Chapter 8

Understanding Emerging Markets

Learning Objectives *After studying this chapter, you should be able to:*

8.1 Understand advanced economies, developing economies, and emerging markets.

8.2 Know what makes emerging markets attractive for international business.

8.3 Learn how to assess the true potential of emerging markets.

8.4 Evaluate the risks and challenges of emerging markets.

8.5 Learn the success strategies for emerging markets.

8.6 Understand corporate social responsibility, sustainability, and the crisis of global poverty.

New Global Challengers: Top Firms from Emerging Markets

Consider a company that describes itself in the following way: "We are the world's largest baking company on the basis of brand positioning, production volume, and sales... We are the indisputable leader in our field in Mexico, Latin America, and the United States. We are present in 22 countries in America, Asia, and Europe; we offer more than 10,000 products and over 100 brands."

You probably did not guess that this is Grupo Bimbo ("Bimbo"), a leading company based in Mexico (www.grupobimbo.com). Bimbo owns such brands as Sara Lee, Brownberry, Arnold, and Plus Vita, among others. Founded in humble circumstances in 1945, this privately held company is now a global player in the bread, bakery, and snack markets.

Bimbo is one of thousands of companies from emerging markets that compete on a global scale. Emerging markets are lower-income countries that, in contrast to advanced economies, are currently experiencing rapid industrialization, modernization, and economic growth. Examples include Brazil, China, India, Russia, and Mexico. Emerging markets represent attractive markets and low-cost manufacturing bases. However, they also have high-risk business environments with evolving commercial infrastructure and legal systems. Despite their drawbacks, emerging markets have begun to produce *new global challengers*, top firms that are fast becoming key contenders in world markets. Bimbo is an example of a global challenger.

Source: fuyu liu/Shutterstock

Other examples of large multinational companies originating from emerging markets include Mexico's Cemex (one of the world's largest cement producers), Russia's Lukoil (global energy), and Turkey's Yildiz Holding (a diversified conglomerate that owns Godiva Chocolatier and United Biscuits). Brasil Foods (BRF) exemplifies the challengers' international entrepreneurial savvy. The firm's 2017 sales were more than $13 billion, of which half were from international markets. It operates farms and markets processed foods and ready-to-eat meals. BRF has built world-class distribution and supply-chain management systems and exports about half its annual production.

New global challengers from emerging markets leverage low-cost labor in their home countries. They also possess engineering and managerial talent often superior to that of competitors in advanced economies. Many new global challengers are family-owned or family-run businesses (family conglomerates) and enjoy numerous advantages. They often access low-interest loans from home-country, government-owned banks.

Many are expanding internationally by taking their established brands to global markets. China's Hisense operates in multimedia, household appliance, telecommunications, information technology, technology services, and real estate. The firm is known for stylish, low-priced consumer electronics. Hisense sells its products in more than 130 countries.

Some new global challengers leverage superior engineering capability. Hong Kong's Johnson Electric is the world leader in small electric motors for automotive and consumer applications. Brazil's Embraer taps the large pool of experienced, low-cost engineers in that country to build innovative small jets. It has become the world's leading producer of regional jet aircraft.

Many global challengers from emerging markets benefit from local bases of natural resources. Russia's Rusal is extracting the country's rich reserves of bauxite to produce aluminum for international markets. Most the world's natural resources are located in developing economies, and a growing number of new global challengers use these to their advantage. China's CNOOC (China National Offshore Oil Corporation), for example, is acquiring oil and gas reserves in Asia and Africa.

The new global challengers from emerging markets pose a growing competitive challenge to companies from advanced economies such as Europe, Japan, and North America.

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Questions

8-1. What are emerging markets? Give examples of emerging markets.

8-2. What are new global challengers? What advantages do they typically possess?

8-3. Do new global challengers pose any threat to firms from advanced economies? Explain.

SOURCES: Peter Buckley and Xiaowen Tang, "Internalization Theory and the Performance of Emerging-Market Multinational Enterprises," *International Business Review* 26, No. 5 (2017), pp. 976–990; Exequiel Hernandez and Mauro Guillén, "What's Theoretically Novel About Emerging-Market Multinationals?," *Journal of International Business Studies* 49, No. 1 (2018), pp. 24–33; Daniel Azevedo, *Meet the New Challengers*, June 27, 2016, Boston Consulting Group, www.bcg.com; Juichuan Chang, "The Early and Rapid Internationalization of Asian Emerging MNEs," *Competitiveness Review*, March 1, 2011, pp. 171–187; "Hisense Launches High-Tech TVs," *CNET*, January 8, 2018, www.cnet.com; "Multipolarity: The New Global Economy," *The World Bank*, 2011; Carol Liao, Christoph Nettesheim, and David Lee, "Will China's Global Challengers Be the Next Global Leaders?," *BCG Perspectives,* January 8, 2015, www.bcgperspectives.com; "'Multilatinas' on the Move," *Business Latin America*, January 9, 2012, pp. 4–5.

The opening case describes how emerging market countries are giving birth to multinational companies that are challenging their counterparts from the advanced economies. These *new global challenger* firms leverage local advantages such as low-cost labor and superior skills to compete successfully around the world. Historically, most trade and investment were conducted among the advanced economies, the world's wealthiest countries. Today, however, developing economies and especially emerging markets play important and growing roles in international business.

In this chapter, we discuss emerging market economies and contrast them with the advanced and developing economies. Each country group poses distinctive opportunities and risks. By analyzing a country in terms of its stage of economic development, the manager can gain insights into the purchasing power of its citizens, the sophistication of its business sector, the adequacy of its commercial infrastructure, and numerous other areas. Let's explore the country groups in detail.

8.1 Understand advanced economies, developing economies, and emerging markets.

Advanced Economies, Developing Economies, and Emerging Markets

The map in Exhibit 8.1 highlights the country groups examined in this chapter: **advanced economies**, **developing economies**, and **emerging markets**. Exhibit 8.2 provides an overview of key differences among the three country groups. The group with the largest number of countries by far is the developing economies. However, they contribute least to world GDP, and their citizens have very low incomes. Their *disposable income*, the proportion of personal income they spend on purchases other than food, clothing, and housing, is very limited. Approximately 10 percent of all developing economy residents live on less than \$2 per day. Average income in at least 20 countries, most of them in sub-Saharan Africa, is less than \$2,000 per year.[1] The combination of low income and often high birth rates promotes poverty in these countries.

Exhibit 8.2 also reveals countries' technological development. The developing economies are at a very early stage, whereas the emerging markets are quickly catching up to the advanced economies. *Technology* is the knowledge and application of tools, techniques, systems, and methods of organization to serve industry, science, and the arts. Technology is vital to economic development and includes not just hardware—computers, telephones, and industrial machinery; it also includes the educational systems, worker skill levels, and banking infrastructure. In the advanced economies and emerging markets, information and communications technologies have had an enormous impact on knowledge acquisition and on worker and personal productivity.

Let's define the different country groups.

Advanced economies. Post-industrial countries characterized by high per-capita income, highly competitive industries, and well-developed commercial infrastructures. They are the world's richest nations and include Australia, Canada, Japan, New Zealand, the United States, and most countries in Europe.

Developing economies. Low-income countries characterized by limited industrialization and stagnant economies. They make up the largest group of countries and include Bangladesh, Nicaragua, and Zaire.

Emerging markets. Also called emerging market economies, they are former developing economies that have achieved considerable industrialization, modernization, and rapid economic growth since the 1980s. Some 30 countries are considered emerging markets and are found mainly in Asia, Latin America, and Eastern Europe. The largest are Brazil, Russia, India, and China (sometimes abbreviated BRIC).

Absence of such technologies in the developing economies helps explain why they are well behind the other countries in education, economic output, and future prospects. Let's discuss the three country categories in detail.

Advanced Economies

Having reached a mature state of industrial development, advanced economies have largely evolved from manufacturing economies into sophisticated, largely service-based economies. Home to only about 14 percent of the world's population, they have long dominated international business. They account for nearly two-thirds of world GDP, more than half of world trade in products, and three-quarters of world trade in services.

Advanced economies have democratic, multiparty systems of government. Their economic systems are usually based on capitalism. They have tremendous purchasing power, with few restrictions on international trade and investment. They host the world's largest MNEs. Advanced economies include the United States, Canada, Japan, and many in Western Europe.

Developing Economies

Developing economies are sometimes called *underdeveloped countries* or *third-world countries*. These terms are imprecise and often offensive because, despite poor economic conditions, developing economies tend to be highly developed in historical and cultural terms.

Developing economies are hindered by high infant mortality, malnutrition, short life expectancy, illiteracy, and poor education systems. For example, the proportion of children who finish primary school in most African countries is less than 50 percent.[2] Because education is strongly correlated with economic development, poverty tends to persist. Lack of adequate health care is a major concern. Some 90 percent of the world's AIDS victims are found in developing economies, an additional hardship that hampers their development. Many adults cannot work or care for their children and require significant medical care. As a result, productivity is stagnant in many areas, leading to a vicious cycle of persistent poverty.

Governments in developing economies are often severely indebted. Some countries in Africa, Latin America, and South Asia have debt levels that approach or exceed their annual gross domestic product. This means it would cost a year's worth of national productive output just to pay off the national debt. Much of Africa's poverty is the result of government policies that discourage entrepreneurship, trade, and investment. Bureaucracy and red tape in developing economies deter firms from these countries from participating in the global economy.

As illustrated in Exhibit 8.3, there are substantial differences in the economic profiles of the three country groups. In particular, the exhibit reveals that developing economies lack numerous conditions needed for successful economic development, including low trade barriers and substantial international trade and investment. Advanced economies rank well in these areas, and emerging markets are showing consistent improvement.

EXHIBIT 8.1

Advanced Economies, Developing Economies, and Emerging Markets

Source: Based on data from the IMF, *World Economic Outlook: October 2017* (Washington, DC: International Monetary Fund, 2017).

Advanced Economies - Post-industrial countries characterized by high per-capita income, highly competitive industries, and well-developed commercial infrastructure.

Emerging Markets - Former developing economies that have achieved substantial industrialization, modernization, and rapid economic growth since the 1980s.

