a flowering plant in the crocus family. It is native to the Mediterranean, Asia Minor, and India. Today, however, saffron is cultivated primarily in Spain, where the plant thrives in its soil and climate. Attempts to grow saffron in other parts of the world have generally been unsuccessful.[8]

A nation can develop a *comparative advantage* in a product if it can supply it more efficiently and at a lower price than it can supply other goods, compared with the outputs of other countries. China is profiting from its comparative advantage in producing textiles. On the other hand, ensuring that its people are well educated is another way a nation can develop a comparative advantage in skilled human resources. India, for example, has acquired a comparative advantage in software development with its highly educated workforce and low wage scale. As a result, several companies have moved part or all of their software development to India.

Canon has adopted a strategy for research and development based on various nations' comparative advantage in engineering knowledge. Rather than basing all of its research at its Tokyo headquarters, the company operates regional headquarters in Europe and the Americas, each focused on a different area of expertise. In the United States, engineers concentrate on digital and networking technology, whereas Canon engineers in France focus on telecommunications.

assessment check

1. Define absolute advantage.
2. How does a nation acquire a comparative advantage?

MEASURING TRADE BETWEEN NATIONS

Clearly, engaging in international trade provides tremendous competitive advantages to both the countries and individual companies involved. Any attempt to measure global business activity requires an understanding of the concepts of balance of trade and balance of payments. Another important factor is currency exchange rates for each country.

balance of trade difference between a nation's exports and imports.

balance of payments overall money flows into and out of a country.

A nation's **balance of trade** is the difference between its exports and imports. If a country exports more than it imports, it achieves a positive balance of trade, called a *trade surplus*. If it imports more than it exports, it produces a negative balance of trade, called a *trade deficit*. The States has run a trade deficit every year since 1976. Despite being the world's top exporter, the U.S. has an even greater appetite for foreign-made goods, which creates a trade deficit.

A nation's balance of trade plays a central role in determining its **balance of payments**—the overall flow of money into or out of a country. Other factors also affect the balance of payments, including overseas loans and borrowing, international investments, profits from such investments, and foreign aid payments. To calculate a nation's balance of payments, subtract the monetary outflows from the monetary inflows. A positive balance of payments, or a *balance-of-payments surplus*, means more money has moved into a country than out of it. A negative balance of payments, or *balance-of-payments deficit*, means more money has gone out of the country than entered it.

Major U.S. Exports and Imports

The United States, with combined exports and imports of nearly $3 trillion, leads the world in the international trade of goods and services. As listed in Table 4.2, the leading categories of goods exchanged by U.S. exporters and importers range from machinery and vehicles to scientific and telecommunications equipment. Strong U.S. demand for imported goods is partly a reflection of the nation's prosperity and diversity.

Although the United States imports more goods than it exports, the opposite is true for services. U.S. exporters sell more than $338 billion in services annually. Much of that money comes from travel and tourism—money spent by foreign nationals visiting the United States. The increase in that figure is especially significant because the dollar has not been worth as much in terms of foreign currencies in recent years. U.S. service exports also include business and technical services such as engineering, financial services, computing, legal services, and

Table 4.2 Top Ten U.S. Exports and Imports

Exports	Amount (in billions)	Imports	Amount (in billions)
Electrical machinery	$86	Motor vehicles	$173
Motor vehicles	$63	Petroleum, petroleum products	$130
Transport equipment	$43	Electrical machinery	$83
Office machines and data-processing equipment	$41	Office machines and data-processing equipment	$81
Miscellaneous manufactured articles	$35	Telecommunications equipment	$71
Power-generating machinery	$34	Apparel and clothing	$68
General industrial machinery	$32	Miscellaneous manufactured articles	$64
Professional scientific instruments	$31	General industrial machinery	$38
Specialized machinery	$25	Organic chemicals	$33
Telecommunications equipment	$24	Power-generating machinery	$32

Sources: Annual data from International Trade Administration, "U.S. Manufacturers Trade: Top Ten Product Exports, Imports, Balances," U.S. Department of Commerce, accessed June 11, 2006, http://www.ita.doc.gov.

entertainment, as well as royalties and licensing fees. Major service exporters include America Online, Citibank, Walt Disney, Allstate Insurance, and Federal Express, as well as retailers such as The Gap and Starbucks.

Businesses in many foreign countries want the expertise of U.S. financial and business professionals. Entertainment is another major growth area for U.S. service exports. Recently Disney, which already operates theme parks in France and Japan, opened a theme park on Hong Kong's Lantau Island. The company invested $318 million for a 43 percent share of the new Magic Kingdom and its three hotels. It also earns fees for managing the theme park and has announced plans to build one in Shanghai as well.

With annual imports far exceeding $1 trillion, the United States is by far the world's leading importer. American tastes for foreign-made goods—which show up as huge trade deficits with the consumer-goods-exporting nations of China and Japan—also extend to European products. The 25 countries of the European Union (EU) ship more than $220 billion of merchandise, including Audi cars, Saeco espresso machines, Norelco electric shavers, to U.S. buyers.[9]

Exchange Rates

A nation's **exchange rate** is the rate at which its currency can be exchanged for the currencies of other nations. It is important to learn how foreign exchange works because we live in a global community and the value of currency is an important economic thermometer for every country. Each currency's exchange rate is usually quoted in terms of another currency, such as the number of Mexican pesos needed to purchase one U.S. dollar. About 11 pesos are needed to exchange for a dollar. A Canadian dollar can be exchanged for approximately 79 cents in the United States. The euro, the currency used in many of the EU countries, has made considerable moves in exchange value during its few years in circulation—ranging from less than 90 cents when it was first issued to around $1.27 in American currency in more recent years. European consumers and businesses now use the euro to pay bills by check, credit card, or bank transfer. Euro coins and notes are also used in many EU-member countries.

exchange rate value of one nation's currency relative to the currencies of other countries.

Foreign exchange rates are influenced by a number of factors, including domestic economic and political conditions, central bank intervention, balance-of-payments position, and speculation over future currency values. Currency values fluctuate, or "float," depending on the supply and demand for each currency in the international market. In this system of *floating exchange rates*, currency traders create a market for the world's currencies based on each country's relative trade and investment prospects. In theory, this market permits exchange rates to vary freely according to supply and demand. In practice, exchange rates do not float in total freedom. National governments often intervene in currency markets to adjust their exchange rates.

Nations influence exchange rates in other ways as well. They may form currency blocs by linking their exchange rates to each other. Many governments practice protectionist policies that seek to guard their economies against trade imbalances. For instance, national governments sometimes take deliberate action to devalue their currencies as a way to increase exports and stimulate foreign investment. **Devaluation** describes a drop in a currency's value relative to other

AP PHOTO/XINHUA, PANG XINGLEI

After nearly a decade of pegging the foreign exchange rate of the yuan to the U.S. dollar, China changed its policy. It now allows its currency to float more flexibly on a mix of foreign currencies. Such a change might make Chinese imports to the United States more expensive, but it might also make U.S. exports to China cheaper.

"They Said It"

"Don't overlook the importance of worldwide thinking. A company that keeps its eye on Tom, Dick, and Harry is going to miss Pierre, Hans, and Yoshio."

—Al Ries (b. 1929)
U.S. advertising executive

currencies or to a fixed standard. In Brazil, a recent currency devaluation made investing in that country relatively cheap, so the devaluation was followed by a flood of foreign investment. Pillsbury bought Brazil's Brisco, which makes a local staple, *pao de queijo*, a cheese bread formed into rolls and served with morning coffee. Other foreign companies invested in Brazil's construction, tourism, banking, communications, and other industries. For an individual business, the impact of currency devaluation depends on where that business buys its materials and where it sells its products. St. Paul, Minnesota–based St. Jude Medical, which develops, manufactures, and distributes heart-monitoring and surgical devices, does about a quarter of its business in western Europe. Declines in the dollar-euro exchange rate made its products more competitively priced with those of competing medical suppliers, boosting revenues and profits. When the dollar began to climb again, the growth in value of the euro slowed.[10]

Business transactions are usually conducted in the currency of the particular region in which they take place. When business is conducted in Japan, transactions are likely to be in yen. In the United Kingdom, transactions are in pounds. With the adoption of the euro among the countries of the EU, the number of foreign currencies in that region has been reduced. (The euro is the common currency adopted by some members of the European Union, which include founding members Belgium, Denmark, France, Germany, Greece, Italy, Ireland, Luxembourg, the Netherlands, and the United Kingdom.) Other countries' currencies include the Australian dollar, the Indian rupee, the Italian lira, the Mexican peso, the Taiwanese dollar, and the South African rand.

Exchange rate changes can quickly create—or wipe out—a competitive advantage, so they are important factors in decisions about whether to invest abroad. In Europe, a declining dollar means that a price of ten euros is worth more, so companies are pressured to lower prices. At the same time, the falling dollar makes European vacations less affordable for U.S. tourists because their dollars are worth less relative to the euro.

On the Internet you can find currency converters such as those located at http://beginnersinvest.about.com/cs/currencycalc/index.htm, which can help in your dollar-for-dollar conversions. It also helps you understand how much spending power a U.S. dollar has in other countries.

Currencies that owners can easily convert into other currencies are called *hard currencies*. Examples include the euro, the U.S. dollar, and the Japanese yen. The Russian ruble and many central European currencies are considered soft currencies because they cannot be readily converted. Exporters trading with these countries often prefer to barter, accepting payment in oil, timber, or other commodities that they can resell for hard-currency payments.

The foreign currency market is the largest financial market in the world, with a daily volume in excess of 1.5 trillion U.S. dollars. This is about 50 times the size of the transaction volume of all the equity markets put together, so the foreign exchange market is the most liquid and efficient financial market in the world.

assessment check

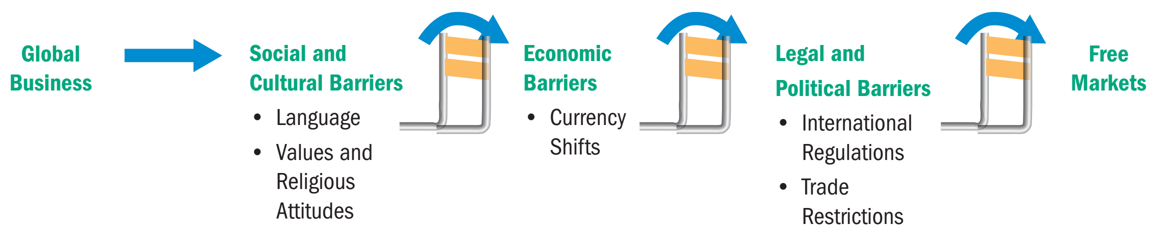
1. Compare balance of trade and balance of payments.
2. Explain the function of an exchange rate.
3. What happens when a currency is devalued?

BARRIERS TO INTERNATIONAL TRADE

All businesses encounter barriers in their operations, whether they sell only to local customers or trade in international markets. Countries such as Australia, Germany, and New Zealand regulate the hours and days retailers may be open. Besides complying with a variety of laws and exchanging currencies, international companies may also have to reformulate their products to accommodate different tastes in new locations. Frito-Lay exports cheeseless Cheetos to Asia, and Domino's Pizza offers pickled-ginger pizzas at its Indian fast-food restaurants.

Figure 4.2

Barriers to International Trade



In addition to social and cultural differences, companies engaged in international business face economic barriers as well as legal and political ones. Some of the hurdles shown in Figure 4.2 are easily breached, but others require major changes in a company's business strategy. To successfully compete in global markets, companies and their managers must understand not only how these barriers affect international trade but also how to overcome them.

Social and Cultural Differences

The social and cultural differences among nations range from language and customs to educational background and religious holidays. Understanding and respecting these differences are critical in the process leading to international business success. Businesspeople with knowledge of host countries' cultures, languages, social values, and religious attitudes and practices are well equipped for the marketplace and the negotiating table. Acute sensitivity to such elements as local attitudes, forms of address, and expectations regarding dress, body language, and timeliness also helps them win customers and achieve their business objectives. See the "Business Etiquette" feature for some tips about courtesy in other cultures.

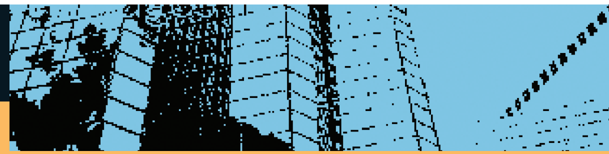
Language English is the second most widely spoken language in the world, followed by Hindustani, Spanish, Russian, and Arabic. Only Mandarin Chinese is more commonly used. It is not uncommon for students abroad for whom English is not their first language to spend eight years of elementary and high school in English language classes. Understanding a business colleague's primary language may prove to be the difference between closing an international business transaction and losing the sale to someone else. Company representatives operating in foreign markets must not only choose correct and appropriate words but also translate words correctly to convey the intended meanings. Firms may also need to rename products or rewrite slogans for foreign markets. See the "Hit & Miss" feature for examples of some spectacular failures in this area.

Potential communication barriers include more than mistranslation. Companies may present messages through inappropriate media, overlook local customs and regulations, or ignore differences in taste. Cultural sensitivity is especially critical in cyberspace. Web site developers must be aware that visitors to a site may come from anywhere in the world. Some icons that seem friendly to U.S. Internet users may shock people from other countries. A person making a high-five hand gesture would be insulting people in Greece; the same is true of making a circle with the thumb and index finger in Brazil and a two-fingered peace sign with the back of the hand facing out in Great Britain. Even colors can pose problems. In the Middle East, people view green as a sacred color, so a green background on a Web page would be inappropriate there.

Gift-giving traditions employ the language of symbolism. For example, in Latin America, knives and scissors should not be given as gifts because they represent the severing of friendship.

"They Said It"

"If you speak three languages, you are trilingual. If you speak two languages, you are bilingual. If you speak one language, you're American."
—Anonymous



(b)usiness (e)tiquette

Global Etiquette: Learning about Differences

Committing a social blunder in class or at home is one thing, but committing one in a foreign country may mean the end of your business relationship with your host. Each culture has its own set of rules and customs, and before you head out to dinner with your foreign business associates or venture into their country for a meeting, you'll need to learn all you can about global etiquette and what is and is not appropriate abroad.

For instance, in Iraq you shake hands gently, always with the right hand, and do not use your left hand to eat, gesture, or touch others. If a woman is present, allow her to greet you first. She will shake hands with only her fingertips.

Here are some additional little-known facts about other countries and their customs:

1. In Chile, business gifts should be of good quality but not lavish, and women should not give gifts to men because the gesture can be misunderstood.
2. When in South Africa, dress well in public because your host will expect it.
3. In Iraq, if you must point at something, use your entire hand, not just one finger, which is considered a sign of contempt.
4. The Chinese do not speak with their hands, so do not use large gestures and remember that men should not touch women in public.
5. In Egypt members of the same sex stand much closer to each other than North Americans and Europeans do, but men and women stand farther apart.
6. Avoid casual dress when doing business in Japan and dress to impress, but remember that shoes will be taken off frequently so they should be easy to remove.
7. It is impolite to show the soles of your shoes in Russia.
8. In Germany sudden changes in business transactions are unwelcome even if they are positive, and humor in business settings is not encouraged.

Most important, learn the basic vocabulary and historical background of the country and region, as well as the proper use of greetings and introductions. Pay attention to your physical gestures, facial expressions, dress, and dining and drinking habits. Mastering the details can save you embarrassment and perhaps make or break your career.

Sources: International Business Center Web site, accessed June 11, 2006, http://www.cyborlink.com; Peter Edidin, "How to Shake Hands or Share a Meal with an Iraqi," *The New York Times*, March 6, 2005, p. WK 7; "City Tips," *Worth*, March 2005.

Flowers are generally acceptable, but Mexicans use yellow flowers in their Day of the Dead festivities, so they are associated with death.

Values and Religious Attitudes Even though today's world is shrinking in many ways, people in different countries do not necessarily share the same values or religious attitudes. Marked differences remain in workers' attitudes from country to country, for instance.

U.S. society places a higher value on business efficiency and low unemployment than European society, where employee benefits are more valued. The U.S. government does not regulate vacation time, and employees typically receive no paid vacation during their first year of employment, then two weeks' vacation, and eventually up to three or four weeks if they stay with the same employer for many years. In contrast, the EU mandates a minimum paid vacation of four weeks per year, and most Europeans get five or six weeks. In these countries, a U.S. company that opens a manufacturing plant would not be able to hire any local employees without offering vacations in line with a nation's business practices.

U.S. culture values national unity, with tolerance of regional differences. The United States is viewed as a national market with a single economy. European countries that are part of the 25-member EU are trying to create a similar marketplace. However, many resist the idea of being European citizens first and British, Danish, or Dutch citizens second. British consumers differ from Italians in important ways, and U.S. companies that fail to recognize this variation will run into problems with brand acceptance.

