**Chapter 7: FOREIGN DIRECT INVESTMENT**

**Foreign Direct Investmen**t: Purchase of physical assets or a significant amount of the ownership (stock) of a company in another country to gain a measure of management control

**Portfolio Investment:** Investment that does not involve obtaining a degree of control in a company

**Drivers of FDI Flows**

1. Globalization
2. Mergers and Acquisitions

**Theories of Foreign Direct Investment International Product Life Cycle**

1. New Product Stage
2. Maturing Product Stage
3. Standardized Product Stage

**Theories of Foreign Direct Investment Market Imperfections (Internalization)**

Market Imperfections: 1.Trade Barriers & 2.Specialized Knowledge

**Theories of Foreign Direct Investment Eclectic Theory**

Eclectic Theory:

1. Location Advantage
2. Ownership Advantage
3. Internalization Advantage

**Theories of Foreign Direct Investment Market Power**

1. Vertical Integration
2. Backward Integration
3. Forward Integration

These 3 factors will lead to what is called **Market Power**

**Management Issues and Foreign Direct Investment**

1. Control
2. Purchase-or-Build Decision (Greenfield investment)
3. Production Costs (Rationalized production, Mexico’s Maquiladora, Cost of research and development)
4. Customer Knowledge
5. Following Clients
6. Following Rivals

**Why Governments Intervene in FDI**

Balance of Payments

**Current Account:** National account that records transactions involving the export and import of goods and services, income receipts on assets abroad, and income payments on foreign assets inside the country

**Capital Account:** National account that records transactions involving the purchase and sale of assets

**Reasons for Intervention by the Host Country**

1. Control the Balance of Payments Obtain Resources and Benefits
2. Access to Technology
3. Management Skills and Employment

**Why Governments Intervene in FDI Home Country: A. Discouraging Outward FDI**

1. Investing in other nations sends resources out of the home country and lowers investment at home.
2. FDI outflow can damage a nation’s balance of payments if the investment abroad eliminates an export market.
3. Jobs created abroad by an FDI outflow may replace jobs in the home country.

**B. Home Country: Promoting outgoing FDI**

1. Increase Long-Term Competitiveness
2. “Sunset” Industries

**Government Policy Instruments and FDI: Host Countries**

Promotion

1. Financial incentives: Low or waived taxes & Low-interest loan
2. Infrastructure improvements: Better seaports, roads, and telecom networks

Restriction

1. Ownership restrictions: Prohibit investment
2. Performance demands: a.Local content requirements b.Export targets c.Technology transfers

**Government Policy Instruments and FDI: Home Countries**

Promotion:

1. Insurance on assets abroad 2.
2. Loans and loan guarantees
3. Special tax treaties
4. Tax breaks on profits earned abroad q
5. Persuade other nations to accept FDI

Restriction:

1. Higher taxes on foreign income
2. Sanctions that prohibit investing in certain nations

**Chapter 8: REGIONAL ECONOMIC INTEGRATION**

**Regional Economic Integration (Regionalism):** Process whereby countries in a geographic region cooperate to reduce or eliminate barriers to the international flow of products, people, or capital.

**Degrees of Economic and Political Integration**

**Free Trade Area**: Removes all barriers to trade among members with each nation determining its own barriers against nonmembers

**Customs Union:** Adds the requirement that all members set a common trade policy against nonmembers

**Common Market:** Adds the free movement of labor and capital and sets a common trade policy against nonmembers

**Economic Union:** Requires members to harmonize their tax, monetary, and fiscal policies, create a common currency, and concede some sovereignty to the larger organization

**Political Union:** Requires members to coordinate their economic and political policies against nonmembers, with a few exceptions

**Case for Regional Integration**

1. Trade Creation
2. Greater Consensus
3. Political Cooperation
4. Employment Opportunities
5. Corporate Savings

**Case Against Regional Integration**

1. Trade Diversion
2. Shifts in Employment
3. Loss of National Sovereignty

**Chapter 9: INTERNATIONAL FINANCIAL MARKETS**

**Capital Market:** System that allocates financial resources in the form of debt and equity according to their most efficient uses

**International capital market**: Network of individuals, companies, financial institutions, and governments that invest and borrow across national boundaries (Lenders and Borrowers)

**Forces Expanding the International Capital Market**

1. Information Technology
2. Deregulation
3. Financial Instruments
4. Securitization

**Offshore Financial Centers**

1. Operational centers: London, Switzerland…
2. Booking centers: Cayman Islands, Bahamas

**International Bond Market**: Market consisting of all bonds sold by issuing companies, governments, or other organizations outside their own countries.

**Types of International Bonds**

Eurobond: Bond issued outside the country in whose currency it is denominated.