Developing Economies - Low-income countries characterized by limited industrialization and stagnant economies.

EXHIBIT 8.2

Key Differences Among the Three Major Country Groups

Sources: Based on latest data available from World Bank, www.worldbank.org; International Monetary Fund, www.imf.org; and Internet World Stats, www.internetworldstats.com.

Dimension	Advanced Economies	Developing Economies	Emerging Markets
Representative Countries	Canada, France, Japan, United Kingdom, United States	Angola, Bolivia, Nigeria, Bangladesh	Brazil, China, India, Indonesia, Turkey
Approximate Number of Countries	35	125	30
Population (% of world)	13%	32%	55%
Approximate Average Per-Capita Income (U.S. dollars; PPP basis)	$44,400	$3,650	$13,830
Approximate Share of World GDP (PPP basis)	45%	5%	50%
Population (millions)	1,040	2,380	4,180
Telephone Lines per 1,000 People (fixed and mobile)	1,700	680	1,100
Secure Internet Servers per 1,000,000 People	1,287	12	72
Internet Users per 1,000 People	902	365	576
Motor Vehicles per 1,000 People	602	60	230

EXHIBIT 8.3

Trade Conditions in the Major Country Groups

Sources: Based on International Monetary Fund, www.imf.org; World Bank, www.worldbank.org; and Central Intelligence Agency, *World Factbook 2018*, www.cia.gov.

Trade Condition	Advanced Economies	Developing Economies	Emerging Markets
Industry	Highly developed	Poor	Rapidly improving
Competition	Substantial	Limited	Substantial
Trade Barriers	Minimal	Moderate to high	Moderate
Trade Volume	High	Low	High
Inward FDI	High	Low	Moderate to high

Emerging Market Economies

Emerging markets are found primarily in East and South Asia, Eastern Europe, and Latin America. A few emerging markets are also located in Africa and the Middle East. Their most distinguishing characteristic is rapidly improving living standards and a growing middle class with rising economic aspirations.[3] As a result, they have become very attractive destinations for exports, FDI, and global sourcing.

Because their economies have transformed so dynamically, Hong Kong, Israel, Singapore, South Korea, and Taiwan have moved beyond the emerging-market stage. Several emerging markets are likely to join the group of wealthy nations in the not-too-distant future. For example, the Czech Republic and Poland have now matured into dynamic and competitive economies. Similarly, some countries currently classified as developing economies have the potential to become emerging markets in the near future. These frontier economies include the European countries of Estonia, Latvia, Lithuania, Slovakia; and the Latin American countries of Costa Rica, Panama, and Uruguay. In the Middle East, the United Arab Emirates has also transformed itself into a dynamic economy with a sophisticated commercial infrastructure.

Finally, you should know that economic prosperity often varies *within* a particular emerging market. There are usually two parallel economies in these countries—the urban areas and the rural sector. Compared to rural areas, urban areas tend to have more developed economic infrastructure and more middle-class consumers with greater disposable income, which then facilitates discretionary consumption.[4]

Certain emerging markets that have evolved from centrally planned economies to liberalized markets—specifically China, Russia, and several Eastern European countries—are called **transition economies**. These countries were once socialist states but have been largely transformed into capitalism-based systems, partly through a process of **privatization**—the transfer of state-owned industries to private concerns. Privatization and the promotion of new, privately owned businesses have allowed the transition economies to attract substantial direct investment from abroad. Long burdened by excessive regulation and entrenched government bureaucracy, they are gradually introducing legal frameworks to protect business and consumer interests and ensure intellectual property rights. They hold much potential.[5]

Transition economies
A subset of emerging markets that evolved from centrally planned economies into liberalized markets.

Privatization
Transfer of state-owned industries to private concerns.

Exhibit 8.4 contrasts the national characteristics of emerging markets with the other two country groups. Developing economies tend to be rooted in the agriculture and commodities sectors, which provide little basis for creating wealth. By contrast, emerging markets and advanced economies specialize in knowledge- and capital-intensive manufacturing and services sectors. These sectors provide ample added value and create superior living standards.

In purchasing-power terms, emerging markets now account for about half of world GDP.[6] Exhibit 8.5 shows the total, incremental contribution to world GDP of the leading economies from 2000 through 2020. Emerging markets, especially China, India, and Brazil, have contributed enormously to world growth in GDP and will continue to do so in the future. Although advanced economies such as the United States and Europe will remain relatively robust, the emerging markets hold the most promise as target markets and engines of global commerce in the future. In coming decades, it is estimated that the majority of growth in world GDP will come from emerging markets, especially Brazil, Russia, India and China, the BRIC countries. Presently, emerging markets represent more than one-third of world exports and receive more than one-third of world FDI.

In addition to proactive market liberalization, several factors contributed to the rise of emerging markets. The presence of low-cost labor; knowledge workers; government support; low-cost capital; and powerful, highly networked conglomerates also helped make these countries formidable

EXHIBIT 8.4
National Characteristics of Major Country Groups

Characteristic	Advanced Economies	Developing Economies	Emerging Markets
Median Age of Citizens	42 years	22 years	31 years
Major Sector Focus	Services, branded products	Agriculture, commodities	Manufacturing and services
Economic and Political Freedom	Free or mostly free	Mostly repressed	Moderately free or mostly not free
Economic/Political System	Market	Command or mixed	Mixed
Regulatory Environment	Minimal regulations	Highly regulated, burdensome	Significantly regulated, with some liberalization
Country Risk	Low	Moderate to high	Moderate to high
Intellectual Property Protection	Strong	Weak	Moderate and improving
Infrastructure	Well-developed	Inadequate	Moderate and improving

Sources: Based on International Monetary Fund, www.imf.org; Central Intelligence Agency, *World Factbook*, 2018, www.cia.gov.

EXHIBIT 8.5

Estimated Total Contribution to World GDP, 2015 Through 2020 (in billions of U.S. dollars and as a percentage of world GDP)

Source: Based on International Monetary Fund, World Economic Outlook Database, www.imf.org, 2018.

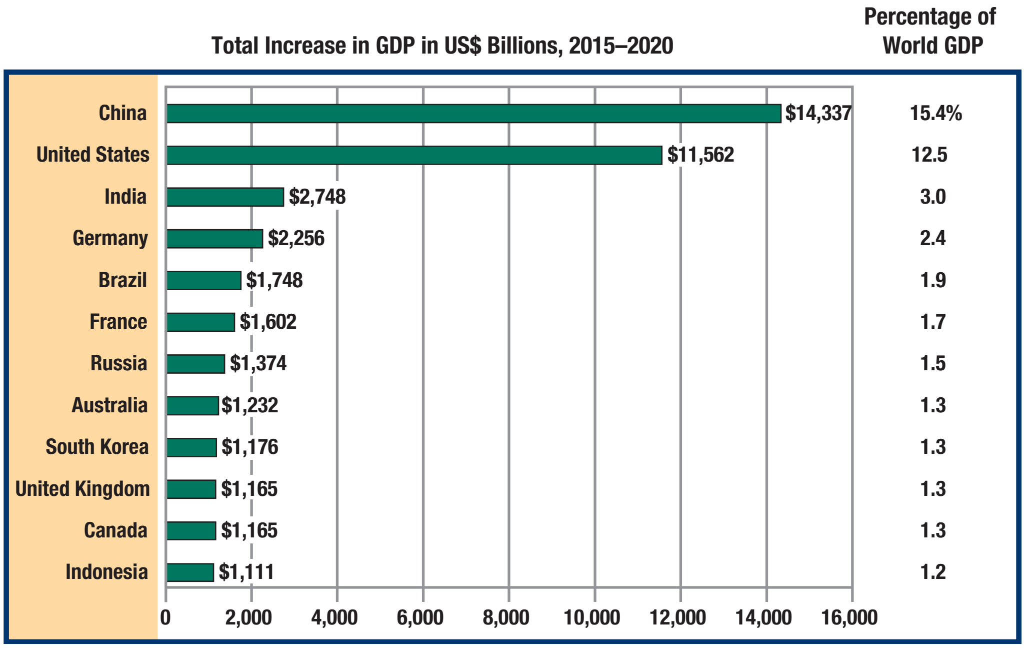


EXHIBIT 8.6

Emerging Market Global Challengers

Source: Based on Daniel Azevedo, *Meet the New Challengers*, June 27, 2016, Boston Consulting Group, www.bcg.com.

Country	Example Multinational Firms	Representative Industries
Brazil	Brasil Foods Embraer Natura Cosmeticos	Food processor Aerospace Cosmetics
China	Alibaba Group Huawei Technologies Lenovo Group	E-commerce Information and communications technology Computer technology
India	Bharti Airtel Infosys Tata Motors	Telecommunications services Technology consulting Automotive
Mexico	America Movil Cemex Grupo Bimbo	Telecommunication Building materials Baking, snacks
Russia	Gazprom Lukoil Severstal	Natural gas Oil Steel and mining
Turkey	Koc Holding Sabanci Holding Yildiz Holding	Industrial Industrial and financial Confectionary, biscuits, snacks

New global challengers Leading firms from emerging markets that are fast becoming key contenders in world markets.

players in the global economy. As highlighted in the opening case, **new global challengers** are leading firms from emerging markets that are fast becoming key contenders in world markets. Exhibit 8.6 provides a sample of these firms. Most are highly diversified, operating in sectors from manufacturing, services, trade, and even education.

An example from Egypt is Global Telecom Holding, formerly Orascom Telecom Holding (www.gtelecom.com). This mobile telecommunications provider has become an industry leader in Africa and the Middle East. As the world's sixth-largest mobile telecommunications provider, it has strung together a telecom empire of more than 86 million subscribers in Africa, Asia, Europe, North America, and the Middle East.

Emerging market multinationals have also been on a shopping spree, acquiring companies in the advanced economies. In the auto industry, for example, Zhejiang Geely Holdings of China now owns Volvo. Tata of India acquired Jaguar and Land Rover. Emerging market multinationals have acquired numerous former advanced economy brands. Examples include Godiva (owned by Turkish Yildiz), AMC Theaters (owned by Dalian Wanda group of China), and The Body Shop (owned by Brazil's Natura).