Religion plays an important role in every society, so businesspeople also must cultivate sensitivity to the dominant religions in countries where they operate. Understanding religious cycles and the timing of major holidays can help prevent embarrassing moments when scheduling meetings, trade shows, conferences, or events such as the opening of a new manufacturing plant. People doing business in Saudi Arabia must take into account Islam's monthlong observance of Ramadan, when work ends at noon. Friday is the Muslim Sabbath, so the Saudi workweek runs from Saturday through

HIT & MISS

Lost in Translation

The fact that product names and marketing slogans don't always translate well from one country or culture to another is widely known. But mistakes still happen. Although Chevrolet denies the popular myth about its Nova flopping in Latin America because *no va* means "won't go" in Spanish, most marketers would agree with British business writer Simon Anholt, who says, "Language is in many respects such a silly little thing, but it has the power to bring marketing directors to their knees. That's where the terror lies."

Here are some recent translation errors made—or avoided—by international automakers.

- Toyota's MR2 is known as the MR in France, because in French "MR-deux" sounds too much like merde, another name for manure.
- Mercedes-Benz shortened "Grand Sports Tourer" to GST, but the initials remind Canadians of an unpopular tax on goods and services dubbed the "gouge and screw tax."
- Ford had to change the name of its Pinto in Brazil, where it connotes part of the male anatomy in Portuguese. The car now goes by the name Corcel.
- Although there was no translation problem, Toyota's Canadian division had international naming troubles of its own. The firm announced plans to introduce its new model, the Celica Tsunami. It quickly backpedaled after the disastrous waves hit Southeast Asia, renaming the car the Celica Sport Package.

Car makers are not alone in their naming troubles. Ikea customers are still wondering who chose the names of the Fartfull workbench. The Mexican firm Corona had to rechristen its beer in Spain, because a winemaker there already bore the same name. Corona was fortunate to adopt Coronita, which is easy to associate with its company name. And Sweden's toffee-and-licorice ice cream product known as Nogger Black has come under fire. "We certainly had no intention that the name 'Nogger' would be associated with any negative word," says its maker, GB Glace.

Questions for Critical Thinking

1. Consultants advise against relying solely on non-native translators to help marketing campaigns cross international lines because they lack detailed knowledge of the language and culture. "You can be saved by the right secretary in another country reading [your communications]," says one. Do you agree? Why or why not?
2. One marketing executive says that even perfect literal translations will not ring true to those in other countries. What does he mean, and why is that a potential problem?

Sources: Timothy Noah, "MooLatte, Bested," *Slate*, accessed June 11, 2006, http://slate.msn.com; "What's in a Name? For Cars, Everything," *Detroit News*, accessed June 11, 2006, http://www.detroitnews.com; Sergio Beristain, "Does Your Brand Register Abroad?" Brandchannel.com, accessed June 11, 2006, http://www.brandchannel.com; Ed Garsten and Brett Clanton, "A Tsunami by Any Other Name," *Time*, January 24, 2005, p. 17; Mark Lasswell, "Lost in Translation," *Business 2.0*, August 2004, pp. 68–70.

Thursday. Furthermore, Muslims abstain from alcohol and consider pork unclean, so gifts of pigskin or liquor would be offensive.

Some devout Muslims have raised concern about interest-bearing loans in their nations, such as car loans or home mortgages, which they fear are to be considered usury by the standards of the Qur'an. However, because Muslims have traditionally been traders, and because the Qur'an supports trade, such reservations are slowly being overcome with the help of arguments by Muslim scholars showing that usury implies that the lender is taking unjust advantage of the borrower. Ordinary loans, on the other hand, can help increase the value of the borrowers' assets or property, and they can also help achieve the goal of helping distribute wealth more widely.[11]

Economic Differences

Business opportunities are flourishing in densely populated countries such as China and India, as local consumers eagerly buy Western products. Although such prospects might tempt American

Lack of infrastructure is a concern for global telecommunications. Chinese firm Huawei Technologies helped develop the industry in China, and it now provides network, data communications, and telecommunications products throughout the world through 8 regional headquarters and 55 branch offices outside China.

firms, managers must first consider the economic factors involved in doing business in these markets. A country's size, per-capita income, and stage of economic development are among the economic factors to consider when evaluating it as a candidate for an international business venture.

Infrastructure Along with other economic measures, businesses should consider a country's **infrastructure.** Infrastructure refers to basic systems of communication (telecommunications, television, radio, and print media), transportation (roads and highways, railroads, and airports), and energy facilities (power plants and gas and electric utilities). The Internet and technology use can also be considered part of infrastructure.

Many consumers in the United States, western Europe, Japan, and Hong Kong own cell phones. Even most of their children have their own phones. So the availability of telecommunications technology creates fertile soil for Internet businesses that use wireless communication. There are about 1.5 billion mobile phone users worldwide, for instance. In rural Kenya, some of the country's 3 million mobile phone users share a phone with several other people, but they enjoy inexpensive text messaging for about a third the cost of sending an e-mail over the country's often unreliable Internet service. A Kenyan firm called OneWorld International has sprung up that puts employers and job seekers in almost instant touch with each other through subscriptions to text messages carried by mobile phone. "The service has an advantage," says a human resource employee for Softa Bottling Company. "It reaches as many people as possible within the shortest time." In fact, about 5,000 people have already signed up for the job search service, which also distributes public health information about AIDS and cancer.[12]

Financial systems also provide a type of infrastructure for businesses. In the United States, buyers have widespread access to checks, credit cards, and debit cards, as well as electronic systems for processing these forms of payment. In many African countries, such as Ethiopia, local businesses do not accept credit cards, so travelers to the capital city, Addis Ababa, are warned to bring plenty of cash and traveler's checks.

Currency Conversion and Shifts Despite growing similarities in infrastructure, businesses crossing national borders encounter basic economic differences: national currencies. Foreign currency fluctuations may present added problems for global businesses. As explained earlier in the chapter, the values of the world's major currencies fluctuate in relation to each other. Rapid and unexpected currency shifts can make pricing in local currencies difficult. Shifts in exchange rates can also influence the attractiveness of various business decisions. A devalued currency may make a nation less desirable as an export destination because of reduced demand in that market. However, devaluation can make the nation desirable as an investment opportunity because investments there will be a bargain in terms of the investor's currency.

Political and Legal Differences

Like social, cultural, and economic differences, legal and political differences in host countries can pose barriers to international trade. Advocates for children in Britain have long fought to ban television advertising aimed at kids. With concerns for childhood obesity on the rise and blame being laid at the door of fast-food advertising, Turner Broadcasting plans a new cartoon series for British TV that will promote fruit and vegetables to young audiences. The program is offered free to other broadcasters. "We wanted to counter the possible negative effects of advertising on kids' TV," says general manager Richard Kilgariff, "but [the program] quickly developed into a positive project to provide parents and broadcasters with a tool to fight obesity."[13]

To compete in today's world marketplace, managers involved in international business must be well versed in legislation that affects their industries. Some countries impose general trade restrictions. Others have established detailed rules that regulate how foreign companies can operate. The one consistency among all countries is the striking lack of consistent laws and regulations governing the conduct of business.

Political Climate An important factor in any international business investment is the stability of the political climate. The political structures of many nations promote stability similar to that in the United States. Other nations, such as Indonesia, Congo, and Bosnia, feature quite different—and frequently changing—structures. Host nations often pass laws designed to protect their own interests, sometimes at the expense of foreign businesses.

In recent years, the political structures of Russia, Turkey, the former Yugoslavia, Hong Kong, and several central European countries including the Czech Republic and Poland have seen dramatic changes. Such political changes almost always bring changes in the legal environment. Hong Kong's status as part of China makes it an economy where political developments produced changes in the legal and cultural environments. Since the collapse of the Soviet Union, Russia has struggled to develop a new market structure and political processes.

Legal Environment When conducting business internationally, managers must be familiar with three dimensions of the legal environment: U.S. law, international regulations, and the laws of the countries where they plan to trade. Some laws protect the rights of foreign companies to compete in the United States. Others dictate actions allowed for U.S. companies doing business in foreign countries.

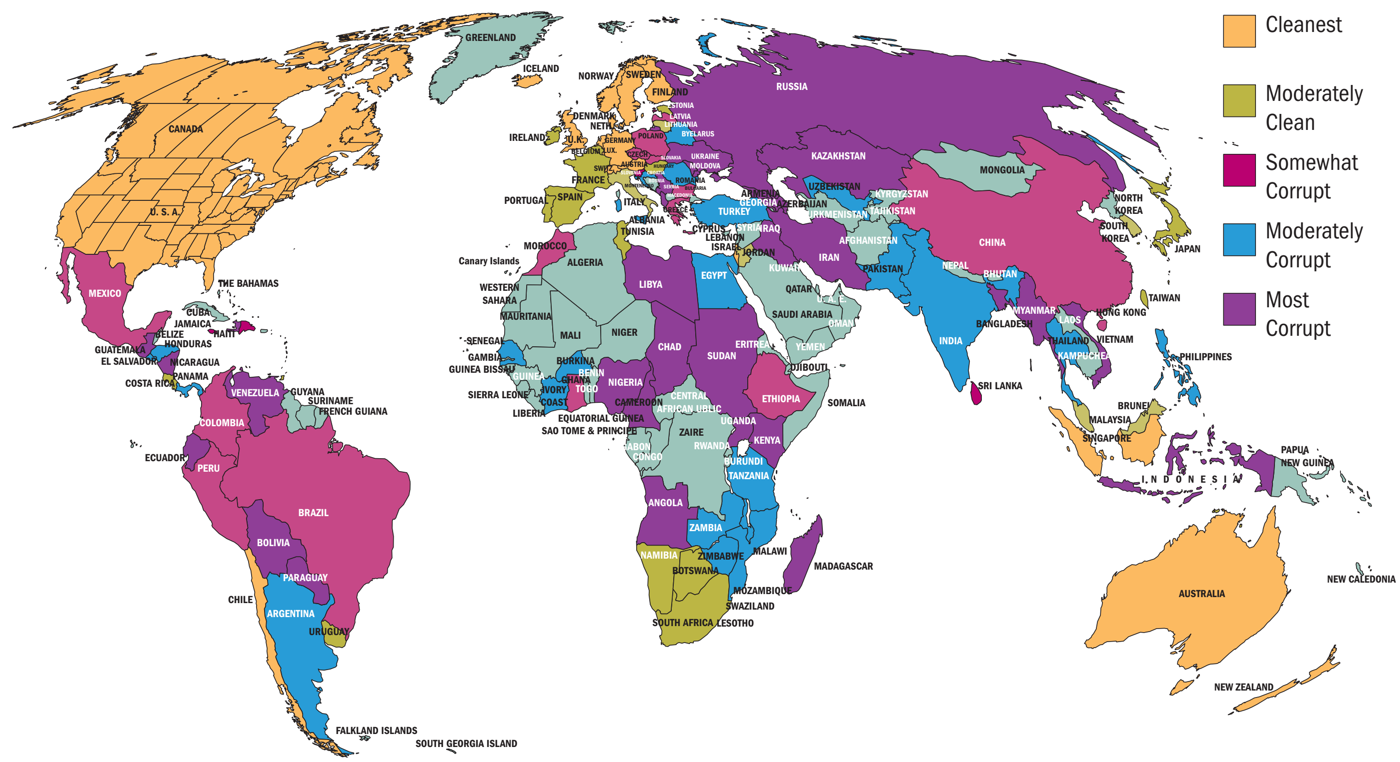
The *Foreign Corrupt Practices Act* forbids U.S. companies from bribing foreign officials, political candidates, or government representatives. This act prescribes fines and jail time for U.S. managers who are aware of illegal payoffs. Until recently, many countries, including France and Germany, not only accepted the practice of bribing foreign officials in countries where such practices were customary but allowed tax deductions for these expenses. The United States, France, Germany, and 33 other countries recently signed the Organization for Economic Cooperation and Development Anti-Bribery Convention. This agreement makes offering or paying bribes a criminal offense and ends the deductibility of bribes.[14]

Still, corruption continues to be an international problem. Its pervasiveness, combined with U.S. prohibitions, creates a difficult obstacle for Americans who want to do business in many foreign countries. Chinese pay *huilu*, and Russians rely on *vzyatka*. In the Middle East, palms are greased with *baksheesh*. Figure 4.3 compares 102 countries based on surveys of perceived corruption. This Corruption Perceptions Index is computed by Transparency International, a Berlin-based international organization that rates the degree of corruption observed by businesspeople and the general public.

The growth of online business has introduced new elements to the legal climate of international business. Patents, brand names, trademarks, copyrights, and other intellectual property are difficult to police, given the availability of information on the Internet. However, some countries are adopting laws to protect information obtained by electronic contacts. Malaysia imposes stiff fines and long jail terms on those convicted of illegally accessing computers and using information that passes through them.

International Regulations To regulate international commerce, the United States and many other countries have ratified treaties and signed agreements that dictate the conduct of international business and protect some of its activities. The United States has entered into

Figure 4.3 Corruption in Business and Government



Source: Data from Transparency International, "Transparency International Annual Corruption Perceptions Index," Internet Center for Corruption Research, http://en.wikipedia.org/wiki/Corruption_Perceptions_Index.

many *friendship, commerce, and navigation treaties* with other nations. Such treaties address many aspects of international business relations, including the right to conduct business in the treaty partner's domestic market. Other international business agreements involve product standards, patents, trademarks, reciprocal tax policies, export controls, international air travel, and international communications.

When Congress granted China full trade relations with the United States, China agreed to lower trade barriers, including subsidies that held down the prices of food exports, restrictions on where foreign law firms can open offices, and taxes charged on imported goods. In exchange for China's promise to halve these taxes, called *tariffs*, the United States granted Chinese businesses equal access to U.S. markets enjoyed by most other countries.

Many types of regulations affect the actions of managers doing business in international markets. Not only must worldwide producers and marketers maintain required minimum quality levels for all the countries in which they operate, but they must comply with numerous specific local regulations. Britain prevents advertisers from encouraging children to engage in such unhealthy behavior as overeating or replacing regular meals with candy and snack foods. Malaysia's Censorship Board prohibits nudity and profanity on TV. Germany and France allow publishers to set prices that retailers charge for their books. Because companies such as Amazon.com adhere to the fixed prices, German customers looking for English-language books can get better prices by buying at the U.K. Web site, even with the extra shipping costs.

A lack of international regulations or difficulty in enforcement can generate its own set of problems. Software piracy offers an example, particularly in Asia. More than 90 percent of all software used in Vietnam, for instance, is pirated, making it the biggest offender against intellectual property rights laws and regulations enforced by the World Trade Organization (WTO) worldwide. Close behind Vietnam were Ukraine, China, Zimbabwe, and Indonesia. Translated into dollars, that level of piracy means a loss of about a third of the software industry's annual revenue of $90 billion, according to a regional director for the Business Software Alliance, a worldwide watchdog agency. Contrary to claims that buying software legally is too expensive, the director said, "If you can afford the hardware, you can afford the software." But piracy remains widespread, despite WTO sanctions against offending nations. And with the number of Internet users expected to rise in China alone by about 100 million people over the next few years, enforcement efforts are likely to increase.[15]

Types of Trade Restrictions

Trade restrictions such as taxes on imports and complicated administrative procedures create additional barriers to international business. They may limit consumer choices while increasing the costs of foreign-made products. Trade restrictions are also imposed to protect citizens' security, health, and jobs. A government may limit exports of strategic and defense-related goods to unfriendly countries to protect its security, ban imports of insecticide-contaminated farm products to protect health, and restrict imports to protect domestic jobs in the importing country.

Other restrictions are imposed to promote trade with certain countries. Still others protect countries from unfair competition. Regardless of the political reasons for trade restrictions, most take the form of tariffs. In addition to tariffs, governments impose a number of nontariff—or administrative—barriers. These include quotas, embargoes, and exchange controls.

Tariffs

Taxes, surcharges, or duties on foreign products are referred to as **tariffs.** Governments assess two types of tariffs—revenue and protective tariffs—both of which make imports more expensive for domestic buyers. Revenue tariffs generate income for the government. Upon returning home, U.S. leisure travelers who are out of the country more than 48 hours and who bring back goods purchased abroad must pay import taxes on their value in excess of $200 to $1,600, depending on the country of origin. This duty goes directly to the U.S. Treasury. The sole purpose of a protective tariff is to raise the retail price of imported products to match or exceed the prices of similar products manufactured in the home country. In other words, protective tariffs seek to level the playing field for local competitors.

tariff tax imposed on imported goods.

Of course, tariffs create a disadvantage to companies that want to export to the countries imposing the tariffs. In addition, governments do not always agree on the reasons behind protective tariffs. So they do not always have the desired effect. The U.S. imposes a tariff on foreign competitors accused of selling products at lower prices in the United States than U.S. manufacturers charge. The government recently passed a bill giving the money from these tariffs directly to U.S. plaintiff companies, instead of to the Treasury as in the past. In retaliation, U.S. exports of paper, textiles, machinery, farm products, oysters, and other products to Canada, Brazil, Chile, India, South Korea, and Mexico will be subject to punitive tariffs of 15 percent, which may end up costing U.S. exporters as much as $150 million a year, a number some observers say will only grow.[16]

Nontariff Barriers

Nontariff, or administrative, trade barriers restrict imports in more subtle ways than tariffs. These measures may take such forms as quotas on imports, restrictive standards for imports, and export subsidies. Because many countries have recently substantially reduced tariffs or eliminated them entirely, they increasingly use nontariff barriers to control flows of imported products.