Foreign Bond: Bond sold outside the borrower’s country and denominated in the currency of the country in which it is sold

**International Equity Market**: Market consisting of all stocks bought and sold outside the issuer’s home country.

**Drivers**

1. Spread of Privatization
2. Economic Growth in Emerging Markets
3. Activity of Investment Banks
4. Advent of Cybermarkets

**Eurocurrency Market**: Market consisting of all the world’s currencies that are banked outside their countries of origin. U.S. dollars deposited in a bank in Tokyo are called **Eurodollars.**

**Appeal of the Eurocurrency Market**

Appealing Feature: Absence of regulation: Reduces transaction costs, interbank interest rates Non-appealing Feature: Greater risk of default,Yet fairly safe

**Functions of the Foreign Exchange Market**

1. Conversion: To facilitate transactions, invest directly abroad, or repatriate profits
2. Hedging: Insure against potential losses from adverse exchange-rate changes
3. Arbitrage: Instantaneous purchase and sale of a currency in different markets for profit Speculation: Sequential purchase and sale (or vice-versa) of a currency for profit

**Spot Rates**

1. Spot Rate: Exchange rate requiring delivery of the traded currency within two business days
2. Spot Market: Market for currency transactions at spot rates
3. Buy and Sell Rates: A markup

**Forward Rates**

1. Forward Rate: Exchange rate at which two parties agree to exchange currencies on a specified future date
2. Forward Market: Market for currency transactions at forward rates
3. Forward Contract: Contract that requires the exchange of an agreed-on amount of a currency on an agreed-on date at a specified exchange rate • Derivatives

**Swaps, Options, and Futures**

1. Currency Swap: Simultaneous purchase and sale of foreign exchange for two different dates
2. Currency Option: Right, or option, to exchange a specified amount of a currency on a specified date at a specified rate
3. Currency Futures Contract: Contract requiring the exchange of a specified amount of currency on a specified date at a specified exchange rate, with all conditions fixed and not adjustable

**Market Instruments and Institution**

1. Interbank Market: Market in which the world’s largest banks exchange currencies at spot and forward rates • Clearing: Process of aggregating the currencies that one bank owes another and then carrying out the transaction
2. Securities Exchange: Exchange specializing in currency futures and options transactions
3. Over-the-Counter (OTC) Market: Decentralized exchange encompassing a global computer network of foreign exchange traders and other market participants
4. Convertible (Hard) Currency: Currency that trades freely in the foreign exchange market, with its price determined by the forces of supply and demand

**Market Instruments and Institution, Instruments for Restricting Currencies**

1. Policies for restricting currency convertibility include: Central bank approval, Import licenses, Multiple exchange rate system, Import deposit requirements, Quantity restrictions
2. Countertrade: Practice of selling goods or services that are paid for, in whole or in part, with other goods or services

**Chapter 10: INTERNATIONAL MONETARY SYSTEM**

**Importance of Exchange Rates**

1. **Devaluation:** Intentionally lowering the value of a nation’s currency
2. **Revaluation:** Intentionally raising the value of a nation’s currency
3. **Desire for Predictability and Stability**:

Stable exchange rates: Improve accuracy of forecasts and financial planning

Predictable exchange rates: Reduce surprises of unexpected rate changes

**Efficient versus Inefficient Market View**

Efficient Market View: View that prices of financial instruments reflect all publicly available information at any given time

Inefficient Market View: View that prices of financial instruments do not reflect all publicly available information

**Forecasting Techniques**

1. Fundamental Analysis: Technique that uses statistical models based on fundamental economic indicators to forecast exchange rates Fundamental Analysis
2. Technical Analysis: Technique that uses charts of past trends in currency prices and other factors to forecast exchange rates

**Law of One Price**: Principle that an identical item must have an identical price in all countries when the price is expressed in a common currency

**Purchasing Power Parity (PPP):** PPP can be interpreted as the exchange rate between two nations’ currencies that is equal to the ratio of their price levels.

**Role of Inflation**: Inflation erodes people’s purchasing power.

Money Supply: Monetary policy directly affects interest rates and money supply • Fiscal policy indirectly affects taxes and spending

Employment: High employment raises wages, which are embodied in consumer prices

Interest Rates: High interest rates lower borrowing and spending, which lowers inflation

**How Exchange Rates Adjust to Inflation**

Exchange rates adjust to different rates of inflation in different countries. It is Necessary to maintain PPP between nations

Exchange rate at the beginning of the year: Eb= 8 pesos/$ Inflation in Mexico (i1 = 20%) Inflation in USA (i2 = 3%)

• Exchange rate (Ee) at the end of the year Ee= Eb(1 + i1)/(1 + i2)= 9.3pesos/$

**Role of Interest Rates**: How do interest rates affect exchange rates between two currencies?

Two Types: Real interest rates, Nominal interest rates

Fisher Effect: Nominal interest rate = real interest rate + inflation rate

International Fisher Effect: Principle that a difference in nominal interest rates supported by two countries’ currencies will cause an equal but opposite change in their spot exchange rates

**Evaluating PPP**

Impact of Added Costs: PPP assumes no transportation costs.