Each year, *Forbes* magazine publishes a list of the world's 2,000 largest firms, the *Global 2000*. The number of companies from emerging markets in the list now exceeds 500. Over the past several years, some firms from advanced economies have fallen off the *Forbes* list. For example, between 2016 and 2017 alone, 25 U.S. companies and 20 Japanese firms fell off the list, while 63 companies from China were added. These statistics reveal how fast new global challengers are displacing traditional MNEs from the advanced economies and becoming key competitors in world markets. Managers in advanced economy firms need to devise innovative strategies to compete skillfully with them.[7]

China is the largest emerging market. Its population of 1.3 billion people represents one-fifth of the world's total, and its economy has been growing at an impressive rate. The country's role in international business is expanding rapidly. China already has produced numerous new global challengers, such as Shanghai Automotive (China's top automaker), Sinopec (a large oil company), and Shanghai Baosteel (a steel manufacturer). Chinese exports now account for about 12 percent of total world merchandise exports.[8] The figure is impressive given that nearly all of the world's 200 or so countries export.[9]

MyLab Management Watch It! 1

If your professor has assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete the video exercise titled The New Global Challengers.

What Makes Emerging Markets Attractive for International Business?

8.2 Know what makes emerging markets attractive for international business.

Emerging markets are attractive to internationalizing firms as target markets, manufacturing bases, and sourcing destinations.

Emerging Markets as Target Markets

Emerging markets have become important target markets for a wide variety of products and services. The largest emerging markets have doubled their share of world imports in the past few years. The growing middle class in emerging markets implies rising demand for various consumer products, such as electronics and automobiles, and services such as health care.[10] Roughly one-quarter of Mexico's 122 million people enjoy affluence equivalent to that of the middle class in the advanced economies. In some product categories, demand is growing fastest in emerging markets. For example, the fastest-growing markets for power tool companies such as Black & Decker and Robert Bosch are in Asia, Latin America, Africa, and the Middle East.[11] Technology firms such as Cisco and Intel and fashion companies such as Hermes and Ralph Lauren generate a large and growing proportion of their revenues from sales to such countries.[12]

Global pharmaceutical companies such as Pfizer and GlaxoSmithKline have increased their emphasis on developing and marketing drugs in emerging markets. This change in strategy has resulted from a rapidly expanding middle class whose members can pay for quality medications. Industry forecasts indicate that the global pharmaceutical market will reach nearly $1.3 trillion by 2018, with emerging markets accounting for about half of total global growth and nearly half of total sales. For example, Merck and Pfizer have launched popular drugs in India, using innovative pricing strategies that make once-expensive medications affordable for millions of low-income consumers.[13]

Source: Sergey Rusanov/Shutterstock

The presence of lower-wage, high-quality labor makes emerging markets top locations for global manufacturing.

Businesses in emerging markets are important targets for machinery, equipment, and technology sales. For example, demand is huge for textile machinery in India, for agricultural equipment in China, and for oil and gas exploration technology in Russia. In a similar way, governments and state enterprises in emerging markets are major targets for sales of infrastructure-related products and services such as machinery, power transmission equipment, transportation equipment, high-technology products, and other products that countries in the middle stage of development typically need.

Emerging Markets as Manufacturing Bases

Firms from Japan, Europe, the United States, and other advanced economies have invested vast sums to develop manufacturing facilities in emerging markets. These markets are home to low-wage, high-quality labor for manufacturing and assembly operations. In addition, some emerging markets have large reserves of raw materials and natural resources. For example, Mexico, India, and China are important production platforms for manufacturing cars and consumer electronics. South Africa is a key source for industrial diamonds. Brazil is a center for mining bauxite, the main ingredient in aluminum. Thailand has become an important manufacturing location for Japanese MNEs such as Sony and Sharp. Motorola, Intel, and Philips manufacture semiconductors in Malaysia and Taiwan.

Emerging markets enjoy considerable success in certain industries. Examples include Brazil in iron ore and processed foods, Taiwan and Malaysia in personal computers, and South Africa in mining. Two of the world's top-selling beer brands are new global challengers based in China (Snow, made by China Resources Snow Breweries) and Brazil (Skol, made by AB InBev). Together, these firms produce more than 50 million barrels of beer annually.[14] South Korea's Samsung is the world's largest electronics company and the leading producer of semiconductors and flat-screen TVs. It has displaced Sony (Japan) and Motorola (United States) in these industries.

Note, however, that MNEs tend to shift manufacturing locations as conditions evolve in individual countries. When choosing production locations, managers consider manufacturing capacity, output quality, logistical factors, and especially the cost of labor. As economic conditions in emerging markets improve, worker wages tend to rise. As this occurs, MNEs may move manufacturing to other, lower-cost countries. For example, as wages rose in China, footwear producers such as Adidas and Nike moved much of their manufacturing to Vietnam. Wages in Vietnam are about one-third those in China, and Vietnam has emerged as a low-cost production destination in the footwear industry.[15]

Outsourcing
The procurement of selected value-chain activities, including production of intermediate goods or finished products, from independent suppliers.

Global sourcing
The procurement of products or services from independent suppliers or company-owned subsidiaries located abroad for consumption in the home country or a third country.

Emerging Markets as Sourcing Destinations

Many companies subcontract their noncore business activities to specialized suppliers, a trend known as **outsourcing**, the procurement of selected value-chain activities, including production of intermediate goods or finished products, from independent suppliers or company-owned subsidiaries. Outsourcing helps firms become more efficient, concentrate on their core competencies, and obtain competitive advantages. When outsourcing relies on suppliers or production bases located abroad, it is known as **global sourcing** or *offshoring*.

Emerging markets serve as excellent platforms for sourcing. Numerous MNEs have established call centers in Eastern Europe, India, and the Philippines. Firms in the IT industry such as Dell and IBM reap big benefits from the ability to outsource certain technological functions to knowledge workers in India. Many Intel and Microsoft programming activities are performed in

Bangalore, India. Investments from abroad benefit emerging markets because they lead to new jobs and production capacity, transfer of technology and expertise, and linkages to the global marketplace.

Assessing the True Potential of Emerging Markets

8.3 Learn how to assess the true potential of emerging markets.

Firms targeting emerging markets for sales, manufacturing, or sourcing must seek reliable information to support managerial decision making. However, emerging markets are characterized by unique circumstances that usually hinder managers' ability to acquire needed facts and figures. Limited data, unreliable information, or the high cost of conducting market research pose formidable challenges for estimating the true potential of emerging markets. In such cases, MNEs may need to improvise and use creative methods to generate needed findings.[16]

In the early stages of market research, managers examine three important statistics to estimate market potential: per-capita income, size of the middle class, and market potential indicators. Let's examine each in turn.

Per-Capita Income as an Indicator of Market Potential

When evaluating the potential of individual markets, managers often start by examining aggregate country data, such as gross national income (GNI) or per-capita GDP, expressed in terms of a reference currency such as the U.S. dollar. For comparison, the second column in Exhibit 8.7 provides per-capita GDP for a sample of emerging markets and for the United States. For example, China's per-capita GDP converted at market exchange rates was $9,377, whereas that of the United States was $61,687 in 2018.

However, per-capita GDP converted at market exchange rates paints an inaccurate picture of market potential because it overlooks the substantial price differences between advanced economies and emerging markets. Prices are usually lower for most products and services in emerging markets. For example, a U.S. dollar exchanged and spent in China will buy much more than a dollar spent in the United States.

What should managers do to estimate market potential more accurately? The answer lies in using per-capita GDP figures adjusted for price differences. Economists estimate real buying power by calculating GDP statistics based on **purchasing power parity (PPP)**. The PPP concept suggests that, in the long run, exchange rates should move toward levels that would equalize the prices of an identical basket of goods and services in any two countries. Since prices vary greatly among countries, economists adjust ordinary GDP figures for differences in purchasing power. Adjusted per-capita GDP more accurately represents the number of products consumers can buy in a given country, using *their own currency* and consistent with *their own standard of living*.

Purchasing power parity (PPP)
An adjustment for prices that reflects the number of goods that consumers can buy in their home country, using their own currency and consistent with their own standard of living.

Country	Per-Capita GDP, Converted Using Market Exchange Rates	Per-Capita GDP, Converted Using PPP Exchange Rates
Brazil	$10,515	$15,919
China	9,377	17,943
India	1,989	7,750
Mexico	10,021	20,028
Poland	15,050	30,827
Russia	10,630	28,918
South Africa	6,292	13,591
South Korea	30,919	41,173
Turkey	11,125	27,635
Vietnam	2,482	7,378
United States	61,687	61,687

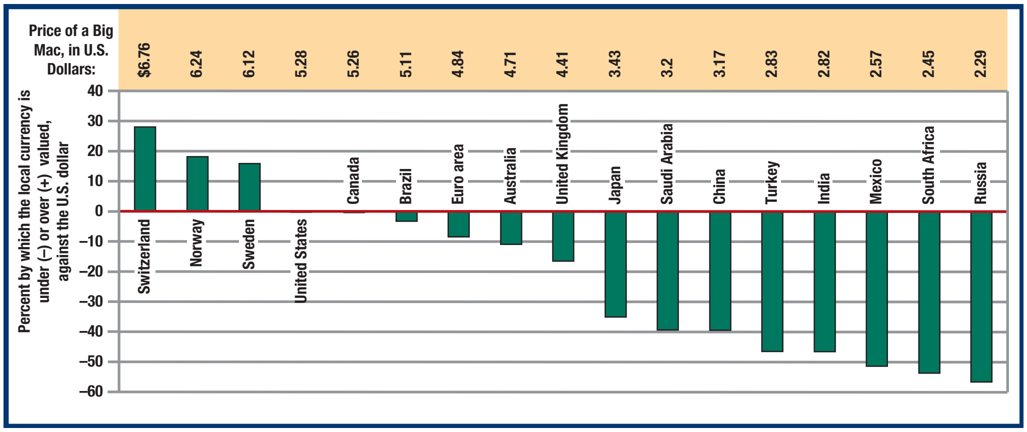
EXHIBIT 8.7
Difference in Per-Capita GDP, in Conventional and Purchasing Power Parity (PPP) Terms (U.S. dollars)

Source: Based on data from International Monetary Fund, *World Economic Outlook Database*, 2018, www.imf.org.