Quotas limit the amounts of particular products that countries can import during specified time periods. Limits may be set as quantities, such as number of cars or bushels of wheat, or as values, such as dollars' worth of cigarettes. Governments regularly set quotas for agricultural products and sometimes for imported automobiles. Although the U.S. government had previously imposed about 1,000 quotas related to clothing imports from various countries, many of them have now been lifted. Recently, however, quotas on three categories of clothing from China were reinstated, following claims by U.S. manufacturers that the lifting of quotas had created a huge flow of inexpensive cotton garments that might endanger thousands of jobs.[17]

Quotas help prevent **dumping,** a practice that developed during the 1970s. In one form of dumping, a company sells products abroad at prices below its cost of production. In another, a company exports a large quantity of a product at a lower price than the same product in the home market and drives down the price of the domestic product. Dumping benefits domestic consumers in the importing market, but it hurts domestic producers. It also allows companies to gain quick entry to foreign markets.

More severe than a quota, an **embargo** imposes a total ban on importing a specified product or even a total halt to trading with a particular country. Embargo durations can vary to accommodate changes in foreign policy. The U.S. government recently rejected a United Nations resolution opposing the United Sates' long-standing trade embargo on Cuba.

Another form of administrative trade restriction is **exchange controls.** Imposed through a central bank or government agency, exchange controls affect both exporters and importers. Firms that gain foreign currencies through exporting are required to sell them to the central bank or another agency. Importers must buy foreign currencies to pay for their purchases from the same agency. The exchange control authority can then allocate, expand, or restrict foreign exchange in accordance with national policy.

assessment check

1. How might values and attitudes form a barrier to trade, and how can they be overcome?
2. What is a tariff? What is its purpose?
3. Why is dumping a problem for companies marketing goods internationally?

REDUCING BARRIERS TO INTERNATIONAL TRADE

Although tariffs and administrative barriers still restrict trade, overall the world is moving toward free trade. Several types of organizations ease barriers to international trade, including groups that monitor trade policies and practices and institutions that offer monetary assistance. Another type of federation designed to ease trade barriers is the multinational economic community, such as the European Union. This section looks at the roles these organizations play.

Organizations Promoting International Trade

For the 60 years of its existence, the **General Agreement on Tariffs and Trade (GATT),** an international trade accord, sponsored a series of negotiations, called rounds, that substantially reduced worldwide tariffs and other barriers. Major industrialized nations founded the multinational organization in 1947 to work toward reducing tariffs and relaxing import quotas. The last set of negotiations—the Uruguay Round—cut average tariffs by one-third, in excess of $700 billion; reduced farm subsidies; and improved protection for copyright and patent holders. In addition, international trading rules now apply to various service industries. Finally, the new agreement established the **World Trade Organization (WTO)** to succeed GATT. This organization includes representatives from 149 countries.

World Trade Organization (WTO) 149-member international institution that monitors GATT agreements and mediates international trade disputes.

World Trade Organization

Since 1995, the WTO has monitored GATT agreements among the member nations, mediated disputes, and continued the effort to reduce trade barriers throughout the world. Unlike provisions in GATT, the WTO's decisions are binding on parties involved in disputes.

The WTO has grown more controversial in recent years as it issues decisions that have implications for working conditions and the environment in member nations. Concerns have been expressed that the WTO's focus on lowering trade barriers encourages businesses to keep costs down through practices that may increase pollution and human rights abuses. Particularly worrisome is the fact that the organization's member countries must agree on policies, and developing countries tend not to be eager to lose their low-cost advantage by enacting stricter labor and environmental laws. Other critics claim that if well-funded U.S. firms such as fast-food chains, entertainment companies, and Internet retailers can freely enter foreign markets, they will wipe out smaller foreign businesses serving the distinct tastes and practices of other countries' cultures.

Trade unions in developed nations complain that the WTO's support of free trade makes it easier to export manufacturing jobs to low-wage countries. According to the U.S. Department of Commerce, about a million U.S. jobs are lost each year as a result of imports or movement of work to other countries, and the pace of the migration has increased in the last few years. They are not always minimum-wage jobs either. But many small and midsized firms have benefited from the WTO's reduction of trade barriers and lowering of the cost of trade. They currently make up 97 percent of all firms that export goods and services, according to the Department of Commerce. "Trade is now seamless and global," says Randy Tofteland, CEO of SoftBrands, a Minneapolis firm with 500 employees that sells software for the hospitality industry. "Those that take advantage of it are going to be the long-term winners."[18]

The most recent round of WTO talks was called the *Doha Round* after the city in Qatar where it began. After several years of heated disputes and collapsed negotiations, the eight leading industrial nations committed themselves to successful conclusion of the talks. Under discussion were ways to improve global agricultural trade and trade among developing countries. The leaders worked to reduce domestic price supports, eliminate export subsidies, and improve market access for goods. Such changes should help farmers in developing countries compete in the global market.[19]

Although free trade can indeed contribute to economic growth and change, including the creation of new jobs, concerns about WTO policy have led to protest demonstrations—sometimes violent—beginning with the WTO meeting in Seattle a few years ago.

World Bank Shortly after the end of World War II, industrialized nations formed an organization to lend money to less developed and developing countries. The **World Bank** primarily funds projects that build or expand nations' infrastructure such as transportation, education, and medical systems and facilities. The World Bank and other development banks provide the largest source of advice and assistance to developing nations. Often, in exchange for granting loans, the World Bank imposes requirements intended to build the economies of borrower nations.

The World Bank has been criticized for making loans with conditions that ultimately hurt the borrower nations. When developing nations are required to balance government budgets, they are sometimes forced to cut vital social programs. Critics also say that the World Bank should consider the impact of its loans on the environment and the treatment of workers.

International Monetary Fund Established a year after the World Bank, the **International Monetary Fund (IMF)** was created to promote trade through financial cooperation and, in the process, eliminate barriers. The IMF makes short-term loans to member nations that are unable to meet their expenses. It operates as a lender of last resort for troubled nations. In exchange for these emergency loans, IMF lenders frequently require significant commitments from the borrowing nations to address the problems that led to the crises. These steps may include curtailing imports or even devaluing currencies. Throughout its existence, the IMF has worked to prevent financial crises by warning the international business community when countries encounter problems meeting their financial obligations. Often, the IMF lends to countries to keep them from defaulting on prior debts and to prevent economic crises in particular countries from spreading to other nations.

However, some countries owe far more money than they can ever hope to repay, and the debt payments make it impossible for their governments to deliver desperately needed services to their citizens. The nations of sub-Saharan Africa are hard-pressed to deal with the ravages of AIDS, yet their debt exceeds their GDP and is three times as high as their total annual exports. The so-called Group of Eight economic powers—the United States, Britain, France, Germany, Japan, Italy, Canada, and Russia—recently agreed to offer full debt relief to African countries that are working toward government reforms on behalf of education and welfare.[20]

"They Said It"

"The merchant has no country."
—Thomas Jefferson (1743–1826) 3rd president of the United States

International Economic Communities

International economic communities reduce trade barriers and promote regional economic integration. In the simplest approach, countries may establish a *free-trade area* in which they trade freely among themselves without tariffs or trade restrictions. Each maintains its own tariffs for trade outside this area. A *customs union* sets up a free-trade area and specifies a uniform tariff structure for members' trade with nonmember nations. In a *common market*, or economic union, members go beyond a customs union and try to bring all of their trade rules into agreement.

North American Free Trade Agreement (NAFTA) agreement among the United States, Canada, and Mexico to break down tariffs and trade restrictions.

One example of a free-trade area is the **North American Free Trade Agreement (NAFTA)** enacted by the United States, Canada, and Mexico. Other examples of regional trading blocs include the MERCOSUR customs union (joining Brazil, Argentina, Paraguay, Uruguay, Chile, and Bolivia) and the ten-country Association of South East Asian Nations (ASEAN).

COURTESY OF ONTARIO MINISTRY OF ECONOMIC DEVELOPMENT AND TRADE.

This message from Ontario, Canada, promotes the province's favorable business climate. The ad states that more than 1,500 multinational companies are located there and highlights the province's low basic business costs and educated workforce.

NAFTA

NAFTA became effective in 1994, creating the world's largest free-trade zone with the United States, Canada, and Mexico. With a combined population of more than 435 million and a total GDP of nearly $14 trillion, North America represents one of the world's most attractive markets. The United States—the single largest market and one of the world's most stable economies—dominates North America's business environment. Although fewer than 1 person in 20 lives in the United States, the nation's more than $11 trillion GDP represents about one-fifth of total world output.[21]

Canada is far less densely populated but has achieved a similar level of economic development. In fact, Canada's economy is booming and has been growing at a faster rate than the U.S. economy in recent years. More than two-thirds of Canada's GDP is generated in the services sector, and three of every four Canadian workers are engaged in service occupations. The country's per-capita GDP places Canada in the top ten nations in terms of its people's spending power. Canada's economy is fueled by trade with the United States, and its home markets are strong as well. The United States and Canada are each other's biggest trading partners. About 85 percent of Canada's exports and about 60 percent of its imports are to or from the United States.[22] U.S. business is also attracted by Canada's human resources. For instance, all major U.S. automakers have large production facilities in Canada.

Mexico is moving from developing nation to industrial nation status, thanks largely to NAFTA. Mexico's trade with the United States and Canada has tripled since the signing of NAFTA, although 40 percent of the country's 106 million people still live below the poverty line and per-capita income is a quarter that of the United States.[23] But Mexico's border with the United States is busy with a nearly endless stream of traffic transporting goods from Mexican factories into the United States. Along its so-called NAFTA Highway between Nuevo Laredo, Mexico, and Laredo, Texas, $52 billion worth of appliances, auto parts, computers, and other goods made the trip in a recent year—amounting to 38 percent of all Mexican exports to the United States.[24]

By eliminating all trade barriers and investment restrictions among the United States, Canada, and Mexico over a fifteen-year period, NAFTA opens more doors for free trade. The agreement also eases regulations governing services, such as banking, and establishes uniform legal requirements for protection of intellectual property. The three nations can now trade with one another without tariffs or other trade barriers, simplifying shipments of goods across the partners' borders. Standardized customs and uniform labeling regulations create economic efficiencies and smooth import and export procedures. Trade among the partners has increased steadily, more than doubling since NAFTA took effect.

CAFTA

Passed by Congress and signed by President Bush in 2005, the **Central American Free Trade Agreement (CAFTA)** created a free-trade area among the United States, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua. The agreement ends most tariffs on nearly $33 billion in products traded between the United States and its Latin American neighbors. Agricultural producers such as corn, soybean, and dairy farmers stand to gain under the relaxed trade rules. U.S. sugar producers, which were supported by subsidies keeping their prices higher than the rest of the world's, fought against CAFTA's passage. And labor unions complained that the agreement would lower labor standards and export millions more jobs to lower-wage countries. But overall, CAFTA's effects should be positive, increasing both exports and imports substantially, much as NAFTA did.[25]

Central American Free Trade Agreement (CAFTA) agreement among the United States, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua to reduce tariffs and trade restrictions.

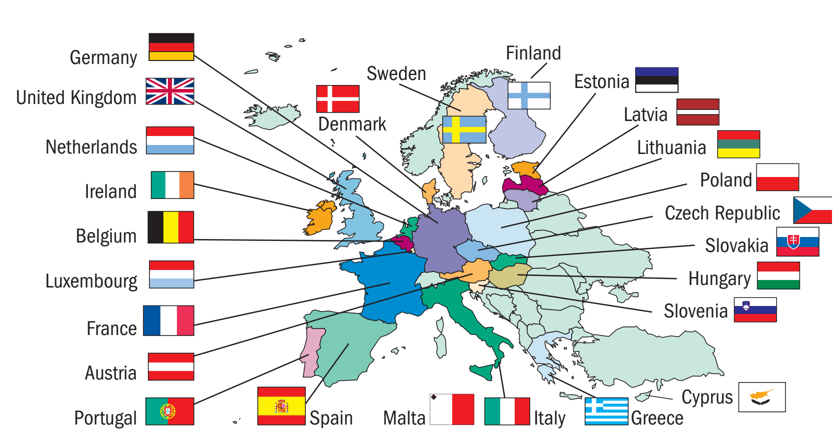
European Union (EU) 25-nation European economic alliance.

European Union

Perhaps the best-known example of a common market is the **European Union (EU).** The EU combines 25 countries, more than 450 million people, and a total GDP exceeding $12 trillion to form a huge common market.[26] As Figure 4.4 shows, ten countries—Cyprus, Malta, Estonia, Latvia, Lithuania, Hungary, Poland, the Czech Republic, Slovakia, and Slovenia—are the latest EU members. Some observers think the EU's efforts to unite Europe suffered a setback after two countries, France and the Netherlands, voted against the proposed constitution intended to make the organization run more smoothly after its recent enlargement from 15 to 25 states. All 25 must ratify the constitution before it can take effect.[27]

Figure 4.4

The 25 Nations of the European Union



PHOTODISC/GETTY IMAGES

PHOTODISC/GETTY IMAGES

Twelve of the European Union member states use the euro (€) and so quote prices in that currency (left). Denmark, Sweden, and Great Britain (£) still use their traditional currency, the pound note.

The EU's goals include promoting economic and social progress, introducing European citizenship as a complement to national citizenship, and giving the EU a significant role in international affairs. To achieve its goal of a borderless Europe, the EU is removing barriers to free trade among its members. This highly complex process involves standardizing business regulations and requirements, standardizing import duties and taxes, and eliminating customs checks so that companies can transport goods from England to Italy or Poland as easily as from New York to Boston.

Unifying standards and laws can contribute to economic growth. But just as NAFTA sparked fears in the United States about free trade with Mexico, some people in western Europe worried that opening trade with such countries as Poland, Hungary, and the Czech Republic would cause jobs to flow eastward to lower-wage economies.

The EU also introduced the euro to replace currencies such as the French franc and Italian lira. For the twelve member states that have already adopted the euro, potential benefits include eliminating the economic costs of currency exchange and simplifying price comparisons. Businesses and their customers now make check and credit card transactions in euros and use euro notes and coins in making cash purchases.

assessment check

1. What international trade organization succeeded GATT and what is its goal?
2. Compare and contrast the goals of the World Bank and the International Monetary Fund.
3. Identify the members of NAFTA and briefly explain how it works.
4. What are the goals of the European Union and how do they promote international trade?

GOING GLOBAL

While expanding into overseas markets can increase profits and marketing opportunities, it also introduces new complexities to a firm's business operations. Before deciding to go global, a company faces a number of key decisions, beginning with the following:

- Determining which foreign market(s) to enter
- Analyzing the expenditures required to enter a new market
- Deciding the best way to organize the overseas operations

These issues vary in importance depending on the level of involvement a company chooses. Education and employee training in the host country would be much more important for an electronics manufacturer building an Asian factory than for a firm that is simply planning to export American-made products.

The choice of which markets to enter usually follows extensive research focusing on local demand for the firm's products, availability of needed resources, and ability of the local workforce to produce world-class quality. Other factors include existing and potential competition, tariff rates, currency stability, and investment barriers. A variety of government and other sources are available to facilitate this research process. A good starting place is the CIA's *World Factbook*, which contains country-by-country information on geography, population, government, economy, and infrastructure.

U.S. Department of Commerce counselors at the agency's district offices offer a full range of international business advice, including computerized market data and names of business and government contacts in dozens of countries. As Table 4.3 shows, the Internet provides access to many resources for international trade information.

Levels of Involvement

After a firm has completed its research and decided to do business overseas, it can choose one or more strategies:

- Exporting or importing
- Entering into contractual agreements such as franchising, licensing, and subcontracting deals
- Direct investment in the foreign market through acquisitions, joint ventures, or establishment of an overseas division

Although the company's risk increases with the level of its involvement, so does its overall control of all aspects of producing and selling its goods or services.

Companies frequently combine more than one of these strategies. Web portal Yahoo! used joint ventures with local firms to gain a quick presence in Japan, Britain, France, Germany, and South Korea. Only after developing experience as an international company has Yahoo! begun to engage in direct investment by creating foreign subsidiaries. Waiting to develop expertise before moving overseas is risky for online businesses, though, because Web sites are so easy for competitors to copy. Alando, an auction Web site based in Germany, looked remarkably like eBay. Rather than fight the company, eBay entered Germany by acquiring Alando.