Impact of Trade Barriers: PPP assumes no barriers to international trade.

Impact of Business Confidence and Psychology: PPP overlooks the human aspect of exchange rates

**Fixed Exchange-Rate Systems**

International Monetary System: Collection of agreements and institutions that govern exchange rates

Fixed Exchange Rate System: System in which the exchange rate for converting one currency into another is fixed by international agreement

**The Gold Standard**

Advantages of the Gold Standard:

1. Reduced the risk in exchange rates
2. Imposed strict monetary policies
3. Help correct a nation’s trade imbalance

**Collapse of the Gold Standard**

* Aggressive printing of paper currency caused high inflation
* Decision of the United States to devalue its currency and Britain’s decision not to do so: Lowered the price of U.S. exports on world markets, Increased the price of imports from Britain (and other countries), lowering its export earnings, Countries devalued their currencies in retaliation
* Competitive devaluations: No longer an accurate indicator of a currency’s true value, By 1939, gold standard was effectively dead

**Today’s Exchange-Rate Arrangements**

* Managed Float System
* “Pegged” Exchange-Rate Arrangement: “Peg” a country’s currency to a more stable and widely used currency in international trade.
* Currency Board: Monetary regime based on an explicit commitment to exchange domestic currency for a specified foreign currency at a fixed exchange rate.

**Chapter 11: INTERNATIONAL STRATEGY AND ORGANIZATION**

**Planning and Strategy**

Planning: Process of identifying and selecting an organization’s objectives and deciding how the organization will achieve those objectives

Strategy: Set of planned actions taken by managers to help a company meet its objectives

**Strategy formulation**

1. Identify company mission, vision, and goals (why the co exists and what to achieve)
2. Identify core competencies (competitive advantage) and value chain activities (divide activities to primary and support activity)
3. Formulate strategy

**National differences that complicate strategy formulation**

1. Language
2. Religious beliefs
3. Customs
4. Traditions
5. Climate
6. Political and legal systems
7. Economic systems
8. Determinant of location

**Strategy Formulation**

1. Multinational (Multidomestic) Strategy: adapting products and their marketing strategies in each national market to suit local preferences
2. Global Strategy: Offering the same products using the same marketing strategy in all national markets

**Corporate-Level Strategies:** Growth, Stability, Retrenchment, Combination (use the three in different departments)

**Business-Level Strategies:** low cost, differentiation, focus (focus on one of the 2 or both)

**Issues of Organizational Structure Centralization versus Decentralization**

Organizational Structure: Way in which a company divides its activities among separate units and coordinates activities among those units

Centralization: Coordination is paramount, Financial control and cost savings

Decentralization: Improves local responsiveness, Increases accountability

**Issues of Organizational Structure Coordination and flexibility**

Structure and Coordination: Design an appropriate organizational structure, Defines areas of responsibility and chains of command

Structure and Flexibility: Organizational structure is often modified to suit changes

**Work Teams**

Self-Managed Team: Team in which the employees from a single department take on the responsibilities of their former supervisors

Cross-Functional Team: Team composed of employees who work at similar levels in different functional departments

Global Team: Team of top managers from both headquarters and international subsidiaries who meet to develop solutions to company-wide problems

**Chapter 12: ANALYZING INTERNATIONAL OPPORTUNITIES**

**Screening Process for Potential Markets and Sites**

**Stage 1:** identify basic appeal: determine basic demand and the availability of resources.

**Stage 2:** asses the national business environment: Cultural Forces, Political and Legal Forces, Economic and Financial Forces, Other Forces (Transport Costs and Country Image

**Stage 3:** Measure Market or Site Potential:

* Measure market potential: Industrialized Markets: Data readily available, Forecasting market demand, Income elasticity

Emerging Markets: Biggest emerging markets are more important today than ever, Large consumer bases and rapid growth rates, Lack of information

Market potential indicator: Market Size, Market Growth Rate, Market Intensity, Market Consumption Capacity, Commercial Infrastructure, Economic Freedom, Market Receptivity, Country Risk

* Measuring Site Potential**:** Labor and management, Productivity, Wage levels, Training needs, Local infrastructure

**Step 4:** Select the Market or Site

* **Field Trips**
* **Competitor Analysis—Should address the following issues:** Number of competitors in each market (domestic and international), Market share of each competitor, Whether each competitor’s product appeals to a small market segment or has mass appeal, Whether each competitor focuses on high quality or low price, Whether competitors tightly control channels of distribution, Customer loyalty commanded by competitors, Potential threat from substitute products, Potential entry of new competitors into the market, Competitors’ control of key production inputs (such as labor, capital, and raw materials)