EXHIBIT 8.8

The Big Mac Index 2018

Source: Based on *The Economist*, "The Big Mac Index," January 17, 2018, www.economist.com.



Now examine per-capita GDP, adjusted for purchasing power parity, for the same sample of countries in the third column in Exhibit 8.7. Note that a more accurate estimate of China's per-capita GDP is $17,943, stated in PPP terms—considerably higher than per-capita GDP at market exchange rates suggests. Compare the two figures for other countries as well. These adjusted estimates help explain why firms target emerging markets despite the seemingly low income levels in conventional income statistics.

Another way to illustrate the PPP concept is to examine the Big Mac Index developed by *The Economist* newsmagazine (www.economist.com). The index first gathers information about the price of hamburgers at McDonald's restaurants worldwide. It then compares the prices based on actual exchange rates to those based on the PPP price of Big Macs to assess whether a nation's currency is under- or overvalued. Exhibit 8.8 presents the Big Mac Index for the most recent year. It reveals that several currencies in Europe are overvalued, whereas those of emerging markets are undervalued. For example, the index implies that the Chinese yuan and the Russian rouble are substantially undervalued compared to the dollar.[17] The Big Mac Index assumes that business costs and McDonald's strategies are identical across countries. While these assumptions may not be realistic, the index provides a useful approximation of purchasing power and currency valuations around the world.

Even when per-capita income is adjusted for purchasing power parity, managers should exercise care in relying on it as an indicator of market potential in an emerging or developing economy. There are four reasons for this caution.

- Official data do not account for the informal economy, where economic transactions are not officially recorded and are therefore left out of national GDP calculations. In developing economies, the informal economy is often as large as the formal economy. Countries usually lack sophisticated taxation systems, and individuals and businesses often underreport income to minimize tax obligations. Also not normally captured by national GDP estimates are barter exchanges in which no money changes hands.
- Most people in emerging markets and developing economies are on the low end of the income scale. As you may recall from your statistics training, mean or average does not always represent a normal distribution; often, median income more accurately depicts purchasing power.
- *Household income* is substantially larger than per capita income in these countries due to the presence of multiple wage earners in individual households. Multiple-income households have much greater spending power than individuals, a fact overlooked by statistics that emphasize per-capita GDP.
- Governments in these countries may underreport national income so they can qualify for low-interest loans and grants from international aid agencies and development banks.

In addition to per-capita GDP, managers should examine other market potential indicators, including GDP growth rate, income distribution, commercial infrastructure, the rate of urbanization, consumer expenditures for discretionary items, and unemployment rate. Managers will also find the size and growth rate of the middle class to be revealing. Let's explore this next.

Middle Class as an Indicator of Market Potential

In every country, the middle class represents the segment of people between wealthy and poor. Middle-class households in the emerging markets now have access to substantial disposable income. This allows them to engage in discretionary consumption, which means buying goods beyond simple necessities. These include better housing, modern furniture and appliances, health care, and education for children. They may even take holidays and own a car. Middle-class consumers also tend to be better educated and hold professional jobs. The middle class in emerging markets is also distinguished by unique values, attitudes, and expectations toward the future. For example, they tend to be generally more active in politics and concerned about democracy, freedom, and the environment. They are usually more tolerant of alternative lifestyles.

The middle class makes up the largest proportion of households in advanced economies. In emerging markets, the size and growth rate of the middle class are signals of a dynamic market economy. Best estimates indicate the middle class constitutes about 350 million consumers in each of China and India.[18] Exhibit 8.9 provides average household income data for a sample of emerging markets with sizable middle-class populations. Households constitute multiple individuals, typically entire families, often with two or more income earners. Consequently, households tend to have considerably more purchasing power than individuals.

Demographic trends suggest that, in the coming two decades, the proportion of middle-class households in emerging markets will continue to grow, representing enormous spending power. The most growth by far will occur in East Asia, especially China. In population terms, Asia is expected to account for about half the world's middle class by the year 2020.[19] As incomes increase, spending patterns will evolve, fueling growth across various product and service categories.

Country	Average Income per Household (U.S. $)
Brazil	$30,940
China	27,225
India	7,849
Indonesia	14,280
Mexico	33,448
Nigeria	11,025
Russia	24,300
South Africa	19,180
Thailand	19,740
Turkey	42,674

EXHIBIT 8.9
Average Household Income for a Sample of Emerging Markets, 2017

Sources: Based on United Nations, *United Nations Database on Household Size and Composition 2017* (New York: United Nations, 2017); World Bank, "GNI per Capita, Atlas Method (current US$)," 2017, www.data.worldbank.org.

Note: Data shown are gross national income per household, Atlas method, in current U.S. dollars.

MyLab Management Watch It! 2

If your professor has assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete the video exercise titled Made in America and Mexico.

8.4 Evaluate the risks and challenges of emerging markets.

Risks and Challenges of Emerging Markets

Country risk takes on growing importance in an increasingly interdependent world. More MNEs are doing business in emerging markets, which are beset by various challenges.[20] National and regional crises have global implications, even for firms very remote from crisis locations.

Political Instability

The absence of reliable or consistent governance from recognized government authorities adds to business costs, increases risks, and reduces managers' ability to forecast business conditions. Political instability is associated with corruption and weak legal frameworks that discourage inward investment and the development of a reliable business environment. In Russia, for example, evolving political conditions threaten the business activities of foreign firms. Bureaucratic practices favor well-connected, home-grown firms. Western oil companies have been denied access to Russia's energy resources. In the 2017 *Ease of Doing Business* rankings of the World Bank, Brazil received an overall ranking of 125 out of 190 countries. It ranked 176th in terms of 'starting a business', 170th in 'dealing with construction permits', and 139th in 'trading across borders'. Such conditions tend to discourage firms from entering the Brazilian market.[21]

Weak Intellectual Property Protection

Many countries lack strong laws that protect intellectual property. Even when such laws are present, they may not be enforced, or the judicial process may be painfully slow. In Argentina, for example, enforcement of copyrights on recorded music, videos, books, and computer software is inconsistent. Authorities attempt to stop shipments of pirated merchandise, but inadequate resources and slow court procedures hamper enforcement. Laws against Internet piracy are weak and ineffective.[22] Counterfeiting—unauthorized copying and production of a product—is common in China, Indonesia, and Russia, especially of software, DVDs, and CDs. In India, weak patent laws often discourage investment by foreign firms. In China, counterfeiting extends even to creating fake retail stores, imitating trademark retail outlets of top brands such as Apple and IKEA.[23]

Bureaucracy, Red Tape, and Lack of Transparency

Burdensome administrative rules and excessive requirements for licenses, approvals, and paperwork all delay business activities.[24] Excessive bureaucracy is usually associated with a lack of transparency, suggesting that legal and political systems may not be open and accountable to the public. Bribery, kickbacks, and extortion, especially in the public sector, cause difficulty for managers. Where anticorruption laws are weak, managers may be tempted to offer bribes to ensure the success of business deals. In the *Transparency International* ranking of the most corrupt countries (www.transparency.org), emerging markets such as Russia, Venezuela, and the Philippines are among those with substantial corruption.[25]

Poor Physical Infrastructure

In advanced economies, high-quality roads, drainage systems, sewers, and electrical utilities are taken for granted. In emerging markets, such basic infrastructure is still in development. Many people in rural India do not have access to toilets and sewage treatment systems. Poor sanitation gives rise to illness, and thousands of Indian children die every week from diarrheal illness. India's ports, roads, railways, and airports are insufficient to handle the massive volumes of cargo that enter and leave the country every day. Industrial cities such as Bangalore and Pune periodically experience power outages that can last 24 hours or more.[26] The government is working to improve infrastructure, but MNEs often must build their own systems and find creative solutions to support value-chain activities. In much of the world, firms find themselves building roads, installing localized energy sources, and developing other such systems to conduct business. A subsidiary of Tata Chemicals, part of India's giant Tata conglomerate, had to build its own road and railway infrastructure in Africa to support the firm's operations there.[27]

Partner Availability and Qualifications

Multinational firms often seek alliances with well-qualified local companies in countries characterized by inadequate legal and political frameworks. Through such partners, foreign firms can access local market knowledge, establish supplier and distributor networks, and develop key government contacts. However, well-qualified partners that can provide these advantages are not always readily available in emerging markets, especially smaller ones.

Likely Resistance from Family Conglomerates

Many emerging market economies are dominated by large, family-owned rather than publicly owned businesses. A **family conglomerate (FC)** is a large, highly diversified company that is privately owned. FCs operate in industries ranging from banking to construction to manufacturing. They control the majority of economic activity and employment in emerging markets such as South Korea, where they are called *chaebols*; in India, where they are called *business houses*; in Latin America, where they are called *grupos*; and in Turkey, where they are called *holding companies*. Exhibit 8.10 illustrates some of the world's leading FCs.

Family conglomerate (FC)
A large, highly diversified company that is privately owned.

A typical FC may hold the largest market share in each of several industries in its home country. In South Korea, the top 30 FCs account for nearly half the economy's assets and industry revenues. Samsung is perhaps the most famous Korean FC. In Turkey, the Koc Group accounts for about 20 percent of trading on the Istanbul Stock Exchange, and Sabanci provides more than 5 percent of Turkey's national tax revenue. FCs enjoy various competitive advantages in their home countries, including government protection and support, extensive networks in various industries, superior market knowledge, and access to capital. Hyundai Group was an early mover in South Korea's auto industry and now holds the largest share of that country's car market. When foreign automakers tried to enter the market, they found Hyundai's advantages overwhelming.