"They Said It"

"A day will come when you, France; you, Russia; you, Italy; you, England; you, Germany—all of you nations of the continent, will, without losing your distinctive qualities, be blended into a European fraternity."
—*Victor Hugo (1802–1885) French poet and novelist*

Table 4.3

International Trade Research Resources on the Internet

Web Site and Address	General Description
Asia, Inc. http://www.asia-inc.com	Business news in Asia, featuring articles on Asian countries from India to Japan
Europages http://www.europages.com	Directory of and links to Europe's top 500,000 companies in 33 European countries
World Trade Organization http://www.wto.int	Details on the trade policies of various governments
CIA World Factbook http://www.cia.gov/cia/publications/factbook	Basic facts about the world's nations, from geography to economic conditions
STAT-USA http://www.stat-usa.gov	Extensive trade and economic data, information about trends, daily intelligence reports, and background data (access requires paid subscription to the service)
U.S. Commercial Service http://www.export.gov/comm_svc	Information about Commerce Department counseling services, trade events, and U.S. export regulations
U.S. Business Advisor http://www.business.gov	One-stop access to a range of federal government information, services, and transactions
U.S. State Department http://www.travel.state.gov/travel/cis_pa_tw/tw/tw_1764.html	Listing of the State Department's latest travel warnings about conditions that may affect safety abroad, supplemented by the list of consulate addresses and country information

Importers and Exporters When a firm brings in goods produced abroad to sell domestically, it is an importer. Conversely, companies are exporters when they produce—or purchase—goods at home and sell them in overseas markets. An importing or exporting strategy provides the most basic level of international involvement, with the least risk and control.

Roots, a Canadian clothing manufacturer, has used its success as the chosen outfitter of the U.S. and Canadian Olympic teams to expand its apparel and sportswear brands into the United States and Asia. The company already has 140 stores in Canada and about 70 in Korea, 12 in Taiwan, and 5 in the United States. Roots earns about $200 million in annual sales and now sells eyewear, watches, and fragrance as well.[28]

Exports are frequently handled by special intermediaries called export trading companies. These firms search out competitively priced local merchandise and then resell it abroad at prices high enough to cover expenses and earn profits. When a retail chain such as Dallas-based Pier One Imports wants to purchase West African products for its store shelves, it may contact an export trading company operating in a country such as Ghana. The local firm is responsible for monitoring quality, packaging the order for transatlantic shipment, arranging transportation, and arranging for completion of customs paperwork and other steps required to move the product from Ghana to the United States.

Firms engage in exporting of two types: indirect and direct. A company engages in *indirect exporting* when it manufactures a product, such as an electronic component, that becomes part of another product that is sold in foreign markets. The second method, *direct exporting*, occurs when a company seeks to sell its products in markets outside its own country, as Red Bull does with its energy drink, which is discussed in the "Hit & Miss" feature. Often the first step for companies entering foreign markets, direct exporting is the most common form of international business. Firms that succeed in exporting their products may then move on to other entry strategies.

In addition to reaching foreign markets by dealing with export trading companies, exporters may choose two other alternatives: export management companies and offset agreements. Rather than simply relying on an export trading company to assist in foreign markets, an exporting firm may turn to an *export management company* for advice and expertise. These international specialists help the exporter complete paperwork, make contacts with local buyers, and comply with local laws governing labeling, product safety, and performance testing. At the same time, the exporting firm retains much more control than would be possible with an export trading company.

An *offset agreement* matches a small business with a major international firm. It basically makes the small firm a subcontractor to the larger one. Such an entry strategy helps a new exporter by allowing it to share in the larger company's international expertise. The small firm also benefits in such important areas as international transaction documents and financing, while the larger company benefits from the local expertise and capabilities of its smaller partner.

Countertrade A sizable share of international trade involves payments made in the form of local products, not currency. This system of international bartering agreements is called **countertrade.**

A common reason for resorting to international barter is inadequate access to needed foreign currency. To complete an international sales agreement, the seller may agree to accept part or all of the purchase cost in merchandise rather than currency. Because the seller may decide to locate a buyer for the bartered goods before completing the transaction, a number of international buyers and sellers frequently join together in a single agreement.

Countertrade may often be a firm's only opportunity to enter a particular market. Many developing countries simply cannot obtain enough credit or financial assistance to afford the

HIT & MISS

Red Bull Charges into Global Markets

Few people would expect a drink with a sour berry taste, an outsized price, and ingredients such as amino acid taurine and a carbohydrate called glucuronolactone to capture half of the U.S. energy drink market. But that's exactly what Austrian-based Red Bull has done.

After successfully branching out across Europe, the drink was introduced in the United States with the slogan "Red Bull Gives You Wings." Red Bull packs 80 milligrams of caffeine per 8.3-ounce can, more than twice as much as found in 12 ounces of Coke, and nearly as many calories—110 to the larger Coke's 140. It owes the ingredients taurine and glucuronolactone to the recipe for a tonic discovered in Asia by CEO Dietrich Mateschitz. But the sugar and caffeine, with carbonation added for Western palates, have helped popularize it. College students, club patrons, fans of extreme sports, and truck drivers all pay $2 a can for Red Bull's jolt.

"When we first started, we said there is no existing market for Red Bull, but Red Bull will create it," says Mateschitz. The drink has benefited from an unusual marketing campaign, funded by 30 percent of annual revenues. The Coca-Cola Company, by comparison, spends less than 10 percent of revenues on marketing. Saturating the market with samples, sponsoring hundreds of aspiring athletes, and staging extreme sports events around the world are just a few of the strategies that help increase U.S. sales about 40 percent a year. What could be more appropriate for a hip energy drink than sponsoring a flying contest in which all the flying machines are homemade?

The company is also test-marketing an herbal tea that claims to boost the immune system, and Mateschitz believes many new products lie ahead. "We have the next hundred years in front of us," he says.

Questions for Critical Thinking

1. Do you think it was a smart move to introduce Red Bull throughout Europe before exporting it to the United States? Why or why not?
2. Red Bull sells well in more than 100 countries. What do you think accounts for its success in so many different cultures?

Sources: "Red Bull Founder Rides Wave of Success," 2004 Global Business Influentials, CNN.com, accessed June 11, 2006, http://cnnstudentnews.cnn.com; Christopher Palmeri, "Hansen Natural: Charging at Red Bull with a Brawny Energy Brew," *BusinessWeek*, June 6, 2005, pp. 74–77; Kerry A. Dolan, "The Soda with Buzz," *Forbes*, March 28, 2005, pp. 126–130.

imports that their people want. Countries with heavy debt burdens also resort to countertrade. Russian buyers, whose currency is often less acceptable to foreign traders than the stronger currencies of countries such as the United States, Great Britain, Japan, and EU countries, may resort to trading local products ranging from crude oil to diamonds to vodka as payments for purchases from foreign companies unwilling to accept Russian rubles. Still other countries, such as China, may restrict imports. Under such circumstances, countertrade may be the only practical way to win government approval to import needed products.

Contractual Agreements Once a company, large or small, gains some experience in international sales, it may decide to enter into contractual agreements with local parties. These arrangements can include franchising, foreign licensing, and subcontracting.

Franchising Common among U.S. companies, franchising can work well for companies seeking to expand into international markets, too. A **franchise,** as described in detail in Chapter 5, is a contractual agreement in which a wholesaler or retailer (the franchisee) gains the right to sell the franchisor's products under that company's brand name if it agrees to the related operating requirements. The franchisee can also receive marketing, management, and

Hello Kitty is a worldwide product-licensing phenomenon. Sanrio, the Japanese company that owns the cartoon character, gets nearly $500 million in revenue each year from the furry feline. Shown here perched on a mobile phone, Hello Kitty has also adorned keychains, screen savers, bracelets, pillows, and tens of thousands of other items in its 30-year-plus history.

business services from the franchisor. While these arrangements are common among leading fast-food brands such as McDonald's and KFC, other kinds of service providers also often look to franchising as an international marketplace option.

Domino's Pizza has expanded by about 1,200 franchised stores over the last few years, and two-thirds of them are outside the United States. The pizza company's largest international market is in Mexico, where it is bigger than McDonald's and Burger King combined, and it is also succeeding in Taiwan and Japan. To entice Chinese consumers, who are more interested in dining out than in having food delivered, the chain is trying larger stores with eating areas.[29]

Foreign Licensing In a **foreign licensing agreement,** one firm allows another to produce or sell its product, or use its trademark, patent, or manufacturing processes, in a specific geographical area. In return, the firm gets a royalty or other compensation.

Licensing can be advantageous for a small manufacturer eager to launch a well-known product overseas. Not only does it get a proven product from another market, but little or no investment is required to begin operating. The arrangement can also allow entry into a market otherwise closed to imports due to government restrictions. The popular Hello Kitty cartoon character, for instance, appears on about 22,000 different products around the world at any given time, with hundreds of new items appearing every month as old ones are "retired." Sanrio, the Japanese company that owns the character, produces about 6,000 Hello Kitty items itself. It licenses the wide-eyed cat to other manufacturers such as a winery that makes a Hello Kitty Beaujolais and Mitsubishi, which made a pink Hello Kitty minicar for several years. Other license holders have made Hello Kitty laptops, cell phones, thermoses, and even computer USB hubs and a luxury trailer from Airstream.[30]

Subcontracting The third type of contractual agreement, **subcontracting,** involves hiring local companies to produce, distribute, or sell goods or services. This move allows a foreign firm to take advantage of the subcontractor's expertise in local culture, contacts, and regulations. Subcontracting works equally well for mail-order companies, which can farm out order fulfillment and customer service functions to local businesses. Manufacturers practice subcontracting to save money on import duties and labor costs, and businesses go this route to market products best sold by locals in a given country. Some firms, such as Maryland-based Pacific Bridge Medical, help medical manufacturers find reliable subcontractors and parts suppliers in Asia.[31] Whirlpool, the appliance maker, subcontracts to India and China the manufacture of many of its products, particularly washing machines and refrigerators intended for sale in local markets. These household appliances often require subtle design changes to conform to Asian consumers' needs.[32]

A key disadvantage of subcontracting is that companies cannot always control their subcontractors' business practices. Several major U.S. companies have been embarrassed by reports that their subcontractors used child labor to manufacture clothing.

Offshoring While it is not generally considered a way of initiating business internationally, *offshoring*, or the relocation of business processes to a lower-cost location overseas, has become a widespread practice. China has emerged as the preferred destination for production off-

ARE MANUFACTURERS TAKING ADVANTAGE OF THE AMERICAN JOBS CREATION ACT?

The American Jobs Creation Act of 2004 was an attempt to keep manufacturing jobs in the United States The act granted tax relief to U.S. manufacturers based on the portion of income derived from domestic production. The income ceiling was limited to 50 percent of wages.

The law also created a 9 percent tax deduction to be phased in over six years, repealed export taxes, imposed a one-year moratorium on foreign profits reinvested in the United States, and gave small business capital investment breaks. But lobbyists for various special interests ensured that about 200,000 different manufacturers got the tax breaks, sometimes by stretching the definition of a manufacturing job. For instance, some of the coffee baristas at Starbucks were counted as manufacturing industry workers, along with employees of movie theaters, shopping malls, and NASCAR. The net result in terms of tax revenue lost and jobs created or saved remains to be seen.

Is it ethical for firms to interpret the American Jobs Creation Act in ways that allow the greatest possible tax break, if the purpose is to save jobs?

PRO

1. U.S. manufacturers pay higher tax rates than in any other industrialized country, and they need tax relief to remain competitive and keep jobs at home.
2. The bill is beneficial because it also closes loopholes that allowed businesses to avoid taxes by sending jobs overseas.

CON

1. It is never ethical to stretch a law for any purpose other than what lawmakers intended.
2. Including industries that are not true manufacturers will deprive the government of revenue it could use to strengthen business and save jobs in other ways such as retraining programs.

Summary

The law's effect, in terms of tax revenue and jobs, is still uncertain at this point. The National Association of Manufacturers (NAM) is very optimistic, however. "Over the next 10 years, this landmark legislation will save U.S. manufacturers billions of dollars and create hundreds of thousands of new jobs," said NAM president and former Michigan governor John Engler.

Sources: "President Bush Signs Important Tax Relief for America's Job Creators," press release, House Committee on Ways and Means, accessed June 11, 2006, http://waysandmeans.house.gov; "NAM Says New Tax Measure Is Great News for American Companies and Workers," National Association of Manufacturers, accessed June 11, 2006, http://www.nam.org; Bill Thomas, "Industry Tax Relief Rewards," *Washington Times*, accessed June 11, 2006, http://www.washtimes.com; "Landmark Business Tax Relief Bill Signed into Law," National Association of Manufacturers, accessed June 11, 2006, http://www.nam.org.

solving an ETHICAL controversy

shoring, and India for services offshoring. Many business leaders argue, in favor of offshoring, that global firms must keep their costs as low as possible to remain competitive. But the apparent link between jobs sent overseas and jobs lost at home has made the practice controversial. Legislatures of various states have tried to slow the tide of offshoring through new laws, but many observers believe the real goal should be to improve corporate research and development efforts in the United States. Education reforms, professional retraining, and investment in research and development are among the initiatives cited by a recent survey of professionals in business, government, and higher education.[33] The "Solving an Ethical Controversy" feature considers the effects of the new American Jobs Creation Act, which was intended to slow the loss of jobs to overseas labor markets.

In the meantime, offshoring allows firms such as San Jose–based PortalPlayer, a manufacturer of hardware and software for MP3 media players, to operate almost around the clock. They work with colleagues in India with a twelve-hour time difference. "We keep passing the baton between California and India, and that way, we can cram a lot more work into a 24-hour period," says PortalPlayer's vice president.[34]

"They Said It"

"Outsourcing is just a new way of doing international trade."

—N. Gregory Mankiw (b. 1958)

Former chairman, Council of Economic Advisers

International Direct Investment Investing directly in production and marketing operations in a foreign country is the ultimate level of global involvement. Over time, a firm may become successful at conducting business in other countries through exporting and contractual agreements. Its managers may then decide to establish manufacturing facilities in those countries, open branch offices, or buy ownership interests in local companies.

In an *acquisition*, a company purchases another existing firm in the host country. An acquisition permits a largely domestic business operation to gain an international presence very quickly. This advantage was probably what made the purchase of IBM's ailing Personal Computing Division so attractive to Lenovo Group, the largest PC manufacturer in China. The acquisition boosts Lenovo's share of the Chinese PC market to about a third; in comparison, Dell has about 8 percent. Anchored by a large investment in the company by the Chinese government, which isn't pushing for the quick profits most Western companies must deliver, Lenovo stands poised to make a big impact both at home and abroad. "This is the big experiment," said an information technology consultant. "China is already the factory of the world. Now they're testing whether they can raise the value of that output."[35]

Joint ventures allow companies to share risks, costs, profits, and management responsibilities with one or more host country nationals. H. J. Heinz's European unit recently acquired a majority stake in Petrosoyuz, a top Russian maker of mayonnaise, ketchup, and other condiments and sauces. The two companies formed a new joint venture company to market the products in Russia and its neighbors in Eastern Europe. The CEO of Heinz Europe said of the move, "This joint venture is consistent with our European strategy to build our core businesses in the rapidly emerging markets of eastern Europe. Additionally, it will give Heinz access to local market understanding that will allow us to expand sales of other popular Heinz brands and products throughout Russia."[36]

By setting up an *overseas division*, a company can conduct a significant amount of its business overseas. This strategy differs from that of a multinational company in that a firm with overseas divisions remains primarily a domestic organization with international operations. Panasonic and General Electric, for instance, both rely on overseas divisions. Panasonic's Automotive Systems Company, headquartered in Japan, has overseas divisions in the United States, Mexico, Germany, China, Thailand, Taiwan, and the Czech Republic.[37] General Electric's energy technology company, GE Energy, has headquarters in Atlanta and divisions in Barcelona; Florence, Italy; and Shanghai. Its transportation division has locations in Canada, Italy, and Brazil.[38]

assessment check

1. Name three possible strategies for beginning overseas business operations.
2. What is countertrade?
3. Compare and contrast licensing and subcontracting.
4. Describe joint ventures.

From Multinational Corporation to Global Business

A **multinational corporation (MNC)** is an organization with significant foreign operations. As Table 4.4 shows, firms headquartered in the United States make up half the list of the world's largest multinationals. The United Kingdom and the Netherlands have two companies each, and Japan's Toyota Motor rounds out the top ten.

Many U.S. multinationals, including Nike and Wal-Mart, have expanded their overseas operations because they believe that domestic markets are peaking and foreign markets offer greater sales and profit potential. Other MNCs are making substantial investments in developing countries in part because these countries provide low-cost labor compared with the United States and western Europe. In addition, many MNCs are locating high-tech facilities in countries with large numbers of technical school graduates, such as India.

multinational corporation (MNC) firm with significant operations and marketing activities outside its home country.

Table 4.4

The World's Leading Companies (Based on a Combined Ranking for Sales, Profits, Assets, and Market Value)

Rank and Company	Business	Country of Origin
1. Citigroup	Banking	United States
2. General Electric	Conglomerate	United States
3. Bank of America	Banking	United States
4. American International Group	Insurance	United States
5. HSBC Group	Banking	United Kingdom
6. Exxon Mobil	Oil and gas	United States
7. Royal Dutch/Shell Group	Oil and gas	Netherlands
8. BP (British Petroleum)	Oil and gas	United Kingdom
9. JPMorgan Chase	Financial Services	United States
10. UBS	Financial Services	Switzerland

Source: "The World's Leading Companies," *Forbes*, accessed May 19, 2006, http://www.forbes.com.

DEVELOPING A STRATEGY FOR INTERNATIONAL BUSINESS

In developing a framework in which to conduct international business, managers must first evaluate their corporate objectives, organizational strengths and weaknesses, and strategies for product development and marketing. They can choose to combine these elements in either a global strategy or a multidomestic strategy.