**Secondary Market Research**

* Process of obtaining information that already exists within the company or that can be obtained from outside sources
* Relatively inexpensive

Main Sources of Secondary Data International Organizations

1. Government Agencies
2. International Organizations
3. Industry and Trade Associations
4. Service Organizations
5. Internet

Problems with Secondary Research

Availability of Data: In many emerging and developing countries, Information is hard to obtain, Reliability is questionable

Comparability of Data: Terms differ greatly from one country to another, Different ways in which countries measure data

**Primary Market Research**

1. Primary Market Research
2. Trade Show
3. Focus Group
4. Consumer Panel
5. Survey
6. Environmental Scanning

Problems with Primary research

* Cultural variables
* Language
* Illiteracy rates among the local population

**Chapter 13: SELECTING AND MANAGING ENTRY MODES**

**Entry Mode:** Institutional arrangement by which a firm gets its products, technologies, human skills, or other resources into a market

Categories: Exporting, importing, and countertrade, Contractual entry, Investment entry

**Exporting, Importing, and Countertrade Why Companies Export**

1. Achieve economies of scale
2. Diversify sales
3. Gain international business experience

**Developing an Export Strategy: A Four-Step Model**

1. Identify a potential market.
2. Match needs to abilities.
3. Initiate meetings.
4. Commit resources.

**Degree of Export Involvement, Forms of Export Involvement**

Direct Exporting

1. Local Sales Representatives
2. Distributors

Indirect Exporting

1. Agents
2. Export Management Companies
3. Export Trading Companies

**Avoiding Export and Import Blunders**

1. Common reasons for export and import blunders: Failure to conduct adequate market research, Failure to obtain adequate export advice
2. To avoid committing such blunders: Hire a **freight forwarder:** a specialist in export-related activities

**Types of Countertrade**

1. **Barter:** mokayada without money
2. **Counter-purchase**: selling goods to a country and promise to buy from them
3. **Offset:** selling cars for $1000 and buy something you don’t know it know in $1000
4. **Switch Trading:** buy $100 in Syria and sell this order to another country
5. **Buyback:** sell pasta machines for Germany and get paid from them in pasta not money

**Export/Import Financing**

1. **Advance Payment:** Export/import financing in which an importer pays an exporter for merchandise before it is shipped
2. **Documentary Collection:** Export/import financing in which a bank acts as an intermediary without accepting financial risk
3. **Letter of Credit:** Export/import financing in which the importer’s bank issues a document stating that the bank will pay the exporter when the exporter fulfills the terms of the document
4. **Open Account:** Export/import financing in which an exporter ships merchandise and later bills the importer for its value

**Contractual Entry Modes**

1. **Licensing**: Practice by which one company owning intangible property (the licensor) grants another firm (the licensee) the right to use that property for a specified period of time

**Advantages** Finance expansion, Reduces risks, Reduce counterfeits, Upgrade technologies

**Disadvantages** Restrict licensor’s activities, Reduce global consistency, Lend strategic property

1. **Cross Licensing:** Practice by which companies use licensing agreements to exchange intangible property with one another
2. **Franchising**: Practice by which one company (the franchiser) supplies another (the franchisee) with intangible property and other assistance over an extended period

**Advantages** Low cost and low risk, Rapid expansion, Local knowledge

**Disadvantages** Cumbersome, Lost flexibility

1. **Management Contract:** Practice by which one company supplies another with managerial expertise for a specific period of time

**Advantages** Few assets risked, Nations finance projects, Develops local workforce **Disadvantages** Personnel at risk, Create competitor

1. **Turnkey (Build–Operate– Transfer) Project:** Practice by which one company designs, constructs, and tests a production facility for a client firm

**Advantages** Firms specialize in competency, Nations obtain infrastructure **Disadvantages** Politicized process, Create competitor

1. **Wholly Owned Subsidiary:** Facility entirely owned and controlled by a single parent company

**Advantages** Day-to-day control, Coordinate subsidiaries

**Disadvantages** Expensive, High risk

1. **Joint Venture:** Separate company that is created and jointly owned by two or more independent entities to achieve a common business objective

**Advantages** Reduce risk level, Penetrate markets, Access channels

**Disadvantages** Partner conflict, Lose control

1. **Strategic Alliance**: Relationship whereby two or more entities cooperate (but do not form a separate company) to achieve the strategic goals of each

**Advantages** Share project cost, Tap competitors’ strengths, Gain channel access **Disadvantages** Partner conflict, Create competitor

**Strategic Factors in Selecting an Entry Mode**

1. Selecting Partners for Cooperation
2. Cultural Environment
3. Political and Legal Environments
4. Market Size
5. Production and Shipping Costs
6. International Experience