An FC's origins and growth often derive from a special relationship with the government. The government may protect the FC by providing it with subsidies, loans, and tax incentives. The government may set up market-entry barriers to competitors. In some cases, the government may even launch the FC. The government of Thailand launched the Siam Cement Group. One of the largest FCs in Indonesia, the Bimantara Citra Group, got its start by selling its foreign oil

EXHIBIT 8.10
A Sample of Leading Family Conglomerates

Family Conglomerate	Home Country	Primary Sectors	Distinction
ALFA	Mexico	Petrochemicals, machinery, foods, electronics, telecommunications	One of the world's largest producers of engine blocks and petrochemicals
Astra	Indonesia	Motor vehicles, financial services, heavy equipment, agribusiness, information technology	Largest distributor of automobiles and motorcycles in Indonesia
Ayala	Philippines	Real estate, financial services, utilities, telecommunications, electronics	Oldest and largest conglomerate in the Philippines
Hyundai	South Korea	Automobiles, shipbuilding	Truly global car company, selling Sonatas, Elantras, and other models in nearly 200 countries
Reliance Industries	India	Petroleum products, retailing, chemicals, textiles, solar energy systems	Named by *Forbes* one of the "world's 100 most respected companies"
Russian Standard	Russia	Alcoholic beverages, banking, life insurance	The leading premium producer of vodka in Russia
Sabanci Holding	Turkey	Cars, cement, energy, retailing, insurance, telecom, tires, plastic, hotels, paper, tobacco	Controls about 70 companies, including Turkey's largest bank, Akbank
Tatung	Taiwan	Computers, liquid crystal display televisions, network devices, media players, home appliances	OEM manufacturer for HP, Acer and Dell; world's largest producer of flat panels for the TV industry
Votorantim Group	Brazil	Finance, energy, agribusiness, mining, steel, paper	One of the largest industrial conglomerates in Latin America

allocations to the state-owned oil monopoly. The group has long enjoyed a close relationship with the Indonesian government and secured numerous lucrative contracts. When the Hyundai Group in South Korea experienced a financial crisis, the Korean government and Hyundai's major creditors provided more than $300 million in assistance.[28]

Family conglomerates provide huge tax revenues and facilitate national economic development. This helps explain why governments eagerly support them. The fact that they dominate the commercial landscape in many emerging markets suggests they will be either formidable competitors or capable partners, possibly with much bargaining power. We return to this issue in the next section.

8.5 Learn the success strategies for emerging markets.

Success Strategies for Emerging Markets

The strategies that MNEs developed decades ago and refined in mature advanced-economy markets are often inappropriate for the unique circumstances in emerging markets. Foreign firms must devise creative strategies to succeed.[29] For example, Toyota developed a line of inexpensive cars, costing about $7,000, for low-income countries. In India, it built a large factory to boost its share of the Indian car market to 10 percent.[30] Skoda and Volkswagen are building low-cost cars targeted to emerging markets such as China, India, and Russia.[31] In this section, we discuss strategies that firms employ to succeed in emerging markets.

Customize Offerings to Unique Emerging Market Needs

Successful firms develop a deep understanding of the distinctive characteristics of buyers, local suppliers, and distribution channels in emerging markets. They build constructive relationships with the communities where they operate, partly to understand local conditions better and partly to earn customer respect and loyalty. The ability to customize offerings and devise innovative business models depends largely on the firm's *flexibility* and entrepreneurial orientation. In emerging markets, many people are illiterate, and fewer than one in three has regular access to the Internet and other computer-based systems.[32] Consequently, MNEs employ creative approaches to promote their offerings in local markets. Where suppliers and distribution channels are lacking, they develop their own infrastructure to obtain needed raw materials and components or move finished goods to local buyers.[33]

MNEs must set prices appropriate for local conditions. Many firms devise innovative products and packaging to keep prices low. In India, for example, General Electric developed a lightweight electrocardiograph machine that sells for just $1,500, far cheaper than similar machines in advanced economies. Low pricing means that doctors and clinics in poor areas can purchase the machine and offer health care for a fraction of the cost required by earlier technologies. The Chinese Internet company Tencent developed a free messaging service that captured the local market for mobile phone communications. Chinese consumers prefer text messaging over voice communications because pricing is cheaper.

Partner with Family Conglomerates

Family conglomerates are formidable players in their respective economies and have much capital to invest in new ventures. For example, most major FCs in Korea, as well as Koc and Sabanci in Turkey, Vitro in Mexico, and Astra in Indonesia, own their own financing operations in the form of insurance companies, banks, and securities brokers. Many FCs possess extensive distribution channels throughout their home countries. They have a deep understanding of local markets and customers. In addition, they often have political clout, which enables them to navigate the complex bureaucracy.

For foreign firms wanting to do business in emerging markets, FCs can make valuable venture partners.[34] By collaborating with an FC, the foreign firm can:

- Reduce the risks, time, and capital requirements of entering the market.
- Develop helpful relationships with governments and other key local players.
- Target market opportunities more rapidly and effectively.
- Overcome infrastructure-related hurdles.
- Leverage FC resources and local contacts.

There are many examples of successful FC partnering. Ford partnered with Kia to introduce the Sable line of cars in South Korea and benefited from Kia's strong distribution and after-service network. Digital Equipment Corporation (DEC) designated Tatung, a Taiwanese FC, as the main distributor of its workstations and client-server products in Taiwan. DEC gained access to Tatung's local experience and distribution network. In Turkey, Danone, the French yogurt producer and owner of Evian brand of bottled water, entered a joint venture with Sabanci, a large local FC. Danone brought ample technical knowledge in packaging and bottling and a reputation for health-friendly products, but it lacked information about the local market. As the Turkish market leader, Sabanci knew the market, retailers, and distributors. The collaboration helped make Danone the most popular bottled water in the first year after entry.

Source: Pavel L Photo and Video/Shutterstock

Emerging market governments are important potential customers for various products and services. Pictured here is a government ministry in Russia.

Target Governments in Emerging Markets

In emerging markets and developing economies, government agencies and state-owned enterprises are an important customer group for three reasons:

- Governments buy enormous quantities of products (such as computers, furniture, office supplies, and motor vehicles) and services (such as architectural, legal, and consulting services).
- State enterprises in areas such as railways, airlines, banking, oil, chemicals, and steel buy goods and services from foreign companies.
- The public sector influences the procurement activities of various private or semiprivate corporations. In India, the government works directly in planning housing projects. Construction firms lobby the government to gain access to promising deals to build apartments and houses for local dwellers.

Tenders
Formal offers a buyer makes to purchase certain products or services.

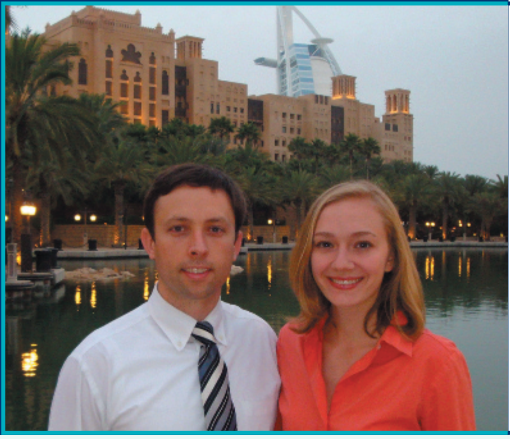
Emerging market governments regularly announce **tenders**—formal offers made by a buyer to purchase certain products or services. A tender is also known as a request for proposals (RFPs). Government agencies seek bids from suppliers to procure bulk commodities, equipment, and technology or to build power plants, highways, dams, and public housing. Vendors submit bids to the government to work on these projects.

Governments in emerging markets as well as developing countries often formulate economic development plans and annual programs to build or improve national infrastructure. To find vendors, the government follows specific buying procedures that lead to large, lucrative sales to international vendors. Securing major government contracts usually requires substantial competencies and resources. Firms competing for such projects assemble a team of managers and technical experts, especially when pursuing large deals. Governments prefer dealing with vendors that offer complete sales and service packages. The most successful vendors also offer financing for major sales, in the form of low-interest loans or grants. Governments are attracted by deals that create local jobs, employ local resources, reduce import dependence, and provide other country-level advantages.

Bechtel, Siemens, General Electric, Hitachi, and other major vendors regularly participate in bidding for global tenders from emerging market governments. Some of the largest construction projects include the Panama Canal expansion and the Channel Tunnel between Britain and France. Another megaproject, the Three Gorges Dam on the Yangtze River in China, cost more than $37 billion. Numerous global contractors worked on the project, including ABB, Kvaerner, Voith, Siemens, and General Electric.

You Can Do It

RECENT GRADS IN IB



ANDREW and JAMIE WASKEY

Andrew's majors: Master of international business (MIB), bachelor's in Spanish
Jamie's majors: Master of international business (MIB), bachelor's in international affairs and modern language
Andrew's jobs since graduation: Various positions in international logistics at DHL and other firms; marketing intern at U.S. Department of Commerce (Shanghai, China)
Jamie's jobs since graduation: Research manager at YouGov (Dubai, United Arab Emirates); market research analyst at Delta Air Lines (Atlanta, GA); market research intern at U.S. Department of Commerce (Buenos Aires, Argentina)
Objectives: Leverage and grow our international expertise while accelerating the global positioning of our firms and creating a life filled with adventure.

Source: Andrew & Jamie Waskey

Andrew and Jamie Waskey met during their master of international business (MIB) program at a major university. As undergraduates, both majored in international studies and Spanish. They enjoy traveling and learning languages, especially in emerging markets in Latin America. After completing college, Andrew worked for DHL, the international logistics company. The MIB degree provided an internship with DHL and the U.S. Department of Commerce office in Shanghai, China.

After completing her undergrad degree, Jamie worked for a nonprofit organization. She desired a career in international market research, so she attended an MIB program. In her last semester, she completed an internship in Buenos Aires, Argentina, performing market research for the U.S. Department of Commerce there.

Andrew and Jamie married after earning their MIB degrees and quickly secured international jobs in Atlanta with Delta Airlines and BlueLinx Corporation. Networking was key to obtaining these and later jobs. Both were committed to living and working abroad. Andrew is currently director at MistAMERICA in Dubai, where he is responsible for the Middle East and North Africa.