Global Business Strategies

In a **global business** (or *standardization*) **strategy,** a firm sells the same product in essentially the same manner throughout the world. Many companies simply modify their domestic business strategies by translating promotional brochures and product-use instructions into the languages of the host nations. Toyota adapts its marketing not only to international markets but to consumer segments within nations. The company's new Scion model is aimed at U.S. youth.[39]

global business strategy offering a standardized, worldwide product and selling it in essentially the same manner throughout a firm's domestic and foreign markets.

A global marketing perspective can be appropriate for some goods and services and certain market segments that are common to many nations. The approach works for products with nearly universal appeal and for luxury items such as jewelry. But food retailers such as McDonald's, PepsiCo, and KFC have discovered how much they must adapt their products to consumer tastes in China, for instance. Spinach, egg, and tomato soup is on KFC's menu in China, as are red-bean sundaes at McDonald's. PepsiCo's Frito-Lay chips are lemon-flavored and packaged in pastel colors to accommodate Chinese consumers' love of product flavors and designs that suggest coolness in hot weather. The redesigned chips became Lay's best-selling new product in China.[40] Scientific equipment, on the other hand, is not bound by geographical differences.

Multidomestic Business Strategies

multidomestic business strategy developing and marketing products to serve different needs and tastes of separate national markets.

Under a **multidomestic business** (or *adaptation*) **strategy,** the firm treats each national market in a different way. It develops products and marketing strategies that appeal to the customs, tastes, and buying habits of particular national markets. Companies that neglect the global nature of the Internet can unwittingly cause problems for potential customers by failing to adapt their strategy. European consumers, for instance, were at first hesitant to adopt online ordering of products ranging from books to railroad tickets. But in recent years, Internet use in western Europe has grown dramatically. Companies as diverse as the European divisions of Amazon.com; Egg PLC of London, an online financial services company; and the French national railroad have seen the numbers of visitors to their Web sites climbing, along with Internet revenues.

assessment check

1. What is a global business strategy? What are its advantages?
2. What is a multidomestic business strategy? What are its advantages?

WHAT'S AHEAD

Examples in this chapter indicate that both large and small businesses are relying on world trade, not just major corporations. Chapter 5 examines the special advantages and challenges that small-business owners encounter. In addition, a critical decision facing any new business is the choice of the most appropriate form of business ownership. Chapter 5 also examines the major ownership structures—sole proprietorship, partnership, and corporation—and assesses the pros and cons of each. The chapter closes with a discussion of recent trends affecting business ownership, such as the growing impact of franchising and business consolidations through mergers and acquisitions.

SUMMARY OF LEARNING GOALS

1 Explain the importance of international business and the primary reasons nations trade.

The United States is both the world's largest importer and the largest exporter, although less than 5 percent of the world's population lives within its borders. With the increasing globalization of the world's economies, the international marketplace offers tremendous opportunities for U.S. and foreign businesses to expand into new markets for their goods and services. Doing business globally provides new sources of materials and labor. Trading with other countries also reduces a company's dependence on economic conditions in its home market. Countries that encourage international trade enjoy higher levels of economic activity, employment, and wages than those that restrict it.

Assessment Check Answers

1.1 Why do nations trade?
Nations trade because trading boosts economic growth by providing a market for products and access to needed resources. This makes production and distribution systems more efficient and reduces dependence on the economy of the domestic market.

1.2 Cite some measure of the size of the international marketplace.
Though developing countries have lower per-capita incomes than developed nations in North America and western Europe, their populations are large and growing. China's population is almost 1.3 billion and India's is roughly 1.1 billion.

2 Discuss the concepts of absolute and comparative advantage in international trade.

Nations usually benefit if they specialize in producing certain goods or services. A country has an absolute advantage if it holds a monopoly or produces a good or service at a lower cost than other nations. It has a comparative advantage if it can supply a particular product more efficiently or at a lower cost than it can produce other items.

Assessment Check Answers

2.1 Define *absolute advantage*.
Absolute advantage means a country can maintain a monopoly in or produce a product at lower cost than any other competitor.

2.2 How does a nation acquire a comparative advantage?
Comparative advantage exists when a nation can supply a product more efficiently and at a lower price than it can supply other goods, compared with the outputs of other countries.

3 Describe how nations measure international trade and the significance of exchange rates.

Countries measure the level of international trade by comparing exports and imports and then calculating whether a trade surplus or a deficit exists. This is the balance of trade, which represents the difference between exports and imports. The term *balance of payments* refers to the overall flow of money into or out of a country, including overseas loans and borrowing, international investments, and profits from such investments. An exchange rate is the value of a nation's currency relative to the currency of another nation. Currency values typically fluctuate, or "float," relative to the supply and demand for specific currencies in the world market. When the value of the dollar falls compared with other currencies, the cost paid by foreign businesses and households for U.S. products declines, and demand for exports may rise. An increase in the value of the dollar raises the prices of U.S. products sold abroad, but it reduces the prices of foreign products sold in the United States.

Assessment Check Answers

3.1 Compare balance of trade and balance of payments.
Balance of trade is the difference between exports and imports; balance of payments is the overall flow of money into or out of a country.

3.2 Explain the function of an exchange rate.
A nation's exchange rate is the rate at which its currency can be exchanged for the currencies of other nations to make it easier for them to trade with one another.

3.3 What happens when a currency is devalued?
Devaluation describes a fall in a currency's value relative to other currencies or to a fixed standard.

4 Identify the major barriers that confront global businesses.

Businesses face several obstacles in the global marketplace. Companies must be sensitive to social and cultural differences, such as languages, values, and religions, when operating in other countries. Economic differences include standard-of-living variations and levels of infrastructure development. Legal and political barriers are among the most difficult to judge. Each country sets its own laws regulating business practices. Trade restrictions such as tariffs and administrative barriers also present obstacles to international business.

Assessment Check Answers

4.1 How might values and attitudes form a barrier to trade, and how can they be overcome?
Marked differences in values and attitudes, such as religious attitudes, can form barriers between traditionally capitalist countries and those adapting new capitalist systems. Many of these can be overcome by learning about and respecting such differences.

4.2 What is a tariff? What is its purpose?
A tariff is a surcharge or duty charged on foreign products. Its purpose is to protect domestic producers of those items.

4.3 Why is dumping a problem for companies marketing goods internationally?
Dumping is selling products abroad at prices below the cost of production or exporting products at a lower price than charged in the home market. It drives the cost of domestic products sharply down.

5 Explain how international trade organizations and economic communities reduce barriers to international trade.

Many international organizations seek to promote international trade by reducing barriers. Examples include the World Trade Organization, the World Bank, and the International Monetary Fund. Multinational economic communities create partnerships to remove barriers to flows of goods, capital, and people across the borders of member nations. Three such economic agreements are the North American Free Trade Agreement, the Central American Free Trade Agreement, and the European Union.

Assessment Check Answers

5.1 What international trade organization succeeded GATT, and what is its goal?

The World Trade Organization (WTO) succeeded GATT with the goal of monitoring GATT agreements, mediating disputes, and continuing the effort to reduce trade barriers throughout the world.

5.2 Compare and contrast the goals of the World Bank and the International Monetary Fund.
The World Bank funds projects that build or expand nations' infrastructure such as transportation, education, and health systems and facilities. The International Monetary Fund makes short-term loans to member nations that are unable to meet their budgets. The fund operates as a lender of last resort.

5.3 Identify the members of NAFTA and briefly explain how it works.
NAFTA created a free-trade zone between the United States, Canada, and Mexico by eliminating trade barriers and investment restrictions among them, as well as easing regulations on services such as banking and establishing uniform rules for protection of intellectual property.

5.4 What are the goals of the European Union and how do they promote international trade?
The European Union's goals include promoting economic and social progress, introducing European citizenship as a complement to national citizenship, and giving the EU a significant role in international affairs. Unifying standards and laws is expected to contribute to international trade and economic growth.

6 Compare the different levels of involvement used by businesses when entering global markets.

Exporting and importing, the first level of involvement in international business, involves the lowest degree of both risk and control. Companies may rely on export trading or management companies to help distribute their products. Contractual agreements such as franchising, foreign licensing, and subcontracting offer additional, flexible options. Franchising and licensing are especially appropriate for services. Companies may also choose local subcontractors to produce goods for local sales. International direct investment in production and marketing facilities provides the highest degree of control but also the greatest risk. Firms make direct investments by acquiring foreign companies or facilities, forming joint ventures with local firms, and setting up their own overseas divisions.

Assessment Check Answers

6.1 Name three possible strategies for beginning overseas business operations.
Strategies are exporting or importing; contractual agreements such as franchising, licensing, or subcontracting; and making direct investments in foreign markets through acquisition, joint venture, or establishment of an overseas division.

6.2 What is countertrade?
Countertrade consists of payments made in the form of local products, not currency.

6.3 Compare and contrast licensing and subcontracting.
In a foreign licensing agreement, one firm allows another to produce or sell its product or use its trademark, patent, or manufacturing process in a specific geographical area in return for royalty payments or other compensations. In subcontracting a firm hires local companies abroad to produce, distribute, or sell its goods and services.

6.4 Describe joint ventures.
Joint ventures allow companies to share risks, costs, profits, and management responsibilities with one or more host country nationals.

7 Distinguish between a global business strategy and a multidomestic business strategy.

A company that adopts a global (or standardization) strategy develops a single, standardized product and marketing strategy for implementation throughout the world. The firm sells the same product in essentially the same manner in all countries in which it operates. Under a multidomestic (or adaptation) strategy, the firm develops a different treatment for each foreign market. It develops products and marketing strategies that appeal to the customs, tastes, and buying habits of particular nations.

Assessment Check Answers

7.1 What is a global business strategy? What are its advantages?
A global business strategy specifies a standardized competitive strategy in which the firm sells the same product in essentially the same manner throughout the world. It works well for goods and services that are common to many nations and allows the firm to market them without making significant changes.

7.2 What is a multidomestic business strategy? What are its advantages?
A multidomestic business strategy allows the firm to treat each foreign market in a different way to appeal to the customs, tastes, and buying habits of particular national markets. It allows the firm to customize its marketing appeals for individual cultures or areas.

Business Terms You Need to Know

exports 92
imports 92
balance of trade 96
balance of payments 96
exchange rate 97
tariff 105
World Trade Organization (WTO) 106
North American Free Trade Agreement (NAFTA) 108
Central American Free Trade Agreement (CAFTA) 109
European Union (EU) 109
multinational corporation (MNC) 116
global business strategy 117
multidomestic business strategy 118

Other Important Business Terms

devaluation 97
infrastructure 102
quotas 105
dumping 106
embargo 106
exchange control 106
General Agreement on Tariffs and Trade (GATT) 106
World Bank 107
International Monetary Fund (IMF) 107
countertrade 112
franchise 113
foreign licensing agreement 114
subcontracting 114
joint ventures 116

Review Questions

1. How does a business decide whether to trade with a foreign country? What are the key factors for participating in the information economy on a global basis?
2. Why are developing countries such as China and India becoming important international markets?
3. What is the difference between absolute advantage and comparative advantage? Give an example of each.
4. Can a nation have a favorable balance of trade and an unfavorable balance of payments? Why or why not?
5. Identify several potential barriers to communication when a company attempts to conduct business in another country. How might these be overcome?
6. Identify and describe briefly the three dimensions of the legal environment for global business.
7. What are the major nontariff restrictions affecting international business? Describe the difference between tariff and nontariff restrictions.
8. What is NAFTA? How does it work?
9. How has the EU helped trade in European businesses?
10. What are the key choices a company must make before reaching the final decision to go global?

Projects and Teamwork Applications

1. When Britain transferred Hong Kong to China in 1997, China agreed to grant Hong Kong a high degree of autonomy as a capitalist economy for 50 years. Do you think this agreement will hold up? Why or why not? Consider China's economy, population, infrastructure, and other factors in your answer.
2. The tremendous growth of online business has introduced new elements to the legal climate of international business. Patents, brand names, copyrights, and trademarks are difficult to monitor because of the boundaryless nature of the Internet. What steps could businesses take to protect their trademarks and brands in this environment? Come up with at least five suggestions and compare your list with your classmates'.
3. The WTO monitors GATT agreements, mediates disputes, and continues the effort to reduce trade barriers throughout the world. However, widespread concerns have been expressed that the WTO's focus on lowering trade barriers may encourage businesses to keep costs down through practices that may lead to pollution and human rights abuses. Others argue that human rights should not be linked to international business. Do you think environmental and human rights issues should be linked to trade? Why or why not?
4. The IMF makes short-term loans to developing countries that may not be able to repay them. Do you agree that the IMF should forgive these debts in some cases? Why or why not?
5. Describe briefly the EU and its goals. What are the pros and cons of the EU? Do you predict that the European alliance will hold up over the next 20 years? Why or why not?
6. Use the most recent edition of "The Fortune Global 500," which is published in *Fortune* magazine normally in late July or early August, or go to *Fortune*'s online version at http://money.cnn.com/magazines/fortune/global500, to answer the following questions.
   a. On what is the Global 500 ranking based (for example, profits, number of employees, revenues)?
   b. Among the world's ten largest corporations, list the countries represented with the number of companies from each nation.
   c. Identify the top-ranked company, along with its Global 500 ranking and country, for the following industry classifications: Food and Drug Stores; Industrial and Farm Equipment; Petroleum Refining; Utilities: Gas and Electric; Telecommunications; Pharmaceuticals.

Case 4.1

Exporting to Afghanistan

In the landlocked country of Afghanistan, devastated by a generation of war and repression, efficient transportation is a rarity. There are only 15 miles of railroad in the country's almost 250,000 square miles, and less than 2,000 miles of paved roads. Despite aggressive efforts by the Ministry of Communication, there are only about 12,000 working telephones in the capital city of Kabul, with a population of nearly 2 million people. Though tens of thousands of refugees have returned during the reconstruction efforts of the last several years, more than 4 million people of the country's population of about 29 million still live outside their country.

The United States is at the head of the massive reconstruction of Afghanistan, and experts believe there will be export opportunities in the recovering nation for years to come. But with almost no business infrastructure such as roads, phones, and hotels, no sales and distribution channels, and little available skilled labor to hire, foreign investment will be painfully slow to flourish. Streamlined licensing procedures and tools for international dispute resolution that are now in place should help.

However, local interpreters and drivers are considered essential for those who know enough about the country, its geography, and its culture and language to transact business on Afghan soil.

The U.S. Department of Commerce warns that limited purchasing power in Afghanistan will dictate the pace of export opportunities. But basic industries that can help Afghans in their reconstruction efforts will likely find markets first. The country desperately needs architectural, construction, telecommunications, and engineering services—as well as goods such as construction materials and building equipment, computer hardware, telecommunications equipment, diesel-powered generators, security and safety equipment, and office furniture. Medium- and long-term needs include aircraft, aircraft parts, and airport and ground-support equipment.

Social change is sure to come, though it may be slow. Exporters should not overlook the chance to do business with Afghan women. "There are barriers," says Sara Rahmani, who runs a new and growing clothing business. "We are recovering from war and devastation and Taliban repression. . . . But there's nothing in Shariah [Islamic law] that says women can't do business."

Questions for Critical Thinking

1. A Commerce Department task force on Afghanistan warns that "only the most experienced, well-informed, and open-minded traveler should consider visiting Afghanistan." What difficulties do you think a business traveler to Kabul would need to overcome? How could he or she prepare for such a trip and ensure its success?
2. It is expected that lower-cost and possibly lower-quality goods and services from Pakistan and Iran will compete with U.S. exports to Afghanistan in the coming years. What can U.S. companies wishing to export to Afghanistan do to combat such competition?

Sources: Matthew Pennington, "Women Go into Business in Afghanistan," *Casper (WY) Star Tribune*, accessed June 11, 2006, http://www.casperstartribune.net; U.S. Department of State, "Background Note: Afghanistan," accessed June 11, 2006, http://www.state.gov; Afghanistan Investment and Reconstruction Task Force, "Traveling to and Doing Business in Afghanistan," U.S. Department of Commerce, accessed June 11, 2006, http://www.export.gov/afghanistan.

VIDEO Case 4.2

Cold Stone Creamery Cools off Consumers around the World

This video case appears on page 611. A recently filmed video, designed to expand and highlight the written case, is available for class use by instructors.

Appendix Part I

The Legal Framework for Business

CLASS-ACTION FAIRNESS

We've all shopped around for the best deal on a car, computer, or sound system. But have you ever heard of lawyers shopping around for clients willing to sue or for the best state courts for their trials? Certain states or counties did seem to reward plaintiffs filing class-action lawsuits with much higher figures than elsewhere. A *class-action suit* groups a number of small plaintiffs, as many as hundreds of thousands of them, to allow for efficient processing under one lawsuit. And the rules for the location of those trials were loose, allowing lawyers to pick locations with juries likely to be favorable to their suits. Certainly, businesses that create defective products that hurt consumers or commit fraud need to be held accountable, and everyone is sympathetic to those who've been harmed. But the mushrooming of frivolous lawsuits was imposing huge fines on businesses and hampering their ability to compete. Critics also said that the lawyers bringing the suits sometimes benefited much more than their clients, receiving percentages of the entire settlement well beyond the work they did. Eventually, the U.S. Chamber of Commerce, legislators, and others called for a change. It came in the form of the **Class-Action Fairness Act of 2005.**

Before the reform, many companies facing such an action, whether it involved a faulty medication or a defective TV, complained that plaintiffs' lawyers shopped around for sympathetic courts. The Class-Action Fairness Act of 2005 imposes certain restrictions on such suits. First, it automatically moves most large, multistate class actions—those with potential damages exceeding $5 million and in which more than two-thirds of the plaintiffs are geographically dispersed—from state courts into federal courts. This restriction prevents "shopping around" in different states for sympathetic courts but lets cases that belong within a particular state remain there. Second, judges must consider the actual monetary value of any damage done so that plaintiffs receive true compensation for injury instead of large—and perhaps arbitrary—awards.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A third major provision of the law affects the way attorneys receive payment for their legal representation. Under the old system, an attorney would usually receive a percentage of the gross settlement amount, regardless of whether all plaintiffs bothered to collect. Now judges can require that any uncollected rewards be given to charities or government organizations, and attorneys may not include those rewards in calculating their fees. Also, if the attorney's fee was not based on a percentage, then it must be based on time actually spent working on the case. Finally, the act ensures that plaintiffs' interests are protected equally with their lawyers'.

Critics of the Class-Action Fairness Act claim that it will suppress legitimate consumer claims, while supporters believe that it will protect jobs and businesses by exposing them to less risk. If it is successful, both consumers and businesses could experience something new: fairness.[1]

OVERVIEW

The first four chapters of the text show how important the legal environment is to business, government, and the general public and how changes occur to rectify problems. The corporate governance failures discussed in Chapter 2 continue to be addressed throughout the book. In the aftermath of corporate wrongdoing, charges against and convictions of business leaders like Tyco's Dennis Kozlowski and WorldCom's Bernard Ebbers, and the bankruptcies of such firms as Enron and WorldCom, we have seen the passage of new laws designed to end abuses by unethical business executives. In addition, we have seen criminal charges against wayward business leaders end in convictions. Bernard Ebbers, former CEO of WorldCom, was convicted of securities fraud, conspiracy, and filing false documents with regulators.[2] These events have also led to new regulations restricting investment advisors, accountants, and board members in their oversight responsibilities. A business environment of personal greed and excess is being cleaned up to reflect the demands of ethical business leaders, government officials, investors, and the general public.

On a more personal level, you may be frustrated by all the junk e-mail (called *spam*) you receive, in addition to pop-up messages. Also, those annoying telephone solicitations became so pervasive that a Do Not Call law was enacted, making it illegal to call anyone listed on the federal do-not-call roster maintained by the Federal Trade Commission.

Legal issues affect every aspect of business. In fact, most of the remaining chapters will discuss legislation that specifically affects the business functions analyzed in each chapter. Already, an overview of the legal environment was presented in Chapter 2, and legislation affecting international operations was covered in Chapter 4. Chapter 5 discusses laws related to small businesses. Laws regarding human resources management and labor unions are examined in Chapter 9. Laws affecting other business operations, such as environmental regulations and product safety, are one of the topics in Chapter 13, and marketing-related legislation is examined in Chapter 14. Finally, legislation pertaining to banking and the securities markets is discussed in Chapters 17 and 18. In this appendix, we provide an overall perspective of legislation at the federal, state, and local levels, and point out that, while business executives may not be legal experts, they do need to be knowledgeable in their specific area of responsibility. A good dose of common sense also helps avoid potential legal problems.

Despite the best efforts of most businesspeople, legal cases do arise. A dispute may arise over a contract, an employee may protest being passed over for a promotion, or a town may challenge the environmental impact of a new gas station. Unfortunately, the United States has the dubious distinction of being the world's most litigious society. Lawsuits are as common as business deals. Consider Wal-Mart, which is involved in up to 7,000 legal cases at any one time. Even if you are never involved in a lawsuit, the cost still affects you. The average U.S. family pays a hidden "litigation tax" of $2,900 each year because of the costs of lawsuits that force businesses to increase their prices.[3] Small businesses, including doctors' offices, are often the hardest hit and may cut back on their services or close.

On the lighter side, every day there are news reports of proposed new laws intended to protect businesses, consumers, and the general public—but somehow miss the mark. One Texas legislator proposed a law prohibiting weather forecasters from calling themselves "meteorologists" unless they had a certain degree. In Oklahoma, another legislator tried to revive the cockfighting industry—which was banned in his state—by proposing that fighting roosters wear miniature boxing gloves and protective vests. Neither bill was passed.[4]

This appendix looks at the general nature of business law, the court system, basic legal concepts, and finally the changing regulatory environment for U.S. business. Let's start with some initial definitions and related examples.

LEGAL SYSTEM AND ADMINISTRATIVE AGENCIES

judiciary the branch of government charged with settling disputes among parties through the application of laws.

The **judiciary**, or court system, is the branch of government responsible for settling disputes among parties by applying laws. This branch consists of several types and levels of courts, each with a specific jurisdiction. Court systems are organized at the federal, state, and local levels. Administrative agencies also perform some limited judicial functions, but these agencies are more properly regarded as belonging to the executive or legislative branches of government.

At both the federal and state levels, **trial courts**—courts of general jurisdiction—hear a wide range of cases. Unless a case is assigned by law to another court or to an administrative agency, a court of general jurisdiction will hear it. The majority of cases, both criminal and civil, pass through these courts. Within the federal system, trial courts are known as *U.S. district courts*, and at least one such court operates in each state. In the state court systems, the general jurisdiction courts are often called *circuit courts*, and states typically provide one for each county. Other names for general jurisdiction courts are superior courts, common pleas courts, or district courts.

"They Said It"

"When you go into court, you are putting your fate into the hands of 12 people who weren't smart enough to get out of jury duty."
—Norm Crosby (b. 1927) American comedian

State judiciary systems also include many courts with lower, or more specific, jurisdictions. In most states, parties can appeal the decisions of these lower courts to the general jurisdiction courts. Examples of lower courts are probate courts—which settle the estates of people who have died—and small-claims courts—where people can represent themselves in suits involving limited amounts of money. For example, a landlord might go to small-claims court to settle a dispute with a tenant over a security deposit.

Appeals of decisions made at the general trial court level are heard by **appellate courts.** Both the federal and state systems have appellate courts; for instance, the U.S. Court of Appeals for the Seventh Circuit, located in Chicago, covers Illinois, Indiana, and Wisconsin.[5] The appeals process allows a higher court to review the case and correct any lower court error indicated by the appellant, the party making the appeal.

Appeals from decisions of the U.S. circuit courts of appeals can go all the way to the nation's highest court, the U.S. Supreme Court. Appeals from state courts of appeal are heard by the highest court in each state, usually called the *state supreme court*. In a state without intermediate appellate courts, the state supreme court hears appeals directly from the trial courts. Parties who are not satisfied by the verdict of a state supreme court can appeal to the U.S. Supreme Court and may be granted a hearing if they can cite grounds for such an appeal and if the Supreme Court considers the case significant enough to be heard. In a typical year, the Supreme Court hears roughly 1 percent of the 7,500 cases filed.[6]

While most cases are resolved by the system of courts described here, certain highly specialized cases require particular expertise. Examples of specialized federal courts are the U.S. Tax Court for tax cases and the U.S. Court of Claims, which hears claims against the U.S. government itself. Similar specialized courts operate at the state level.

Administrative agencies, also known as bureaus, commissions, or boards, decide a variety of cases at all levels of government. These agencies usually derive their powers and responsibilities from state or federal statutes. Technically, they conduct hearings or inquiries rather than trials. Examples of federal administrative agencies are the Federal Trade Commission (FTC), the National Labor Relations Board, and the Federal Energy Regulatory Commission. Examples at the state level include public utility commissions and boards that govern the licensing of various trades and professions. Zoning boards, planning commissions, and boards of appeal operate at the city or county level. The FTC has the broadest power of any of the federal regulatory agencies. It enforces laws regulating unfair business practices, and it can stop false and deceptive advertising practices.

TYPES OF LAW

Law consists of the standards set by government and society in the form of either legislation or custom. This broad body of principles, regulations, rules, and customs that govern the actions of all members of society, including businesspeople, is derived from several sources. **Common law** refers to the body of law arising out of judicial decisions, some of which can be traced back to early England. For example, in some states, an unmarried couple who has lived together for a certain period of time is said to be legally husband and wife by common law.

Statutory law, or written law, includes state and federal constitutions, legislative enactments, treaties of the federal government, and ordinances of local governments. Statutes must be drawn precisely and reasonably to be constitutional, and thus enforceable. Still, courts must frequently interpret their intentions and meanings.

With the growth of the global economy, a knowledge of international law becomes crucial. **International law** refers to the numerous regulations that govern international commerce. Companies must be aware of the domestic laws of trading partners, trade agreements such as NAFTA, and the rulings of such organizations as the World Trade Organization. International law affects trade in all kinds of industries. Recently, the Canadian government announced it would add a 15 percent surtax on such diverse products as oysters, pigs, and cigarettes from the United States. This action is in response to the Continued Dumping and Subsidy Offset Act (commonly called the Byrd Amendment), which distributes proceeds the United States collects to firms, primarily U.S. steel companies. The World Trade Organization declared the Byrd Amendment illegal. "Retaliation is not our preferred option, but it is a necessary action," stated former Canadian trade minister Jim Peterson. "International trade rules must be respected."[7]

In a broad sense, all law is business law because all firms are subject to the entire body of law, just as individuals are. In a narrower sense, however, **business law** consists of those aspects of law that most directly influence and regulate the management of various types of business activity. Specific laws vary widely in their intent from business to business and from industry to industry. The legal interests of airlines, for example, differ from those of oil companies.

State and local statutes also have varying applications. Some state laws affect all businesses that operate in a particular state. Workers' compensation laws, which govern payments to workers for injuries incurred on the job, are an example. Other state laws apply only to certain firms or business activities. States have specific licensing requirements for businesses, such as law firms, funeral directors, and hair salons. Many local ordinances also deal with specific business activities. Local regulations on the sizes and types of business signs are commonplace. Some communities even restrict the sizes of stores, including height and square footage.

law standards set by government and society in the form of either legislation or custom.

common law body of law arising out of judicial decisions, some of which can be traced back to early England.

statutory law written law, including state and federal constitutions, legislative enactments, treaties of the federal government, and ordinances of local governments.

business law aspects of law that most directly influence and regulate the management of business activity.

"They Said It"

"The minute you read something that you can't understand, you can almost be sure it was drawn up by a lawyer."

—Will Rogers (1879–1935) American actor and humorist

REGULATORY ENVIRONMENT FOR BUSINESS

Government regulation of business has changed over time. Depending on public sentiment, the economy, and the political climate, we see the pendulum swing back and forth between increased regulation and deregulation. But the goal of both types of legislation is protection of healthy competition. One industry that has experienced some deregulation in the past is still subject to relatively tight regulations: banking. Despite the relaxation of banking regulations across state lines and the advent of online banking, laws governing everything from stock trading to retirement investing remain strict. Recently, several bills were proposed in Congress to shore up the Pension Benefit Guaranty Corporation, an agency that is running at a $20 billion deficit, particularly after assuming the pensions of some bankrupt companies, including United Airlines. The agency is not funded by tax dollars—instead, it is financed by insurance premiums and investments. But the bills did not pass. When asked later about the agency's ability to continue to absorb such burdens, the chairman of the Federal Reserve noted that the agency's difficulties could be handled within current banking regulations.[8]

Let's look at the issues surrounding regulation and deregulation, and the legislation that has characterized them.

Antitrust and Business Regulation

John D. Rockefeller's Standard Oil monopoly launched antitrust legislation. Breaking up monopolies and restraints of trade was a popular issue in the late 1800s and early 1900s. In fact, President Theodore Roosevelt always promoted himself as a "trust-buster." The highly publicized Microsoft case of the 1990s is an example of antitrust litigation.

During the 1930s, several laws designed to regulate business were passed. The basis for many of these laws was protecting employment. The world was in the midst of the Great Depression during the 1930s, so the government was focused on keeping its citizens employed. Recently, government officials became concerned with the security aspects of international business transactions, Internet usage, the sources of funds, and their effects on U.S. business practices. So, new regulatory legislation in the form of the USA Patriot Act was enacted in 2001. In 2005, Congress voted to extend most provisions of the Patriot Act indefinitely.[9]

The major federal antitrust and business regulation legislation includes the following:

Law	What It Did
Sherman Act (1890)	Set a competitive business system as a national policy goal. The act specifically banned monopolies and restraints of trade.
Clayton Act (1914)	Put restrictions on price discrimination, exclusive dealing, tying contracts, and interlocking boards of directors that lessened competition or might lead to a monopoly.
Federal Trade Commission Act (1914)	Established the FTC with the authority to investigate business practices. The act also prohibited unfair methods of competition.
Robinson-Patman Act (1936)	Outlawed price discrimination in sales to wholesalers, retailers, or other producers. The act also banned pricing designed to eliminate competition.
Wheeler-Lea Act (1938)	Banned deceptive advertising. The act gave the FTC jurisdiction in such cases.
Patriot Act (2001; extended in 2005)	Limited interactions between U.S. and foreign banks to those with "know your customer" policies; allowed the U.S. Treasury Department to freeze assets and bar a country, government, or institution from doing business in the United States; gave federal authorities broad powers to monitor Internet usage and expanded the way data is shared among different agencies.

Business Deregulation

Deregulation was a child of the 1970s whose influence continues today. Many formerly regulated industries were freed to pick the markets they wanted to serve. The deregulated industries, such as utilities and airlines, were also allowed to price their products without the guidance of federal regulations. For the most part, deregulation led to lower consumer prices. In some cases, it also led to a loss of service. Many smaller cities and airports lost airline service for a while because of deregulation. But small and discount airlines such as Southwest and JetBlue began to focus on and serve those locations, with great success.

Following are several major laws related to deregulation:

Law	What It Did
Airline Deregulation Act (1978)	Allowed airlines to set fares and pick their routes.
Motor Carrier Act and Staggers Rail Act (1980)	Permitted the trucking and railroad industries to negotiate rates and services.
Telecommunications Act (1996)	Cut barriers to competition in local and long-distance phone, cable, and television markets.
Gramm-Leach-Bliley Act (1999)	Permitted banks, securities firms, and insurance companies to affiliate within a new financial organizational structure; required them to disclose to customers their policies and practices for protecting the privacy of personal information.

CONSUMER PROTECTION

Many laws designed to protect consumers have been passed in the last 100 years. In many ways, business itself has evolved to reflect this focus on consumer safety and satisfaction. Following some widely publicized problems with brand-name prescription drugs such as Vioxx, the Food and Drug Administration (FDA) is more closely scrutinizing the accuracy of consumer advertisements for such products. However, the FDA does not have the legal authority to ban all consumer advertising for prescription drugs. It is up to the manufacturers and trade associations such as the Pharmaceutical Research and Manufacturers of America to set industry standards for advertising. Some companies have voluntarily opted to avoid advertising for the first year a prescription drug is available.[10]

The major federal laws related to consumer protection include the following:

Law	What It Did
Federal Food and Drug Act (1906)	Banned adulteration and misbranding of foods and drugs involved in interstate commerce.
Consumer Credit Protection Act (1968)	Required disclosure of annual interest rates on loans and credit purchases.
National Environmental Policy Act (1970)	Established the Environmental Protection Agency to deal with various types of pollution and organizations that create pollution.
Public Health Cigarette Smoking Act (1970)	Prohibited tobacco advertising on radio and television.
Consumer Product Safety Act (1972)	Established the Consumer Product Safety Commission with authority to specify safety standards for most products.
Nutrition Labeling and Education Act (1990)	Stipulated detailed information on the labeling of most foods.
Dietary Supplement Health and Education Act (1994)	Established standards with respect to dietary supplements including vitamins, minerals, herbs, and amino acids.

EMPLOYEE PROTECTION

Chapters 2 and 9 cover many of the issues employers face in protecting their employees from injury and harm while on the job. But employees must also be protected from unfair practices by employers. Recently, concerned about the cutbacks on retiree medical benefits at age 65—when they are eligible for Medicare coverage—AARP (the American Association of Retired Persons) won a court decision protecting the health benefits of retired workers. Under the Age Discrimination in Employment Act, employers must provide the same coverage to all their retirees, regardless of their age.[11] Some of the relevant laws related to employee protection include the following:

Law	What It Did
Fair Labor Standards Act (1938)	For hourly workers, provided payment of the minimum wage, overtime pay for time worked more than 40 hours in a workweek, restricted the employment of children, and required employers to keep records of wages and hours.
OSHA Act (1970)	Required employers to provide workers with workplaces free of recognized hazards that could cause serious injury or death and required employees to abide by all safety and health standards that apply to their jobs.
Americans with Disabilities Act (1991)	Banned discrimination against the disabled in public accommodations, transportation, and telecommunications.
Family and Medical Leave Act (1993)	Required covered employers to grant eligible employees up to twelve workweeks of unpaid leave during any twelve-month period for the birth and care of a newborn child of the employee, placement with the employee of a son or daughter for adoption or foster care, care of an immediate family member with a serious health condition, or medical leave for the employee if unable to work because of a serious health condition.
Uniformed Services Employment and Reemployment Rights Act (1994)	Protected the job rights of individuals who voluntarily or involuntarily leave their jobs to perform military service. Also prohibited employment discrimination in such cases.
American Jobs Creation Act (2004)	Reduced taxes for manufacturing in the United States, provided temporary tax breaks for income repatriated to the United States, and encouraged domestic job growth.