Jamie leveraged her contacts to secure a position with a UK-based market research consultancy in Dubai, YouGov. Jamie's favorite part of the job is learning about and understanding the region's various cultures. She travels around the Middle East to places such as Saudi Arabia. Recently, Jamie became director of Wellspring Research, a market research firm in Dubai.

Success Factors

- Set goals and be persistent in working toward them. If you want to work abroad, pursue your goal actively and remain fully committed.
- Know what you want to do. Develop a clear professional path.
- Leverage friends and other contacts to connect with key people in your field. Building a personal network is key to securing an international position. Interpersonal relationships and teamwork are essential.

Advice for an International Career

- Adopt a patient, flexible, and lighthearted outlook. Maintaining a positive attitude and putting challenges in perspective will enrich your life abroad.
- Keep an open mind to differing conditions and attitudes in foreign environments.
- Be curious about everything. Immersing yourself in the local culture will allow you to adapt easily and acquire a different lens for viewing the world.

Challenges

- Mastering cross-cultural communication and differing management structures
- Adapting to different living situations and diverse and multicultural work environments
- Making friends
- Striking a healthy work–life balance

Source: Photo courtesy Andrew and Jamie Waskey.

Skillfully Challenge Emerging Market Competitors

As the opening case shows, the new global challengers have become formidable competitors. They possess many strengths including access to low-cost labor, skilled workforces, government support, and family conglomerates. For example, India's Mahindra & Mahindra (www.mahindra.com) is capturing market share in the global farm equipment industry, which has been long dominated by admired names such as John Deere and Komatsu. Strong brands such as the Mahindra 5500, a powerful, high-quality tractor, sell for far less than competing models. Mahindra recently established its North American headquarters in the U.S. state of Michigan, a major industrial cluster in the automotive industry. A Mahindra dealership in the U.S. state of Mississippi, a market long dominated by John Deere, sold more than 300 Mahindras in just four months.[35]

Advanced-economy firms can counter in various ways. Initially, managers must conduct research to develop an understanding of the new challengers. It is vital to analyze the advantages and strategies of the emergent firms, which often enjoy superior advantages in the industry in the target market. The next step is to acquire new capabilities that improve the firm's competitive advantages. For example, many incumbents are boosting their R&D to invent new, superior products. Others are partnering with competitors to pool resources against emerging market rivals. Incumbent firms can also match global challengers at their own game by leveraging low-cost labor and skilled workers in locations such as China, Mexico, and Eastern Europe. Many advanced economy firms partner with family conglomerates and others in emerging markets on critical value-chain activities such as R&D, manufacturing, and technical support. Read the *You Can Do It: Recent Grads In IB* feature about Andrew and Jamie Waskey, who have fascinating careers in emerging market countries.

Source: ismed hasibuan/123RF

Investing in emerging markets helps foster economic development and modernize critical infrastructure. This freeway interchange is in Jakarta, Indonesia.

Corporate Social Responsibility, Sustainability, and the Crisis of Global Poverty

8.6 Understand corporate social responsibility, sustainability, and the crisis of global poverty.

Most people in emerging markets and developing economies live in relative poverty. Economic disparity and poverty are critical global challenges.[36] Poverty increases the likelihood of disease, food shortages, terrorism, illicit trade, and international migration. Despite strong growth in emerging markets, many of these nations face cyclical poverty that reduces access to basic social infrastructure such as education, health care, and sanitation. Poverty increases the fragility of national governments.[37] Let's examine how companies help address poverty around the world.

Foster Economic Development

Historically, few companies targeted poor countries because managers assumed there were few profitable opportunities. Today, firms that offer suitable products can earn substantial profits in emerging markets and developing economies. Unilever and P&G sell shampoo for 2 cents per mini-sachet in India. Such pricing, though attractive to local Indians, is actually more profitable for these firms than in the advanced economies. Narayana Hrudayalaya is an insurance company that sells health insurance for less than 20 cents per person per month and has millions of customers. Amul is an Indian company that sells various food products to millions of poor people. Micromax and Qualcomm are marketing low-cost cell phones in India. To succeed, such firms created new business models in manufacturing, packaging, and distribution.[38]

The Swedish telecommunications company Ericsson (www.ericsson.com) helped modernize the telecom infrastructure in rural parts of Tanzania by installing phone lines and cellular systems for households, companies, and aid agencies.[39] The emergence of a cell phone market in Africa led to the emergence of related industries. Local firms produce accessories, such as devices for recharging cell phone batteries. Ericsson's experience suggests that market-based solutions not only contribute to social and economic transformation but can be profitable as well.

Advanced-economy firms that invest in less-developed countries support the development of infrastructure in transportation, communications, and energy systems. Firms create jobs and contribute to regional and sector development. Investment generates local tax revenues, which can be spent to improve living standards among the poor. Many firms develop community-oriented social programs that foster economic and social development.

Source: Salvador Aznar/Shutterstock

Microfinance helps entrepreneurs in developing economies start businesses. Here a group of women in India attend a meeting to learn about development issues.

Microfinance to Facilitate Entrepreneurship

Microfinance provides small-scale financial services, such as microcredit and microloans, that assist entrepreneurs to start businesses in poor countries. By taking small loans, often less than $100, small-scale entrepreneurs acquire enough capital to launch successful businesses. The leading advocate of microfinance is economics professor Muhammad Yunus. He founded the Grameen Bank (www.grameen-info.org), which has made small loans to millions of borrowers in South Asia. Aspiring entrepreneurs use the small loans to buy everything from cows that produce milk to sell in markets to mobile phones that villagers can rent to make calls.[40] The Grameen Bank now has more than 2,500 branches and has inspired similar poverty-reducing efforts, such as the Omidyar Network and the Bill and Melinda Gates Foundation. For his efforts, Yunus was awarded the 2006 Nobel Peace Prize.[41]

Increasingly, mainstream banks view microfinance as a source of future growth. Various institutions now offer small-scale insurance, mortgage lending, and other financial services in poor countries. In Mexico, Cemex's Patrimonio Hoy program (www.cemex.com) has widened access to cement and other building materials. The program helps poor families build their own homes. Thanks to microfinance, home ownership is a reality for tens of thousands of low-income Mexican families.

Ethical Connections

Africa bears the burden of about one-quarter of all disease worldwide yet has only 3 percent of the world's health care workers. Most Africans cannot obtain adequate medical care. Every day, thousands die from treatable or preventable ailments such as malaria and AIDS. MNEs play a growing role to address such challenges. Private firms such as GlaxoSmithKline and General Electric employ innovative business approaches to provide needed medications and medical care to impoverished countries in Africa. Numerous firms have established clinics that provide low-cost health care.

The Special Case of Africa

Africa is relatively stagnant in terms of trade, investment, and per-capita income. Africa's GDP has improved little since the 1960s. The continent is afflicted by illiteracy, malnutrition, and poor sanitation and water supply. Unemployment is stubbornly high in many areas.[42]

However, several African countries are experiencing economic success, with annual GDP growth now approaching 5 percent per year. Ghana is becoming a regional hub for financial and technological services. Nigeria is enjoying a boom in oil and banking. Zambia is developing strengths in mining and agriculture. Tanzania is investing in major power generation projects.[43] Africa is home to abundant natural resources including oil, natural gas, gold, diamonds, copper, coal, and uranium. The continent benefits enormously from a young and growing population. Africa has an energetic workforce employed in top African industries, including processed foods, health care, financial services, and light manufacturing. Accelerating technological change is unlocking new opportunities for growth.[44]

Africa looks increasingly attractive. Coca-Cola sells more than 100 brands and has more than 160 bottling and canning plants there. China's telecommunications giant Huawei has established production and sales operations throughout Africa, selling its mobile phones and network solutions. Huawei provides thousands of jobs for Africans. Chinese firms are also making huge investments in Africa installing green energy systems such as solar power.[45]

Improving conditions in Africa are supported by two major trends. First, compared to earlier times, African governments are doing a better job of managing their national economies. Policy reforms in various countries emphasize economic and political freedom. Better governance in several countries is helping drive economic success.

Second, parts of Africa are also receiving a steady inflow of direct investment from abroad. China, India, and other emerging market firms are investing billions in Africa to manufacture and market various products and services. Inspired by such activity, more firms from Europe, Japan, and the United States are exploring Africa for business and investment opportunities.

Although Africa long lacked substantial landline telephony, cell phones are proving vital to the continent's development. Newly installed cellular networks promote economic development by facilitating dramatic gains in worker and company productivity and banking infrastructure.[46] Global Telecom Holding, Millicom, and other telecom firms are establishing cell phone operations from Egypt to South Africa, applying business models that allow them to earn profits even in countries where people live on less than $2 per day. Transsion is a Chinese manufacturer of smartphones that has become the largest smartphone company by sales in Africa. The firm has sold more than 200 million phones on the continent, by leveraging emerging market advantages such as low-cost labor and business savvy for operating in challenging environments.

Gradually, MNEs are finding various market opportunities. By using innovative business models adapted to local conditions, they play a key role in addressing the continent's medical needs and generate profits. For example, establishing chains of low-cost clinics is helping address Africa's health care needs.[47]

The application of business models such as local entrepreneurship, microfinance, targeted marketing, and MNE direct investing holds enormous potential for addressing poverty in Africa.[48] However, critics charge that MNEs do much harm in Africa, such as exploiting local resources, operating sweatshops, and generating pollution. Where do you stand? Can MNEs successfully address poverty and other problems in Africa, or do such firms do more harm than good?

CLOSING CASE

Astra International: Building Successful International Business Around Shifting National Government Policy

Introduction

Astra International is an Indonesian conglomerate established in 1957, with interests in a number of sectors, which includes automotive, financial services, mining, agribusiness, logistics, and information technology. The company was initially a distributor of Japanese cars (Toyota and Daihatsu) and motorcycles (Honda) and through its growing relationship with the Japanese manufacturers was granted sole distributorship in the early 1970s and established joint ventures by the 1980s.