INVESTOR PROTECTION

Chapters 16, 17, and 18 describe the institutions subject to investor protection laws and some of the events that brought the Sarbanes-Oxley law into being. (See the entry in the following table for specific provisions of Sarbanes-Oxley.) Following is a summary of legislation to protect investors:

Law	What It Did
Securities Exchange Act (1934)	Created the Securities and Exchange Commission with the authority to register, regulate, and oversee brokerage firms, transfer agents, clearing agencies, and stock exchanges; the SEC also has the power to enforce securities laws and protect investors in public transactions.
Bank Secrecy Act (1970)	Deterred laundering and use of secret foreign bank accounts; created an investigative paper trail for large currency transactions; imposed civil and criminal penalties for noncompliance with reporting requirements; improved detection and investigation of criminal, tax, and regulatory violations.
Sarbanes-Oxley Act (2002)	Required top corporate executives to attest to the validity of the company's financial statements; increased the documentation and monitoring of internal controls; prohibited CPA firms from providing some types of consulting services for their clients; established a five-member accounting oversight board.

CYBERSPACE AND TELECOMMUNICATIONS PROTECTION

Computers and widespread use of the Internet and telecommunications have dramatically expanded the reach of businesses. They have also raised some thorny issues such as computer fraud and abuse, online privacy, and cyberterrorism. Under a recent Supreme Court ruling, Internet file-sharing services are now held accountable if their intention is for consumers to use software to exchange songs and videos illegally. Although lower courts had ruled that file-sharing services such as Grokster and Streamcast couldn't be sued, the Supreme Court unanimously decided that there was enough evidence of unlawful intent on the part of these companies. This ruling also helps protect copyrights, which are covered later in this appendix.[12]

Following are some of the major laws enacted to regulate cyberspace and telecommunications:

Law	What It Did
Computer Fraud and Abuse Act (1986)	Clarified definitions of criminal fraud and abuse for federal computer crimes and removed legal ambiguities and obstacles to prosecuting these crimes; established felony offenses for unauthorized access of "federal interest" computers and made it a misdemeanor to engage in unauthorized trafficking in computer passwords.
Children's Online Privacy Protection Act (1998)	Authorized the FTC to set rules regarding how and when firms must obtain parental permission before asking children marketing research questions.
Identity Theft and Assumption Deterrence Act (1998)	Made it a federal crime to knowingly transfer or use, without lawful authority, a means of identification of another person with intent to commit, aid, or abet any violation of federal, state, or local law.
Anticybersquatting Consumer Protection Act (1999)	Prohibited people from registering Internet domain names similar to company or celebrity names and then offering them for sale to these same parties
Homeland Security Act (2002)	Established the Department of Homeland Security; gave government wide new powers to collect and mine data on individuals and groups, including databases that combine personal, governmental, and corporate records including e-mails and Web sites viewed; limited information citizens can obtain under the Freedom of Information Act; gave government committees more latitude for meeting in secret.
Amendments to the Telemarketing Sales Rule (2003)	Created a national "do not call" registry, which prohibits telemarketing calls to registered telephone numbers; restricted the number and duration of telemarketing calls generating dead air space with use of automatic dialers; cracked down on unauthorized billing; and required telemarketers to transmit their Caller ID information. Telemarketers must check the do-not-call list quarterly, and violators could be fined as much as $11,000 per occurrence. Excluded from the registry's restrictions are charities, opinion pollsters, and political candidates.
Check Clearing for the 21st Century Act (2003)	Created a substitute check, allowing banks to process check information electronically and to deliver substitute checks to banks that want to continue receiving paper checks. A substitute check is the legal equivalent of the original check.

THE CORE OF BUSINESS LAW

Contract law and the law of agency; the Uniform Commercial Code, sales law, and negotiable instruments law; property law and the law of bailment; trademark, patent, and copyright law; tort law; bankruptcy law; and tax law are the cornerstones of U.S. business law. The sections that follow set out the key provisions of each of these legal concepts.

Contract Law and Law of Agency

Contract law is important because it is the legal foundation on which business dealings are conducted. A **contract** is a legally enforceable agreement between two or more parties regarding a specified act or thing.

contract legally enforceable agreement between two or more parties regarding a specified act or thing.

Contract Requirements As Figure 1 points out, the four elements of an enforceable contract are agreement, consideration, legal and serious purpose, and capacity. The parties must reach *agreement* about the act or thing specified. For such an agreement, or contract, to be valid and legally enforceable, each party must furnish *consideration*—the value or benefit that a party provides to the others with whom the contract is made. Assume that a builder hires an electrician to install wiring in a new house. The wiring job and the resulting payment are the considerations in this instance. In addition to consideration, an enforceable contract must involve a *legal and serious purpose*. Agreements made as a joke or involving the commission of crimes are not enforceable as legal contracts. An agreement between two competitors to fix the prices for their products is not enforceable as a contract because the subject matter is illegal.

The last element of a legally enforceable contract is *capacity*, the legal ability of a party to enter into agreements. The law does not permit certain people, such as those judged to be insane, to enter into legally enforceable contracts. Contracts govern almost all types of business activities. You might sign a contract to purchase a car, to do a job for someone as a freelancer or outsourcer, or to lease an apartment.

"They Said It"

"A verbal contract isn't worth the paper it's written on."
—Samuel Goldwyn (1882–1974) American motion picture producer

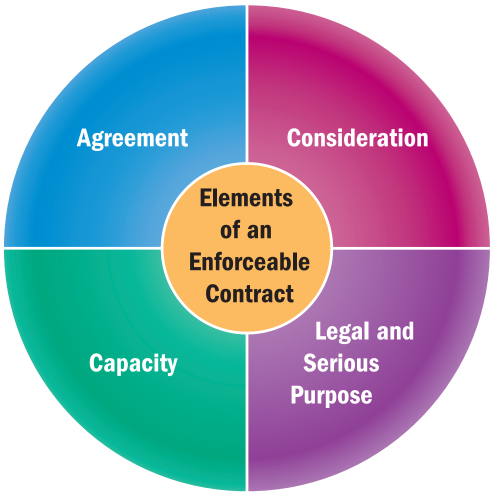
Breach of Contract A violation of a valid contract is called a **breach of contract.** The injured party can go to court to enforce the contract provisions and, in some cases, collect **damages**—financial payments to compensate for a loss and related suffering.

Law of Agency All types of firms conduct business affairs through a variety of agents, such as partners, directors, corporate officers, and sales personnel. An **agency** relationship exists when one party, called the *principal*, appoints another party, called the *agent*, to enter into contracts with third parties on the principal's behalf.

agency legal relationship whereby one party, called the principal, appoints another party, called an agent, to enter into contracts with third parties on the principal's behalf.

The law of agency is based on common-law principles and case law decisions of state and federal courts. Relatively little agency law has been enacted into statute. The law of agency is important because the principal is generally bound by the actions of the agent.

Figure 1 Four Elements of an Enforceable Contract



The legal basis for holding the principal liable for acts of the agent is the Latin maxim *respondeat superior* ("let the master answer"). In a case involving agency law, the court must decide the rights and obligations of the various parties. Generally, the principal is held liable if an agency relationship exists and the agent has some type of authority to do the wrongful act. The agent in such cases is liable to the principal for any damages.

Uniform Commercial Code

Most U.S. business law is based on the **Uniform Commercial Code**—usually referred to simply as the UCC. The UCC covers topics such as sales law, warranties, and negotiable instruments. All 50 states have adopted the UCC, although Louisiana also relies on the Napoleonic Code from its French origins. The UCC is actually a "model law" first written by the National Conference of Commissioners on Uniform State Laws, which states can then review and adopt, adopt with amendments, or replace with their own laws. The idea of the UCC is to create at least some degree of uniformity among the states.[13]

Sales law governs sales of goods or services for money or on credit. Article 2 of the UCC specifies the circumstances under which a buyer and a seller enter into a sales contract. Such agreements are based on the express conduct of the parties. The UCC generally requires written agreements for enforceable sales contracts for products worth more than $500. The formation of a sales contract is quite flexible because certain missing terms in a written contract or other ambiguities do not prevent the contract from being legally enforceable. A court will look to past dealings, commercial customs, and other standards of reasonableness to evaluate whether a legal contract exists.[14]

sales law law governing the sale of goods or services for money or on credit.

Courts also consider these variables when either the buyer or the seller seeks to enforce his or her rights in cases in which the other party fails to perform as specified in the contract, performs only partially, or performs in a defective or unsatisfactory way. The UCC's remedies in such cases usually involve the award of monetary damages to injured parties. The UCC defines the rights of the parties to have the contract performed, to have it terminated, and to reclaim the goods or place a lien—a legal claim—against them.

Warranties Article 2 of the UCC also sets forth the law of warranties for sales transactions. Products carry two basic types of warranties: an *express warranty* is a specific representation made by the seller regarding the product, and an *implied warranty* is only legally imposed on the seller. Generally, unless implied warranties are disclaimed by the seller in writing, they are automatically in effect. Other provisions govern the rights of acceptance, rejection, and inspection of products by the buyer; the rights of the parties during manufacture, shipment, delivery, and passing of title to products; the legal significance of sales documents; and the placement of the risk of loss in the event of destruction or damage to the products during manufacture, shipment, or delivery.

Negotiable Instruments The term **negotiable instrument** refers to commercial paper that is transferable among individuals and businesses. The most common example of a negotiable instrument is a check. Drafts, certificates of deposit, and notes are also sometimes considered negotiable instruments.

negotiable instrument commercial paper that is transferable among individuals and businesses.

Article 3 of the UCC specifies that a negotiable instrument must be written and must meet the following conditions:

1. It must be signed by the maker or drawer.
2. It must contain an unconditional promise or order to pay a certain sum of money.
3. It must be payable on demand or at a definite time.
4. It must be payable to order or to bearer.

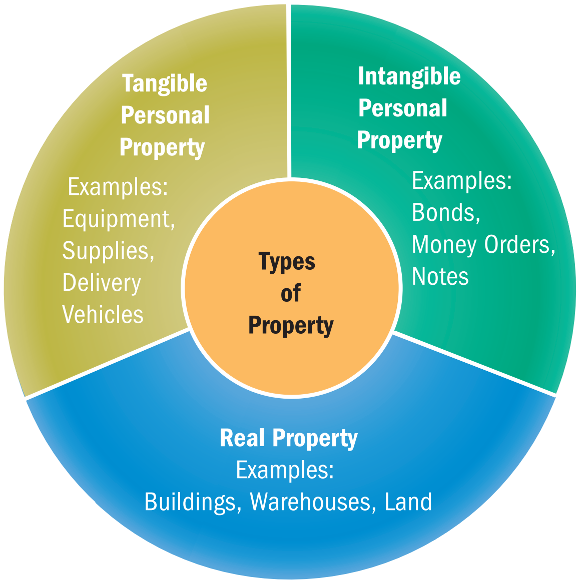
Checks and other forms of commercial paper are transferred when the payee signs the back of the instrument, a procedure known as *endorsement*.

Property Law and Law of Bailment

Property law is a key feature of the private enterprise system. *Property* is something for which a person or firm has the unrestricted right of possession or use. Property rights are guaranteed and protected by the U.S. Constitution. However, under certain circumstances property may be legally seized. In a recent ruling by the U.S. Supreme Court, the city of New London, Connecticut, was granted permission to seize a distressed area of real estate—owned by individual citizens—for future economic development by private business. In response, several states are now proposing laws to ban such practices.[15]

As Figure 2 shows, property can be divided into three basic categories. *Tangible personal property* consists of physical items such as equipment, supplies, and delivery vehicles. *Intan-*

Figure 2 Three Basic Types of Property



gible personal property is nonphysical property such as mortgages, stocks, and checks that are most often represented by a document or other written instrument, although it may be as vague and remote as a computer entry. You are probably familiar with certain types of intangible personal property such as checks or money orders. But other examples include bonds, notes, letters of credit, and warehouse receipts.

A third category of property is *real property*, or real estate. All firms have some interaction with real estate law because of the need to buy or lease the space in which they operate. Some companies are created to serve these real estate needs. Real estate developers, builders, contractors, brokers, appraisers, mortgage companies, escrow companies, title companies, and architects all deal with various aspects of real property law.

The law of bailment deals with the surrender of personal property by one person to another when the property is to be returned at a later date. The person delivering the property is known as the *bailor*, and the person receiving the property is the *bailee*. Some bailments benefit bailees, others benefit bailors, and still others provide mutual benefits. Most courts now require that all parties practice reasonable care in all bailment situations. The degree of benefit received from the bailment is a factor in court decisions about whether parties have met the reasonable-care standards.

Bailment disputes are most likely to arise in business settings such as hotels, restaurants, banks, and parking lots. A series of rules have been established to govern settlement of these disagreements. The law focuses on actual delivery of an item. For instance, a restaurant owner is not liable if a customer's coat or purse is stolen from the back of his or her chair. This is because the customer has not given the item to the restaurant for safekeeping. However, if the customer delivers the coat or purse to the restaurant checkroom, receives a claim check, and the item is stolen, then the restaurant is liable.

TRADEMARKS, PATENTS, AND COPYRIGHTS

Trademarks, patents, and copyrights provide legal protection for key business assets by giving a firm the exclusive right to use those assets. A **trademark** consists of words, symbols, or other designations used by firms to identify their offerings. The Lanham Act (1946) provides for federal registration of trademarks. Trademarks are a valuable commercial property. For instance, Coca-Cola is considered the world's most widely recognized trademark, so it is very valuable to the company.

If a product becomes too well known, its fame can create problems. Once a trademark becomes a part of everyday usage, it loses its protection as a legal trademark. Consider the fate of *aspirin*, *cola*, *nylon*, *kerosene*, and *linoleum*. All these product names were once the exclusive property of their manufacturers, but they have passed into common language, and now anyone can use them. Companies often attempt to counter this threat by advertising that a term is actually a registered trademark. As more firms expand overseas, unintentional overlap between trademarks occurs. Recently, the Indian software firm Wipro, which holds 180 trademarks in India and 3 registered trademarks in Japan, was served notice by the German advertising firm Wipro Werbeagentur, alleging infringement of the German company's trademark. Wipro software denied the allegations.[16] In another international dispute, India's Jet Airways, which was founded in 1993 and plans to begin service between Mumbai and Newark International Airport in New Jersey, has been accused by another Jet Airways (based in Maryland) of trademark infringement.[17]

A **patent** guarantees an inventor exclusive rights to an invention for seventeen years. Copyrights and patents have a constitutional basis; the U.S. Constitution specifies that the federal government has the power "to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive rights to their respective writings or discoveries." Recently, the patent process and patent laws have been under scrutiny. Congress has approved a fee hike in order to hire 900 more staff in an attempt to speed the patent process. In addition, business trade groups have recommended a review that would allow the patent office instead of courts to deal with complaints. A proposal has also been floated to award a patent to the first person to file—instead of trying to prove who came up with the idea for an invention first.[18]

A **copyright** protects written or printed material such as books, designs, cartoon illustrations, photos, computer software, music, and videos. This class of business property is referred to as *intellectual property*. Copyrights are filed with the Library of Congress. Congress recently extended copyright protection for creative material by an additional 20 years, covering artistic works for the lifetime of the creator plus 70 years; for companies the time is 95 years. Not surprisingly, the Internet has opened up a whole new realm of copyright infringement, ranging from downloading music files to illegally sharing video footage. Recently, people suspected of using the popular BitTorrent file-sharing program to obtain versions of the movie *Star Wars Episode III: Revenge of the Sith* were served search warrants for copyright infringement.[19]

As mentioned earlier, the U.S. Supreme Court has ruled that Internet file-sharing services will be held accountable if they intend for their customers to use the software illegally. "We hold that one who distributes a device with the object of promoting it to infringe copyright, as shown by the clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties," wrote Justice David H. Souter.[20] And the U.S. government is becoming stricter about piracy of U.S. property from overseas. "Before Russia enters the [World Trade Organization], many of us will have to be convinced that the Russian government is serious about cracking down on the theft of intellectual property," said Senator Orrin Hatch, who chairs the Senate copyright subcommittee.[21]

Despite publicity about Internet copyright infringement, many people engage in the practice unintentionally. In an effort to educate children, the director of the U.S. Patent and Trademark Office recently gave a commencement speech to a group of elementary school students in Utah about the seriousness of downloading music, movies, and games illegally from the Internet.[22]

Law of Torts

A **tort** (French for "wrong") refers to a civil wrong inflicted on another person or the person's property. The law of torts is closely related to the law of agency because a business entity, or principal, can be held liable for torts committed by its agents in the course of business dealings. Tort law differs from both criminal and contract law. While criminal law is concerned with crimes against the state or society, tort law deals with compensation for injured people who are the victims of noncriminal wrongs.