Acknowledging the successful rise of Astra, the company won a number of Finance Asia awards in 2018, placed among the top three "Best Managed Company," "Best Corporate Governance," and "Best Corporate Social Responsibility" under its "Best CEO" for its performance throughout Asia. In 2018, *Globe-Asia* recorded Astra International as the top company group in Asia with its total assets of $ 14.7 billion (it was recorded as Jardine Matheson/Astra International, as 50.1 percent of Astra International shares have been owned by Jardine Matheson Group Ltd. since 2011).

Indonesia obtained its independence after a short Japanese occupation (1942–1945), which followed 340 years of Dutch colonization (1602–1942). Indonesian foreign policies have been in constant flux, with many changes occurring over the last six decades since independence. Over this time, five key changes to Indonesia's foreign trade and investment policies has been identified. The following will demonstrate each of the changes and how Astra International was able to adapt and grow into the successful conglomerate it is today.

Stage 1: 1945–1966

The first president of Indonesia, Soekarno, introduced a guided democracy that tried to balance the power of a number of influential groups, the army, religious (Islamic), and communist interests. During this period, the policy focus was to build a national culture and convert Dutch/Japanese interests into Indonesian assets while maintaining an anti-foreign policy to trade and investment. During this period Indonesia faced economic difficulties with basic infrastructure lacking and available assets functioning poorly. It was during this period that William Soeryajaya, the Chinese-Indonesian founder of Astra International, took the opportunity to assist economic development by opening an agriculture trade and distributing company in Jakarta in 1957. In doing so, he built up knowledge about various industries, such as agriculture, trade, and transportation.

Stage 2: 1966–1974

In 1966, the Soekarno Government ended, and its anti-foreign investment policy was largely viewed as a failure because the economic conditions of the country had not improved. In stark contrast to Soekarno, the second president, Soeharto, put a greater focus on economic development and was quick to implement an open-door policy. He introduced long-term development policies that plotted the path and objectives of the country's development in blocks of five years. During the first block of planned development (1969–1974) priority was given to the establishment of a manufacturing sector, especially industries supporting agriculture. This included the production of agricultural machinery and the manufacturing of products to substitute imports, with the focus being to increase the use of domestic labor and raw materials. At the same time, the Indonesian government called for tenders to revitalize or build major infrastructure project.

It was from the government's call for more Indonesian companies to assist in the revitalization projects that William Soeryajaya saw the opportunity to expand his operations internationally. In 1969, Astra International made a commitment to import Chevrolet truck components using an abandoned government warehouse as storage and to set up an assembly line. This was quickly followed by Astra expanding its automotive business into the Japanese car industry by becoming the first distributor for Toyota in Indonesia. Over the next 3–4 years, this was followed by distributorship for Honda motorcycles, Xerox copying machines, United Tractors, and Daihatsu.

But this period was not without its risks. To stimulate growth, the government offered lucrative incentives for foreign traders and investors. Due to a lack of indigenous Indonesian entrepreneurs, most of the new business opportunities were taken up by Chinese-Indonesians, who were willing to take risks and start a business and were therefore the main beneficiaries of the government incentives. The situation created resentment among indigenous Indonesians, and the arrival of the Japanese Prime Minister in Indonesia in 1974 trigged anti-Japanese protests and a riot. Astra's Toyota car distribution office was burnt down during the riots. The demonstrators requested the government to provide equal and transparent opportunities for all—native Indonesians, Indo-Chinese, and foreigners.

Although the import substitution policy was designed to provide incentives for companies to convert imported components into local content, the fact remained that there were very few local companies with the capacity and knowledge to undertake such technical work. The government had not developed the required support mechanisms to help build the skill-base of local firms, whose own financial and non-financial capacities were limited. The protests and riots that took place led Astra International to take a proactive role in the industrial development beyond their own business by developing, supporting, and integrating local partners into their business operations.

Stage 3: 1974–1998

Following the 1974 riot, the Indonesian government reviewed its policies. The second (1974–1979) and third (1980–1985) development blocks were redesigned to allow for more just and equal development of industries in Indonesia. The emphasis was shifted to include greater support for locally based firms and export-based industries, especially firms considered to be small to medium size enterprises (SMEs), which accounted for 87 percent of the employment in the manufacturing sector in Indonesia.

The policy changes put in place by the government encouraged Astra International to consider international joint ventures as a feasible option to conduct business in Indonesia. For foreign firms, joint ventures can reduce both the investment risk for the foreign investor and the market adaptation rates due to the local firm's involvement and knowledge; at the same time, it provides full access to the foreign market. For the local partner, joint ventures afford the firm much-needed capital, management, and technical expertise as well as the opportunity to explore international markets. During this period, Astra International converted two of its distributorships into assembling company joint ventures, one being PT. Toyota Astra Motors and the other PT. Daihatsu Indonesia. Besides the advantages and contribution of the joint ventures, Astra International was also able to create new jobs for the local region by employing a large number of service agents and increasing their after-sales service delivery for both their motorcycle and car operations. The Astra International initiatives aligned with the government's program to reduce economic and social gaps between large enterprises and smaller firms (as was the case before the riot) and to provide vertical integration, which strengthened the value chain of the automotive manufacturers.

In another development from 1974, Astra International established a foundation that focused on education at both formal and informal levels, and in 1980, a second foundation was established called Dharma Bhakti Astra to enhance small enterprise development. Its mission was, first, to develop SMEs that were associated with the Astra Group (subcontractors, vendors and service centers) and, second, to develop and empower non-related SMEs who were located near the company's operations. The foundations formed part of Astra's corporate social responsibility, coupled with the investment in several technical schools and universities in the development and training of various automotive skills. In the 1990s, Astra International established Astra Manufacturing Polytechnics.

Over the two-decade period, Astra International was able expand its operations at a significant rate and establish six core businesses in Indonesia: automotive, financial service, heavy equipment, agribusiness, information technology, and infrastructure. However, in 1998, the Asian Financial Crisis hit the country and William Soeryajaya was forced to sell his share in Astra to pay his son's banking debts as well as Astra's debts, and undertake a restructure of the business.

Stage 4: 1998–2004

In 1999, as pressure of the financial crisis grew, the political situation in Indonesian became even more uncertain. President Soeharto was replaced by his vice president, Bacharuddin Jusuf Habibie, and the centralized national government shifted to a decentralized system. This meant that the central government's control over planning and budgeting was shifted to local and regional governments. During the period 1998–2004, Indonesia held four elections and the country was dominated by conflicting political parties and changing presidencies. For business, the situation during this period was very uncertain. The Asian financial crisis also resulted in the restructuring of Astra International. Astra was forced to refocus its business, a conglomerate of more than 300 companies, with the restructuring of Honda motorcycle, BMW, and Daihatsu and the sell-off of its telecommunication and timber businesses. As part of these changes, Astra International consolidated the research and development activities at a number of their subsidiaries. In 2003, two subsidiaries, Toyota Astra Motors and Daihatsu Indonesia, launched new vehicles, Toyota Avanza and Daihatsu Xenia, which were both developed to use the same engine. This was followed by Toyota Rush and Daihatsu Terios in 2006, which were based on the same modular components because of a joint R&D project between the two companies.

In the financial sector, Astra International teamed up with Standard Chartered Bank to acquire 89.12 percent of Permata Bank in 2004 (each of them own 44.56 percent of the share). Permata Bank is a merger of five local banks which already caters to mainly businesses customers in various sectors in most trading cities and districts in Indonesia. The investment in the financial sectors aims to provide financial service to support the Indonesian businesses along the supply chain.

During this time, Astra International maintained its presence in the education sector and the development of SMEs through its Dharma Bhakti Astra Foundation. Dharma Bhakti Astra Foundation training centers introduced Astra Quality Management Systems, established micro-finance options for expanding local companies, and provided support for SME partners in the Indonesia International Motor Show exhibition. The foundation's focus was to empower local companies to become strong enough to face difficult financial situations and to develop close working ties with other institutions, including government and private enterprises, such as local banks. The foundation received awards from the national government for poverty reduction and SME development initiatives.

Stage 5: 2004–2018

During this period, the Indonesian political system stabilized. Having successfully navigated through some very difficult financial times, Astra International became a stronger company thanks to an injection from Jardine Matheson Group, a Hong Kong conglomerate that bought 50.1 percent of Astra International shares through its Singapore-based subsidiary, Jardine Cycle and Carriage Ltd. The Dharma Bhakti Astra Foundation refocused its efforts on building SMEs partners in three key sectors: automotive, agribusiness, and mining. It established memoranda of understanding with key Indonesian banks (BCA, Mandiri, Bank Mandiri Syariah) for better access to finance for their SME partners. The Astra Foundation established a supplier relationship with Pertamina (an Indonesian state-owned mining company) and set up joint training centers in various areas of Indonesia. The foundation was able to successfully develop strong customers, suppliers, and support networks of its core business in Indonesia and employed retired employees to be trainers for local SMEs. In 2008, for the first time, Astra International exported CBU (component build-up) items to Japan and began promotion of its low-cost green car (LCGC). It is expected that the Astra LCGC will be the next generation of revenue for the company, including its SMEs partners. The LCGC was able to obtain an exemption from the luxury items tax, which applied to all other cars.

Astra International believes that the strong Indonesian economy (with growth at 5.1 percent in 2017), a greater emphasis on achieving better environmental outcomes and the low cost of the car will be strong factors in the success of the LCGC in the Indonesian market. While Astra International's revenue from the Indonesian car market is large, there is growing dissent with the country's current transport model. Many economists, environmentalists, and transportation specialists argue that Indonesia, with more than 264 million people, urgently needs to focus on a mass transportation system (especially in the island of Java, where 150 million live) rather than the current individual vehicle system.

In February 2018, responding to the growing demand for high mobility with low cost as well as the need to move to a digital economy, Astra International injected $150 million along with Google's holding company, Alphabet, in Go-Jek, an Indonesia-based platform for online taxis (both cars and motorcycles), courier services, and food and shopping delivery. The decision to support Go-Jek allowed Astra International to gain markets in startups, as the drivers and vendors of Go-Jek Food are mostly young.

Although the Indonesian government aims to move to a greener economy, the infrastructure of the country is not evenly developed. In the last decade, Astra International has established Astra Infra to build, own, and manage toll roads of Java with a range of ownership from join venture to fully ownership. The movement runs parallel to the strategy to support a rechargeable hybrid car system in the future, as building integrated green industries is a long process. Currently, Astra international faces challenges from political pressure, as Indonesian elections may change the rule of the game, and instant results are often demanded by political parties.

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Case Questions

8-4. Briefly summarize the political environment in Indonesia over the five periods.

8-5. Why has Astra International been so successful in operating under high levels of political and economic uncertainty?

8-6. What are the risks of doing business in emerging markets such as Indonesia, and how can they be reduced?

8-7. What did Astra International do to limit the impact of multinational firms operating in Indonesia?

8-8. If you were a foreign firm, would you consider doing business in Indonesia?

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END-OF-CHAPTER REVIEW

MyLab Management

Go to **www.pearson.com/mylab/management** to complete the problems marked with this icon.

Key Terms

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Summary

In this chapter, you learned about:

- **Advanced economies, developing economies, and emerging markets**

  Advanced economies are post-industrial countries characterized by high per-capita income, highly competitive industries, and well-developed commercial infrastructure. They consist mainly of post-industrial societies of Western Europe, Japan, the United States, Canada, Australia, and New Zealand. The **developing economies** are low-income countries that have not yet industrialized. Due to low buying power and limited resources, their participation in international business is limited. The **emerging markets** are former developing economies on their way to becoming advanced economies. They are transforming themselves into market-driven economies by liberalizing trade and investment policies, privatizing industries, and forming economic blocs. Brazil, Russia, India, and China are leading exemplars.

- **What makes emerging markets attractive for international business**

  Emerging markets represent promising export markets for products and services. They are ideal bases for manufacturing activities and popular destinations for **global sourcing**—procurement of products and services from foreign locations.

- **Assessing the true potential of emerging markets**

  In the early stages of market research, to reliably estimate demand in emerging markets, managers examine three important statistics: per-capita income, size of the middle class, and market potential indicators. Income should be adjusted for **purchasing power parity**.

- **Risks and challenges of emerging markets**

  Emerging markets pose various risks, including political instability, inadequate legal and institutional frameworks, lack of transparency, and inadequate intellectual property protection. **Family conglomerates** are large, diversified, family-owned businesses that dominate many emerging markets and represent formidable rivals and attractive choices for partnerships.

- **Success strategies for emerging markets**

  Firms should adapt strategies and tactics to suit unique, local conditions. Some firms succeed by partnering with family conglomerates. Governments are often major buyers but require specific strategies. Successful advanced-economy firms conduct research, acquire capabilities specific to target markets, and leverage advantages available in emerging markets, such as low-cost labor.

- **Corporate social responsibility, sustainability, and the crisis of global poverty**

  In emerging markets and developing economies, leading firms undertake activities that facilitate economic development. They can serve low-income countries with inexpensive, specifically designed products and services and community involvement. Such efforts should aim to ensure environmental sustainability. Microfinance, availability of small-scale loans to emerging-market entrepreneurs, is promoting entrepreneurial initiatives. Although Africa long stagnated in terms of income, trade, and investment, several African countries are beginning to experience economic success. Africa receives substantial investment from abroad and benefits from microfinance and abundant mobile telephones.

Test Your Comprehension

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8-9. What were developing countries called in the past? What factors distinguish them from other countries?

8-10. Why are countries such as Mexico, Brazil, and India often considered ideal manufacturing bases for global corporations?

8-11. Many emerging countries have political instability. What are the consequences of this?

8-12. Some emerging countries suffer from very poor physical infrastructure. What are the signs of this? Give some examples of the consequences of this issue.

8-13. Describe the process for selling to foreign governments and state enterprises.

8-14. Doing business in emerging markets involves strategies that are often distinct from those of other international venues. What types of business approaches can firms use when doing business in emerging markets?

8-15. What social and sustainability characteristics are typical of emerging markets? What can businesses do to support the development of poor countries in emerging markets?

Apply Your Understanding

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8-16. Suppose you work at Microsoft in its Xbox video game console division. Microsoft has long targeted Xbox to the advanced economies, especially in North America and Europe. Management would like to sell more Xbox Ones to emerging markets. What characteristics of emerging markets might make them attractive for sales of the Xbox? Identify the major risks and challenges that Microsoft might encounter in selling the Xbox One to emerging markets.

8-17. Walk&Talk Inc. makes walkie talkies—handheld, portable, two-way radio transceivers. They are used in settings where mobile phone communications may be costly or impractical, including outdoor recreation, military, public safety, and business. Walk&Talk has been trying to export its products to various emerging markets and has enjoyed little success so far. You know a lot about emerging markets and have been anxious to share your views with Walk&Talk's president, Mr. Roger Wilko. What strategies would you recommend Roger pursue in doing business with emerging markets? You conclude there is growing demand among small businesses and recreational users abroad. Explain how the firm should go about selling to emerging market customers.

8-18. *Ethical Dilemma*: One mission of the IMF is to help poor countries overcome economic crises by providing loans and policy advice. Financial assistance to Greece in 2010 became the biggest bailout in global financial history: the total amounted to nearly $330 billion. Finances came from the European Stability Mechanism (ESM) and the IMF. Critics argue the IMF rescues countries that fail to put in place robust regulatory systems and responsible fiscal and monetary policies. The critics assert that economic prosperity is best determined by market forces and free enterprise. They claim that reviving poor countries is too costly and discourages responsible behavior. They claim that local officials are less likely to enact policies that ensure stable economic growth if they know wealthy countries will provide bailouts. Suppose you are a financial officer at the IMF. Where do you stand on this? Use the Ethical Framework in Chapter 4 and decide whether the IMF should bail out Ukraine.

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8-19. The World Bank sponsors the Doing Business database (www.doingbusiness.org), which provides measures of business regulations and their enforcement for countries worldwide. Firms can use these measures to analyze specific regulations that enhance or constrain investment, productivity, and growth. Visit the site and choose two emerging markets. Then answer the following questions: How well does each country rank in terms of ease of starting a business, employing workers, and trading across borders? How long does it take to start a business? How much time does it take to pay taxes? Review other statistics and identify which country is most friendly for doing business.

8-20. Using globalEDGE™, find the country commercial guide for two emerging markets of your choice. Compare the two countries on the following dimensions: "leading sectors for exports and investment" and "marketing products and services." Which of the two countries is more promising for marketing laptop computers? Which of the two countries is more promising for sales of portable electrical power generators? Which of the two countries is more promising for sales of telecommunications equipment? Justify your answers.

8-21. The three groups of countries described in this chapter can be contrasted in terms of degree of economic freedom. It refers to the extent to which economic activities in a nation can take place freely and without government restrictions. Various organizations have developed indexes of economic freedom, including the Cato Institute (www.cato.org), the Heritage Foundation (www.heritage.org), and the Fraser Institute (www.fraserinstitute.org). In measuring economic freedom, such indexes consider factors such as trade policies, extent of government intervention, monetary policies, inward foreign direct investment, property rights, and commercial infrastructure. Countries are classified into categories such as free, mostly free, mostly unfree, and repressed. Explore one of the economic freedom indexes by visiting one of the mentioned sites and entering "economic freedom" in the search engine. How are emerging market and developing economies classified? What is the relationship between market liberalization and economic development? How might market liberalization contribute to reducing poverty in developing economies?

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Learning About and Assessing Emerging Markets

Emerging markets are rapidly industrializing and dynamic economies. When deciding to do business in emerging markets, the first step is to identify the most attractive countries to enter. This involves comparing numerous countries across various criteria. Because each emerging market is distinctive, the manager researches and determines which markets to enter. Such knowledge helps avoid wasting company resources and maximizes the firm's profits and competitive advantages. In this exercise, assume you are a product manager of a firm that makes and markets mobile telephones. Your task is to analyze factors in leading emerging markets and choose the best one to target with exports of your product.

Background

Emerging markets are high-growth, high-potential economies with relatively high living standards. They are industrialized, vibrant economies with a growing middle class. They represent a middle ground between developed economies and developing economies.

Emerging markets house the largest proportion of world population, and their participation in foreign trade is big and growing. They are increasingly viable markets for various products. Although the advanced economies represent the present and past of international business, emerging markets represent the future. There are numerous emerging markets, with distinctive characteristics. Dynamic changes in these societies complicate assessing their current market potential. The firm needs to investigate the most appropriate emerging markets to enter. A complete list of the emerging market countries follows.
To complete this exercise in your MyLab, go to the **Career Toolbox**.

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Chapter 9

The International Monetary and Financial Environment

Learning Objectives *After studying this chapter, you should be able to:*

9.1 Learn about exchange rates and currencies in international business.

9.2 Explain how exchange rates are determined.

9.3 Understand the emergence of the modern exchange rate system.

9.4 Describe the monetary and financial systems.

9.5 Identify the key players in the monetary and financial systems.

9.6 Understand the global debt crisis.

The European Union and the Euro

The European Union (EU) was established in 1993. In 2017, it had 28 member countries. The EU created the European Monetary Union (EMU) and the European Central Bank (ECB; www.ecb.int) with the goal of establishing a common currency, the euro. In 2002, euro banknotes and coins were issued and replaced older national currencies. In 2018, the euro was the sole official currency of 19 EU member states: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain. The remaining EU countries opted not to join the eurozone. By establishing a common currency, the EMU aims to knit the participating EU economies into a unified whole, reduce the problem of fluctuating exchange rates, and facilitate trade and price comparisons.

MNEs operating in the eurozone have reduced business costs by simplifying their accounting, financial, and marketing activities with the use of a single currency. The euro allows firms to coordinate prices across the EU.

The ECB treats the eurozone as one region rather than as separate countries with differing economic conditions. ECB monetary policy is complex because of the diverse economic and fiscal conditions that characterize each eurozone country. For example, the ECB aims to keep inflation low by carefully limiting the supply of euros, but the policy response for controlling deflation, just as harmful as inflation, is to increase the money supply. ECB policy aimed at fixing deflation in one country might trigger inflation in another. Devising monetary policy that suits economic conditions in all EMU countries is challenging.

Monetary policy is further complicated by the recent admission into the EU of lower-income countries such as