Tort cases are often extremely complex and may result in large monetary awards. It is typical to read or hear about cases in which patients are awarded millions of dollars in compensation for inadequate medical care. But what about pets? Lawsuits have surged around pets, their owners, and veterinarians. In the last few years, courts in several states have awarded damages to pet owners whose pets were lost or injured while under veterinary care. In Kentucky, a jury awarded $15,000 to the owner of a German shepherd that did not survive surgery. In California, a judge awarded $28,000 in general damages to the owner of a Rottweiler that had to have its teeth capped after improper dental surgery.[23]

Types of Torts A tort may be intentional, or it may be caused by negligence. Assault, slander, libel, and fraud are all examples of intentional torts. Businesses can become involved in such cases through the actions of both owners and employees. A security guard who uses excessive force to apprehend an alleged shoplifter may have committed a tort. Under agency law, the guard's employers, such as a shopping mall or retailer, can be also held liable for any damages or injury caused by the security guard.

The other major group of torts result from negligence. This type of tort is based on carelessness rather than intentional behavior that causes injury to another person. Under agency law, businesses can also be held liable for the negligence of their employees or agents. A delivery truck driver who kills a pedestrian while delivering goods creates a tort liability for his or her employer if the accident results from negligence.

Product Liability An area of tort law known as **product liability** has been developed by both statutory and case law to hold businesses liable for negligence in the design, manufacture, sale, or use of products. Some states have extended the theory of tort law to cover injuries caused by products, regardless of whether the manufacturer is proven negligent. This legal concept is known as *strict product liability*.

The business response to product liability has been mixed. To avoid lawsuits and fines, some recall defective products voluntarily; others decide to fight recall mandates if they believe the recall is not justified. Auto manufacturers and toy makers typically issue voluntary recalls, as do drug manufacturers.

Bankruptcy Law

bankruptcy legal nonpayment of financial obligations.

Bankruptcy, legal nonpayment of financial obligations, is a common occurrence in contemporary society. The term *bankruptcy* is derived from *banca rotta*, or "broken bench," referring to the medieval Italian practice of creditors breaking up the benches of merchants who did not pay their bills.

Federal legislation passed in 1918 and revised several times since then provides a system for handling bankruptcies. Bankruptcy has two purposes. One is to protect creditors by providing a way to obtain compensation through debtors' assets. The second goal, which is almost unique to the United States, is to also protect debtors, allowing them to get a fresh financial start.

Federal law recognizes two types of bankruptcy. Under voluntary bankruptcy, a person or firm asks to be judged bankrupt because of inability to repay creditors. Under involuntary bankruptcy, creditors may request that a party be judged bankrupt.

Personal Bankruptcies With a growing number of individuals amassing large personal debt—often through credit cards—Congress recently revised personal bankruptcy law to make it more difficult for people to erase their debt instead of being held accountable for it. Under the revised law, it will be harder for individuals to file Chapter 7 bankruptcy, which traditionally has wiped out most debt. If their earnings exceed their state's median income, they will instead be required to file Chapter 13 bankruptcy, which sets up a repayment plan as designed by the court. Despite criticism by consumer groups that say that banks and credit card companies have caused the problem by encouraging personal debt, many people agree that the revisions are fair. "This practical reform will help ensure that debtors make a good-faith effort to repay as much as they can afford," said President George W. Bush as he signed the legislation into law. "This new law will help make credit more affordable, because when bankruptcy is less common, credit can be extended to more people at better rates."[24]

Business Bankruptcies Businesses can also go bankrupt for a variety of reasons—mismanagement, plunging sales, an inability to keep up with changes in the marketplace. Under Chapter 11 a firm may reorganize and develop a plan to repay its debts. Chapter 11 also permits prepackaged bankruptcies, in which companies enter bankruptcy proceedings after obtaining approval of most—but not necessarily all—of their creditors. Often companies can emerge from prepackaged bankruptcies sooner than those that opt for conventional Chapter 11 filings. Airlines have managed to accomplish this, as well as large retailers such as Kmart.

Tax Law

A branch of law that affects every business, employee, and consumer in the United States is tax law. A **tax** is an assessment by a governmental unit. Federal, state, and local governments and special taxing authorities all levy taxes. Appendix B, "Personal Financial Planning," also covers tax law.

tax assessment by a governmental unit.

Some taxes are paid by individuals and some by businesses. Both have a decided impact on contemporary business. Business taxes reduce profits, and personal taxes cut the disposable incomes that individuals can spend on the products of industry. Governments spend their revenue from taxes to buy goods and services produced by businesses. Governments also act as transfer agents, moving tax revenue to other consumers and transferring Social Security taxes from the working population to retired or disabled people.

Governments can levy taxes on several different bases: income, sales, business receipts, property, and assets. The type of tax varies from one taxing authority to the other. The individual income tax is the biggest source of revenue for the federal government. Many states also rely heavily on income taxes as well as sales taxes, which vary widely. Cities and towns may collect property taxes in order to operate schools and improve roads. So-called luxury taxes are taxes on items like yachts, and sin taxes are levied on items such as cigarettes and alcohol. During the past decade, the issue of whether to tax different types of Internet services and use has been hotly debated.

"They Said It"

"I am convinced that if most members of Congress did their own taxes, we would have had tax reform long ago."

—Bill Archer (b. 1928)
American politician

Business Terms You Need to Know

judiciary 126
law 127
common law 127
statutory law 127
business law 127
contract 132
agency 132
sales law 133
negotiable instrument 133
bankruptcy 136
tax 137

Other Important Business Terms

Class-Action Fairness Act of 2005 124
trial courts 126
appellate courts 126
international law 127
breach of contract 132
damages 132
Uniform Commercial Code 132
trademark 134
patent 135
copyright 135
tort 135
product liability 136

Projects and Teamwork Applications

1. Many firms incorporate in Delaware. Such choices are at least partially because Delaware regularly updates its corporate laws. A recent update permits the roughly 500,000 corporations registered in Delaware to hold electronic annual meetings. Delaware also allows annual meetings to be held via Web, e-mail, or fax. What is your opinion of the first state's novel approach to corporate governance? What advantages and disadvantages do you think can result? Discuss your opinions with the class.
2. When a business loses its case in a trial, it may have a chance to appeal to a higher appellate court. That's what the accounting firm Arthur Andersen did after being found guilty of destroying certain documents related to its client Enron as the energy giant fell apart. Specifically, Andersen was convicted of "corruptly persuading its employees to destroy documents." Later, the U.S. Supreme Court overturned the ruling because the jury in the lower court had not been told that, in order to find Andersen guilty, they needed to decide that Andersen had acted "knowingly to subvert an investigation."[25] The court's ruling did little to help Andersen, because its employees left to find other work after the first judgment. Do you agree with the Supreme Court ruling? Do you think that businesses should be able to appeal court decisions based on technicalities such as a person's intent? Why or why not? Discuss your views with the class.
3. On your own or with a classmate, use a Web search engine to select and research a state or federal business-related law enacted during the past year. Why was this legislation passed? What were the arguments for and against it? How do you think the new law will affect businesses? Consumers? Society in general?
4. In place of professional fees—typically billed on an hourly basis—some attorneys accept cases on a contingency basis. The attorney earns nothing if he or she loses the case. If the case results in an award, the attorney collects a contingency fee, which is typically 30 percent or more of the total award. On your own or with a classmate, do online research and construct arguments for and against contingency fees.
5. Because it can copy and distribute material anywhere in the world at lightning speed, the Internet has created a whole new challenge for those who create intellectual property—text, music, videos, software, and the like. Some people argue that old copyright laws are obsolete—they may actually stifle technological creativity. Others claim that creators must be protected at all costs. But some are beginning to think in terms of a new copyright, which preserves some rights but relinquishes others. For instance, music artists might ask for permission and payment for the commercial use of their work, but not for noncommercial use. They might allow a certain amount of sampling before purchase.[26] On your own or with a classmate, use a Web search engine to research examples of companies and cases—such as Napster and Grokster—involving Internet file sharing and copyright. Then write your own opinion about what a "new" copyright should cover.

The Second City

Part 1 Case

The Second City Theater Continuing Case
Second City: First in Comedy

Writer A. J. Liebling derided the city of Chicago as inferior to what he considered the more appealing cities of Paris, London, and, in particular, New York. Indeed, in his articles for the *New Yorker*, he dubbed Chicago "the second city," after New York, which he considered the country's first city. Chicagoans were understandably offended, but a group of young aspiring performers, including many University of Chicago alumni, embraced Liebling's jab and self-mockingly adopted the name "The Second City" for their new cabaret theater.

Second City opened its doors on December 16, 1959, and the theater's unique brand of social and political satire soon made it a Chicago institution. From the beginning, Second City began building its unique "brand" of theater, reaching larger and larger audiences, and over the years the Second City brand grew to become one of the strongest in comedy. Branding was just getting started at many U.S. businesses in the late 1950s when The Second City was founded. This period would come to be known by business historians as "The Marketing Era," when corporations began to adopt a consumer orientation and to distinguish their brand. The success of Second City in Chicago helped foster the establishment and growth of dozens of theaters in the city.

Almost from the theater's inception, alumni have garnered critical and commercial triumphs. Early troupe members Alan Arkin, Barbara Harris, and Severn Darden enjoyed film and theater success, and in the 1970s, many Second City actors, including John Belushi and Dan Aykroyd, gained fame on the (then) new weekly television show *Saturday Night Live*. This trend of achievement has continued and accelerated through the last 25–30 years. Today, many of the most famous comedic television and film stars have in some way traveled through Second City's doors. For many people, Second City's name has become synonymous with live comedic theater. Patrons enjoy the "up close" and interactive experience at a Second City performance, and the theater labors to maintain and build a strong sense of relationship with its audience.

Success for the theater has also bred expansion. In the United States, Second City currently operates in Chicago, Detroit, Denver, and Las Vegas, with training centers in Los Angeles and New York. The oldest offshoot of the theater is in Toronto, which opened its doors in 1973. Since then Second City has maintained strong ties to its Canadian branch. Canada remains Second City's strongest foreign market, where it is currently involved in a significant amount of television and film production, fueled by government funding available for Canadian productions. Also, Second City's Canadian home base of Toronto is the country's media center. Canada is not the only area of international expansion for the company. In 1962, the theater made its first London appearance with an artistic exchange with the English satirical performing group The Establishment. In 1992, Second City began a long-running relationship with the English Theater in Vienna, Austria, and three years later performed in the Edinburgh Fringe Festival in Edinburgh, Scotland.

Kelly Leonard, vice president of The Second City and president of Second City Theatricals, said, "We aren't focused on international growth. However, it's clear that many of our endeavors can potentially translate internationally. Our focus starts on what our base business is, content creation and talent development, and we look at opportunities that grow out of those two core competencies."

Today, three touring companies travel around the globe, bringing Second City performances to remote audiences worldwide. In 2001, one of Second City's touring companies traveled through Saudi Arabia, Kuwait, and the United Arab Emirates, entertaining U.S. troops stationed abroad. In 2002, Second City toured Tokyo, Singapore, Bangkok, and Hong Kong. Recently, the theater has expanded into the high seas, bringing weekly performances to audiences aboard various international cruise lines. These international performances are often attended by English speakers who live on foreign soil, as well as a growing audience of non-native English speakers.

International growth brings increased revenues and audiences but also potential pitfalls. The biggest potential pitfall is relying on an international audience "getting the jokes" created by a U.S.-based theater company. But as foreign audiences learn what makes Americans laugh, the lesson just may come from The Second City—something that might have disappointed A.J. Liebling and others who see Manhattan as the center of the cultural universe.

QUESTIONS

1. Identify how Second City might use technology to expand its markets. What dangers might it face in its use of technology?
2. What value does a Second City performance bring to its customers?
3. Identify specific factors that might drive demand higher and lower for Second City's products.
4. What unique challenges does Second City face as the company tries to expand internationally?

Part 1: Launching Your Global Business and Economics Career

In Part 1, "Business in a Global Environment," you learned about the background and current issues driving contemporary business. The part includes four chapters and an appendix covering such issues as business ethics and social responsibility, economic challenges facing global and domestic business, competing in global markets, and the legal framework for business. Business has always been an exciting career field, whether you choose to start your own company, work at a local business, or set your sights on a position with a multinational corporation. But today's environment is especially attractive because businesses are expanding their horizons to compete in a global economy—and they need dedicated and talented people to help them accomplish their goals. In fact, professional and business service jobs are found in some of the fastest-growing industries in the U.S. economy and are projected to grow by nearly 28 percent over a decade.[1] So now is the time to explore several different career options that can lead you to your dream job. Each part in this text profiles the many opportunities available in business. Here are a few related to Chapters 1 through 4.

If you're good at number crunching and are interested in how societies and companies function, then maybe a career as an *economist* is in your future. Economists study how resources are allocated, conduct research by collecting and analyzing data, monitor economic trends, and develop forecasts. They look into such vital areas as the cost of energy, foreign trade and exchange between countries, the effect of taxes, and employment levels—both from a big-picture national or global viewpoint and from the perspective of individual businesses. Economists work for corporations to help them run more efficiently, for consulting firms to offer special expertise, or for government agencies to oversee economic decision making. Typically, advanced degrees are needed to climb to top-level positions. Economists usually earn about $72,780 per year.[2]

Or perhaps you are interested in global business. Companies increasingly search the world for the best employees, supplies, and markets. So you could work in the United States for a foreign-based firm such as Nokia or Toyota; abroad in Africa, Asia, Europe, or Latin America for a U.S.-based firm such as Microsoft or Wal-Mart; or with overseas co-workers via computer networks to develop new products for a firm such as General Electric. With technology and telecommunications, distance is no longer a barrier to conducting business. Global business careers exist in all the areas you'll be reading about in this text—business ownership, management, marketing, technology, and finance.

Global business leaders are not born but made—so how can you start on that career path? Here are the three areas that businesses consider when selecting employees for overseas assignment:

- ***Competence***—including technical knowledge, language skills, leadership ability, experience, and past performance.
- ***Adaptability***—including interest in overseas work, communication and other personal skills, empathy for other cultures, and appreciation for varied management styles and work environments.
- ***Personal characteristics***—level of education, experience, and social compatibility with the host country.[3]

Solid experience in your field or company ranks at the top of the list of needed skills. Firms want to send employees who have expertise in their business and loyalty to the firm to represent them overseas. Those who obtain their master of business administration (MBA) degree are reaping rewards financially: in a recent year, the average starting salary for someone with an MBA reached $88,600 and often included signing bonuses in the tens of thousands of dollars.[4] But companies are reluctant to send new graduates abroad immediately. Instead, they invest in training to orient employees to the new assignment.

Knowledge of and interest in other languages and cultures is the second-highest priority. Businesspeople need to function smoothly in another society, so they are selected based on their familiarity with other languages and cultures. Because China is a business hotspot, some people have become fluent in Mandarin Chinese to boost their career prospects.[5] Also, some elementary school systems are even beginning to offer Chinese language classes in addition to their standard offerings of French, Spanish, German, and Russian.

Finally, employees are evaluated on their personal characteristics to be certain that they will fit well in their new country. More and more diversity is appearing among global managers, and a person's talent is still foremost in making assignments. As IBM's vice president of global workforce diversity puts it, "We have to be in compliance with a country's laws and sensitive to its local customs, but we also want the very best talent."[6]

Career Assessment Exercises in Economics and Global Business

1. With the change in the leadership at the U.S. Federal Reserve (the nation's central bank), economists have been highlighted in the news. Alan Greenspan, who retired after eighteen years as head of the Fed, turned over the reins to Benjamin Bernanke. Both men have backgrounds in economics. To get an idea of the role economists play in a federal government agency, research either Greenspan's or Bernanke's background, qualifications, and abilities. Assess how they performed or are performing at the Fed. Now make a list of your own skills. Where is there a match? What do you need to change?
2. To see the effect of the global economy in your town, go to a major retailer. Take a survey of the number of different countries represented in the products on the shelves. Compare your list with those of your classmates to see who found the most countries and what goods those countries provided. Go online to research the career opportunities at the firm's Web site.
3. To learn more about other countries, do research online for a country in which you are interested. Here are two sources that may be useful:

    - *The World Factbook*, published by the Central Intelligence Agency, http://www.cia.gov/cia/publications/factbook. This publication, updated yearly, contains a wealth of information about countries—geography and climate, population statistics, cultural and political information, transportation and communications methods, and economic data.

- *The Wall Street Journal's CollegeJournal* Web site, http://www.collegejournal.com. This site has a Global Careers link, which contains articles on international news and trends, country profiles, and career tips for several countries.

Write a one-page summary of what you found. Make a list of abilities you would need to function well as a businessperson in that country. Concentrate on the areas of competence, adaptability, and personal characteristics. Now formulate a plan to gain those skills.